

June 30, 2023

Julia R. Gordon
Assistant Secretary for Housing - FHA Commissioner
Department of Housing and Urban Development
Office of Housing
451 Seventh Street SW
Washington, DC 20410

RE: Comments on Draft Mortgagee Letter: Payment Supplement Partial Claim

Dear Commissioner Gordon:

The National Consumer Law Center, on behalf of its low-income clients, and the Center for Responsible Lending appreciate the opportunity to comment on the proposed Payment Supplement Partial Claim (PSPC) proposal posted on the Office of Single Family Drafting Table. We applaud FHA for developing the PSPC in response to the current elevated interest rate environment. The PSPC will provide needed payment relief to borrowers who have no other options for receiving a sustainable mortgage payment, and as a result, the program will help borrowers avoid unnecessary foreclosures.

We also greatly appreciate HUD's decision to post a draft of the PSPC policy prior to its release so that stakeholders can identify and propose policy adjustments that will help the program best serve borrowers. We have several recommendations to improve the PSPC. In addition to the highlights we have included below, we have also completed HUD's spreadsheet with line-by-line suggestions.

1. HUD should amend bankruptcy-related provisions in order to prevent unnecessary exclusion of borrowers from the program.

HUD should eliminate proposed amendments to the general Partial Claim eligibility rules for borrowers that have received a chapter 7 discharge. The proposed language is unnecessary, does not comport with standard bankruptcy practice, and will exclude a significant number of borrowers.

For over a decade, HUD has had clear language allowing loss mitigation, including Partial Claims, for borrowers who have filed for bankruptcy relief. According to the current version of Handbook 4000.1, "The Mortgagee may consider Loss Mitigation Options for those Borrowers who have received a Chapter 7 bankruptcy discharge and did not reaffirm the FHA-insured mortgage debt under applicable law." HUD included a similar version of this language in Mortgagee Letter 2013-32.¹ This language (in both places) was developed after consideration of

¹ Mortgagors with an active Chapter 7 or Chapter 13 bankruptcy case are eligible for FHA Loss Mitigation Options to the extent that such Loss Mitigation does not violate federal bankruptcy law or orders of the Bankruptcy Court or Bankruptcy Trustee. In addition, mortgagors who have received a Chapter 7

homeowners' need for access to loss mitigation after a bankruptcy discharge and the fact that standard industry servicing practices had shifted to clarify that loss mitigation options must be preserved for borrowers who have received a discharge. There have been no changes in the statutes and regulations governing Partial Claims since 2009.

Without providing any justification, HUD proposes to dramatically limit the ability of FHA borrowers who have discharged personal liability for their loans to access Partial Claims. The new policy allows borrowers to access Partial Claims only if they have reaffirmed their mortgages.

HUD's policy is contrary to standard consumer bankruptcy practice, in which borrowers routinely discharge their mortgage debt without entering into a reaffirmation agreement. The Bankruptcy Code requires that in order to be effective, a reaffirmation agreement must be approved before the bankruptcy discharge is entered.² A borrower whose bankruptcy case closed years ago cannot go back and reopen the case in order to reaffirm a mortgage debt. Under HUD's proposed policy, many borrowers who simply followed standard bankruptcy practice will be shut out of vital loss mitigation without any means of fixing the issue.

In the vast majority of chapter 7 bankruptcy cases filed by a homeowner, there is no reaffirmation of the mortgage debt. Reaffirmation agreements are entered into sparingly, and can only be effective if they satisfy certain bankruptcy code requirements, because they are contrary to the "fresh start" that is the principal purpose of consumer bankruptcy. Mortgage borrowers can continue paying the mortgage debt, and creditors can foreclose if payment is not made, obviating the need for any reaffirmation of personal liability. In the most recent calendar year, only about 28% of chapter 7 bankruptcy filers entered into at least one reaffirmation agreement, and almost all of those involved car loans.³

