

COMMENTS
to the
Consumer Financial Protection Bureau
12 CFR Part 1024
[Docket No. CFPB-2012-0034]
RIN 3170-AA14
2012 Real Estate Settlement Procedures Act
(Regulation X)
Mortgage Servicing Proposal

by the
National Consumer Law Center
on behalf of its low income clients

as well as

National Association of Consumer Advocates

October 9, 2012

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The **National Consumer Law Center**² ("NCLC") submits the following comments on behalf of its low-income clients, as well as **National Association of Consumer Advocates**.³

These comments deal exclusively with the proposed changes to Regulation X (under the Real Estate Settlement Procedures Act "RESPA") in the CFPB's servicing proposal. Separately, we supply comments on the proposed changes to Regulation Z (under the Truth in Lending Act, "TILA").

¹ 77 Fed. Reg. 75200 (Sept. 17, 2012).

² The **National Consumer Law Center, Inc. (NCLC)** is Since 1969, the nonprofit National Consumer Law Center® (NCLC®) has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness. NCLC publishes a series of consumer law treatises including Mortgage Lending, Truth in Lending and Foreclosures. These comments are written by NCLC attorneys Alys Cohen, John Rao, Margot Saunders and Diane Thompson. These authors provide assistance on a daily basis to the attorneys and housing counselors working with distressed homeowners across the country. These comments are based on these conversations as well as our knowledge and expertise in RESPA specifically and consumer law in general.

³ The **National Association of Consumer Advocates** ("NACA") is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.

I. Introduction and Summary of Comments

The CFPB should be congratulated for its hard work on this complicated subject and for those proposed rules that benefit homeowners. Some parts of this proposal are very positive. Other proposals, however, do affirmative harm, and even the beneficial ones have gaps and weaknesses.

Omissions in the proposed loss mitigation rules, in particular, combined with the statement that loss mitigation is not required, squander an opportunity to extend recent progress in this area, undermine existing practices as industry standard, potentially roll back stronger state law protections and will result in a long-term decrease in assistance available to homeowners facing foreclosure. Weak information management and outreach improvements will not in any way substitute for the needed substantive protections.

- We are most concerned with the affirmative harm posed by the proposed loss mitigation procedures. (Proposed 12 C.F.R. § 1024.41.) This proposed regulation provides that “servicers that offer loss mitigation options in the “ordinary course of business” to borrowers would be required to implement procedures to process those evaluations. Applications must be reasonably evaluated, and there are time limits by which the servicer must provide information and respond before proceeding to a foreclosure sale. However, the proposed rule fails to require any substantive standards for loan modifications and would take a major step backward by permitting dual track – proceeding with the foreclosure process while evaluating the homeowner for loss mitigation. In fact, the regulation explicitly states that it is not imposing any requirement to offer loss mitigation at all. As it stands, this proposed regulation represents a major retreat from many existing requirements. Servicers must be required to undertake loss mitigation, including loan modification reviews and offers, prior to initiation of foreclosure. The proposed rule would do affirmative harm and should be rewritten or withdrawn.
- Servicers should be required to offer affordable, NPV-positive loan modifications to qualified homeowners facing hardship. Eligibility rules and any NPV test should be publically available and provided directly to the homeowner up front.
- Homeowners seeking assistance after a foreclosure has started should have their foreclosures paused while their files are reviewed, and if needed, while any appeal from a denial is processed, in a timely fashion. The deadline for seeking such help must be set shortly before the sale—at seven days—not at 90 days.

The CFPB’s failure to require meaningful loss mitigation signals a retreat from responsible, proven steps to save homes. Loan modification requirements and dual track limitations are now applicable to most of the mortgage market through the federal Home Affordable Modification Program (HAMP), the federal-Attorneys General (AG) settlement with the five large bank servicers, and the Servicing Alignment Initiative for Fannie Mae and Freddie Mac. However, many of these will expire and none of them apply to the entire industry. The CFPB regulations on loss mitigation should advance consumer protections for homeowners, not set them back. Further discussion of needed changes to the loss mitigation proposal is below.

Additionally, we have concerns about the other parts of the proposed regulations. These include:

- **Error resolution and information requests.** (Proposed 12 C.F.R. §§ 1024.35 and 1024.36.) The Dodd Frank Act sets a shorter time period for servicers to respond to Qualified Written Requests (QWRs), which are used by homeowners for a broad array of servicer inquiries, and requires that the response be without charge. The proposed regulation accomplishes these goals for the newly defined “requests for information” and the error resolution procedures. The current regulation on QWRs, requiring servicers to respond to borrowers’ assertions of error relating to all servicing obligations, is deleted. The proposed regulation sets out only nine specific grounds under which a homeowner can request error resolution from the servicer. The lack of a general catch-all provision fails to follow the directive in RESPA itself, which requires error resolution for a servicer’s failure to timely respond to a “borrower’s request to correct errors relating to . . . avoiding foreclosure, or other standard servicer’s duties.” (12 U.S.C. § 2605 (k)(1)(C)). Despite this clear mandate, the proposed regulation would not even permit a borrower to request error resolution based on an improper denial of a loan modification application. The regulations should retain the catch-all provision in the Real Estate Settlement Procedures Act (RESPA) that allows homeowners to challenge abuses by servicers that are not specifically listed in the regulation. Confining RESPA’s protections to a closed list of servicer acts would strip borrowers of protections and enforcement rights currently available under RESPA. Without a catch-all provision, homeowners will be unable to obtain correction of servicer errors and abuses and may be more likely to face foreclosure.

The error resolution procedure must be expanded to include a general ground that covers any borrower request to avoid foreclosure or address other “standard servicer’s duties”. Without this change, this provision represents a retreat from current legal consumer protections – when additional mandates are clearly necessary to prevent inappropriate foreclosures.

- **Force-placed insurance.** (Proposed 12 C.F.R. § 1024.37.) Under the proposed rule, servicers would not be permitted to charge a borrower for force-placed insurance coverage unless the servicer has a reasonable basis to believe the borrower’s insurance was cancelled for a reason other than non-payment of the premium, and has provided required notices. Additional notices are required when force-placed insurance will be provided. Most importantly, servicers would be required to pay the borrower’s existing insurance policy rather than purchase force-placed insurance if there is an escrow account and the reason for policy cancellation is nonpayment.

This proposal would improve protections for consumers but it should also apply to homeowners without escrow accounts.

- **Information management policies and procedures.** (Proposed 12 C.F.R. § 1024.38.) The CFPB proposal would require servicers to establish reasonable information management policies and procedures. Accurate document retention and servicing file requirements are specified, and the servicer is required to provide a homeowner with the entire “servicer file” upon request, which includes the note, the mortgage, a schedule of all payments, and collection records. There is a safe harbor from legal liability when a servicer does not engage

in a “pattern or practice” of meeting the objectives of the section. Surprisingly, however, there are no requirements for verification of the right to foreclose. Given the massive problems with servicers’ record keeping, this seems the most obvious of omissions.

This provision should contain no safe harbor for servicer non-compliance and should affirmatively require servicers to provide borrowers with verification of the servicer’s right to foreclose before initiating foreclosure.

- **Early intervention with delinquent borrowers.** (Proposed 12 C.F.R. § 1024.39.) Servicers would be required to make good faith efforts to notify delinquent borrowers of their loss mitigation options and provide information to the borrower about the foreclosure process. The required early intervention efforts are good, but these efforts do not require a notice explaining the various loss mitigation strategies actually offered by the servicer and how to apply for them.

This provision needs to include a specific requirement that servicers provide detailed information about all of the loss mitigation strategies employed by the servicer, the eligibility requirements, and the steps required for homeowners to apply for these options.

- **Continuity of contact with delinquent borrowers.** (Proposed 12 C.F.R. § 1024.40.) Servicers would be required to provide delinquent borrowers with access to dedicated personnel to assist them with loss mitigation options where applicable. This is a good requirement, yet critical protections are omitted.

Servicers should be required to provide an electronic portal for communications with borrowers or their designated representatives, particularly for delivering documentation for a loan modification request. Conventional application procedures should still be available as well.

II. Definitions, Coverage and Exemptions

A. Inclusions and Exclusions

Subordinate mortgages. We applaud the extension of RESPA coverage to subordinate closed-end credit.⁴ Many of the problems with application of payments, loss mitigation issues, and force-placed insurance arise in the context of subordinate liens. It is entirely appropriate for these home secured loans to be covered by RESPA.

Reverse mortgages. We also agree that reverse mortgages should be covered by RESPA.⁵ This will be especially important in the future as we hope that the CFPB requires the creation of escrow accounts to handle taxes and insurance payments owed on homes secured by reverse mortgages. Escrow accounts are necessary to deal with the escalating problems caused by reverse mortgage homeowners whose entire available equity was exhausted, leaving no funds to assist with the payment of the ongoing expenses of taxes and property insurance. Our comments to the CFPB

⁴ Proposed § 1024.2(A)(1)(i).

⁵ Proposed § 1024.2(A)(1)(i).

on the Request for Information Regarding Senior Financial Exploitation describe our proposal more fully on this subject.⁶

Open-end credit. It is unfortunate that the proposed regulations would not include open-end credit secured by homes under the protections of RESPA. The discussion of the reasons for this continued exclusion⁷ indicates that there are a number of reasons for this decision, some of which may be based on an erroneous understanding of the dynamics of HELOCs and the TILA protections covering these loans.

There are many situations of spurious open-end credit in which predatory lenders purport to extend open end-loans which are not in fact open-end. They do this to avoid the stricter disclosures and substantive provisions for closed-end credit, as well as the stiffer penalties for violations of those rules.⁸ In fact, because of the extensive problems with open-end credit, in 2010 Congress extended the protections of HOEPA to open-end credit.⁹

The extension of HOEPA to cover open-end credit is a recognition of the dangers of these loans. Lenders have an incentive to mischaracterize credit as open-end because the disclosures for open-end credit are not as robust as they are for closed-end credit and make it more difficult for consumers to understand the total price or comparison shop.¹⁰ Open-end transactions have been used to finance, and disguise the price of, big ticket items such as home improvements, satellite dishes, cars, and even homes. Consumers entering into open-end transactions come away with much less of the critical “cost of credit” information than they would if the loans were closed-end.

Moreover, there is an erroneous assumption that TILA’s protections for open-end credit under the Fair Credit Billing Act provide equivalent protections to those under RESPA.¹¹ In fact the Fair Credit Billing Act only protects consumers against –

1. An extension of credit that was not made to the consumer,¹² or a credit extension which was not made in the amount reflected on the statement;¹³
2. An unauthorized extension of credit, i.e., an extension of credit to someone without actual, implied, or apparent authority to use the credit card or account;¹⁴
3. An extension of credit that is not properly identified under the specific rules for identification of transactions;¹⁵
4. An extension of credit for property or services that was not accepted by the consumer or the consumer’s designee;¹⁶

⁶ See, NCLC Comments to the Consumer Financial Protection Bureau on Request for Information Regarding Senior Financial Exploitation, 77 FR 36491 (June 19, 2012), Docket No. CFPB-2012-0018. Available at http://www.nclc.org/images/pdf/debt_collection/cfpb-financial-exploitation-comments-aug-2012.pdf.

⁷ 77 Fed. Reg. 75200, 57216 (Sept. 17, 2012).

⁸ See, NCLC, *Truth in Lending*, (7th Ed. 2010), § 9.6.2.4.3; also see § 6.2.3.

⁹ Publ. L. No. 111-203, § 1431, 124 Stat. 2157 (July 21, 2010).

¹⁰ The APR that is disclosed in credit card applications/solicitations and upon account opening does not include the impact of fees, whereas most fees must be included in the APR for a closed-end loan.

¹¹ 77 Fed. Reg. 75200, 57217 (Sept. 17, 2012).

¹² Reg. Z § 226.13(a)(1).

¹³ 15 U.S.C. § 1666(b)(1).

¹⁴ Reg. Z § 226.13(a)(1).

¹⁵ Reg. Z § 226.13(a)(20).

¹⁶ Official Staff Commentary § 226.13(a)(3)-1.

5. An extension of credit for property or services not delivered to the consumer or the consumer's designee as agreed;¹⁷
6. Failure to include a payment or other credit to the account;¹⁸
7. A computational or accounting error in the credit related portion of the statement;¹⁹
8. An extension of credit for which the consumer requests additional clarification or documentation²⁰ (e.g., because the transaction cannot be identified from the information given);²¹ or
9. Failure to send the periodic statement to the consumer's last known address if the creditor had received the address, in writing, at least twenty days before the end of the billing cycle for the periodic statement.²²

These billing errors are primarily intended to deal with the use of an open-end credit account to finance retail purchases of goods and services. Only two of these billing errors overlap with the types of issues which can be addressed with a servicer under RESPA (compare this list with the list of errors in proposed § 1024.35(b)). Numbers 6 and 7 of the list above overlap with proposed § 1024.35(b)(3) and possibly (b)(2), respectively. None of the other errors listed in § 1024.35(b), as RESPA-covered errors for which a homeowner can obtain redress, are considered billing errors for open-end credit. In addition, RESPA applies not only to billing error inquiries but to any request for information relating to the servicing of a federally related mortgage loan, whereas the TILA billing error notice provision applies only to billing errors.

Moreover, whether the improper assessment of a finance charge can be a billing error is the subject of some dispute. While such an error could conceivably fit into one or more billing error categories, the Fifth Circuit and other courts have taken a narrow view in a series of cases.²³ In these cases the consumers had been advised to send billing error disputes challenging the assessment of finance charges during the history of the account based on the issuer's alleged failure to give proper TILA disclosures. Most of the courts in these cases have held that such challenges were not proper

¹⁷ 15 U.S.C. § 1666(b)(3); Reg. Z § 226.13(a)(3).

¹⁸ 15 U.S.C. § 1666(b)(4); Reg. Z § 226.13(a)(4). This provision can be invoked when a card issuer fails to post a payment sent by the consumer, even though the card issuer never received the funds. *See Purcell v. Universal Bank, N.A.*, 2003 WL 1962376 (E.D. Pa. Apr. 28, 2003). The issuer's failure to promptly post a payment from the consumer violates § 1666b of TILA.

¹⁹ 15 U.S.C. § 1666(b)(5); Reg. Z § 226.13(a)(5); Official Staff Commentary § 226.13(a)(5)-1.

²⁰ *Burnstein v. Saks Fifth Avenue*, 208 F. Supp. 2d 765 (E.D. Mich. 2002) (a request for clarification can constitute a billing error triggering creditor's obligations for resolution), *subsequent proceeding at* 85 Fed. Appx. 430 (6th Cir. 2003) (appeal mooted by jury finding of fact adverse to plaintiff). *See also Cunningham v. Bank One*, 487 F. Supp. 2d 1189 (W.D. Wash. 2007) (following *Burnstein v. Saks Fifth Avenue*); *Garner v. MBNA Am. Bank, N.A.*, 2007 WL 119900 (N.D. Tex. Jan. 18, 2007) (request for clarification and documentary evidence to explain transaction sufficient to constitute a proper billing error notice); *Raney v. First Nat'l Bank of Omaha*, 2006 WL 2588105 (E.D. Ky. Sept. 8, 2006) (consumer only required to assert a billing error and ask for additional clarification about that error); *Lau v. Credit Concepts*, 2007 WL 593623 (N.D. Okla. Feb. 21, 2007) (following *Raney*); *Belmont v. Associates Nat'l Bank*, 119 F. Supp. 2d 149 (E.D.N.Y. 2000) (sending a periodic statement to consumer was billing error where consumer requested clarification as to whether he was an obligor on the account). *See also* Reg. Z § 226.8 nn.16, 17.

²¹ Reg. Z § 226.13(a)(2). Under Reg. Z § 226.8, the creditor can escape liability for failure to properly identify each credit transaction by treating an inquiry for clarification or documentation as a billing error.

²² 15 U.S.C. § 1666(b)(6); Reg. Z § 226.13(a)(7).

²³ *Esquibel v. Chase Manhattan Bank*, 2008 WL 1881494 (5th Cir. Apr. 29, 2008); *Langenfeld v. Chase Bank USA, N.A.*, 537 F. Supp. 2d 1181 (N.D. Okla. 2008); *Cunningham v. Bank One*, 487 F. Supp. 2d 1189 (W.D. Wash. 2007).

billing error disputes.²⁴ These courts believed that the challenges did not fit in the category of requests for “additional clarification including documentary evidence thereof,” because such requests only apply to “extensions of credit” and finance charges are not extensions of credit.²⁵ In addition, some of these courts rejected the argument that the improper assessment of finance charges was a “computation error,” because the courts believe this argument merely restated the “additional clarification” claim they had rejected.²⁶

Finally, the proposed exemption from RESPA coverage of home equity lines of credit covered by TILA and Reg. Z directly conflicts with the language in RESPA that expressly requires a servicer to respond to borrower inquiries regarding the “servicing” of any “federally related mortgage loan.”²⁷ The statutory definition “federally related mortgage loan” does not include an exemption for open-end credit. Courts which have considered this conflict between the statute and the existing regulation have concluded that the regulation is not entitled to agency deference and is therefore ineffective.²⁸

Proposed change:

Open-end credit transactions secured by consumer’s homes should be fully covered by RESPA.

