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Loan Servicing Déjà Vu

K&L Gates originally published this alert prior to July 21, 2010, the date on which President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act into law. However, this alert discusses the final version of the bill that would eventually be signed into law.

Loan servicers that are reeling from ever changing state laws and HAMP requirements can breathe a sigh of relief that the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) left most of its ammunition for other segments of the financial services industry.¹ Title XIV of the Dodd-Frank Act, entitled Mortgage Reform and Anti-Predatory Lending Act (the “Mortgage Reform Act” or the “Act”), would impose new restrictions and requirements on the residential mortgage industry, but in many cases these changes piggyback the regulations issued by the Federal Reserve Board (“FRB” or “the Board”) in 2008. Nevertheless, there are changes that may have a material impact on loan servicers and open them up to a federal cause of action with a private right of enforcement.

In this Alert, we address the provisions of the Mortgage Reform Act that impose duties on mortgage servicers, which are found primarily in Subtitles E and G of the Act. Those Subtitles’ servicing provisions address:

- Qualified written requests
- Escrow accounts
- Force placed insurance
- Periodic statements
- Crediting of payments
- Payoff statements
- HAMP requirements
- Tenant protections following foreclosure

Other K&L Gates client alerts describe the abundant other provisions in the Mortgage Reform Act and the larger Dodd-Frank Act relating to residential mortgage lending, including the creation of the new gargantuan Consumer Financial Protection Bureau (“the Bureau”) within the Federal Reserve, the imposition of new mortgage loan origination requirements, the dilution of federal preemption of state laws for national banks (and the remaining entities with federal thrift charters) and their operating subsidiaries, the impact of the amendments to the Alternative Mortgage Transactions Parity Act, and the consequences of the new “skin in the game” requirements under the new risk retention rules. In addition, other alerts from K&L Gates will address other aspects of financial reform in the Dodd-Frank Bill on the [K&L Gates web site specially dedicated to Financial Services Reform](#).

A loan servicer reviewing these provisions may get a sense of déjà vu. In fact, many of the Act's loan servicing provisions are duplicative of current federal requirements. Others represent standards set by highly publicized settlement agreements between some loan servicers and federal and state governmental authorities. Yet others appear to legislate against what are common industry practices (but which will now be accompanied by a federal cause of action for failure to comply).

Another reason for a sense of déjà vu is that these servicing provisions were topics of the mortgage reform efforts of the 110th Congress and the FRB, on which we reported in a 2008 client alert.² And in fact, many of the servicer-related requirements found in the Mortgage Reform Act, such as timely crediting payments, promptly responding to payoff requests, and establishing escrow accounts on "higher risk" mortgages are currently law under Regulation Z, leading to potentially redundant (and sometimes inconsistent) requirements.

The few things the Act does not do are noteworthy. The Act does not set limits on specific servicing fees (except certain fees relating to qualified written requests ("QWRs") and "high-cost" loans). Nor does the Act appear to fundamentally alter the nature of the loan servicing business, which is in contrast to some of the sea changes the Act imposes on the residential mortgage loan origination side of the business.

Effective Date

Assuming the Mortgage Reform Act is signed into law, when will it become effective? Unfortunately, the Act's description of its effective dates is not a model of clarity. According to the Mortgage Reform Act, a section or provision of the Act will generally not take effect until any required rulemaking process is complete and final regulations implementing the pertinent section or provision are final. For those provisions that do not specifically require a regulator to issue implementing regulations, the effective date is unclear.