This significant exclusion of borrowers with bankruptcy discharges is not required, as the law governing Partial Claims does not require borrowers to have personal liability to HUD for the Partial Claim. To the contrary, HUD's statute and regulation allow the agency to take a non-recourse mortgage on the property that secures the loan as a means of repaying the Partial Claim. The Partial Claim statute simply states that "the mortgagor shall agree to repay the amount of the insurance claim to the Secretary upon terms and conditions acceptable to the Secretary."⁴ The implementing regulation states that "[t]he mortgagor must execute a mortgage

bankruptcy discharge and did not reaffirm the FHA-insured mortgage debt under applicable law are eligible to be considered for Loss Mitigation Options." HUD Mortgagee Letter 2013-32 (Sept. 10, 2013), p. 6

² 11 U.S.C. § 524(c)(1); *In re Smith*, 467 B.R. 122 (Bankr. W.D. Mich. 2012)

³ Bankruptcy Abuse Prevention and Consumer Protection Act Report (2022), table 4, <https://www.uscourts.gov/statistics-reports/analysis-reports/bankruptcy-abuse-prevention-and-consumer-protection-act-report>; GAO Report to Congress, *Bankruptcy: Implementation of Reform Act's Debt Reaffirmation Agreement Provisions* (2007) at 25, <https://www.gao.gov/products/gao-08-94> (finding that 54-87% of reaffirmation agreements were for car loans).

⁴ 12 U.S.C. 1715u(b)(2)(C) (emphasis added).

in favor of HUD with terms and conditions acceptable to HUD for the amount of the partial claim under § 203.414(a).”⁵

It is unclear what policy concern motivated HUD’s proposed restriction on Partial Claim eligibility. Amendments to the Bankruptcy Code from 2005 make clear that lenders can engage with borrowers to reinstate ongoing payments on a mortgage debt without violating the discharge order entered in a chapter 7 case.⁶ After a chapter 7 discharge, the borrower is still required to pay the mortgage or face foreclosure. The lender retains the right to enforce the debt against the property even though the discharge order bars direct collection against the debtor.⁷ In many states, including California and Texas, state law bars collection of a mortgage debt as a personal liability of the debtor in any event by precluding a deficiency claim against the borrower after a foreclosure sale conducted according to the state’s standard practice.

If HUD’s concern is to avoid any potential violation of the discharge order from a borrower’s past chapter 7 case, there is a simple way to address this issue. The language of the Partial Claim documents can be modified with a sentence or two acknowledging the impact of any chapter 7 discharge.

This same issue arose in the context of the Home Affordable Modification Program (“HAMP”). HAMP modifications frequently involved the forbearance and restructuring of pre-bankruptcy mortgage debt. At the outset of the HAMP program, lenders and servicers were concerned that HAMP modifications might violate the discharge order if a borrower had received a bankruptcy discharge. Recognizing that it was impossible for borrowers to reaffirm these debts once the bankruptcy discharge is entered, the Treasury Department and the GSEs established uniform guidelines to add standard language to modification agreements to state that for borrowers in bankruptcy, the loan modification was non-recourse. By modifying the security agreement and stating that no personal liability attached, servicers avoided any potential conflict with bankruptcy discharge orders.

In its first set of guidelines for the HAMP program published in 2009, the Treasury Department stated that borrowers who had received chapter 7 discharges and did not reaffirm their mortgage debts were eligible for HAMP modifications.⁸ The guidelines required the modified loan agreement to contain the following language: “I was discharged in a Chapter 7 bankruptcy proceeding subsequent to the execution of the Loan Documents. Based on this representation, Lender agrees that I will not have personal liability on the debt pursuant to this Agreement.”⁹ The HAMP program modified millions of home loans from early 2009 through 2016. During this time the program rules were updated and modified many times. However, the HAMP guidelines preserving eligibility for borrowers with chapter 7 discharges through this supplemental loan

⁵ 24 C.F.R. 203.371(c).