B. Transfer of Servicing Notices

The proposed regulation and Commentary (§ 1024.33) makes several important changes to the notices regarding transfer of servicing previously required by Reg X (§ 1024.21(b), (c) and (d)). While most of the changes are fine, we have serious concerns with three of the proposed changes, and have several additional recommendations for the content and effect of the notice:

1. The Transfer of Servicing Notice Must Be Sent to Each Borrower.

The proposed Commentary (§ 1024.33(b)(3)-2) removes the obligation that transfer of servicing notices be sent to all borrowers, and allows these critically important notices to be sent just to the primary borrower. Every borrower who is liable for the mortgage and is obligated on the mortgage must be provided with the essential information of the new name and address of the servicer to whom mortgage payments must be made.

²⁴ *Esquibel v. Chase Manhattan Bank*, 2008 WL 1881494 (5th Cir. Apr. 29, 2008); *Langenfeld v. Chase Bank USA, N.A.*, 537 F. Supp. 2d 1181 (N.D. Okla. 2008); *Cunningham v. Bank One*, 487 F. Supp. 2d 1189 (W.D. Wash. 2007). *But see* *Gengo v. Target Nat’l Bank*, 513 F. Supp. 2d 42 (S.D. Tex. 2007); *Raney v. First Nat’l Bank of Omaha*, 2006 WL 2588105 (E.D. Ky. Sept. 8, 2006); *Eicken v. U.S.A.A. Fed. Sav. Bank*, 2006 WL 1663371 (S.D. Tex. June 12, 2006) (Eicken I).

²⁵ *Esquibel v. Chase Manhattan Bank*, 2008 WL 1881494 (5th Cir. Apr. 29, 2008); *Langenfeld v. Chase Bank USA, N.A.*, 537 F. Supp. 2d 1181 (N.D. Okla. 2008); *Cunningham v. Bank One*, 487 F. Supp. 2d 1189 (W.D. Wash. 2007).

²⁶ *Esquibel v. Chase Manhattan Bank*, 2008 WL 1881494 (5th Cir. Apr. 29, 2008); *Langenfeld v. Chase Bank USA, N.A.*, 537 F. Supp. 2d 1181 (N.D. Okla. 2008).

²⁷ 12 U.S.C. § 2605(e)(1)(A).

²⁸ *Cortez v. Keystone Bank, Inc.*, 2000 WL 536666 (E.D.Pa. May 02, 2000)(refusing to apply Regulation X open-end credit exclusion from RESPA’s error resolution provisions). *See also* *Hawkins-El v. First American Funding, LLC*, 2012 WL 4099048 (E.D. N.Y. Sep 19, 2012)(finding that subordinate lien exclusion conflicts with statute); *MorEquity, Inc. v. Naeem*, 118 F.Supp.2d 885 (N.D. Ill. 2000) (noting in *dicta* that the regulation conflicts with RESPA).

Notice to only one party is no guarantee that multiple obligors, or even the party who is actually making payments on the mortgage, will receive it. For example, in a divorce or separation, a notice mailed to only one borrower might well not be passed on to the other borrower, who may actually reside in the home and be the person making the payments. This can easily occur if the borrower not living in the home has provided the postal service with a change of address request. Often the “primary” borrower is the husband (his name is generally listed first on loan documents), but the wife remains in the home with the children after a separation or divorce. In these situations, the wife must receive the transfer of servicing notice, so that she can ensure that the payments are made to the new servicer.

It is also not uncommon for a borrower not living in the home to be ordered under a family court decree to make direct payments on the mortgage as a form of support. The borrower obligated to make payments in that situation should be sent transfer notices even if he or she is not the “primary” obligor. These concerns are amplified in situations where domestic violence is implicated; failure to ensure that all borrowers receive notice can enable financial and economic abuse.

The proposed Commentary is also problematic because the CFPB has failed to provide a definition of “primary” borrower. Consumers typically are not informed by the lender or servicer as to which of the obligors is the “primary” borrower. The Fannie/Freddie Uniform Instruments also do not define “primary” borrower, nor do they designate on the documents which party is the “primary” borrower. We are also unaware of any industry standard as to the definition of “primary” borrower or the procedure for designating the “primary” borrower. Moreover, who the primary borrower is can change over time, due to death, divorce, or separation, as well as changes in the relative economic position of the borrowers. By giving servicers discretion to determine when a “primary” borrower is “readily apparent,” without any explicit guidance on this issue from the CFPB, the Commentary will produce confusion, uncertainty, and unnecessary litigation.

Sending two notices is not costly, simplifies compliance, and reduces the risk that an interested borrower will not receive the notice. There is no reason not to send the identical notice of the servicing transfer to all borrowers who might have a reasonable interest in the information.

2. The Requirement that the Transfer of Servicing Notice Describe the Borrower’s Complaint Resolution Rights Should Not Be Deleted.

The proposed regulation also deletes the requirement currently set forth in § 1024.21(d)(3)(vii) that the transfer of servicing notice include a statement of the borrower’s rights in connection with complaint resolution. The reasons given for this deletion are frankly confusing. It is not at all clear how, under the proposed regime, borrowers will be apprised of their rights to error resolution (under proposed § 1024.35) and requests for information (under proposed § 1024.36). In fact, none of the mandatory contacts with borrowers proposed by the CFPB require disclosure of these rights. Significantly, neither the periodic billing statement proposal (§ 1026.41) or the early intervention notice (§ 1024.39) require the servicer to inform the borrower of the right to dispute errors or obtain account information.

The CFPB should not assume that consumers are aware of their RESPA rights or that they will exercise these rights if they are merely provided servicer contact information that they can use if they have “questions.” In fact, because consumers are provided monthly reminders of their billing

dispute rights under TILA for credit card accounts, the lack of any disclosure of similar rights for mortgage transactions might well lead consumers to believe that no such rights exist.

The CFPB has failed to put forward any compelling justification for eliminating a disclosure provided under current law. It certainly cannot be a cost issue, as the language in the proposed Appendix MS-2 barely covers one side of the Notice. Adding a paragraph about the error resolution and information rights might at most extend some of the information to the back side of the Notice, but would not require an additional page or increased postage.

3. The Transferring Servicer Should Be Required to Forward to the New Servicer Any Payments Received from the Borrowers.

The proposed regulation also would allow a transferring servicer to return payments to borrowers, rather than forward them to the appropriate servicer (proposed § 1024.33(c)(2)). This proposal has no rational basis and will undoubtedly lead to tremendous confusion, defaults, unnecessary fees, and, potentially, more foreclosures. As the CFPB acknowledges in its prefatory comments, most servicers currently “already transfer misdirected payments to the appropriate servicer in connection with a servicing transfer.”²⁹ The transferring servicer can easily pass these payments along to the new servicer, smoothing the transition between servicers, and reducing significant opportunity for unnecessary harm to homeowners. If the CFPB is concerned about checks sent to the former servicer from third-parties other than the borrower, such as a check under the Hardest Hit program, the regulation should be narrowly drafted to deal with that specific type of situation.

4. The Transfer of Servicing Notices Should Include the History and Current Status of the Account.

Transfer notices should advise if the homeowner is current and whether there are any unpaid fees, and the status of loss mitigation options being considered. A full payment history, including allocation of the payments to interest, principal, late fees, and other fees should be included by both the old and the new servicer, so that the homeowner may promptly ascertain if there is a discrepancy in the records.

Many servicing problems occur at or near the time of transfer of servicing, often caused by the old and new servicers difficulties in communicating with each other and reconciling accounting records with respect to borrower payments made during the transition period. Errors involving even just one or two payments can spiral into a threatened foreclosure despite borrower efforts to prove that payments were in fact made. This is a common problem.³⁰ In proposing the information management policies and procedures in § 1024.36, the CFPB has referred to the “demonstrated failures” of the major servicers to document and verify information relating to borrower accounts.

Even borrowers who are current with their mortgage payments may be apprehensive about a transfer of servicing and have concerns that their account is being treated as current upon transfer to the new servicer. Providing information about loan status at transfer will help alleviate borrower concerns and give borrowers prompt notice if there is an error or problem.

²⁹ 77 Fed. Reg. 75200, 57220 (Sept. 17, 2012).

³⁰ *E.g.*, *Rawlings v. Dovenmuehle Mortgage, Inc.*, 64 F. Supp. 2d 1156 (M.D. Ala. 1999).

5. The Borrower Should Be Entitled to Rely on the Listing of Fees in the Transfer of Servicing Notices.

Fee omissions in transfer notices should be binding. If a fee is not listed in the payment history provided by the servicer at the time of the transfer of servicing, in the “goodbye letter” and “hello letter” to the homeowner, as having been incurred, it should be deemed to have been waived.

Proposed changes:

1. Retain the current obligation on servicers to provide transfer of servicing notices to all borrowers.
2. Retain the current obligation on servicers to provide basic information about borrowers’ rights to error resolution and the ability to request information about their loans.
3. Require the transferring servicer to forward all payments received from borrowers after the transfer date to the appropriate servicer.
4. Require that transfer notices provide information about the default status of the loan, and include a full payment history.
5. Require that fees not listed in the payment history provided at the transfer of servicing be waived.

III. Error resolution and information requests. (Proposed 12 C.F.R. §§ 1024.35 and 1024.36).

A. The Omission of the Catch-all Provision for Error Resolution is a Reduction of Homeowner Rights from the Current Law.

1. The Proposed Regulation’s Omission of a Catch-all Provision Will Reduce Consumer Protections and Harm Borrowers.

Proposed section 1024.35 contains a specific list of nine errors for which a homeowner can request resolution. The list is generally good, but it is incompatible with the statutory scheme because the list is exclusive. Thus, while it seems entirely appropriate for the CFPB to define – as it has done in proposed § 1024.35(b) – a list of nine *examples* for which the borrower might request resolution of the error, a tenth subsection needs to be added to make this list complete:

- (10) Any other failure of the servicer to comply with standard servicer duties.

The proposed regulations on error resolution and information merge two different and supplemental provisions on important consumer rights into a new procedure. The proposed regulation deletes the preexisting regulation on Qualified Written Requests (“QWRs”), and replaces it with provisions on error resolution (proposed § 1024.35) and information requests (proposed § 1024.36). We have no quarrel with the decision to designate separate sections of the regulations for error resolution and information requests.

The problem is that the proposed regulation limits the grounds for error resolution and information requests to nine specific “covered errors,” leaving no general catch-all ground to hold servicers accountable for their errors. There are many important additional grounds upon which

borrowers might need to assert errors or request information. For example, what if a servicer fails to apply a payment on a daily accrual loan on the date of the receipt, which causes additional interest charges to the consumer? Or what if the servicer refuses to consider a borrower for a particular loan modification program that is offered to other borrowers? Or what if the reasons the servicer is refusing to provide a particular loss mitigation option is that the servicer is relying upon flawed valuation information relating to the value of the home? All of these – and many more – are typical problems that homeowners have with servicers. All of these problems are not covered in this select list of nine errors, and yet, they all lead to terrible problems, and eventually to wrongful foreclosures.

The exclusive “covered error” list is an inappropriate exercise of the CFPB’s authority not only because it is contrary to the statutory language but also because it deprives borrowers of an existing statutory remedy and enforcement mechanism. There are a number of RESPA requirements and consumer protections that were placed by Congress in sections of RESPA that are not directly subject to the private right of action under section 2605(f). However, the statutory scheme devised by Congress makes a remedy available to consumers through the error resolution process, after the borrower notifies the servicer of the error and the servicer is given an opportunity to correct the error.

For example, Congress enacted section 2609 (section 10 of RESPA) in response to reports of lender and servicer abuses concerning “over-escrowing,” that is the practice of requiring borrowers to pay more into an escrow account than is needed to make timely escrow disbursements and provide a cushion.³¹ Section 2609(a) therefore sets limits on the escrow deposits a servicer may demand following an escrow account analysis. If the servicer miscalculates the escrow deposit, the borrower currently has the right to send a QWR to the servicer seeking correction of the error, a new monthly payment amount, and a refund of any overpaid amounts. Under the proposed regulation, none of the “covered errors” directly addresses this situation as they deal only with a servicer’s failure to “accept,” “apply,” and “credit” a payment, not whether an escrow deposit or payment amount was calculated correctly in the first instance.

In the above example, the borrower may not become aware of the “over-escrowing” until the next annual escrow account statement is provided. If at that time the servicer informs the borrower that there is now a \$1,250 surplus in the escrow account and that the surplus will be credited against next year’s escrow payments, this treatment of the surplus clearly violates Reg. X § 1024.17(f)(2) as any surplus greater than \$50 must be refunded to the borrower. Under current law, the borrower may send a QWR that disputes the error and demands a refund of the surplus. The proposed regulation denies the borrower this fundamental right by providing that the failure to refund an escrow account balance is a “covered error” only at the time of loan payoff under § 1024.34(b).

The Commentary itself demonstrates the problems caused by an exclusive error list. In Commentary § 35(a)(2), an example is provided of a borrower who submits a letter that claims to be a “Notice of Error” that indicates that the borrower did not receive an annual escrow account statement. The Commentary suggests that borrower is not harmed in this situation, even though the failure to send the escrow statement is not a “covered error,” because the letter effectively only sought information: “Although the servicer’s failure to provide the borrower an annual escrow statement is not defined as an error pursuant to § 1024.35(b), such a letter may constitute an

³¹ See *Aitken v. Fleet Mortgage Corp.*, 1992 WL 33926 (N.D. Ill. Feb. 12, 1992).

information request under § 1024.36(a) that triggers an obligation by the servicer to provide an annual escrow statement.”

This completely ignores the consequences of the failure to send an annual escrow statement and the need for error resolution. If an escrow statement is not provided, the borrower will in almost every case be paying the incorrect contractual installment payment, resulting in a surplus, shortage, or deficiency on the escrow account. Even if the borrower suspects that the monthly payment amount may not be correct because no escrow account statement was received, the borrower cannot use the error resolution process because the failure to correctly calculate the monthly installment escrow payment is not a covered error. The failure to provide the escrow statement goes well beyond a mere informational lapse by the servicer and could ultimately result in the servicer asserting that the loan is in default. The borrower must be able to invoke the RESPA error resolution process to correct this potentially devastating servicer errors.

For each of the servicer escrow violations described above, the borrower currently has the right to demand correction by sending a QWR. Importantly, if the servicer fails to correct the errors as required by § 2605(e)(2), the borrower can bring a court action seeking actual damages caused by the servicer’s errors. The CFPB proposal denies borrowers the right to seek court redress under § 2605(f) because errors related to the escrow requirements are not on the exclusive error list. Additionally, the CFPB proposal denies consumers the protection from negative credit reporting under § 2605(e)(3) because such error resolution requests will not be treated as a QWR.

Adding more specific subsections will not address the real issue here. The CFPB should not presume that expanding the closed list beyond what is currently proposed will be exhaustive. Developing a comprehensive list of errors that relate to the “servicing” of mortgage loans or “other standard servicer’s duties” is an impossible task. Moreover, the list could not possibly predict the future and would need to be frequently amended as standard servicer’s duties change over time.

2. The Omission of a Catch-All Is Contrary to RESPA.

In contrast to the proposed rule, RESPA does not limit the grounds on which consumers can request information or servicer errors can be resolved. The statute – both the old section on QWR, and the new section added by the Dodd-Frank Act – is open ended. In two separate places -- 12 U.S.C. § 2605(e), the longstanding provision governing QWRs, and 12 U.S.C. § 2605(k), the Dodd-Frank provision governing “servicer prohibitions”-- RESPA dictates that there should be a general catch-all in both error resolution and information.

Section 2605(e) permits consumers to obtain information about the servicing of their mortgage and escrow accounts by providing a written inquiry to the servicer. When the written inquiry questions a servicer’s actions on the account, this provision requires the servicer to respond to the specific dispute and take corrective action when appropriate. A borrower inquiry made under this provision is referred to as a “qualified written request,” which “includes a statement of the reasons for the belief of the borrower, to the extent applicable, that the account is in error or provides sufficient detail to the servicer regarding other information sought by the borrower.”³²

³² 12 U.S.C. § 2605(e)(1)(B).