On one hand, the Act says that any section of the Mortgage Reform Act "for which regulations have not been issued on the date that is 18 months after the designated transfer date shall take effect on such date." This would seem to say that those provisions

of the Mortgage Reform Act that do not specifically require the applicable regulator to adopt implementing regulations do not become effective until 18 months after the designated transfer date, unless the applicable regulator decides to adopt regulations to implement the provisions anyway, and specifies an earlier effective date in those regulations. On the other hand, others have asserted that the foregoing effective date applies only to those provisions of Mortgage Reform Act for which the applicable regulator is required to issue regulations. This would mean that the provisions for which a regulator is not required to issue regulations (either because regulations are authorized, but not required, or the section is silent with respect to implementing regulations) would be subject to the Dodd-Frank Act's default effective date—which is the day after the President signs the bill. This would be an alarming and unreasonable result given the time it would take to implement the many statutory requirements in an orderly manner. Hopefully, the Board will clarify the effective date of the provisions of the Mortgage Reform Act for which regulations are not expressly required.

Responding to Qualified Written Requests and Other Requests Under RESPA

The Mortgage Reform Act would amend the Real Estate Settlement Procedures Act ("RESPA") to shorten existing time frames for responding to QWRs. Section 6(e) of RESPA requires a loan servicer, upon receipt of a QWR, to take certain actions with respect to borrower inquiries regarding "information related to the servicing" of a federally related mortgage loan. Such action includes providing information requested by the borrower, conducting an investigation of the borrower's concerns, providing an explanation or clarification of the reasons the servicer believes the account is correct and, if necessary, making appropriate corrections to the borrower's account. Upon a violation of Section 6 of RESPA, a borrower may recover actual damages if the loan servicer fails to comply with these provisions and statutory damages if there is a pattern or practice of noncompliance with RESPA by the loan servicer.

Loan servicers would be required to acknowledge receipt of a QWR within 5 days of receipt, versus

the existing 20 day time frame. Actual responses to QWRs would be required within 30 days, versus the existing 60 days, with a possible 15 day extension if the servicer notifies the borrower of the delay and its reason. In addition, servicers would be prohibited from charging fees for responding to a “valid QWR.” A servicer may consider the Mortgage Reform Act’s contemplated shortened time frame burdensome, since many requests involve tracking down a particular document from storage or from a transferor servicer, or information from prior servicers. Indeed, for large servicers with large mail rooms, the risk of QWRs not arriving at the right desk within the right time frame could create material liability. The Mortgage Reform Act, however, would not amend the regulations made pursuant to RESPA that allow a servicer to establish a separate and exclusive office and address for the receipt and handling of QWRs. Because of the potential for substantial penalties for failing to meet the new QWR deadline, any timeline imposed by statute or regulation should be designed to accommodate the most difficult requests rather than the most simple requests. While RESPA provides remedies for violations of Section 6, discussed above, the Bureau would have the additional power under the Consumer Financial Protection Act of 2010 (“CFPA”) to order remedies such as rescinding or reforming contracts, civil money penalties of up to \$1 million per day in some cases, disgorgement for unjust enrichment, and restitution upon violations of federal consumer financial laws, which includes RESPA.

While many—probably the majority—of QWRs are reasonable, the mortgage industry believes that the QWR process sometimes is abused by gadflies who want to harass their servicers, or by attorneys for borrowers who use it as a discovery tool. In fact, servicers have had to expend considerable resources trying to respond to overbroad discovery-type requests that are delivered under the guise of QWRs. The industry had wanted Congress to clarify that a QWR is a request for an explanation concerning how an account has been serviced and why certain charges were imposed, rather than a vehicle for informal discovery, but Congress chose not to clarify the existing requirements.

The Bureau is expressly charged with further describing in regulations what qualifies as a valid

QWR. Since the provision requires the Bureau to prescribe regulations, it would appear that this provision would become effective upon the date of the future regulations. Hopefully, the Bureau will address the industry’s legitimate concerns regarding QWRs.

The Mortgage Reform Act also imposes a set of new servicer requirements under Section 6(k) of RESPA concerning borrowers’ inquiries. According to the new provisions, a servicer of a federally related mortgage may not fail to take “timely action to respond to a borrower’s requests 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.” Since RESPA currently requires a servicer to respond to a QWR within a specified time period, and since this new provision does not reference QWRs, the new “timely response” requirement appears to apply to all requests by the borrower, although this conclusion is far from certain. The requirement to respond to a request related to “other standard servicer’s duties” is similarly ambiguous. Violations of this requirement, like others found in Section 6, could result in the recovery of actual damages and statutory damages if there is a pattern or practice of noncompliance with RESPA by the loan servicer.

