

**Housing Finance Reform Should Improve Upon  
Existing Mortgage Servicing Rules  
October 2013**

**Background.** Following the recent economic crisis, new mortgage servicing rules have been adopted in an effort to improve loss mitigation outcomes for homeowners facing foreclosure and for the investors in those loans. Following the Home Affordable Modification Program (HAMP), changes to FHA and GSE servicing regimes, and the National Mortgage Settlement, the mortgage servicing companies have continued to circumvent existing requirements at the expense of investors, homeowners and communities. While the CFPB issued regulations creating long-term procedural rules on default servicing, significant loopholes remain. A new GSE system should better promote loss mitigation that benefits investors while avoiding unnecessary foreclosures. Mortgage servicers often benefit from pursuing foreclosure over loss mitigation. Housing finance reform should realign incentives to maximize beneficial outcomes.

The data make clear that more must be done to promote a sustainable mortgage servicing system.

**Foreclosure rates are still high.** *In the second quarter of 2013, 2.13% of prime loans and 11.01% of subprime loans were in foreclosure. These rates are comparable to the percent of foreclosures at the onset of the economic collapse in 2008 and are much higher than any we have seen since before the turn of the current century.*

**Most homeowners still do not get the best modifications available, and many who qualify get no modification at all.** *While HAMP loan modifications have the best results, with post-modification delinquency rates at half of other modifications, most homeowners receive either a proprietary modification with less advantageous terms or no modification at all. In fact, 3% of delinquent homeowners in the second quarter of 2013 received non-HAMP modifications, while only 1% received HAMP trial modifications and another 1% received HAMP permanent modifications. The remaining 95% of delinquent homeowners received no modification.*

**Loan modifications are not adequately keyed to affordability.** *Homeowners who receive loan modifications with substantial reductions in loan payments fare much better than those with increased payments or even those with small payment decreases. Yet, there is insufficient standardization of payment reductions and post-modification debt-to-income ratios. Modifications that reduced monthly principal and interest payment by 20% or more consistently had the lowest 60-day delinquency rates in the first quarter of 2013, at 8.8%, while modifications with payments reduced by less than 10% showed delinquency rates at 22.2%. Modifications where monthly payments were increased showed the highest re-default rates at 29%, more than three times as high as the rates for payment reductions of 20% or more. Loan modifications with*

*target debt-to-income ratios tend to provide more sustainable payment reductions. Moreover, loan modifications have generally tended to overlook back-end DTI, which is a key driver of redefault.*

**Principles.** Housing finance reform legislation should include several key improvements to existing mortgage servicing rules:

**Require affordable loan modifications.** One key piece of any legislation must be a mandate for servicers to provide affordable loan modifications where they also benefit investors. The CFPB has declined to issue such a mandate. The data show that almost all delinquent homeowners still get no modification at all. Those homeowners lucky enough to receive a modification seldom get one with the best terms available. GSE securitization should promote proven regimes for modifying loans with optimum loan performance. This should also include limited, government-backed portfolio capacity to hold modified loans.

**Stop dual track.** Homeowners seeking loan modifications should not be faced with an ongoing foreclosure while they are processing their loan modification request. Instead, such foreclosures should be put on temporary hold rather than subjecting the homeowner to the “dual track” of foreclosure and loss mitigation. Current rules provide protection for some homeowners but leave many homeowners still facing foreclosure while they are seeking loan modifications. Dual track protections must be keyed to the homeowner’s initial application in order to promote timely loan modification reviews over foreclosures. Requirements keyed to a “complete application” invite manipulation of the process based on a subjective determination of an application’s status.