Subsection (e) generally requires servicers to respond to borrower inquiries and correct account errors and allows for a broad array of inquiries.³³ There is a substantial body of case law surrounding the panoply of servicer obligations relating to QWRs, much of it substantially helpful to homeowners in their efforts to understand the mystifying mechanisms by which servicers operate.³⁴ The existing version of Regulation X, specifically, 12 C.F.R. § 1024.21(e), sets out the specific duties of a servicer once a QWR is received. Importantly, the definition of a QWR includes the broad language:

... [A] qualified written requests means a written correspondence . . . that includes, or otherwise enables the servicer to identify, the name and account of the borrower, and includes a statement of the reasons that the borrower believes the account is in error, if applicable, or that provides sufficient detail to the servicer regarding information relating to the servicing of the loan sought by the borrower.³⁵

The general grant of authority in § 2605(k)(1)(e) to establish servicer obligations does not give the CFPB power to write § 2605(e)(1)(B) out of the statute. Congress has made abundantly clear that a borrower need only provide a statement of the reasons that the borrower believes that the account is in error. The Dodd-Frank Act did not change this statutory language and no other provision in the Act reflects any attempt by Congress to limit borrowers' dispute rights. Any attempt to confine the borrower to an exclusive list of covered errors is in clear conflict with the statute. The proposed regulation must include a provision that carries out the Congressional intent to freely allow borrowers to dispute servicing errors.

The addition of section 2605(k) in Dodd-Frank further supports the imperative to maintain the catch-all provision. The new provision, § 2605(k), is an entirely separate, supplemental provision *expanding* the dispute and information rights available to borrowers.³⁶ Subsection 2605(k)(1)(C) requires a servicer to take timely action to respond to a borrower's request to correct errors relating to –

. . . . allocation of payments, final balances for purposes of paying off the loan, or avoiding foreclosure, or other standard servicer's duties. (Emphasis added).³⁷

By referring to foreclosure avoidance and standard servicer duties, a request under subsection (k) cannot reasonably be limited to a defined, exclusive list of servicer duties.

³³ 12 U.S.C. § 2605(e).

³⁴ See, National Consumer Law Center, *Foreclosures* (4th Ed. 2012), Chapter 9.

³⁵ 12 C.F.R. § 1024.21(e)(2)(i). See *Catalan v. GMAC Mortg. Corp.*, 629 F.3d 676, 687 (7th Cir. 2011) (“Any reasonably stated written request for account information can be a qualified written request. To the extent that a borrower is able to provide reasons for a belief that the account is in error, the borrower should provide them, but any request for information made with sufficient detail is enough under RESPA to be a qualified written request and thus to trigger the servicer’s obligations to respond.”).

³⁶ Pub. L. No. 111-203, 124 Stat. 1376, Title XIV, § 1463(a) (July 21, 2010).

³⁷ Pub. L. No. 111-203, 124 Stat. 1376, Title XIV, § 1463(a) (July 21, 2010).

3. Judicial Interpretations of the Scope of the QWR Support the Inclusion of Loss Mitigation in the Error Resolution Provision

Judicial opinions on the scope of a QWR inquiry support a catch-all provision that can account for the broad array of servicers' loss mitigation duties. These decisions have turned on how broadly or narrowly courts have construed the "relating to the servicing" language in section 2650(e). For example, a request for information about the identity of the owner of the loan has been held to be a proper QWR.³⁸ Similarly, some courts have held that a request for information (under §2605(e)) related to the status of a loan modification application is a proper qualified written request.³⁹ These opinions are consistent with the view that loss mitigation has become a routine function of servicers in the servicing of mortgage loans.⁴⁰ In particular, an inquiry related to the Home Affordable Modification Program (HAMP) should qualify because the only method of obtaining a HAMP modification based on the design of the program is through a participating servicer. In fact, Congress has specifically stated that the loan modification analysis required by the HAMP program is the standard of the residential mortgage servicing industry under both federal and state law.⁴¹ Although these opinions adopt the view that QWRs relating to loss mitigation and loan ownership are proper under current law, notices of error based on these servicing duties could be ignored by a servicer under the proposed regulation because they do not relate to a "covered error."

While there are a number of judicial interpretations misconstruing the QWR to not include these inquiries, that does not mean that they are correct – or that they should be an appropriate interpretation of the combined statutory provisions under RESPA for both the QWR and the new Dodd-Frank addition of § 2605(k)(1)(C) (adding "other standard servicer's duties). In fact, the Dodd-Frank Act's enactment of § 2605(k)(1)(C) as a supplemental provision can be construed as a response by Congress to the judicial opinions that have wrongly applied the QWR provisions. Congressional intent is clearly articulated in the new provision using the open-ended language of "other standard servicer's duties." The CFPB should implement this statutory language, not constrain it.

³⁸ See *Davis v. Greenpoint Mortg. Funding, Inc.*, 2011 WL 7070222 (N.D. Ga. Sep 19, 2011)(holding that an inquiry regarding the identity of the entity on whose behalf the servicer receives payments relates to the servicing of the loan); *Selby v. Bank of America, Inc.*, 2011 WL 902182 (S.D. Cal. Mar 14, 2011)(request for contact information for "Master Servicer" of the obligation and for identity and contact information for the note owner relate to servicing of loan); *Woods v. Greenpoint Mortg. Funding, Inc.*, 2010 WL 1729711 (E.D. Cal. Apr. 28, 2010) (information regarding on whose behalf the servicer is accepting loan payments is related to servicing and a proper subject of a QWR; by failing to give borrower a "straight answer" to request for identity of owner of mortgage, servicer harmed borrower by preventing him from rescinding the loan).

³⁹ See *Diamond v. One West Bank*, 2010 WL 1742536 (D. Ariz. Apr. 29, 2010). *But see Williams v. Wells Fargo Bank, N.A., Inc.*, 2010 WL 1463521 (N.D. Cal. Apr. 13, 2010) (request for loan origination documents as part of borrowers' inquiry about "options" for loan modification or short sale was not a QWR).

⁴⁰ See, e.g. *CWCapital Asset Mgmt., L.L.C. v. Chicago Properties, L.L.C.*, 610 F.3d 497, 500 (7th Cir. 2010) (describing the common duties of a servicer of loans in a securitized trust, including "modifying the mortgage to make its terms less onerous to the borrower").

⁴¹ See *Helping Families Save Their Homes Act of 2009*, Pub. L. No. 111-22, 123 Stat. 1632 (2009) ("The qualified loss mitigation plan guidelines issued by the Secretary of the Treasury under the Emergency Economic Stabilization Act of 2008 shall constitute standard industry practice for purposes of all Federal and State laws.")

B. The Rule Should Protect Borrowers from Foreclosure and Adverse Credit Reports During the Response Period.

The proposed rule allows adverse reports to credit reporting agencies, and foreclosures to continue during the response period for a notice of error – as did HUD’s previous version of the QWR rule. The only exception in the error resolution provision is the one carried over from the old regulation: disputes relative to payments require that the servicer not report to the CRA while the error is being resolved (§ 1024.35(h)(i)). Foreclosures, however, may proceed even if the payment dispute goes to the very right of the servicer to declare the account in default. The one new exception relating to foreclosure proceedings applies only if the borrower sends a notice of error involving the servicer’s failure to suspend a scheduled foreclosure sale after a borrower has submitted a complete loss mitigation application by the deadline set by the servicer and the servicer has not yet responded in accordance with § 1024.41(g).

This limited prohibition on adverse credit reports represents a missed opportunity to address other problems. There should be an expansion of reasons that should toll the reporting of adverse information or the continuance of a foreclosure – including an asserted error for failing to evaluate properly for loss mitigation options or to respond to a notice of error challenging whether there has been a default.

RESPA does not authorize a servicer to proceed with collection or foreclosure during the response period to a QWR or notice of error. Despite the statutory prohibition, in Reg. X, HUD had given servicers a right to proceed with foreclosure, apparently based upon the general language in RESPA § 2615 dealing with the validity of contracts. HUD was wrong to do so, because this statutory provision merely states the uncontroversial proposition that nothing in RESPA affects the “validity or enforceability” of loan agreements or mortgages in connection with federally related mortgage loans. Section 2615 cannot possibly mean that mortgage contract provisions that squarely conflict with RESPA are nevertheless enforceable. For example, if a mortgage contained a provision that the borrower must deposit a cushion on the escrow account equal to one-fourth of the total disbursements (the equivalent of 4 months of escrow payments), or that limits the borrower to one QWR (or notice of error) per year, or that requires a borrower to pay a \$200 fee for a response to a QWR, clearly these contract provisions must give way to the statute and are unenforceable. HUD’s construction of § 2516 (which was adopted by the CFPB in these proposed regulations) leads to the absurd result that mortgage holders and servicers could by contract avoid duties required by Congress in RESPA.

The more logical construction of § 2615 in the context of the entire statutory scheme is that it is intended to serve the same function as a severability clause in a contract. In other words, if a mortgage contract contains an unlawful provision such as those in the above examples, the contract as a whole would nevertheless remain valid and enforceable even though the individual provisions that violate RESPA would not be enforceable.

Based on this proper construction of § 2615, the CFPB should implement the intent of Congress to permit a notice of error to be used by the borrower for the purpose of “avoiding foreclosure.” Congress could not possibly have intended in enacting § 2605(k)(1)(C) that a servicer would be permitted to foreclose on a borrower before responding to a borrower’s notice of error that asserts that the loan is not in default and that the servicer has no grounds under the mortgage or applicable state law to foreclose. Even if the CFPB does not accept our interpretation of § 2615, it

should conclude as a matter of statutory construction that the general language in § 2615 has been superseded by the more recent and specific Dodd-Frank amendment to RESPA which directly adopts an error resolution process for “avoiding foreclosure.”⁴²

Finally, if the CFPB continues to believe that § 2615 prevents it from requiring servicers to suspend foreclosure during the response period to a notice of error that disputes the servicer’s authority to foreclose, then the CFPB should declare under its TILA unfair and deceptive⁴³ authority that proceeding with foreclosure in this situation by a mortgage holder or servicer is an unfair and deceptive practice and is therefore prohibited.

C. The Error Resolution Procedure Should Be Available for Failure to Make Disclosures.

The list of nine specific errors for which the proposed regulations would permit homeowners to demand error resolution from servicers does not include the failure to provide a required disclosure. This is problematic.

Homeowners should be able to demand the resolution of an error involving failure to make a required disclosure. This is especially important, for example, in situations in which escrow disclosures are required, because the statute does not provide a private right of action to enforce the disclosures mandated in 12 U.S.C. § 2609, but only provides for CFPB enforcement.

We are *not* saying that the failure to provide a disclosure within the technical time limits required by RESPA, which was nevertheless provided at a later time, should always be the basis of an error resolution. Indeed, the proposed regulation on error resolution already includes a defense to an action for error resolution for servicers when the notice of error is unduly burdensome (proposed § 1024.35(g)(ii)). An error complaining about a servicer’s failure to provide a disclosure *on time* when the disclosure was actually provided, and where no harm was caused by the delay, would surely be burdensome.

However, an error complaining about the servicer’s failure to provide the disclosure at all is surely not overly burdensome and is exactly the type of error for which a homeowner should be able to seek correction.

Below we will deal with the problems relating to the interplay of the error resolution and the loss mitigation provisions in these proposed regulations. The changes in the timing requirements for error resolution are consistent with the statutory changes made by Dodd Frank and are otherwise satisfactory.

D. The Servicer Should Be Required to Treat a Notice of Error Sent by the Borrower’s Representative as Valid Upon Receipt.

The proposed Commentary (§ 35(a)(1) and 36(a)(1)) correctly provides, consistent with the statute, that a notice of error and a request for information is deemed to be submitted if it is submitted by an agent of the borrower. However, the Commentary then states that the servicer may “undertake reasonable procedures to determine if a person that claims to be an agent of a borrower

⁴² 12 U.S.C. § 2605(k)(1)(C).

⁴³ 15 U.S.C. § 1639(l)(2)(A).

has authority from the borrower to act on the borrower's behalf." The CFPB must clarify that while a servicer may seek information about the agent's authority, the notice of error or request for information sent by an agent must be treated as valid upon receipt even if not accompanied by an authorization, and that a servicer cannot demand an authorization from the borrower before complying with its requirements under § 1024.34(d) and (e) or § 1024.36(c) and (d). RESPA does not require that an authorization be provided and a communication does not lose its status as a QWR (or notice of error and a request for information) simply because it is not accompanied by a client authorization.⁴⁴

E. Requests for Information

We applaud and appreciate the proposal to include a homeowner's oral requests for information as sufficient to trigger a servicer's obligations (proposed § 1024.36(a)) and to prohibit charges for responding to these requests – as required by the statute (proposed § 1024.36(g)).

We are concerned, however, by the exception in proposed § 1024.35(f) that would allow the servicer to avoid responding to the information request when the servicer "reasonably determines" that the request is for duplicative, confidential, or irrelevant information, or if the request is "overbroad and unduly burdensome." This is problematic as it potentially requires borrowers to state with too much specificity what they think the problem is, when they may not know. Again, the statute does not require the borrowers to know exactly the nature of the problem they are seeking information about. Homeowners are often unsophisticated and they may not be able to specifically articulate the problem. A general request for information about the status of their loan should be sufficient.

The Seventh Circuit in *Catalan v. GMAC Mortg. Corp.* made this abundantly clear in construing the existing RESPA QWR provisions: “

Any reasonably stated written request for account information can be a qualified written request. To the extent that a borrower is able to provide reasons for a belief that the account is in error, the borrower should provide them, but any request for information made with sufficient detail is enough under RESPA to be a qualified written request and thus to trigger the servicer's obligations to respond.”⁴⁵

Moreover, servicers have historically been quick to categorize all requests for information as being irrelevant, duplicative, or pertaining to confidential material. Blessing servicers' arbitrary exercise of unlimited discretion invites litigation from sophisticated homeowners and leaves unsophisticated homeowners at the mercy of large bureaucratic institutions who, as the CFPB has noted, have failed dismally to be responsive to homeowners' concerns.

The CFPB has a choice here in whether to put the burden on the homeowner in seeking to compel servicers to answer legitimate requests for information or to put the burden on the servicer in seeking to quash impertinent requests from homeowners. One side or the other will have to bear the initial burden of seeking court redress in the face of recalcitrance by the other; nothing in

⁴⁴ See *Moon v. GMAC Mortgage Corp.*, 2009 WL 3185596 (W.D. Wash. Oct. 2, 2009) (letter sent by borrower's attorney that was not signed by the borrower and did not contain an authorization was a qualified written request).

⁴⁵ *Catalan v. GMAC Mortg. Corp.*, 629 F.3d 676, 687 (7th Cir. 2011).

RESPA or in the CFPB's general mandate suggests that it is proper to put that burden on the homeowner rather than the servicer.

The time schedule to respond is dramatically improved – from 60 days to as short as 10 days for some information – however, the longest time allowed is 30 days. These new time periods are largely dictated by the new statutory language and will improve the borrower inquiry process.

Proposed changes for Error Resolution and Information Request Procedures:

1. A tenth subsection needs to be added to the list of errors in § 1024.35(b):

(10) Any other failure of the servicer to comply with standard servicer duties.

2. Proposed subsections 1024.35(f)(2) and (i)(2), which address errors and foreclosure sales, should be amended to apply not only to a notice of error under subsection (b)(9) but also to any notice of error that disputes the servicer's authority to foreclose. This would include errors relating to whether the account is actually in default and whether the servicer has properly evaluated the borrower for loss mitigation options.

3. The error resolution procedure should be available to rectify the failure to make a required disclosure.

4. The CFPB should clarify in the Commentary that a notice of error or request for information sent by an agent must be treated as valid upon receipt even if not accompanied by an authorization.

IV. Force-placed Insurance

The Dodd-Frank Act made substantial changes to RESPA to protect homeowners from improper force-placed insurance. The statutory changes follow huge abuses in the marketplace in force-placed insurance.⁴⁶ Typically an insurer will issue a master policy to the servicer or lender under which coverage for individual properties can be added, deleted, or modified. The lender, not the borrower, is named as the insured and coverage is often limited to the lender's interest in the property, that is, the loan balance.⁴⁷ When an individual property is added to the master policy, the creditor pays the premium and then seeks reimbursement from the consumer. The cost of such insurance is almost always much higher than a standard homeowner's insurance policy.

⁴⁶ See, e.g., Jeffrey Meitrodt, *Forced Insurance Policies Cripple Minnesota Homeowners*, Star Tribune, Oct. 8, 2012, available at <http://www.startribune.com/local/172979991.html>.

⁴⁷ See *Caplen v. Security Nat'l Servicing Corp., Inc.*, 514 F. Supp. 2d 746 (E.D. Pa. 2007) (force-placed insurance for benefit of lender not borrower), *aff'd*, 343 Fed. Appx. 833 (3d Cir. 2009). See also *Edwards v. Homeq Servicing Corp.*, 2008 WL 544180 (E.D. La. Feb. 25, 2008) (force-placed flood insurance protects lenders interests not those of borrower). Some insurers may offer dual interest policies issued to the borrower and containing a standard mortgage clause in favor of the lender. In such cases, coverage may extend beyond the loan balance up to the replacement value of the home. Unlike regular homeowner's insurance, force-placed insurance also does not generally cover the contents of the home or liability for personal injury occurring on the property.

This type of insurance presents extraordinary potential for abuse.⁴⁸ Insurers often provide lenders with refunds, kickbacks, or other compensation in relation to force-placed insurance policies. In some cases, commissions are paid to affiliates of the lender.⁴⁹ Because the lender makes the decision about which insurer to use, and since the lender does not eventually have to pay for the premium, there is a built-in incentive for the lender to select the insurer that pays the lender, or its affiliates, the most in the form of kickbacks or other compensation.