⁶ 11 U.S.C. § 524(j).

⁷ Johnson v. Home State Bank, 501 U.S. 78 (1991).

⁸ Home Affordable Modification Program Supplemental Directive 09-01, Introduction to the Home Affordable Modification Program (April 6, 2009) p. 2.

⁹ Home Affordable Modification Program Supplemental Directive 09-01, Introduction to the Home Affordable Modification Program (April 6, 2009) p. 16.

document language remained in effect and unchanged throughout the life of the program.¹⁰ The GSE HAMP program, in effect over the same period, implemented a similar guideline adding a bankruptcy clause to GSE loan modification documents.

HUD should continue its current policy of allowing Partial Claims for borrowers with past bankruptcy discharge orders. This policy worked for over a decade and is not in need of change. If HUD is now concerned about the impact of chapter 7 discharges on partial claims, HUD should implement a practice of requiring a simple change to its Partial Claim documents. This would be as simple as adding a sentence to say, "HUD acknowledges that due to my past chapter 7 discharge, I have no personal liability on this partial claim." The Partial Claim would be non-recourse, rather than recourse. The assumption that borrowers can go back and reopen closed bankruptcy cases to reaffirm personal liability on FHA loans is based on a misconception of how bankruptcy law works. That misconception should not lead HUD to ignore practical solutions and deprive many of the neediest FHA borrowers of this important tool for keeping their homes.

For borrowers who are currently in bankruptcy, it is not necessary to obtain bankruptcy court approval prior to the execution of the partial claim, and indeed, many courts will not approve mortgage modifications because they believe they have no authority to do so.¹¹ If HUD wishes to require bankruptcy court approval in any circumstances, it should specify that court approval should be sought only if required by the bankruptcy code or rules. For borrowers in an active chapter 7 bankruptcy, they should not be required to reaffirm the debt, but should be offered a non-recourse Partial Claim just like borrowers who have a past chapter 7 discharge.

2. HUD should not automatically terminate PSPC in connection with any transfer of the home, especially for transfers to successors in interest that are protected by Garn-St Germain.

Under the proposed policy, the servicer must terminate PSPC assistance in connection with any transfer of the loan, including transfers that are protected by the Garn–St Germain Depository Institutions Act. Automatically canceling the PSPC upon death of the borrower will immediately increase the mortgage payment and, as a result, will put unnecessary burdens on heirs who are already dealing with loss.

HUD should revise its policy to allow, at a minimum, for the PSPC and Payment Supplement Agreement to continue in effect after a Garn-St. Germain-exempt transfer of the home. This would include a transfer of the home related to death of the borrower or a divorce or separation. The Garn-St Germain Act prohibits a lender from exercising a due-on-sale clause based on this kind of intra-family transfer.¹² Similarly, the CFPB included confirmed successors in interest in

¹⁰ See Making Home Affordable Program: Handbook for Servicers of Non-GSE Mortgages v. 5.1 Ch. II § 6.4 (May 26, 2016).

¹¹ See, e.g., *In re Smith*, 409 B.R. 1 (Bankr. D.N.H. 2009) and *In re Wofford*, 449 B.R. 362 (Bankr. W.D. Wis. 2011).

¹² 12 USC 1701j-3(d).

the definition of “borrower” permitted to apply for loss mitigation with the protections of the RESPA servicing rule.¹³ Successors-in-interest after a Garn-exempt transfer are usually eligible for the broad array of loss mitigation options, for the same policy reasons that Congress saw fit to prohibit the exercise of a due-on-sale clause.¹⁴ There is no legal or principled reason why the PSPC needs to be treated differently. HUD should also consider when to allow the PSPC to continue for non-Garn-exempt transfers.