**Establish registry standards that maintain transparency and deference to state rules.** Any new MERS-type electronic registry should be public, transparent, and supplemental to state requirements. Only a public, supplemental system will assure homeowners of access to key information in the foreclosure process while allowing states to continue their role as primary regulators of their own foreclosure procedures. The registry system should include records of servicing rights and ownership of mortgages and deeds of trust, as well as ownership of the promissory notes themselves. The system should assign each security instrument and related promissory note a unique identification number and should ensure compliance with federal e-sign requirements. Participation in the registry system must be mandatory. Enforcement of registry system requirements should include a schedule of sanctions for noncompliance.

**Authorize direct purchase of insurance, including force-placed insurance, by the Corporation.** The current system, in which the GSEs reimburse servicers for force-placed hazard and flood insurance, has resulted in vastly inflated prices for borrowers and, when borrowers default, the GSEs and taxpayers. A mechanism allowing the Corporation to purchase force-placed insurance -- as well as title insurance and private mortgage insurance - - directly from insurers would decrease costs for borrowers and the Corporation by circumventing the kickbacks to servicers that drive up insurance prices.

**Promote transparency and accountability.** An Office of the Ombudsman should be established to assist with consumer complaints and compliance matters. This would help remedy the current situation in which non-compliance problems with GSE loans often go unaddressed. Moreover, loan level data collection and reporting should include demographic and geographic information, to ensure that civil rights are protected and equal opportunity to avoid foreclosure is provided. Aggregate information about complaints and the data about loss mitigation must be publicly available, as HMDA data is.

***Recommendations on Loss Mitigation and Electronic Registry Provisions in Corker-Warner, S. 1217.***

Page 41, line 16, insert new (14): purchase insurance in connection with mortgages insured or securitized by the Corporation.

page 63, line 5 insert: “bona fide and reasonable” prior to “insurance premiums”

page 63, line 13, insert at end of text within (E): ", including through affordable loan modifications consistent with a publically available net present value determination as defined by the Corporation"

page 63, line 14, insert new (F):

(F) the establishment of procedures for the servicer to refrain from initiating a judicial or non-judicial foreclosure, or where a foreclosure has been initiated, from taking any additional steps in the judicial or non-judicial foreclosure, once an initial request for loss mitigation has been made by the homeowner, until completion of the review of any loss mitigation application, including written notice to the homeowner documenting any denial and a requisite appeal process;

page 63, at end of line 19 after “liquidated” insert: ", including provisions for the cessation of advances when there is no longer any reasonable possibility of the recovery of such advances from the liquidation of the property or as appropriate to facilitate modification of the loan pursuant to subparagraph (E)"

page 64, line 14, insert new (E): “(E) a proscription against any servicer maintaining any financial interest in insurance products related to mortgages serviced by the servicer or its affiliates other than the coverage provided by the insurance; and”

page 66, line 3 insert new (C)(2):

(C)(2) The Corporation shall establish an Office of the Ombudsman to receive complaints from homeowners, homeowners’ representatives and other designated third parties. The Ombudsman shall have the authority to investigate, including but not limited to the right to obtain information, documents, and records, in whatever form kept, from the servicer, and to resolve disputes between any homeowner and the servicer of an eligible mortgage.

page 96, line 13: insert new subsection (2):

(2) loss mitigation, including the development of uniform standards and practices

(A) requiring servicers to offer homeowners affordable loan modifications consistent with a publically available net present value determination as defined by the Corporation; and

(B) requiring servicers to refrain from initiating a judicial or non-judicial foreclosure, or where a foreclosure has been initiated, from taking any additional steps in the judicial or non-judicial foreclosure, once an initial request for loss mitigation has been made by the homeowner, until completion of the review of any loss mitigation application, including written notice to the homeowner documenting any denial and a requisite appeal process;

page 97, line 9 insert after “investors”: “, and community stakeholders and representatives of homeowners”

page 97, line 15 insert after “loan level information”: “, including demographic and geographic data,”

page 98, line 1 insert new (7):

“(7) foreclosure and loss mitigation outcomes; and”

Page 98, line 13 insert new subsection (c):

“(c)Free Access—The database shall be electronically accessible, at no charge, to the public.”

page 98, line 17 remove all language in subsection (1) after “public” and insert a period.