The practice of force placing insurance on homeowners has been a significant problem with very serious consequences. The placement of this insurance and the lender's efforts to obtain reimbursement from the consumer frequently necessitate a huge increase in the homeowner's monthly payments. As a result, homeowners have often been unable to make the new monthly payments in full, incurring late payment penalties and other fees, and eventually leading to foreclosure. Courts have found servicers liable for the lapse in the homeowner's coverage when the servicer maintained an escrow account for the payment or renewal of the homeowner's insurance but failed to make the required payments.⁵⁰

Under the new section added to RESPA in 2010 adding protections against force-placed insurance (§ 2605(l)), servicers are prohibited from obtaining force-placed hazard insurance unless there is a reasonable basis to believe the borrower has failed to comply with the loan contract's requirement to maintain property insurance. In addition, servicers are prohibited from imposing any charge on borrowers for force-placed insurance unless the servicer sends two written notices to the

⁴⁸ See, e.g., *American Bankers Ins. Co. of Florida v. Alexander*, 818 So. 2d 1073 (Miss. 2001), *overruled on other grounds by* *Capital City Ins. Co. v. G.B. "Boots" Smith Corp.*, 889 So. 2d 505 (Miss. 2004). See generally National Consumer Law Center, *Unfair and Deceptive Acts and Practices* § 10.5.10 (7th ed. 2008 and Supp.) (more details about the abuses in force-placed insurance).

⁴⁹ See *Abels v. JPMorgan Chase Bank, N.A.*, 2009 WL 5342768 (S.D. Fla. Nov. 23, 2009) (breach of implied covenant of fair dealing sufficiently pleaded where lender purchased force-placed insurance from affiliate at excessive rate).

⁵⁰ See, e.g., *See Bilek v. Am. Home Mortg. Servicing, Inc.* 2010 WL 2836976 (N.D. Ill. July 15, 2010) (denying servicer's motion to dismiss where plaintiffs alleged servicer maintained an escrow account for the purposes of paying taxes and insurance); *U.S. Bank Nat'l Ass'n v. James*, 2009 WL 2448578 (D. Me. Aug. 9, 2009), *report adopted*, 2009 WL 2753868 (D. Me. Aug. 26, 2009); *Smith v. GMAC Mortgage Corp.*, 2007 WL 2593148 (W.D.N.C. Sept. 5, 2007); *U.S. Bank Nat'l Ass'n v. James*, 2009 WL 2448578 (D. Me. Aug. 9, 2009) (denying motion to dismiss claims based on servicer failure to timely pay insurance); *Smith v. GMAC Mortgage Corp.*, 2007 WL 2593148 (W.D.N.C. Sept. 5, 2007); *Booker v. Washington Mut. Bank, F.A.*, 2007 WL 475330 (M.D.N.C. Feb. 9, 2007). See also *In re Ocwen Mortgage Servicing Litig.*, 2006 WL 794739 (N.D. Ill. Mar. 22, 2006), *aff'd*, 491 F.3d 638 (7th Cir. 2007) (numerous complaints filed alleging, *inter alia*, wrongful placement of force placed insurance); *Vician v. Wells Fargo Home Mortgage*, 2006 WL 694740 (N.D. Ind. Mar. 16, 2006) (denying servicer's motion to dismiss claims for breach of contract, breach of fiduciary duty, unjust enrichment, and violations of state UDAP statute and TILA, based on allegations of improper force placed insurance); *Dowling v. Select Portfolio Servicing, Inc.*, 2006 WL 571895 (S.D. Ohio Mar. 7, 2006) (denying servicer's motion to dismiss RICO and fraud claims where servicer improperly force placed insurance on homeowners' property, then attempted to collect cost of premiums, and eventually initiated foreclosure proceedings); *Barbera v. WMC Mortgage Corp.*, 2006 WL 167632 (N.D. Cal. Jan. 19, 2006) (dismissing TIL and RESPA claims as time-barred and remanding state claims to state court where servicer, among other things, initially ignored homeowner's proof of insurance and then failed to credit homeowner's account for premium charges during period of overlapping coverage); *Hyderi v. Washington Mut. Bank*, 235 F.R.D. 390 (N.D. Ill. 2006) (challenging servicer's policy of not paying insurance bills out of escrow unless it received bill from insurer; class certification denied); *Stevens v. Citigroup, Inc.*, 2000 WL 1848593 (E.D. Pa. Dec. 15, 2000) (finding claims brought regarding force placed insurance not barred by the filed rate doctrine); *Johnson v. HomeEq Servicing Corp.*, 2005 WL 2899632 (Ky. Ct. App. Nov. 4, 2005) (reversing lower court decision and holding that lender, by force placing insurance, waived right to claim homeowner in default for failure to obtain insurance); *Am. Bankers Ins. Co. of Florida v. Alexander*, 818 So. 2d 1073 (Miss. 2001) (filed-rate doctrine not bar to plaintiff claims that lender overcharged for force placed insurance), *overruled on other grounds by* *Capital City Ins. Co. v. G.B. "Boots" Smith Corp.*, 889 So. 2d 505 (Miss. 2004).

borrower, at least 30 days apart. The notices must remind borrowers of their obligation to maintain hazard insurance on the property, and inform the borrowers that the servicer lacks evidence of insurance coverage. Borrowers must be informed of the requirements that they must meet to show that they have coverage, and servicers must warn borrowers that the servicer may obtain coverage at the borrower's expense if the borrower fails to provide evidence of coverage. Finally, servicers must terminate force-placed insurance coverage and refund to borrowers any premiums charged during any period when the borrower had private insurance coverage. Importantly, all charges related to force-placed insurance must be bona fide and reasonable.⁵¹

The proposed regulation on force-placed insurance – § 1024.37 – is specific and carefully delineates each of the separate steps that a servicer must take before it is permitted to force place insurance. These requirements are quite good and entirely consistent with the words and intent of the statute. We particularly applaud the CFPB for spelling out the requirement for bona fide and reasonable charges for force-placed insurance:

A bona fide and reasonable charge is a charge for a service actually performed that bears a reasonable relationship to the servicer's cost of providing the service, and is not otherwise prohibited by applicable law.⁵²

One of the most significantly positive requirements in the entire set of proposed servicing regulations also deals with assisting homeowners to avoid force-placed insurance. It is the proposed change to the regulation governing servicers' handling of escrow accounts: §1024.17(k)(5). This change would require that servicers who maintain escrow accounts must make payments for hazard insurance from a borrower's escrow account, regardless of the status of the borrower's account, and regardless of whether there are sufficient funds in the escrow account.⁵³ This requirement will apply unless the servicer has "a reasonable basis to believe that the borrower's hazard insurance has been canceled or not renewed for reasons other than nonpayment of premium charges."⁵⁴ The servicer would be required to continue those payments rather than force-placing a separate policy, even if there is insufficient money in the escrow account.

HUD's regulations under RESPA – now carried over by the CFPB in § 1024.17(k)(1) – have permitted servicers to decline to make payments from escrow for taxes, insurance, and other property-related expenses if the homeowner is 30 days delinquent. There is no authority in the underlying statute for this exemption. The CFPB should overturn the entire 30 day exception, and delete subsection § 1024.17(k)(1) entirely. Unfortunately, the proposed rule does not delete the 30 day exception, and only provides protections for hazard insurance, rather than requiring servicers to also pay property taxes from the escrow account even if the account is 30 days late. Many accounts will cure and the failure to make payments at that early stage on behalf of the borrower will wreak havoc on a consumer's account. This problem will only be exacerbated once homeowners know about the new force-placed insurance rule, because they are likely to be unaware that the protection did not apply to them in the first 30 days of their delinquency.

⁵¹ 12 U.S.C. § 2605(l).

⁵² Proposed § 1024.37(i)(2).

⁵³ Proposed § 1024.17(k)(5).

⁵⁴ Proposed § 1024.17(k)(5).

By amending the escrow section of the servicing regulations, rather than including the affirmative requirement to pay for hazard insurance in the force-placed insurance section, the CFPB has avoided requiring servicers who do not maintain an escrow account to pay the hazard insurance premium to avoid force placing insurance. This is unfortunate, and an unnecessary distinction between homeowners.

The fact that there is no escrow account does not mean that the servicer will be unaware of the impending lapse in homeowners insurance and unable to pay the premium to preserve it. The standard requirement in Pooling and Servicing Agreements and mortgages and deeds of trusts is that the borrower's insurance policy shall contain a standard mortgage clause and shall name the lender as mortgagee or as additional loss payee.⁵⁵ Thus, the servicer is typically notified by the borrower's insurance company if the borrower has failed to maintain insurance coverage.

The new RESPA language regarding force-placed insurance is not limited to homeowners for whom servicers maintain escrow accounts.⁵⁶ In fact, whenever a servicer force places insurance it advances funds to provide hazard insurance covering the property, so there is no greater risk advancing these funds for homeowners for whom there is no escrow. Servicers should be required to do the following – which is exactly what Fannie Mae⁵⁷ authorizes in the same situation:

- Advance the funds for unpaid property insurance and pay the borrower's premium.
- Revoke the waiver of the escrow requirement under the mortgage.
- Establish a new escrow account, which requires an escrow account analysis pursuant RESPA § 2609, for the payment of insurance premiums and taxes in the future.
- Enter into a payment plan with the homeowner to recover the advanced premium over the next twelve months. This is exactly how the servicer would recoup a shortage or deficiency if there were already an escrow account.⁵⁸

This is similar to what is required to be done by Servicers in this situation in the National Mortgage Settlement.⁵⁹

Proposed changes:

1. Existing § 1024.17(k)(1) and proposed § 1024.17(k)(5) should be deleted.
2. The following language in a new subsection (2) of proposed § 1024.36 (new language is underlined) should be added:

⁵⁵ See, e.g., Fannie Mae/Freddie Mac Uniform Instruments, First Lien Security Instruments, Form 3005: California Deed of Trust, available at www.freddiemac.com/uniform/unifsecurity.html.

⁵⁶ 12 U.S.C. § 2605(l).

⁵⁷ Fannie Mae Servicing Guide, Chapter 6, § 103.

⁵⁸ 12 C.F.R. 1024.17.

⁵⁹ For non-escrow accounts, the National Mortgage Settlement requires the servicer to send borrowers for first lien loans on the servicer's primary servicing system a statement offering to advance the premium due on the existing policy if the borrower agrees to set up an escrow account and to both repay the advanced premium and to pay the future premiums. Settlement Term Sheet, Exhibit A (Servicing Standards), ¶ VII.A.3.a.vi.

(1) A servicer must make payments from a borrower's escrow account in a timely manner to pay the premium charge on a borrower's hazard insurance, as defined in § 1024.31, unless the servicer has a reasonable basis to believe that the borrower's hazard insurance has been canceled or not renewed for reasons other than nonpayment of premium charges. If the borrower's escrow account does not contain sufficient funds to pay the premium charge, the servicer must advance funds to make such payment.

(2) If the servicer does not maintain an escrow account for a borrower and all notices required by this section have been provided, a servicer shall revoke any prior waiver of the escrow requirement, establish an escrow account, and advance the premium charge on a borrower's hazard insurance, as defined in § 1024.31, unless the servicer has a reasonable basis to believe that the borrower's hazard insurance has been canceled or not renewed for reasons other than nonpayment of premium charge.

3. Additionally, we specifically adopt the comments on force-placed insurance provided in this docket by the Center for Economic Justice. These comments provide excellent and detailed explanation of the insurance market, and include proposed changes that we endorse, including the following points:

- The regulations should better define or the staff commentary should better describe the "reasonable basis" for placing and charging a borrower for force-placed insurance.
- The disclosures to borrowers should be improved by emphasizing the critical differences in coverage between force-placed insurance and voluntary insurance.
- The exclusion of flood insurance should be limited to flood insurance obtained through the National Flood Insurance Program to better reflect requirements of the Flood Disaster Protection Act.
- The definition of bona fide and reasonable charges should be revised to exclude unreasonable costs and other costs unrelated to the provision of force-placed insurance.

V. Information Management Policies and Procedures

As the CFPB notes in the prefatory comments to the proposed regulation, citing Federal Reserve Board Governor Daniel K. Tarullo and the National Mortgage Settlement between the 50 state Attorneys General and five major bank servicers:⁶⁰

[M]ajor servicers demonstrated failures to document and verify, in accordance with applicable law, information relating to borrower mortgage loan accounts in connection with foreclosure proceedings. Examinations by prudential regulators found “critical deficiencies in foreclosure governance processes, document preparation processes, and oversight and monitoring of third parties . . . [a]ll servicers [examined] exhibited similar deficiencies, although the number, nature, and severity of deficiencies varied by servicer.”(Citations omitted.)⁶¹

⁶⁰ The National Mortgage Settlement is available at <http://www.nationalmortgagesettlement.com/>.

⁶¹ 77 Fed. Reg. 75200, 57247 (Sept. 17, 2012).

Based on these thoroughly established and gross inadequacies in record keeping, and using its general authority to regulate servicing provided in Dodd Frank under RESPA section 2605(k)(1)(E), a new requirement to manage information reasonably is proposed. Proposed § 1024.38, would require servicers to establish “reasonable information management policies and procedures.” The determination (presumably by the servicer’s regulator) of the reasonableness of a servicer’s policies and procedures would take into account the servicer’s size, scope, and nature of its operations.

Surprisingly, the rule requires a servicer to have policies and procedures, rather than actually to retain documents and maintain good filing systems. Indeed, a servicer has a safe harbor from compliance with the rule if its policies and procedures satisfy the rule—regardless of whether it also has a practice of failing to comply with those policies and procedures.

The proposal is excellent to the extent that it requires that borrowers be provided, upon request, the borrower’s entire servicing file, including:

- (i) A schedule of all payments credited or debited to the mortgage loan account, including any escrow account as defined in § 1024.17(b) and any suspense account;
- (ii) A copy of the borrower’s mortgage note;
- (iii) A copy of the borrower’s deed of trust;
- (iv) Any collection notes created by servicer personnel reflecting communications with borrowers about the mortgage loan account;
- Data fields, including phone numbers; and
- Copies of documents provided by the borrower to the servicer.

This information will be extraordinarily helpful to homeowners. The requirement for a schedule of all payments should not be limited to the payments made to the current servicer, but should clearly cover all the payments made on the loan from the very first payment through the most recent payment made.

Oversight of service providers. Subsection (b)(3) of § 1024.38 is confusing and far too specific, however. It requires that servicers “[f]acilitate the sharing of accurate and current information regarding the status of an evaluation of a borrower’s completed loss mitigation application and the status of any foreclosure proceeding among servicer personnel assigned to a borrower pursuant to § 1024.40 and service providers responsible for handling foreclosure proceedings.” Does this mean that information about pending loan modification applications should not be shared? Or that ongoing discussions about other loss mitigation strategies should not be conveyed within a servicer’s shop? All of the information about loss mitigation, and more specifically, loan modification considerations, applications, approvals, and denials – including the reasons for the denials – should be shared among all of the servicer’s personnel. The limitation of this requirement to “completed loss mitigation application” is far too severe, and will cause homeowners with substantially completed applications to forego these sensible protections.

Servicing transfers. We applaud the broad language on the information that should be shared between servicers in a servicing transfer in § 1024.38(b)(4). It is implicit in this language that the new servicer should be bound by the promises and agreements made by the previous servicer; however, this should be articulated explicitly as well. We also support the last sentence of the proposed regulation, which specifies that the transferred information and documents should include

information related to the handling of loss mitigation applications. We believe that the CFPB should also specify that the information and documents should at a minimum include the “servicing file” described in § 1024.38(c)(2).

Safe harbor. We are concerned, however, that proposed § 1024.38(a)(2) provides a safe harbor, which allows a servicer to satisfy these requirements if the servicer does not engage in a pattern or practice of failing to achieve any of the objectives set forth in proposed § 1024.38(b) and does not engage in a pattern or practice of failing to comply with any of the standard requirements in proposed § 1024.38(c). This essentially leaves individual consumers with no recourse when the procedures are not followed – even where the failure to follow such procedures has interfered with the consumer’s ability to obtain key information about that consumer’s servicing file. Who would have the burden of proof on this pattern and practice question? Once the homeowner raises the issue of whether a servicer has violated the requirements of this provision, and the servicer defends the allegation by pointing to its policies and procedures manuals, does the servicer then prevail by *saying* it does not have a pattern and practice of violating its own manuals? Would it then fall on the homeowner to prove a pattern and practice as a way of defeating the safe harbor defense? This would very burdensome and difficult to prove without extensive discovery and analysis, which is beyond the capacity of most homeowners’ counsel. The safe harbor thus would become a large basis for immunity from the requirements of the rule, severely undermining its efficacy.