The Payment Supplement Agreement and Partial Claim Promissory Note and Security Interest documents will be signed by the borrower when the PSPC is put in place. If the property is later transferred due to death or divorce, it will still be subject to the Partial Claim security interest, such that all amounts advanced by the servicer and reimbursed by HUD are secured by the security interest. There is no need for personal liability on the Partial Claim Promissory Note, for the same reasons discussed above with respect to chapter 7 bankruptcy. If HUD or a servicer believes that the successor in interest needs to become a party to the Payment Supplement Agreement or Promissory Note, the successor could execute a simple assumption agreement once it becomes apparent that a Garn-exempt transfer has occurred.

Revising the proposed Mortgagee Letter to explicitly allow a PSPC to remain in effect after a death or divorce will not harm HUD and will prevent heirs from unnecessary payment shock. The post-transfer partial claim payments will remain collectable by HUD through the subordinate mortgage. The servicer should simply continue to operate the PSPC as normal unless it is explicitly canceled.

3. HUD should work with consumer advocates, the CFPB, industry, and other stakeholders on developing form communication and disclosures.

Because HUD’s approach is new and innovative, it will be critical for servicers to clearly and consistently communicate with borrowers. We urge HUD to develop phone scripts and template letters for servicers to use to explain the PSPC to borrowers and to inform borrowers of their eligibility. Specifically, HUD should develop templates for the following items: Payment Supplement Promissory Note, Payment Supplement Agreement Rider, Payment Supplement Partial Claim Disclosure, Disclosure Prior to Expiration / Payment Increase, and Payment Supplement Termination Notice. HUD should share draft forms with stakeholders and work with the CFPB to test the forms via consumer focus groups. Given that the program does not provide relief over the entire life of the loan and given that the program will involve a lump sum payment due at the end of the loan, the success of the program will depend on borrowers understanding those aspects of the PSPC and planning accordingly.

¹³ See 12 CFR 1024.30, 1024.31.

¹⁴ FHA, Fannie Mae, and Freddie Mac’s loss mitigation rules generally make successors in interest eligible for the same options that are available to borrowers. See FHA Servicing Handbook Sec. III.A(2)(j)(ii)(B)(4)(b) (regarding “non-borrowers who acquired title through an exempted transfer”); Fannie Mae Servicing Guide D1-4.1-02; Freddie Mac Servicing Guide 9207.2. FHA recently stopped permitting servicers to offer streamlined COVID Recovery options to successors and instead funneled them into FHA-HAMP; but in substance that gives successors a comparable payment reduction.

4. HUD's guidance should explicitly allow the Homeowner Assistance Fund (HAF) or other similar reinstatement assistance fund to cover borrower arrearages as a precursor to PSPC approval.

HUD's PSPC guidance should specifically address how HAF and other potential reinstatement relief programs fit with the PSPC. The PSPC requires a reinstatement of arrears before the servicer can determine how much payment relief a borrower can receive. Borrowers who are eligible for programs that provide reinstatement assistance can use the assistance to minimize the amount of Partial Claim they need to use up front, and thereby preserve as much as possible of the Partial Claim for any future defaults. Because the reinstatement must occur first, servicers should not have any operational challenges in integrating relief programs into their PSPC calculations. The servicer should notify the borrower that they are eligible for the PSPC and that if the state has also found them eligible for HAF, the HAF funds can be applied proactively to the arrearage before the PSPC terms are calculated. HUD should also make it clear that HAF funds may be applied to a PSPC (or any partial claim) if those funds are received after the PSPC is initiated.

5. HUD should allow borrowers to accept the Standalone Partial Claim after receiving information about the payment relief options.

Under the current and proposed loss mitigation waterfall, in a loss mitigation discussion the servicer first offers the borrower a Standalone Partial Claim if the borrower has sufficient Partial Claim funds available. The Standalone Partial Claim gives borrowers who have recovered from hardship and can resume making their originally scheduled monthly payments a simple means of reinstating their mortgage without changing the loan term and interest rate and without generating a larger balloon.