Page 99, line 6, replace section 225 with the following:

## SEC. 225. ELECTRONIC REGISTRATION OF ELIGIBLE MORTGAGES

(a) ESTABLISHMENT OF ELECTRONIC REGISTRATION SYSTEM. The Corporation shall establish, operate, and maintain an electronic registry system for all eligible loans in full compliance with the mandates of the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. § 7001, et seq. The system shall automate, centralize, standardize, and improve the tracking of changes in:

(1) the ownership of mortgages, deeds of trust, and other security instruments that collateralize an eligible security interest under the Act;

(2) the ownership of the beneficial interest in promissory notes secured by any of the mortgages, deeds of trust, and other security instruments eligible under the Act; and

(3) servicing rights for any mortgage loan eligible under the Act.

(b) IDENTIFICATION OF MORTGAGES AND NOTES. – The tracking system shall assign an identification number to each security instrument and its related promissory note upon initial registration with the system. The identification number shall continue to identify the security instrument and note through all subsequent assignments and transfers. The Corporation shall develop a numbering system that will assign unique numbers to participants to help in the identification of individual participants. The Corporation shall only permit the inclusion of electronic transferable records, as authorized by 15 U.S.C. § 7021, which have been signed using an electronic signature technology with sufficient safeguards to ensure that the parties have actually signed the document. Further, the tracking system must ensure that there is a single, authoritative copy of the electronic, transferable record in compliance with 15 U.S.C. § 7021(c).

(c) INDIVIDUALS AUTHORIZED TO MAKE REGISTRY ENTRIES. - The Corporation shall develop procedures to register individuals authorized to make entries in the data system. The procedures shall require that servicers and agents of loan owners identify the principal for whom each individual is authorized to act, the scope of the agency, and the identity of the individual's employer.

(d) CUSTODY OF NOTE. – The tracking system will identify by name and street address the entity holding physical custody of the original promissory note for each eligible loan that is in paper form. If the note is in electronic format and it is not registered in the system, the system shall reference an electronic database where the note is registered and the electronic note database must be accessible to the public without charge. The electronic note database must ensure that there is a single, authoritative copy of the electronic note, and no changes except regarding the assignment of the note, can be made to the electronic note, in compliance with 15 U.S.C. § 7021(c).

(e) MANDATORY PARTICIPATION. – Participation in the system shall be mandatory for all eligible loans. Owners of loans or their agents shall have a duty to register each eligible loan and maintain the accuracy of current system data for the loan. All transfers, assignments and other changes in the ownership of eligible promissory notes and security instruments, and the servicing rights for eligible loans, shall be entered into the system. The tracking system will identify each entity entered in the system by name, address, and other contact information. If there is more than one servicer for a particular eligible loan, each servicer shall be identified in the system, including whether the entity is a master servicer, subservicer, or other servicer.

(f) ENFORCEMENT OF REGISTRY REQUIREMENTS/SANCTIONS.- The Corporation shall develop a schedule of sanctions that shall be imposed upon a loan owner and its agent in the event that the loan owner or agent fails to maintain accurate current information in the system for an eligible loan. The sanctions shall be in a form that will be effective to deter non-compliance. In the event of non-compliance, the obligor of an eligible loan shall have a private right of action in

recoupment to recover the amount of the scheduled penalty by way of offset against the loan obligation and reasonable attorneys fees. The obligor may bring such an action in federal court or in a state court proceeding as appropriate under state law.

(g) FREE ACCESS. – All information on the registry shall be electronically accessible, at no charge, to the public.

(h) STATE AND LOCAL LAW. – Nothing in this Act shall be deemed to preempt or limit state and local law regarding recording or registration of interests in land or the foreclosure of interests in land. If state and local law does not recognize and regulate paper notes that have been converted from electronic, transferable records, then no conversions of electronic records to paper notes is permissible.