Foreclosure documentation. Nothing in this proposed regulation appears to require record-keeping or verification of documents used for foreclosures. Given the extensive problems with documentation of the authority to foreclose (both in terms of *who* has the authority, and *whether* the homeowner is really in default), there should be clear mandates that before proceeding to foreclosure servicers must provide to the borrower a verification, along with supporting documents, of their authority to foreclose. This would not interfere with the state foreclosure process, but it would substantially improve the servicers’ obligations to ensure that the authority actually exists before the foreclosure is initiated.

The National Mortgage Settlement requires servicers to “implement a process to ensure that the foreclosing entity has a documented enforceable interest in the promissory note and mortgage (or deed of trust),” as well as numerous, additional other requirements to ensure the reliability and accuracy statements in affidavits, sworn statements, declarations and other documents.⁶² Certainly the CFPB’s servicing standards should require at least as much.

Record retention. Section 1024.38(c)(1) provides that a servicer shall retain records that document actions taken by the servicer until one year after the loan is discharged or servicing is transferred. We believe that as a matter of public policy a regulated utility subject to a remedial consumer protection statute (such as RESPA) should not be permitted to destroy records before the statute of limitations has expired on claims a borrower may bring under the remedy section of the statute. RESPA provides that a complaint seeking relief under § 2605(f) must be filed within three years of the violation.⁶³ To ensure that records remain available during the discovery process if litigation is initiated, we urge the CFPB to require record retention for a five year period after loan

⁶² National Settlement, §I C, at A-8, available at <http://www.nationalmortgagesettlement.com/>

⁶³ 12 U.S.C. § 2614.

discharge or transfer. This is the current rule for escrow records and we are not aware that this rule has been burdensome for servicers.⁶⁴

Proposed changes: The following changes should be made to § 1024.38:

1. The safe harbor in § 1024.38 should be eliminated because it undermines a servicer's incentive to establish rigorous standards and ensure compliance with them. If the safe harbor is not eliminated, it is incumbent upon the Bureau to provide further guidance on how it would be implemented to clarify that the burden of proof is on the servicer, not the individual homeowner, in all circumstances to demonstrate compliance.
2. Servicers should be required to implement processes to ensure that a) the foreclosing entity has a documented enforceable interest in the promissory note and mortgage (or deed of trust), and b) all statements used in support or furtherance of foreclosures are verified as reliable and accurate.
3. Servicers should be required to share accurate and all current information regarding the status of all loss mitigation options and foreclosure procedures among servicer personnel assigned to a borrower.
4. Servicers should be required to retain records that document actions taken by the servicer until five years after the loan is discharged or servicing is transferred.

VI. Early Intervention with Delinquent Borrowers

Under proposed 12 C.F.R. § 1024.39 servicers would be required to try to notify delinquent borrowers both orally (within 30 days of being late) and in writing (within 40 days of the delinquency) that the payment is late – and that loss mitigation options may be available. The written notice also includes information about the foreclosure process, a list of housing counselors, a “brief description of loss mitigation options that may be available from the servicer,”⁶⁵ and information “if applicable, informing the borrower how to obtain more information about loss mitigation options from the servicer.”⁶⁶

We applaud the CFPB for proposing these new early intervention requirements for borrowers. They can only be helpful to borrowers. However, as proposed, they will not be nearly as effective in helping to avoid foreclosures as they would be if they included more substantive information.

Loss mitigation options should always be fully explained to the homeowner as early, and as often, as possible. The perfect time to describe them fully is in this first early intervention letter. Adequate, useful information on loss mitigation options can be provided without placing a burden on the servicer. Omitting or limiting such information will delay or inhibit some homeowners from seeking early help—at the stages where loss mitigation success is most likely.

⁶⁴ See Reg. X, § 1024.17(l)(2).

⁶⁵ Proposed § 1024.39(b)(2)(iii).

⁶⁶ Proposed § 1024(b)(2)(iv).

We are also concerned that the CFPB is not proposing to require that the servicer inform the borrower in the 40-day written notice about the servicer's deadline for loss mitigation applications. Under the CFPB's loss mitigation proposal, this date is determined by the servicer and is critical to the proposal for suspension of the foreclosure process. Only applications received by the servicer's deadline are subject to the prohibition on foreclosure sale in § 1024.41(g). However, the CFPB has not required servicers to notify borrowers of this important date. This information should be included in the 40-day written notice.

Finally, the proposed regulation provides that the 40-day written notice is not required more than once during any 180-day period. This limitation is appropriate if there is a continuing default during the 180-day period. However, we believe that if the borrower cures the default after receiving the 40-day written notice and defaults again within the 180-day period, the early intervention notice requirements should apply.

Proposed changes:

Every loss mitigation option offered, along with the requirements to qualify and instructions for applying for it, should be set out with specificity in a disclosure to homeowners as part of this early intervention effort. The 40-day written notice should also include information about the deadline for receipt of loss mitigation applications. The requirement that only one 40-day written notice be provided during any 180-day period should not apply if the borrower cures the default referenced in the notice.

VII. Continuity of Contact

Under proposed § 1024.40, servicers would be required to assign dedicated contact personnel for a borrower no later than five days after providing the early intervention notice. Servicers would be required to establish reasonable policies and procedures designed to ensure that the servicer personnel perform certain specified functions where applicable, such as accessing the borrower's records and providing the borrower with information about how and when to apply for a loss mitigation option and about the status of the application.

There are many good procedures required in this section. Requiring dedicated contact personnel for each borrower is good. The contact is required to have access to all relevant information about the borrower, and to be able to provide the borrower with accurate information about what she needs to do and her status. This is all good. However, there appear to be some important, missed opportunities to solve ongoing problems with contact between servicers and homeowners.

For example, one of the most frustrating and often-cited disputes currently between servicers and homeowners seeking loss mitigation resolutions is the servicer's insistence that the homeowner has not supplied the necessary information to be considered for the option. Quite often the homeowners have supplied the information by fax or even email numerous times. Yet, the servicers deny receiving all the documents. These disputes are extremely frustrating for homeowners and increase the number of avoidable foreclosures.

One simple, sensible way of addressing these absurd miscommunications is through an electronic portal, as is required in the National Settlement. In that agreement servicers develop loan

portals so that borrowers can submit documents electronically and receive an electronic receipt for documents submitted.⁶⁷ Certainly the CFPB's regulations on servicing should require electronic portals, or similarly reliable methods for homeowners to submit information to servicers and receive electronic receipts. This section on continuity of contact is the appropriate place for such a requirement.

Additionally, proposed § 1024.40(b)(ii)(C) requires that the servicer's contact have access to "documents the borrower has submitted to prior servicers in connection with the borrower's application for loss mitigation options offered by those servicer, to the extent that those documents are in the servicer's possession." (Emphasis added.) This language is highly problematic. It implies that it is permissible for a mortgage loan to be transferred from one servicer to another – in the midst of consideration for loss mitigation – without also transferring all of the documents submitted by the borrower. That is not right and should never be permitted. This language also conflicts with the requirement in proposed § 1024.38(b)(4) requiring that servicers transfer on a timely basis all of "the information and documents relating to a transferred mortgage loan."

There must be clear and strong requirements on servicers to ensure that they transfer all of the relevant information and documents and that they receive that information. Both the old and new servicers should be responsible for ensuring that this information is available, and both should be clearly liable if the new servicer does not have this information.

Finally, it is problematic that a safe harbor is allowed for servicers who "satisfy the requirements in paragraph (b)(1) (requiring the establishment of policies and procedures) and do not engage in a pattern or practice of failing to perform the functions set forth" in that section, as long as the servicer does not engage in a pattern or practice. In other words, so long as the servicer has the right "policy" and "procedure" there is no liability on the servicer for failing to follow the policy or procedure. This safe harbor also raises the same question discussed above regarding who has the burden of proof on the pattern or practice requirement.

Proposed changes:

1. Servicers should be required to establish electronic portals to receive homeowner documents and provide electronic receipts.
2. Servicers should be required to transfer, and to ensure that they have received after obtaining the servicing rights, all relevant documents and information relating to the loan and loss mitigation options, as well their status.
3. No safe harbor should be permitted for non-compliance with these requirements.

⁶⁷ National Settlement, § IV E, at A-25, available at <http://www.nationalmortgagesettlement.com/>.

VIII. Loss Mitigation

A. Summary of Proposed Rule and Problems

The proposed regulation § 1024.41 on loss mitigation is surprisingly and grossly inadequate. It would not require servicers to offer any loss mitigation options—in fact they would be permitted to offer none at all. Moreover, the requirements in the proposed regulations would only apply to servicers that make “loss mitigation options available to borrowers in the ordinary course of business.”⁶⁸

The proposed regulation does affirmative harm by setting a standard markedly lower than that currently applicable to most of the servicing industry. In addition to establishing an uneven playing field now, the rule would lower standards as certain currently applicable guidelines expire and thus result in a net loss for consumers, communities, investors, and the market. It may also directly undermine stronger state protections.

We urge the CFPB to rewrite this regulation extensively or withdraw it for re-issuance at another time, if needed, in a manner that provides meaningful protections for homeowners against foreclosure. Basic standards *can* be set that apply across the entire industry while still allowing for flexibility. History shows too clearly that without standards and mandates many unnecessary foreclosures proceed unabated. Time is of the essence as the foreclosure crisis continues to devastate communities, but the rule will only make a difference if it assures a robust loss mitigation system.

Failure to provide a loss mitigation mandate. The proposed regulation only requires those servicers who do offer loss mitigation options in the ordinary course of business to implement procedures to ensure that complete loss mitigation applications are “reasonably evaluated before proceeding with a scheduled foreclosure sale.”⁶⁹ A servicer would be required to secure the information “the servicer regularly obtains and considers in evaluating loss mitigation applications” by its own deadline.⁷⁰ But no specific information is required to be used in this evaluation, and servicers are not required to advise borrowers in advance of all the available loss mitigation options for which the borrower might apply.

Servicers are required to notify the borrower within five days of receiving an incomplete application that the application is incomplete and what additional documents are required.⁷¹ The servicer is required to evaluate the borrower for “all loss mitigation options available from the servicer for which the borrower may qualify.”⁷² But the servicer is not required to evaluate for any specific options, or even to explain to the borrower about all of the available options so that the borrower could determine which might be best for the borrower to consider.

The servicer is required, within 30 days of receiving a borrower’s complete application, to evaluate the borrower for all available options, and, if the denial pertains to a requested loan

⁶⁸ Proposed § 1024.41(a).

⁶⁹ 77 Fed. Reg. 75200, 57202 (Sept. 17, 2012).

⁷⁰ Proposed § 1024.41(b).

⁷¹ Proposed § 1024.41(c).

⁷² Proposed § 1024.41(c)(1).

modification, notify the borrower of the reasons for the servicer's decision, and provide the borrower with at least a 14-day period within which to appeal the decision. While these steps toward documenting denials are welcome, proper documentation of all NPV inputs and outputs, as well as documentation of the particular source for any investor restriction, is essential for transparency and accountability. NPV outputs tell homeowners whether their application was denied as a close call and whether a challenge is useful. NPV inputs ensure transparency in the process.

The proposal requires that appeals be decided within 30 days by different personnel than those responsible for the initial decision.⁷³ However, there are no standards for the appeals, no requirements for the information to be reviewed, and no requirements that homeowners be told the reasons an appeal is denied.⁷⁴ Moreover, while an appeal is allowed, the eligibility and standards, including the NPV test for the homeowner, is not mandated to be available, and thus the homeowner will have little basis for knowing whether an appeal should be pursued. This may result in more unmeritorious appeals that clog the system, and also will provide no check on servicer reviews of loss mitigation applications.

There are no requirements for specific strategies to save homes or homeowners' equity, even to protect investors from unnecessary foreclosures. Unlike the National Settlement, the net present value analyses are not mentioned. While NPV tests can be modified, without them many fewer modifications will be made. Supervision and transparency can be used to ensure NPV tests are not used to lock homeowners out of sensible loss mitigation.

Failure to end dual tracking. The proposed regulation states that a servicer cannot proceed with a foreclosure sale after receiving a completed loan application unless the servicer has complied with the procedural requirements of the section (*i.e.* the servicer has denied the borrower's application and the time for any appeal has expired; or the borrower has declined the proposed loss mitigation options or failed to accept them within 14 days of the offer; or the borrower has failed to comply with the terms of a loss mitigation agreement).⁷⁵ Yet there are no prohibitions against pursuing the foreclosure while the loss mitigation options are under consideration. Not only is dual tracking *not* prohibited in these proposed regulations, it is blessed. In light of the known costs associated with initiating foreclosure, combined with decreased servicer incentives to achieve loss mitigation once a foreclosure has started, this acceptance of a long-time servicer abuse stands starkly in contrast with recent experience, current standards, and common sense.

There is not even a required delay of initiation of foreclosure while an incomplete application is being made complete (proposed §1024.41(b)(2)). Given the huge problems with servicers saying that homeowners have failed to provide all the documents – even when the documents have been provided multiple times – this omission is serious. When combined with a) the failure to require an electronic portal, and b) the failure to require that servicers describe to homeowners all of the available loss mitigation strategies, this omission will leave unsolved one of the most frustrating abuses.

Ultimately, the CFPB's proposal allows unnecessary and arguably illegal foreclosures to proceed and ensures that homeowners wrongfully denied a modification, homeowners in the midst

⁷³ Proposed § 1024.41(d).

⁷⁴ Proposed § 1024.41(h).

⁷⁵ Proposed § 1024.41(g).

of a modification review, and even those homeowners performing under a permanent modification will lose their homes without recourse.

Failure to mandate transparency. The servicer is permitted to require that the borrower accept or reject a particular loss mitigation strategy offered within 14 days of the offer (proposed § 1024.41(e)(1)). But the borrower is expected to make this determination in a vacuum -- without knowing what other strategies might be available, and might be more suitable or affordable for the homeowner. The homeowner also has no means to verify the servicer's assertions. Recent reports and experience with www.checkmynpv.com make clear that such accountability is needed to ensure accurate reviews.

Other specific problems include:

- There is no minimum amount of time for the borrower to gather all the information required and provide it to the servicer in the application for the loss mitigation strategy.
- There is no requirement for a successfully completed trial modification to be promptly (or ever) converted to a permanent modification.
- Servicers are permitted to require the homeowner to accept or reject a loss mitigation strategy while appealing the denial of another strategy (§ 1024.41(e)(4)). A homeowner who is seeking a loan modification should not be pressured, for example, to accept a short sale. Bait and switch is a known abuse in the loss mitigation arena (among others) and should not be enabled by the regulation.
- The appeals process established in the regulation appears to apply only to loan modification denials, rather than to other loss mitigation strategies as well.
- The proposed rule allows servicers to decline to consider a loss mitigation application submitted 90 or fewer days prior to sale, thereby undermining the entire loss mitigation process. In many states, the foreclosure process begins less than 90 days before the sale; homeowners in such states would effectively be denied any opportunity to apply for a loan modification.
- In a fairly complicated interplay between the loss mitigation regulation and the error resolution regulation, it appears that the homeowner can complain to the servicer that it has committed an error when it fails “to suspend a scheduled foreclosure sale in the circumstances described in § 1024.41(g).” (§ 1024.35(b)(9)). And § 1024.41(g) prohibits a servicer from conducting a foreclosure sale if the homeowner has completed the loss mitigation application “within the deadline . . .” unless certain prerequisites have been met. This sets up a way to stop a foreclosure if the servicer has failed to implement the *procedure set out in the regulation*. But it does not appear to establish grounds to stop a foreclosure sale if the servicer has not considered the proper information, or has refused to consider the homeowner for all of the available strategies, or has made a substantive mistake in its review. This must be remedied.

B. Summary of our Recommendations and Legal basis for Recommendations

1. Background and Justification for Substantive Loan Modification Regulations

a) The CFPB Bears Responsibility for Bringing Rationality to Servicing.

With more than eleven million homeowners owing more on their loans than their homes are worth⁷⁶ and several million more foreclosures predicted in the next few years,⁷⁷ there is no question that the need for high-volume, effective loan modifications continues to be urgent. The CFPB is uniquely positioned to address this ongoing crisis, and must do so, competently and aggressively.

The CFPB needs to redraft this proposed regulation. Specific and substantive requirements that servicers are required to follow before initiating, continuing, and completing a foreclosure on a consumer's home are essential.

If the CFPB does not have the time to issue comprehensive regulations on loss mitigation mandating standards designed to save homes from foreclosure, the loss mitigation regulation should be withdrawn for issuance at a later time. There is no statutory mandate in the Dodd-Frank Act to issue this regulation, and thus no time limit on it. As is, this regulation does affirmative harm.

While the interagency guidance process may touch on the same issues, only the CFPB's authority can produce standards that are privately enforceable by homeowners, and only the CFPB has as its primarily goal the protection of consumers from market abuses. Specific standards that apply across the market can be articulated while still allowing for market flexibility to improve upon those standards. Failure to provide such standards would be an abdication of the Bureau's responsibility to regulate the mortgage servicing industry—and homeowners, communities, investors and the market will pay the price for years into the future.

