

January 23, 2018

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Helen M. Albert
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Dear Ms. Roget and Ms. Albert:

On behalf of the clients and communities we represent, we write in response to the recent report from the HUD Office of Inspector General (OIG) that identified significant deficiencies in loss mitigation for FHA insured mortgages. We urge HUD to take crucial, specific steps to address the concerns that the OIG has raised in order to better protect the insurance fund, homeowners and communities.

On September 14, 2017, HUD OIG issued a report entitled "HUD Did Not Have Adequate Controls To Ensure That Servicers Properly Engaged in Loss Mitigation" ("the OIG Report" or "Report"). The OIG Report outlined significant problems with FHA loss mitigation and stated that "a review of 90 statistically sampled claims that closed from January 1, 2012, to December 31, 2015, determined that 26 had significant servicing deficiencies." (OIG report, p. 4) The report recognized that these significant servicing deficiencies, which include failure to properly review borrowers for FHA required loss mitigation, unnecessarily put borrowers at risk of foreclosure. These failures also "resulted in an increased overall risk to the program of a projected \$120.9 million for losses in which servicers did not properly engage in loss mitigation." (*Id.*)

The OIG Report confirms the consistent experience of FHA borrowers. Simply put, we have seen widespread, persistent non-compliance with FHA loss mitigation for many years. With 29% of the sample set demonstrating significant servicing deficiencies, the OIG Report exposes this widespread non-compliance. These findings should serve as a much-needed turning point for borrowers with FHA-insured mortgages and for the Fund.

Unfortunately we believe that the OIG Report understates the breadth of servicer non-compliance with FHA loss mitigation. In its Report, the OIG only reviewed insurance claims submitted by the FHA mortgage servicers where there was a total absence of a loss mitigation default code. This limitation only applies to

approximately 3% of the total insurance claims paid during the two-year period. (OIG Report, p. 5 (14, 763 claims out of the 434,685 paid had no default code.)) This sampling did not examine files in which the FHA lender *did* report a loss default code.

In fact, the OIG Report mentions that a recent HUD survey concluded that FHA mortgage servicers used inaccurate default codes in over 20% twenty percent of the cases that HUD reviewed. (OIG Report, p. 5) Even this 20% figure appears to understate the extent to which FHA mortgage servicers make incorrect statements in their claim documentation. For example, a March 20, 2017 OIG Report that examined lenders' claims documentation found that in over half of the cases reviewed servicers inaccurately reported foreclosure delays and thereby avoided curtailment of insurance payments. These incorrect statements to HUD triggered substantial overpayments from the insurance fund. (See OIG FHA Single Family Mortgage Insurance Claims Audit Report No. 2017-KC-0001 (revised March 20, 2017) pp. 6-7).

Moreover, in our work with FHA borrowers, we consistently see borrowers wrongfully denied for loss mitigation based on the FHA mortgage servicers' errors that would not be revealed by a review of only the servicer file. For example, the servicer file alone may state "unresponsive borrower" when, in fact, the servicer has no record of financial documentation from the borrower that it lost. We also continue to see improper and overly burdensome document requests from FHA mortgage servicers, which create additional barriers to FHA loss mitigation. Discussions with borrowers would have revealed such problems; however, OIG oversight and FHA compliance oversight generally do not involve data collection based on borrower's experiences. The FHA mortgage servicer file often tells only one side of the story and in some cases suggests compliance when such compliance did not actually occur.

In response to the problems identified in the OIG Report, HUD and its OIG should take concrete steps to improve loss mitigation:

1. The OIG should conduct an audit of a larger sample size and include files that have loss mitigation default status codes.

There is no reason to believe that the 29% significant servicing deficiencies and the 63% general servicing deficiencies found in the OIG Report's sample are not also found in claims where an FHA mortgage servicer reports a default code. In order to get a full picture of non-compliance, the OIG's should audit a larger sample of loans that includes default status codes.

2. In evaluating servicer performance, HUD must include outreach to borrowers and an evaluation of borrower complaints.

HUD's servicer oversight function is missing crucial information by not incorporating feedback from borrowers. A fuller picture of loss mitigation compliance requires building borrower feedback into HUD's supervision model. In evaluating a lender's performance, HUD should reach out to a sample of borrowers and get feedback. OIG should specifically reach out to borrowers that the servicer concludes were unresponsive. Based on our experience, OIG will find that a significant portion of these borrowers actually sent in requested documents that the servicers subsequently lost, could not address unreasonable and overbroad requests by the servicers, or could not understand poorly written and irrelevant servicer demands for information. OIG also will likely find that servicers actively discourage applications for help by giving homeowners erroneous information over the phone.