In order for borrowers to make a fully informed decision about the Standalone Partial Claim, servicers should inform borrowers that a payment reduction option may also be available. If the borrower is interested, the servicer should provide the basic terms of the payment relief option, including the monthly payment, the interest rate, the term of the loan, and any amount that will be due in a partial claim. Under HUD's proposed framework in the proposed Mortgagee Letter, if the COVID-19 Recovery Modification cannot achieve a 20% reduction in the borrower's monthly principal and interest payment, the servicer will simply offer the payment relief option that offers the greatest amount of payment relief, whether that be the COVID-19 Recovery Modification or the PSPC. As such, the comparison of payment relief under the COVID-19 Recovery Modification and the PSPC required in Step 7 will become critically important should interest rates fall and modifications increase in effectiveness; without this step, servicers could end up offering only the PSPC in Step 7, even if it would produce a higher monthly payment than the COVID-19 Recovery Modification.

Moreover, in the discussion about options with the servicer, the borrower should have the ability to accept the Standalone Partial Claim as long as the borrower indicates that the option is affordable. Borrowers may want to return to the Standalone Partial Claim, for example, if the

loan modification option would double the borrower's interest rate while only providing a small payment reduction. This situation is likely in the current rate environment for borrowers who have already made use of a portion of their Partial Claim. Allowing the borrower to accept what was previously offered does not add significant complication to the system - it simply allows the borrower to return to an offer previously made.

Moreover, as illustrated in the attached spreadsheet, by simply stating that borrowers can access the Standalone Partial Claim throughout the loss mitigation process, HUD can eliminate confusing language from the proposed policy that makes the system seem more complicated than it actually is.

6. HUD should require periodic, proactive reviews for Advance Loan Modifications (ALM) once interest rates reduce significantly.

Although HUD's proposed PSPC is an innovative and important tool, it remains, by its terms, a temporary relief option for borrowers with long-term hardships. At the end of the payment supplement term, there will be some borrowers who will not have returned to their pre-hardship financial situation and may need a permanent change of terms. As long as interest rates remain relatively high, the availability of payment relief modifications may be very limited.

However, if interest rates significantly decrease, payment relief modifications may again become available. We urge HUD to account for that possibility and to require servicers to periodically review their PSPC participants for streamlined Advance Loan Modifications (ALM). Under the ALM, borrowers receive unsolicited modification offers if a simple term extension and rate adjustment achieves a targeted payment reduction. While ALMs are very unlikely to reach the target payment reduction at this time, by building in an automatic review, HUD can provide a path to permanent relief if rates decrease significantly.

7. HUD should investigate whether the Payment Supplement PC can be implemented using a pre-funded account.

If feasible, HUD may want to consider whether the PSPC process can be simplified by having servicers submit a single claim at inception for arrearages plus the full amount needed to fund the PSPC for the full term. The PSPC funds would be held by the servicer and disbursed each month upon receipt of the borrower's portion of their total monthly payment, which would eliminate the need for servicers to build the operational capability to file multiple Partial Claims over the life of the PSPC. Should HUD be able to structure the PSPC in this manner, servicers will likely be able to offer the PSPC to borrowers in financial hardship sooner, in turn helping these borrowers regain their financial footing sooner and keep their homes. In addition, given the novel nature of the PSPC, reducing the operational burden on servicers should lead to fewer errors that cause borrower harm.

We appreciate the opportunity to comment and again applaud HUD for developing a program to provide payment relief in this current interest rate environment. If you have any questions about this letter or would like to discuss it in more detail, please contact Steve Sharpe, Senior Attorney

at National Consumer Law Center, at [ssharp@nclc.org](mailto:ssharpe@nclc.org) or Kanav Bhagat, consultant to the Center for Responsible Lending, at kanavbhagat@gmail.com.

Sincerely,

National Consumer Law Center (on behalf of its low-income clients)
Center for Responsible Lending