The CFPB is well positioned to establish uniform, strong mortgage servicing standards. The CFPB can use its transferred authority⁷⁸ under the Truth in Lending Act and the Real Estate Settlement Procedures Act to establish vigorous, sensible national mortgage servicing standards that put the entire industry on equal footing and give qualified homeowners access to efficient and enforceable mortgage servicing rules to save their homes.

⁷⁶ CoreLogic, *CoreLogic Reports Negative Equity Increase in Q4 2011* (Mar. 1, 2012), http://www.corelogic.com/about-us/news/asset_upload_file909_14436.pdf [hereinafter *Negative Equity Increase in Q4 2011*] (finding 11.1 million residential mortgages underwater, 22.8% of all mortgaged residential properties); John Kelly, *Zillow Negative Equity Report Shows 1 in 3 Mortgage Holders Underwater*, Zillow Blog (May 24, 2012), <http://www.zillow.com/blog/2012-05-24/zillow-negative-equity-report-shows-1-in-3-mortgage-holders-underwater> (estimating 15.7 million homeowners are underwater).

⁷⁷ Mortg. Bankers Ass'n, *National Delinquency Survey Q4 2010* (Feb. 2011) [hereinafter MBA: *National Delinquency Survey Q4 2010*], at 2 (reporting that the U.S. foreclosure rate, the percentage of outstanding mortgage loans in foreclosure, at the end of the fourth quarter of 2009 was 4.58%, at the end of the fourth quarter of 2010, 4.64%, and, at the end of the fourth quarter of 2011, 4.38%).

⁷⁸ See discussion on the CFPB's authority to establish substantive loss mitigation guidelines, below.

b) Servicers Currently Serve No One's Interests But Their Own .

Servicers often pursue foreclosure over loan modification because it can increase their profits, at the expense of both the investors (for whom they generally work as agents) and homeowners. As a result, homeowners who qualify for loan modifications that also benefit the investor more than foreclosure lose their homes instead. Homeowners and investors also face inflated default servicing fees as servicers extend the foreclosure timeline and pile on fees in the interest of increasing profits. If the loan ends in foreclosure, these fees may be paid out of the foreclosure sale proceeds, before the investors receive their return, leaving investors shortchanged.

Servicers' profit motives encourage them to continue foreclosures during modification reviews, to delay decision-making, and, often, to wrongly deny modifications. Because of the agency problems inherent in the servicer-investor relationship, a mandatory rule is necessary to correct the market's failure to provide for loan modifications when beneficial to both homeowners and investors.

Without strong mandates—and real consequences for noncompliance—servicers will continue to implement modifications haphazardly, leaving the economy in a tailspin. The improvements to mortgage servicing in these proposed servicing regulations address at most the tip of the iceberg of serious servicing issues.

c) There Is a Need for Uniform Servicing Standards.

Confusion reigns in the mortgage servicing industry with respect to loan modifications. Some servicers are covered by HAMP; some are not. Some mortgages are eligible for the program, and some are not.⁷⁹ States' actions to protect their homeowners and to encourage loss mitigation have run into federal preemption challenges, with the result that state servicing laws apply to some servicers, but not others, or apply in some courtrooms but not others.⁸⁰

⁷⁹ HAMP covers 85% of the mortgage servicing market. Tim Massad, *Another Look at the Numbers on HAMP*, U.S. Dep't of the Treasury (Jan. 10, 2012), <http://www.treasury.gov/connect/blog/Pages/Another-Look-at-the-Numbers-on-HAMP.aspx>. HSBC is the only large servicer not covered by HAMP. However, there remains widespread confusion over which servicers are and are not covered. For example, loans serviced by Citimortgage appear to be covered by HAMP, but loans serviced by Citifinancial are not, even though both are part of the same corporate structure. *Also see*, Office of the Comptroller of the Currency & Office of Thrift Supervision, *OCC and OTS Mortgage Metrics Report: Disclosure of National Bank and Federal Thrift Mortgage Loan Data: First Quarter 2011* (June 29, 2011) [hereinafter *Mortgage Loan Data: First Quarter 2011*], at 37, available at <http://www.occ.gov/publications/publications-by-type/other-publications-reports/mortgage-metrics-2011/mortgage-metrics-q1-2011.pdf> (for instance, at 12 months, 35.5% of non-HAMP modifications made in the 4th quarter of 2009 were 60+ days delinquent, compared to 17.7% of HAMP modifications made in the same period).

⁸⁰ *See, e.g. In re Ocwen Loan Servicing, L.L.C., Mortg. Servicing Litig.*, 491 F.3d 638, 643 (7th Cir. 2007). (Many state servicing statutes preempted by regulations issued by Office of Thrift Supervision); *Rumbaua v. Wells Fargo Bank*, 2011 WL 3740828 (N.D. Cal. Aug. 25, 2011) (claim that lender failed to use proper care or comply with industry standards is preempted because it seeks to impose substantive requirements); *Chang v. Wachovia Mortgage*, 2011 WL 2940717 (N.D. Cal. July 21, 2011) (negligence and related claims that would impose duty of care in communications with borrower relate to disclosures and are preempted); *Copeland-Turner v. Wells Fargo Bank*, 2011 WL 2650853 (D. Or. July 6, 2011) (claim regarding failure to record assignment of mortgage is preempted); *Hague v. Wells Fargo Bank*, 2011 WL 6055759 (N.D. Cal. Dec. 6, 2011) (claims based on manner of securitization of mortgage obligation is preempted); *McAnaney v. Astoria Fin. Corp.*, 665 F. Supp. 2d 132, 163–4 (E.D.N.Y. 2009) (state law requiring timely recordation of satisfaction of mortgage is preempted); *Rosenberg v. Washington Mut. Bank*, 849 A.2d 566 (N.J. Super. Ct. App. Div. 2004) (consumer fraud and breach of contract claims based on allegedly deceptive monthly billing statements preempted).

Servicers favor their own proprietary modifications, which lack any transparency and may even be abusive. These private modifications historically have not decreased payment amounts, leading to a significant chance of redefault and further lost equity.⁸¹ Government and industry efforts to align the various programs and alternatives have fallen short.

The lack of uniformity and absence of certainty have exacerbated the current foreclosure crisis. Homeowners are thwarted in their attempts to navigate the available programs and protections designed to help them stay in their homes. Families have unnecessarily lost their homes, investors have borne increased losses, and the housing market has failed to right itself. Homeowners, servicers, and investors all would be served well by national standards that bring efficiency, affordability, accessibility, accountability, and enforceability to the loan modification process.

d) Recent Loss Mitigation History Demonstrates the Need for Efficiency, Affordability, Accessibility, Accountability, and Enforceability.

The content of national standards, regardless of which agency or agencies first adopts them, must be informed by the lessons of the last several years of loss mitigation efforts.

HAMP provides perspective on how to reduce foreclosures while balancing the needs of distressed homeowners, investors, and mortgage servicers. HAMP has demonstrated that sustainable loan modifications are both possible and desirable from the perspective of the vast majority of market participants. Although HAMP was designed to be a temporary solution to an epic crisis, HAMP's lessons provide the framework for responsible servicing going forward. Future banking and foreclosure crises are certain. The crisis has exposed systemic faults in our mortgage markets that were hidden during the "good" days of rapid property appreciation and mortgage product innovation. The CFPB's loan modification regulations must address these gaps in the market. If they do, they will save millions of homes in the near future, and reduce losses to investors and homeowners for decades to come.

HAMP's initiatives fell short of their promise because of servicers' shoddy implementation. Treasury allowed servicers to shortchange HAMP without censure. Worse, Treasury resisted efforts to make public basic assumptions in HAMP, including the details of the critical net present value

as the claims are based on disclosures and disclosure laws are expressly preempted in § 560.2)). *See also* Schilke v. Wachovia Mortgage, 2011 WL 4501381 (N.D. Ill. Sept. 28, 2011) (claim that lender force-placed duplicative, overpriced insurance is preempted unless there is allegation of breach of contract or misrepresentation). *Cf.* Ahmed v. Wells Fargo Bank & Co., 2011 WL 1751415 (N.D. Cal. May 9, 2011) (claims regarding improprieties in foreclosure process are preempted, but not claim that lender misrepresented that loan would be modified). *But see* Santana v. Citimortgage, Inc., 2006 WL 1530083 (Conn. Super. Ct. May 22, 2006) (statute requiring the mortgage holder to file a release within sixty days after payment in full not preempted; releasing the mortgage is not part of the lending process since the debt has been retired; releasing the mortgage is not part of the loan servicing because there is no longer a loan to service); Pinchot v. Charter One Bank, 792 N.E.2d 1105 (Ohio 2003) (state real estate law requiring recordation of a release within ninety days of the pay-off not preempted as it only incidentally affects lending activities; it does not affect "lending" as lending relationship is over before satisfaction is recorded).

⁸¹ *See, e.g.*, Ioan Voicu, Vicki Been, Mary Weselcouch & Andrew Tschirart, Furman Ctr. for Real Estate & Urban Policy, *Performance of HAMP Versus Non-HAMP Loan Modifications – Evidence from New York City* (Oct. 2011), available at http://furmancenter.org/files/publications/paper_mods_performance_102311_1.pdf (finding that HAMP mods have lower redefault rates even after controlling for payment reduction, interest rate reduction and term extension).

test and servicer-specific compliance information. As a result, HAMP covered mortgages like a bit of gauzy lace—nice in itself, but wholly inadequate to the job at hand.

The CFPB’s servicing regulations should incorporate the many successes of HAMP, which provided for increased access to sustainable modifications for many homeowners. When one looks honestly at the successes of HAMP, and the many ways in which HAMP moved the ball forward for both homeowners and investors, it seems clear that modifications like those under HAMP should continue to be available, to provide protection for all homeowners facing foreclosure and investors risking their savings on residential mortgages.

Use of a net present value test, such as HAMP’s, helps investor confidence and removes concerns about the protection of private property interests. An NPV test also provides a standard to ensure a minimally reasonable number of modifications are mandated to be made. While servicers have flexibility to affect a proprietary NPV test, or proprietary variables, and thus modification outcomes (where a test is not mandated), supervision and transparency can assure that NPV tests do not stand in the way of sensible modifications. Minimal subsidies, such as those available under HAMP, are helpful in increasing the scale of the program by boosting the number of modifications that return a net present positive value to the investor, but are not strictly necessary; even without subsidies, many modifications will still benefit the investors more than doing nothing. Offering such modifications to qualifying borrowers must be mandatory, with all servicers participating and meaningful mechanisms for enforcement.

The CFPB’s servicing regulations must not fall into the same trap that HAMP did. The servicing mandates in these regulations must mandate robust disclosure and transparency throughout the loan modification process and rigorous compliance mechanisms.

The critical features of effective national loan modification standards can be synthesized into five core principles: efficiency, affordability, accessibility, accountability, and enforceability. These are standards that can apply across the board to all servicers and mortgages: government-insured,⁸² portfolio, GSE-related, and privately securitized. Servicers can improve upon them, as can government-related mortgage programs, but a baseline is sorely needed. The last several years make clear that investors cannot secure servicer compliance with investor guidelines, even where knowledge of rampant noncompliance is well known.

- **Efficiency:** Evaluation for a standardized loan modification should be mandatory for all loans before the foreclosure process can go forward.
- **Affordability:** Loan modifications must be affordable, fair, and sustainable.
- **Accessibility:** Hardship must be defined to reflect the range of challenges homeowners face, and ensure changes in circumstances are accounted for.

⁸² A recent report by the GAO highlighted the deficiencies in HUD’s current servicing practices and recommended a major refocus on achieving more sustainable outcomes under the existing FHA servicing program. GAO Report to Congressional Addressees: Foreclosure Mitigation: Agencies Could Improve Effectiveness of Federal Efforts with Additional Data Collection and Analysis (GAO Report 12-296 June 2012) at 54-60, *available at* <http://www.gao.gov/assets/600/592028.pdf>.

- **Accountability:** Transparency and accountability throughout the loan modification process are essential, including standards for qualifying for a modification.
- **Enforceability:** Homeowners must be able to protect themselves from servicers' noncompliance.

2. The CFPB has the legal authority to issue substantive regulations mandating specific loan modification processes before foreclosure.

The Consumer Financial Protection Bureau (CFPB) has broad authority to require mortgage servicers to provide proper loss mitigation. The CFPB should use its authority under the Real Estate Settlement Procedures Act (RESPA) and the Truth in Lending Act (TILA) to ensure that homeowners facing foreclosure are reviewed for affordable loan modifications and other loss mitigation strategies prior to the initiation of foreclosure.

The CFPB has the authority under TILA and RESPA to take the following steps:

- Require servicers to undertake loss mitigation, including loan modification reviews and offers, prior to initiation of foreclosure.
- Require servicers to offer affordable, NPV-positive, loan modifications to qualified homeowners facing hardship.
- Require servicers to pause foreclosures during a loan modification review where homeowners seek assistance after a foreclosure has started, and if needed, where there is a timely appeal.
- Maintain the existing legal protection in RESPA that allows homeowners to challenge abuses by servicers, such as unwarranted loan modification denials, that are not specifically listed in the regulation.

The CFPB's rule should apply to all servicers. To the extent there are procedural limitations on initially promulgating a universal rule, the rule initially should apply to all large servicers and also should hold larger entities responsible for the actions of their agents. Subsequent small business rulemaking should be pursued to cover smaller servicers directly.

a) Authority to Fix the Problem: RESPA

RESPA Gives the CFPB Broad Authority Over Servicing. In 1990, Congress first imposed new requirements on servicers of federally related mortgage loans through amendments to RESPA.⁸³ The amendments generally required servicers to respond to borrower inquiries and correct account errors,⁸⁴ disclose information relating to the transfer of servicing operations,⁸⁵ and make timely payments out of escrow accounts.⁸⁶ The 1990 RESPA amendments required a servicer to respond to a "qualified written request" under section 2605(e) if it "includes a statement of the reasons for the belief of the borrower, to the extent applicable, that the account is in error or

⁸³ Cranston-Gonzalez National Affordable Housing Act, Pub. L. No. 101-625, 104 Stat. 4079 (1999) (codified at 12 U.S.C. § 2605).

⁸⁴ 12 U.S.C. § 2605(e).

⁸⁵ 12 U.S.C. § 2605(a), (b).

⁸⁶ 12 U.S.C. § 2605(g).

provides sufficient detail to the servicer regarding other information sought by the borrower.”⁸⁷ These provisions are included in section 6 of RESPA, and are known as the “Servicer Act,” or the Cranston-Gonzales Amendments to RESPA. Authority to issue regulations under RESPA has now been transferred to the CFPB.

Loss mitigation has become a routine function of servicers in the servicing of mortgage loans.⁸⁸ In fact, Congress has specifically stated in another statute that the loan modification analysis required by the HAMP program is the standard of the residential mortgage servicing industry under both federal and state law.⁸⁹ As a result, courts have held that a request for information (under §2605(e)) related to the status of a loan modification application is a proper qualified written request under RESPA.⁹⁰

Dodd-Frank Expands CFPB’s Authority to Issue Regulations Designed to Avoid Foreclosures. In the Dodd Frank Act, Congress left the QWR language in § 2605(e) intact – except to reduce the number of days in which a servicer has to respond, and to clarify that no fees are permitted for responding – and added an additional, new provision in subsection (k). The new provision, § 2605(k), is an entirely supplemental provision *expanding* the dispute and information rights available to borrowers, and expanding the CFPB’s authority to regulate servicing.⁹¹ The provision requires a servicer to take timely action to respond to a borrower’s request to correct errors relating to “allocation of payments, final balances for purposes of paying off the loan, or avoiding foreclosure, or other standard servicer duties.”⁹² Further, the servicer is specifically prohibited from failing –

to comply with any other obligation found by the Bureau of Consumer Financial Protection, by regulation, to be appropriate to carry out the consumer protection duties of this Act.⁹³

In § 2605(k), Congress also has specifically referred to foreclosure avoidance and the CFPB’s authority to pass “any other” appropriate regulation.

The Dodd-Frank amendment makes clear that the CFPB has authority to issue regulations to implement substantive and specific foreclosure avoidance regulations designed to avoid foreclosure. This authority is broad and extends to regulations intended to establish sustainable modifications and to address dual tracking. Indeed, the CFPB has acknowledged its authority to affect state foreclosure proceedings for purposes of carrying out loss mitigation evaluations in its

⁸⁷ 12 U.S.C. § 2605(e)(1)(B).

⁸⁸ *See, e.g.* CWC Capital Asset Mgmt., L.L.C. v. Chicago Properties, L.L.C., 610 F.3d 497, 500 (7th Cir. 2010) (describing the common duties of a servicer of loans in a securitized trust, including “modifying the mortgage to make its terms less onerous to the borrower”).

⁸⁹ *See* Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, 123 Stat. 1632 (2009) (“The qualified loss mitigation plan guidelines issued by the Secretary of the Treasury under the Emergency Economic Stabilization Act of 2008 shall constitute standard industry practice for purposes of all Federal and State laws”).