3. Homeowners need an effective complaint process through HUD.

The OIG's September 2017 Report highlights the need for HUD to develop more effective sampling and review structures to assess servicer compliance with loss mitigation requirements. Opening up a procedure for consideration of borrower complaints can go a long way to solving this problem while also opening up opportunities to resolve individual cases of non-compliance. While the National Servicing Center (NSC) responds to complaints, it consistently takes the position that it has no authority to directly remedy servicer non-compliance. Homeowners need access to a complaint process that will 1) take into account both the homeowners' and the servicers' information and 2) require non-compliant servicers to take corrective action, including forgiveness of accrued interest that accumulated during improper delays. The NSC also should document and analyze the complaints it receives in order to look for larger non-compliance trends. When FHA performs administrative reviews of servicer compliance, homeowners' experience and information must be gathered to provide a full view of what happened.

4. Require written notices of loss mitigation status and decisions to homeowners.

FHA requires servicers to send a notice prior to acceleration of the loan. HUD should require this acceleration notice to summarize how the servicer applied the loss mitigation review waterfall set out in Handbook 4000.1 and to provide the actual inputs used. A calculation worksheet could be supplied for these notices to promote efficiency and accuracy. Such a notice would promote compliance with review requirements and also enable more informed participation by borrowers, in support of HUD's efforts to reduce excessive claims payments. If the servicer did not conduct a waterfall analysis because it determined that the borrower did not express any interest in loss mitigation or provide documents, the notice must indicate this determination and briefly describe the actions the servicer took to solicit the borrower for loss mitigation review and obtain appropriate documents. Simply requiring servicers to state what they have done to comply with the loss

mitigation rules will itself promote closer compliance with the requirements while also providing greater transparency and accountability.

HUD also should require servicers to send notice to borrowers of the results of the servicers' monthly loss mitigation evaluation required under 24 CFR 203.605. The notice, which could be based on a calculation worksheet that the servicer used for the borrower's evaluation, should clearly explain and document why the homeowner was determined ineligible for a particular option. The existing regulations require ongoing loss mitigation reviews, but do not require any notices to the homeowners about this continuing process.

The notices should reference applicable provisions of the FHA loss mitigation handbook and where to find it online so the homeowner can see what the applicable standards for review are. The suggested notices do not create any significant new burden for servicers because they involve little more than giving borrowers the same information that servicers must provide to HUD under current rules. Proper compliance also should require availability of an appeal and dispute resolution process for homeowners to seek review of servicer decisions made in the process described in number 3 above. The appeal process will give HUD access to valuable information about servicer compliance with HUD rules while further limiting unnecessary foreclosures and claims payments. Such information will be an important supplement to HUD's current quality control structure, which currently does not rely on any input from borrowers.

5. HUD must require lenders to document and certify compliance with the loss mitigation requirements.

Under HUD's current regulation, 24 C.F.R. § 203.500, HUD is not allowed to deny a servicer's insurance claim even if it failed to comply with FHA loss mitigation regulations. As a result, servicers are strongly incentivized to pursue foreclosure instead of loss mitigation since foreclosure will lead to a fully paid claim. Although HUD does have a post-payment administrative enforcement process, this process has not curbed servicer non-compliance.

However, requiring servicers to establish their compliance will drastically change the incentive structure. Before a servicer can submit to HUD a claim for payment on a defaulted loan, it should be required to specifically document its compliance with FHA loss mitigation regulations and rules as part of the servicer's claim submission form. The form should include: (1) the servicer's loss mitigation waterfall analysis showing the inputs used and ultimate decisions it reached based on those inputs, or (2) a detailed description of the reasons why the servicer cannot produce a waterfall analysis, including documentation of the actions taken to encourage the submission of a loss mitigation application by the homeowner. If the servicer cannot provide one of these sets of documentation with its insurance claim, HUD should not accept the claim.

6. HUD must reinstate language in the form mortgage documents promoting compliance with servicing requirements.

In 1990, HUD mandated language in the form note and mortgage that limited a non-compliant lender's ability to pursue foreclosure. This language has promoted compliance with FHA requirements and also has improved homeowner access to loss mitigation by allowing borrowers to raise in a foreclosure that a lender has failed to meet its obligations to fully evaluate foreclosure-avoidance options. HUD violated the Administrative Procedure Act when it removed the language without providing any public notice or explanation of the change. HUD proposed similar replacement language, 81 FR 85997 (November 29, 2016), but the agency has not finalized it and has not identified any timeline for completion. In order to avoid unnecessary claims and foreclosures, HUD should promptly restore language to the note and mortgage.

The OIG Report highlighted substantial problems with FHA insured mortgage servicing that HUD must address. We appreciate the OIG's work in preparing this report and urge HUD and the OIG to take additional steps to better measure and address FHA loss mitigation problems.

Sincerely,

Community Legal Services of Philadelphia
Connecticut Fair Housing Center
Empire Justice Center
HomeSmartNY
Housing and Economic Rights Advocates in California
Legal Aid Society of Southwest Ohio
Long Island Housing Services, Inc.
Mobilization for Justice
Mountain State Justice
National Consumer Law Center (on behalf of its low-income clients)
National Fair Housing Alliance
National Housing Law Project
North Carolina Justice Center

cc: Adolfo Marzol, Senior Advisor, Office of the Secretary