⁹⁰ *See* Diamond v. One West Bank, 2010 WL 1742536 (D. Ariz. Apr. 29, 2010). *But see* Williams v. Wells Fargo Bank, N.A., Inc., 2010 WL 1463521 (N.D. Cal. Apr. 13, 2010) (request for loan origination documents as part of borrowers’ inquiry about “options” for loan modification or short sale was not a QWR).

⁹¹ Pub. L. No. 111-203, 124 Stat. 1376, Title XIV, § 1463(a) (July 21, 2010).

⁹² *Id.*

⁹³ 12 U.S.C. § 2605(k)(1)(E).

proposed regulations by providing that the failure to suspend a foreclosure action in certain situations is subject to the error resolution procedures.⁹⁴

b) Authority to Fix the Problem: TILA

TILA Requires the Bureau to Prohibit Unfair or Deceptive Mortgage Practices. The Truth in Lending Act provides that the Bureau “shall prohibit acts or practices in connection with mortgage loans that the Bureau finds to be unfair [or] deceptive”⁹⁵ The legal standard for deception is well established under both the FTC Act and state UDAP statutes. Generally, a practice is deceptive if it is likely to deceive even a minority of consumers. The standard does not require intent to deceive (or knowledge that the act is deceptive). A practice can be deceptive even where it is industry-wide.

The Dodd-Frank Act provides that a practice is unfair where “(A) the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers; and (B) such substantial injury is not outweighed by countervailing benefits to consumers or to competition.”⁹⁶ The Bureau may consider established public policies as evidence to be considered, although not as the primary basis for determining unfairness.⁹⁷

Proceeding with Foreclosure During a Loan Modification Review Is Both Unfair and Deceptive. Pursuing foreclosure during loss mitigation is deceptive because homeowners may be led to believe either that loss of the home is inevitable, and that they should therefore abandon the loss mitigation process, or that they need not continue to defend the foreclosure and can instead rely on the loss mitigation process. This confusion is often compounded by oral reassurances by servicer staff that everything is being taken care of in the loss mitigation process.

Disclosure cannot cure the deceptive nature of the dual track process. The relationship between the legal proceedings to deprive homeowners of their property and the loan modification process conducted off the record, by staff not involved in the foreclosure proceeding, is complex and ambiguous even to experienced attorneys representing lenders as well as to unsophisticated homeowners who are facing the loss of their home. Indeed, disclosure is likely to exacerbate the harm: if homeowners know that foreclosure will proceed even though they complete a loan modification application, many of them will conclude that modification efforts are hopeless—and in many cases they will be correct, because of the inexorable schedule of the foreclosure process and the fees it adds.

The dual track of loss mitigation and foreclosure also is unfair. It regularly causes (and therefore is also likely to cause) substantial injury. Homes often are wrongly sold at a foreclosure sale while an outstanding loss mitigation review is underway or even after a permanent loan modification agreement has been finalized. In some cases, these sales occur months or years after the initial notice of foreclosure is served on the homeowner, during which time the homeowner is making payments under a modified agreement and believes that the foreclosure process has been stopped due to the modification. Reversing a foreclosure is nearly impossible and the loss of

⁹⁴ Proposed § 1024.35(b)(9).

⁹⁵ 15 U.S.C. § 1639(l)(2)(A).

⁹⁶ Pub. L. No. 111-203, 124 Stat. 1376, Title XIV, § 1031(c)(1) (July 21, 2010).

⁹⁷ *Id.* at § 1031(c)(2).

household stability is devastating. The confusion caused by pursuing foreclosure during loss mitigation can steer unrepresented homeowners away from following through on loss mitigation requests; even more frequently, it causes unrepresented homeowners to waive their rights in the foreclosure proceeding in reliance on the loss mitigation process, resulting in unnecessary foreclosures.

Moreover, the costs of foreclosure, including property valuations, preservation and attorneys' fees, and title charges, substantially increase a homeowner's principal balance. Those fees, made necessary only by the continuation of the foreclosure during the pendency of loan modification negotiations, can push loans away from eligibility for a modification that has a positive net present value, strip equity, and inevitably increase arrearages, which must be paid either out of increased loan payments, through an extended amortization period, or with a large balloon payment at the culmination of the mortgage. Thus, continuing foreclosure proceedings during loan modification efforts becomes a self-fulfilling prophecy, making a loan modification that would save the home unaffordable.

This injury is not reasonably avoidable by consumers, nor is it outweighed by countervailing benefits to consumers or competition. A homeowner generally cannot prevent the wrongful sale of a foreclosure during a loss mitigation review. Most homeowners are not able to obtain counsel and even those who do face enormous hurdles in light of the limited communication between servicers and the servicer's own foreclosure attorneys. Homeowners cannot avoid the additional fees charged during the foreclosure by the servicer; the servicer exercises complete and unfettered discretion in the imposition of such fees. Any confusion about the dual track process is caused by the construct of pursuing two contradictory processes simultaneously and is inevitable.

There are no benefits to consumers or the market in failing to provide NPV-positive loan modifications. While some have argued that speeding up the foreclosure process aids the market, a system that results in denying modifications that benefit investors and homeowners, and raising the costs for providing modifications, only harms the market. Moreover, there is little evidence that dual track results in faster foreclosures: the need to process two sets of paperwork and coordinate communications between different divisions of the servicer complicates an already complex process and may ultimately result in more delays in foreclosure.

Concerns that some homeowners who are able to pay might choose default in order to obtain a modification, and thus increase the cost of credit for all, tend to be overblown. Defaulting on a mortgage has significant costs to credit as well as emotional security, and is not a risk most families undertake lightly. Entering into loan modification negotiations is an arduous, time-consuming, and uncertain undertaking. In addition, existing requirements that evaluate the objective affordability of the current mortgage payments combined with verification of income and assets prevent homeowners who could reasonably avoid default from taking advantage of loan modification programs.

Stopping dual track will expedite modification reviews and limit the harm to consumers and the market. Such a rule is needed because of current market dysfunction. Outcomes that benefit both investors and homeowners are hard to achieve because servicers have a financial incentive to drag out the foreclosure instead of promptly granting an NPV-positive loan modification where one is available.

Homeowners do not choose their servicers and thus cannot avoid these market problems. Because homeowners do not enter a loan expecting to default, default remedies such as access to reasonable loan modifications, and fair procedures for obtaining them, are not a subject of negotiation. In fact, they are not on the radar at all when a homeowner initially enters into a loan. Investors, too, have so far faced significant challenges in obtaining compliance with loss mitigation requirements.

Public policy supports an end to dual track. Several measures at the federal and state level already have acknowledged the damage done by the dual track process. HAMP, FHFA and the AG-Federal settlement all require loan modification reviews to be completed prior to the initiation of a foreclosure. Some of these protocols also protect homeowners to some extent from continuation of an existing foreclosure where loss mitigation is underway. State mediation programs recognize the importance of halting the foreclosure process—whether judicial or non-judicial—in order to first complete the loan modification review.

Denying a Qualified Homeowner a Home-Saving Modification that Also Benefits the Investor More Than Foreclosure Is Both Unfair and Deceptive. It is deceptive to deny a modification to an eligible homeowner. Denial of that assistance communicates that the homeowner is not eligible, where the contrary is true. Denial also gives the appearance that the investor, for whom the servicer works, benefits from and agrees with the servicer's denial. This show of solidarity is false in the many cases where the investor explicitly permits loan modifications, and there is an NPV-positive loan modification available.

Wrongful denial of a loan modification also is unfair. Failure to provide an affordable loan modification generally leads to home loss, especially in light of recent, very low, cure rates. Because servicers generally control the modification review process, a homeowner cannot avoid the injury caused by wrongful modification denial. (Counselors and attorneys nationwide help a small percentage of those needing assistance, and can prevent only a fraction of wrongful modification denials; transparency limitations also make such challenges difficult.) Failure to provide an NPV-positive loan modification to a qualified homeowner does not benefit consumers or competition. While they may provide a profit opportunity to the servicer in some circumstances, wrongful denials harm homeowners, communities, and investors.

Loan modifications that benefit investors and homeowners are too hard to get because of market dysfunction; a rule aligning servicer incentives with other market participants would alter that dynamic. Finally, public policy in the last several years has vigorously supported loan modification for eligible homeowners. HAMP, FHFA rules, state laws, and private industry developments all favor a loan modification over foreclosure where the numbers add up. The consensus is clear. A rule mandating such outcomes will move incentives in the right direction.

Failure to Comply with Existing Modification Requirements Also Is Unfair and Deceptive. Where entities fail to comply with existing loss mitigation requirements to which they are bound, such actions are deceptive. For the reasons articulated above, failure to comply with existing modification requirements also is unfair. It causes substantial injury, which is neither reasonably avoidable nor outweighed by benefits to consumers or competition. Public policy promotes the rule of law and compliance with existing standards, particularly on loan modifications.

The Federal Reserve Board has previously used TILA UDAP authority to prohibit a broad array of specific practices. There is ample precedent for a broad application of the CFPB's authority under TILA to prohibit unfair or deceptive practices. The FRB used this rulemaking authority to address such matters as payment of yield spread premiums to mortgage loan originators; steering of consumers into mortgage loans that produce higher compensation to the loan originator unless in the interest of the consumer; exercising inappropriate influence over mortgage loan appraisals; unfair delays in crediting consumers' payments; unfair imposition of late fees; unfair refusal or delay in providing payoff statements; repeat refinancing of high-cost mortgage loans; making higher cost loans without regard to the consumer's ability to repay; and making higher cost loans with onerous prepayment penalties. New rules addressing mortgage servicing issues fit squarely within the historical use of this authority.

C. Recommended Regulations on Loss Mitigation

We recommend that the CFPB mandate the provision of loan modifications, as well as substantive standards for loss mitigation, and loan modifications in particular for all home-secured loans. The Bureau also should require loss mitigation reviews prior to initiation of foreclosure, and it should require that the foreclosure process be halted where loss mitigation is requested after the initiation of foreclosure. This latter requirement is consistent with the procedural approach already taken by the Bureau. The former—a modification mandate and standards—is essential to establishing a functioning servicing market.

The Bureau is well positioned to articulate basic tenets of sustainable loss mitigation and loan modifications. They can serve as a floor, with government actors and other parties improving upon them as applies to any particular portfolio. Failure to provide such guidelines will leave homeowners at the behest of self-interested servicers. While investors and homeowners often have aligned interests, it has become clear that investors cannot act, and certainly not nimbly, to protect their own pecuniary interests in servicing, and thus certainly cannot ensure a functioning system that will stop avoidable foreclosures. Basic standards will also provide consistency for servicers and other market participants, as well as transparency and greater accountability.

1. CFPB Regulations on Servicing Must Require the Servicer to Offer the Homeowner a Modification If it Will Provide a Net Present Value to the Investor over a Foreclosure.

a) A Standardized Net Present Value Test Provides for Screening of Loan Modifications that Benefit the Investor.

1) The Net Present Value Test Protects Both Homeowners and Investors.

Homeowners obviously lose when servicers wrongfully foreclose. They lose their homes, they lose their equity, they lose their social networks. Homeowners facing foreclosure experience stress and strain, to say the least. Even if homeowners pushed into foreclosure are able to obtain a modification, their resources may well be exhausted by the struggle to obtain a modification, and the modification may leave them only slightly better off than they were before the modification.

But investors lose as well. Particularly in a market where no equity cushion exists to absorb servicers' excesses, the fees and costs come out of the supposed security for the investors' money.

According to some data, investors are now losing nearly 60% of the loan value on each foreclosure, over \$145,000 per foreclosure.⁹⁸ In that context, the failure to perform modifications—and the corrosive effect of excess fees—eats away at any return investors could hope to have.⁹⁹

HAMP only mandates loan modifications when the Net Present Value test predicts that the loan modification will return money to the investors compared to doing nothing. It weighs the odds of cure (vanishingly small in the current market), the chances of redefault (lower than you might expect with a HAMP mod), and the expected return on any ultimate foreclosure. When servicers fail to convert trial plans to permanent HAMP modifications, or wrongly deny HAMP modifications, they are costing investors' money—hard money in the form of incentive payments from the government and hard money in the form of lost future payments from the homeowner. A standardized NPV test should be required under any national servicing standards to ensure that servicers are modifying loans where and when they should.

2) The NPV Test must be public

Many advocates and mediators, lacking access to Treasury's NPV test, continue to rely on the FDIC's Loan Mod in a Box spreadsheet. Maine, Hawaii, and Washington State all require that foreclosure mediation programs use the FDIC's Loan Mod in a Box spreadsheet to determine whether a loan modification should occur or not (Washington State only requires the use of the FDIC's Loan Mod in a Box if the loan is not HAMP-eligible).

The FDIC Loan Mod in a Box is likely a good approximation of the HAMP NPV test. The HAMP NPV test was based, in part, on the FDIC Loan Mod in a Box. But it is only an approximation. In one case, Chase claimed that the homeowner had failed the NPV test by \$17,000, while the FDIC Loan Mod in a Box spreadsheet produced a pass on the NPV test in excess of \$30,000. Often, it appears that, even using the servicer's inputs, the homeowner should pass the NPV. In another case, a New Jersey advocate received in discovery a document that appears to show that the present value of a modification exceeds the present value of a foreclosure, even though the servicer denied the modification on the basis of the NPV test. Without access to the actual NPV calculation, homeowners, judges, and mediators are left without any means to resolve these disputes.

Section 1482 of the Dodd-Frank Act mandated that Treasury make available to the public a portal so that homeowners, their advocates, and mediators could check the accuracy of servicers' NPV calculations. Treasury's implementation has lacked full transparency. Any national servicing standards must mandate a public NPV test, with complete transparency.

⁹⁸See Alan M. White, Sept. 26, 2010 Columbia Collateral File Summary Statistics, http://www.valpo.edu/law/faculty/awhite/data/sep10_summary.pdf.

⁹⁹ See, e.g., Jody Shenn, *Mortgage Investors with \$500 Billion Urge End of Practices, Lawyer Says*, Bloomberg News, July 23, 2010, <http://www.bloomberg.com/news/2010-07-23/mortgage-investors-with-500-billion-urge-end-of-practices-lawyer-says.html> (reporting on letters sent to trustees of mortgage pools on behalf of a majority of the investors in the pool); Letter from Kathy D. Patrick to Countrywide Home Loans Servicing, Oct. 18, 2010 (notifying a trust and master servicer of breaches in the master servicer's performance, including the imposition of excessive fees).

b) Modifications Must Be Sustainable and Fair.

1) Loan modifications must be affordable

In order to be sustainable and fair, loan modifications must be affordable. HAMP modifications have re-default rates roughly half that of other loan modification programs.¹⁰⁰ Their re-default rate is low because they are driven by a payment reduction down to an affordable level. Future standards should build on HAMP's success in this area and should adopt, as a general rule, a payment reduction to 31% of income. Building a modification simply on the percent of payment reduction will not achieve broad access to affordability.

Nonetheless, for some homeowners, payments at 31% are not affordable. For those homeowners, monthly payments below 31% should be offered. Second mortgages or high medical debt can render a first mortgage payment of 31% or less unaffordable. Homeowners' actual, reasonable living expenses may mean that 31% is not, in fact, a sustainable and affordable payment when the total dollars available are quite low.

In addition, second liens must be accounted for. Servicers will often service both the first and second liens. Frequently, servicers themselves hold the second lien. Servicers who hold second liens may prefer to gamble on a market recovery rather than recognize their losses now. Many servicers have chosen not to participate in the HAMP second lien program absent a federal mandate. Failure to require action on the second lien results in unsustainable loan modifications and invites gamesmanship and moral hazard on the part of servicers.

2) Modification should be based on a waterfall that prioritizes principal reduction

Practically, principal reductions may be the key to the success of any foreclosure mitigation program. Being "underwater" increases the risk of default, particularly when coupled with unaffordable payments.¹⁰¹ Built into the HAMP NPV calculations is an assumption that default increases as a function of how far underwater the homeowner is. In order to bring down the redefault rate and make loan modifications financially viable for investors, the CFPB regulations must mandate that principal reductions be part of the package.

HAMP permits principal reductions, but does not mandate them, not even in the most extreme cases. HAMP does require forbearance, but only as a method for reducing payments. While forbearance provides affordable payments, it prevents a homeowner from selling or refinancing to meet a needed expense, such as roof repair or college tuition, and sets both the homeowner and the loan modification up for future failure. The CFPB's regulations must do better and must mandate principal reduction where it produces a net benefit to the investors.

¹⁰⁰ Comptroller of the Currency & Office of Thrift Supervision, OCC and OTS Mortgage Metrics Report: Disclosure of National Bank and Federal Thrift Mortgage Loan Data, 4th Quarter 2010 at 6 (2010) <http://www.ots.treas.gov/files/490069.pdf>.

¹⁰¹ See, e.g., Kristopher Gerardi, Christopher L. Foote, & Paul S. Willen, *Negative Equity and Foreclosure: Theory and Evidence* (Fed. Reserve Bank of Boston Pub. Pol'y Paper No. 08-3, June 2008); Andrey Pavlov & Susan Wachter, *Aggressive Lending and Real Estate Markets* (Dec. 20, 2006), available at <http://realestate.wharton.upenn.edu/newsletter/pdf/feb07.pdf>.

3) Modifications should reduce the interest rate before extending the term

While HAMP requires that the interest rate be reduced before the term is extended, many proprietary modifications do not. Inverting the order of the waterfall produces loan modifications that are more costly to the homeowner and more risky for the investor.

Term extension may provide homeowners with immediate payment relief, but it does so at the cost of pushing those payments—plus huge amounts of excess interest—out into the future. One result is that homeowners with term extensions will take much, much longer to pay down principal—meaning that homeowners who are underwater will stay underwater for decades longer. Another result is that the interest risk—that future rates will be lower than present rates—is exacerbated. Particularly since mortgage rates are near record lows, yet refinancing options are few and far between, homeowners should not be locked into high rates for an extended period of time. Switching the waterfall so that term extensions are offered before interest rate reductions gives homeowners the illusion of payment relief, but locks them into debt service for much longer. That increased period of debt service also increases the risk for investors. While a term extension, on paper, does not change the return to the investor (since interest will continue to accrue on the deferred payments), the increased length of time to repay increases the risk that the investor will not get repaid. To take one example, homeowners in their 30's are likely to repay a 30-year mortgage before hitting their retirement years. They are less likely to be able to repay a 40-year mortgage before hitting their retirement years, and are thus more likely to default.

While term extensions are preferable to capitalization modifications, they suffer, long-term, from some of the same risks posed by a failure to reduce the principal balance. Term extensions leave homeowners owing more for longer, and paying more over the life of the loan. Reversing the waterfall does not protect investors from losses incurred through too great an interest rate reduction; the Net Present Value test already does that. Reversing the waterfall reduces the benefit for homeowners of a loan modification and increases the investor's risk.

4) Additional modifications should be available where the homeowner faces additional unexpected hardship

Even after a loan modification is done successfully and is performing, homeowners may still become disabled, lose their jobs, or suffer the death of a spouse. These subsequent, unpredictable events, outside the control of the homeowner, should not result in foreclosure if a further loan modification would save investors' money and preserve homeownership. Foreclosing on homes where homeowners have suffered an involuntary drop in income without evaluating the feasibility of a further modification is punitive to homeowners already suffering a loss and does not serve the interests of investors.

Some servicers provide modifications upon re-default as part of their loss mitigation program. This approach should be standard and mandated.

5) Spouses, children, and ex-spouses should be offered a modification in accord with existing federal law.

The Garn-St Germain Act provides that mortgages should be freely assumable between family members living in the home, whether they acquire title through death or divorce or devise. Servicers currently routinely block modifications when family members seek to assume the mortgage. But if a modification in those circumstances passes the NPV test, there is no reason not to allow it, and the weight of existing federal law supports the assumption of the mortgage and the curing of the default.

6) Waivers should be forbidden in modifications

HAMP has forbidden waiver from its inception and even explicitly authorized loan modifications for homeowners engaged in active litigation with their servicer. Waivers of legal rights may not always be enforceable, but they have a chilling effect on homeowners' exercise of their rights. There is no reason to authorize servicers to require a get out of jail free card from homeowners in order to process a loan modification that is in the best financial interests of the investors. Permitting such waivers will encourage abusive servicer behavior and will impede loan modification processing for homeowners savvy enough to seek legal counsel as to the extent of their waiver.

Despite HAMP's prohibition, waiver continues to be a significant problem, particularly for GSE loans, where there is no specific prohibition on waiver.¹⁰² Reporting by ProPublica found that several servicers continued to request waiver, particularly, but not exclusively, in non-HAMP, or proprietary, modifications.¹⁰³ Bank of America asked homeowners in New York, Maine, Indiana, Connecticut and North Carolina to waive all legal defenses in order to obtain a loan modification.¹⁰⁴ Bank of America employees claimed both that such waivers occur when non-standard modifications are done and that such waivers are part of a standard package and cannot be removed.¹⁰⁵ Homeowners in both HAMP and non-HAMP modifications have been asked to sign waivers of specific claims, often related to allegations of robo-signing or standing.¹⁰⁶ Homeowners in Maryland, Oregon, and California have all been forced to litigate whether accepting a HAMP modification on a GSE loan waives TILA rescission rights.

Servicers continue to press homeowners to waive their rights to a HAMP modification. A Colorado homeowner was told by Bank of America employees that waiver of her rights to a HAMP review was a condition of suspension of the foreclosure sale, despite the fact that there was an ongoing review of the denial of her HAMP application.

¹⁰²See, e.g., *Problems in Mortgage Servicing From Modification to Foreclosure: Hearing Before the Senate Comm. on Banking, Housing & Urban Affairs*, 111th Cong. 29 (Nov. 16, 2010) (statement of Diane E. Thompson) (describing waiver in a PNC loan modification); *Preserving Homeownership: Progress Needed to Prevent Foreclosures: Hearing Before the S. Comm. on Bank., Hous. & Urban Affairs*, 111th Cong. 22 (July 16, 2009)(statement of Diane E. Thompson)(describing problems with waivers in HAMP modifications).

¹⁰³ Paul Kiel, *Borrowing Trouble: Some lenders are modifying mortgages only after homeowners waive their right to sue*, ProPublica, May 8, 2011, <http://www.slate.com/id/2293391/>.

¹⁰⁴ *Id.*

¹⁰⁵ See, e.g., *id.*

¹⁰⁶ See, e.g., *id.*

The CFPB's regulations must follow HAMP's lead and clearly prohibit waivers.

7) Bankruptcy should not be a bar to modification

The CFPB regulations should allow modifications for homeowners in bankruptcy. For over a year, HAMP has required that modifications be allowed for borrowers in bankruptcy that are otherwise eligible. The CFPB servicing regulations should, like the revised HAMP guidelines, explicitly provide that servicers must consider a homeowner seeking a modification even if the homeowner is a debtor in a pending bankruptcy proceeding.

Some servicers have explained their reluctance to do loan modifications in bankruptcy by citing a fear of violating the automatic stay in bankruptcy. Neither the automatic stay nor the discharge order should be a bar to offering an otherwise eligible homeowner a loan modification. HUD, in guidance to FHA servicers, has explicitly recognized that offering a loan modification does not violate the automatic stay or a discharge order.¹⁰⁷

Servicers should be required, upon receipt of notice of a bankruptcy filing, to send information to the homeowner's counsel indicating that a loan modification may be available. Upon request by the homeowner and working through homeowner's counsel, servicers should offer appropriate loan modifications in accordance with the national servicing standards prior to discharge or dismissal, or at any time during the pendency of a chapter 13 bankruptcy, without requiring relief from the automatic stay, and, in the case of a chapter 7 bankruptcy, without requiring reaffirmation of the debt. The bankruptcy trustee should be copied on all such communications. All loan modifications offered in pending chapter 13 cases should be approved by the Bankruptcy Court prior to final execution, unless the Court determines that such approval is not needed. If the homeowner is not represented by counsel, information relating to the availability of a loan modification should be provided to the homeowner with a copy to the bankruptcy trustee. The communication should not imply that it is in any way an attempt to collect a debt.

c) The application process must be simplified

Any discussion of the loan modification process indicates a structure so Byzantine as to be Kafka-esque. Countless loan modifications are denied because of this needless complexity.

1) The CFPB regulations on early intervention should include clear notices of all available loss mitigation options along with information about eligibility requirements.

The proposed early intervention regulations are an excellent start. However, substantive information about the actual loss mitigation options available must be mandated. This can be done in a manner useful to homeowners without posing significant burden on servicers. Indeed, the simpler and shorter the information provided, the more likely it is to be useful to homeowners, and the clearer the information is, the more servicers' burden to respond to inappropriate or incomplete modification requests will be diminished.

¹⁰⁷HUD Mortgagee Letter 2008-32, October 17, 2008.

2) Continuity of contact and document tracking must be mandated

The CFPB has already included in the proposed regulations a good standard for continuity of contact (proposed 12 C.F.R. § 1024.40), with some important additions needed. Servicers lose documents, over and over and over again. Homeowners call endlessly, and are shuffled from person to person. From the homeowner's perspective, one of the biggest obstacles to loan modification is finding a live person who can provide reliable information about the loan account and who has authority to make loan modification decisions. Federal law should require that mortgage servicers provide homeowners with contact information for a real person with the information and authority to answer questions and fully resolve issues related to loss mitigation activities for the loan. Requiring a single person to have custody of a loan modification application from start to finish might ease some of the confusion experienced by homeowners. Document tracking might help homeowners demonstrate that they have, in fact, submitted documents and prevent unnecessary denials for failure to submit documents.

Neither of these procedural steps is a panacea, as illustrated by the case of a Wisconsin homeowner whose attorney finally got a single point of contact, only to have that single point of contact fail to return phone calls or emails for a month. And document tracking systems are subject to both computer and human error. Many proposed and in-place document tracking systems rely on access to housing counselors, computers, and the Internet, or all three. There are parts of the country where there are no HUD-certified housing counselors operating, and even if most homeowners have some Internet access through public libraries, the digital divide remains real.¹⁰⁸ Nonetheless, these procedural steps, if implemented and enforced, would improve servicers' efficiency in processing loan modification applications and reduce inappropriate denials.

d) All loan modifications should be permanent.

The numbers and narratives both tell the same story. Tens of thousands of homeowners are faithfully making monthly trial modification payments with the understanding that a permanent modification will be the reward, yet that final modification is still elusive. The only way to ensure that homeowners obtain finalized agreements—and receive them on time so they can avoid additional increases in arrears and further damage to their credit—is to make loan modifications permanent from the start. Even homeowners who receive permanent modification offers in the mail find that this does not mean the process is over, since servicers often delay by weeks or months the countersigning of the document. Where the servicer initiates foreclosure after the homeowner has entered a permanent modification, as many do,¹⁰⁹ homeowners often find themselves scrambling to prove that there was an agreement. Automatic and permanent modifications from the start will streamline the process and reduce litigation. If permanent modifications are not explicitly adopted, servicers should be required to adjust the account where a conversion delay has occurred, so that the homeowner does not face unwarranted arrears and additional amounts due.

¹⁰⁸ While 57% of households with less than \$30,000 annual income access the internet from home, only 42% own a desktop computer and 38% a laptop computer. Jim Jansen, Pew Research Ctr., Use of the Internet in Higher-Income Households, 2, 9 (2010), available at <http://pewinternet.org/~media//Files/Reports/2010/PIP-Better-off-households-final.pdf>.

¹⁰⁹ See **Error! Reference source not found.**, *supra*.

2. Alternatives for Homeowners for whom a Modification is not Appropriate Should Be Available.

A loan modification is simply not appropriate for some homeowners. Some homeowners did buy too much house, or have insufficient income or other resources to maintain homeownership. Some homeowners wish to exit homeownership in order to relocate for work or family. These homeowners deserve the opportunity to have a dignified and orderly transition from homeownership.

The Administration's Home Affordable Foreclosure Alternative (HAFA) program is a sensible response to this problem. It provides for short sales or deeds-in-lieu of foreclosure, with small payments to homeowners that may be used to pay down junior lien holders or help with moving expenses. (These payments have long been standard in the field, and indeed the payments under HAFA are several thousand dollars lower than what advocates report servicers routinely offered pre-HAFA). HAFA's limited implementation reflects servicer noncompliance more than fundamental weaknesses in the program.

The short sale provisions are helpful, as they require the servicer to identify up front what is an acceptable sales price for the home. This assists homeowners and their realtors in negotiating a sales price, and prevents the chaos engendered by a servicer's refusal to respond to a short sale offer in a timely fashion.¹¹⁰ HAFA also promotes fundamental fairness by requiring servicers to waive any deficiency judgment against homeowners in exchange for negotiating the short sale or deed-in-lieu of foreclosure. (Again, this waiver of deficiency was standard before the current foreclosure crisis).

The problem is that there is no enforcement mechanism for HAFA. Advocates report that homeowners are routinely steered out of HAFA into non-HAFA short sales and deeds-in-lieu, where homeowners are forced to negotiate for all of the protections afforded under HAFA. Future guidelines, again, cannot take servicer compliance for granted and must build in enforcement mechanisms, even for those homeowners who are destined to surrender their homes.

3. Procedural Protections Should Terminate the Dual Track of Loss Mitigation Alongside Foreclosures

a) Loan modification review should occur before foreclosure has been initiated and before any foreclosure-related fees have been incurred.

The regulations must mandate that homeowners always be reviewed for a modification prior to the initiation of a foreclosure in order to contain fees, expedite processing, and reduce the opportunities for error. This is not an open-ended or indefinite proscription: rather, it provides clear guidance to servicers that they can no longer continue to sit on loan modification applications indefinitely. Servicers should be free to initiate the foreclosure as soon as they conduct the review, but specific guidance as to necessary outreach and strict timelines would encourage servicers to expedite loan modification review. Initiation of foreclosure during the loss mitigation review increases costs, decreases servicer incentives to complete the review, and causes confusion about the likelihood of a home-saving loan modification. It is also much harder to stop the foreclosure and

¹¹⁰ Reed Fujii, *Short Sale Process Flawed, Realtors Say*, The Record (July 31, 2011), http://www.recordnet.com/apps/pbcs.dll/article?AID=/20110731/A_BIZ/107310302/-1/A_BIZ04.

provide a modification once it has begun because of the additional parties involved. Failure to adopt this common sense principle will undermine a broad consensus that has already developed on this issue, and undoubtedly result in many more avoidable foreclosures. The National Settlement, HAMP, and FHFA all have rules limiting dual track. It is incumbent upon the Bureau to tackle this issue, to learn from limitations in existing rules, and to implement a clear prohibition on dual tracking.

b) If a foreclosure has been started at the time of a loan modification application or review, both judicial and nonjudicial foreclosures must be frozen during review

For many homeowners, the initiation of foreclosure proceedings is the motivating force to apply for a loan modification. Sometimes, the initiation of foreclosure proceedings is the first time the homeowner understands that the servicer believes that the homeowner is in default. Not infrequently, homeowners believe that they are current or have brought their loans current recently, often on the advice of the servicer, at the time of foreclosure. A homeowner who believes she is current is not going to apply for a loan modification. Often, the need for a loan modification becomes apparent only after the foreclosure is initiated. Sometimes, a homeowner does not seek assistance until the sale has been scheduled.

Servicers' use of serial trial modifications further complicates matters, since the servicer may initiate foreclosure after one trial modification and before the second. Many of the homeowners foreclosed upon while undergoing a loan modification review were placed by servicers in multiple trial modifications, complicating any attempts to unravel when the modification review was completed with respect to the foreclosure filing.

Staying all foreclosures during the pendency of a loan modification review would encourage servicers to expedite their reviews, rather than delaying them, and would provide transparency and fairness to homeowners. Mandated outreach with a defined end to that process can ensure that servicers are not waiting indefinitely to initiate or continue a foreclosure.

Much concern has been raised regarding long foreclosure timelines and the possibility that such a requirement would require a servicer to restart a foreclosure. First, the main reason for long foreclosure timelines is the failure of servicers to meet basic requirements to seek alternatives to foreclosure. States with foreclosure mediation are one laboratory for observing the repeated and lengthy delays occasioned by servicer resistance to basic loss mitigation reviews. Second, language can be crafted that halts, but does not restart, the process. We suggest the following:

With respect to a borrower who submits a request for loss mitigation after a loan has been referred to foreclosure, the servicer must take those actions within its authority that are necessary to halt further activity and events in the foreclosure process, whether judicial or non-judicial, including but not limited to refraining from scheduling a sale or causing a judgment to be entered. Any scheduled sale should be suspended for 60 days, and where the review has not been completed by the end of that period, the sale should be suspended again for another 60 days. Servicers are permitted to take steps necessary to maintain the status quo of the judicial or non-judicial proceeding as of the date the application is submitted, such as by providing status reports in a court foreclosure or mediation process or by providing notice in a non-judicial foreclosure proceeding that is necessary to avoid reinstating the sale process.

As for the question of when an application for loss mitigation is too late, the Bureau's 90-day maximum deadline is unworkable and also wholly undermines the availability of loss mitigation. Loss mitigation applications should be timely as long as they are submitted earlier than seven days prior to the scheduled sale. In several non-judicial states, notice of the sale is not provided until 10-20 days prior to sale.¹¹¹ A seven day rule allows for communication among the various parties while allowing homeowners in all states the chance to save their homes.

D. Enforcement Mechanisms for Non-compliance with Loss Mitigation Standards

If the CFPB mandates the loan modification review and substantive requirements recommended in these comments, then presumably the error resolution procedure in § 1024.35 would be made specifically applicable. A simple way to ensure that the error resolution process covers these new rules would be to amend the current proposed language in § 1024.35(b)(9) to encompass the failure to comply with the mandates on loss mitigation.

¹¹¹ National Consumer Law Center, *Foreclosures* App. E (3rd ed. 2010).