In addition, Section 6(k) provides that a servicer (a) may not fail to respond within 10 business days to a request by the borrower to provide the identity, address, and other relevant information about the owner or assignee of a home mortgage loan, and (b) must comply with any other obligation established by the Bureau by regulation. Again, it is unclear whether the timely response to a borrower’s inquiry about a loan’s ownership is triggered by the servicer’s receipt of a QWR, but the response time is clearly shorter than under the QWR process. This is duplicative of information assignees are already obligated to provide mortgage loan borrowers under the Truth in Lending Act (“TILA”). And considering that TILA permits the assignee to designate another person (e.g., the servicer) to respond to questions, this new requirement seems somewhat nonsensical. In short, it is unclear why this provision is necessary to protect the consumer, or why there are significant penalties for

noncompliance when there is no harm to the borrower for noncompliance.

The Mortgage Reform Act permits (but does not require) the Bureau to issue regulations imposing obligations on loan servicers (in addition to those otherwise contemplated in Section 6(k)) as “appropriate to carry out the consumer protection purpose of [RESPA].”

Force Placed Insurance

The Mortgage Reform Act will amend RESPA to prohibit a servicer from obtaining force placed insurance,³ unless there is “a reasonable basis to believe the borrower has failed to comply with the loan contract’s requirements to maintain property insurance.”

But don’t let the open-ended “reasonable basis to believe” standard lull you into thinking that servicers have flexibility. The Act is extremely specific about the process that a servicer must follow before it can form a “reasonable basis to believe” that the borrower has let his or her insurance lapse:

- The servicer would need to send a written notice to the borrower, by first-class mail, containing a reminder of the borrower’s obligation to maintain insurance on the property securing the federally related mortgage. This notice would need to state that the servicer is without evidence of insurance coverage on the property, and explain clearly how the borrower may demonstrate coverage on the property. The notice would have to state that the servicer may obtain the coverage at the borrower’s expense if the borrower does not demonstrate existing coverage in the timely manner.
- Further, a servicer would need to send a second written notice by first class mail at least 30 days after the first notice, with the same required information as the first.

If by the end of the 15 day period after the second notice was sent the servicer has not received from the borrower any demonstration of insurance coverage, then the servicer may impose a charge for force placed insurance.

These requirements in our experience track the practices of most servicers (although some members of the industry have argued that providing second notices is costly, and unnecessary). What might be burdensome is the Mortgage Reform Act’s requirement that a servicer accept any reasonable form of written confirmation from a borrower of existing insurance coverage, including the existing insurance policy number along with the identity of, and contact information for, the insurance company or agent, or as otherwise required by the Bureau.

These new force placed insurance rules would further require that the premium charged to the consumer be “bona fide and reasonable.” The Bureau is not given express authority under the Mortgage Reform Act to define these terms, but is given general authority to prescribe regulations to carry out the consumer protection purposes of RESPA. Again, we would hope that the Bureau would exercise appropriate discretion and issue regulations setting an objective standard for “bona fide and reasonable.”

If the servicer receives confirmation of a borrower’s existing insurance coverage, the servicer must terminate the force placed insurance within 15 days of receipt and refund to the consumer all force placed insurance premiums paid by the borrower during any period of double coverage, and any related fees charged to the borrower’s account in connection with the force placed insurance. Some in the mortgage industry may assert that servicers should not be held responsible for insurance companies’ failures to recognize that the property was doubly covered. Some in the industry also believe it is unfair for a borrower who failed to act on the notices to receive a mandatory refund, even though the force placed insurer was potentially at risk during the period of double coverage. Overall, the force placed insurance provisions appear to penalize servicers who merely seek to protect the note holder’s interests in the security property.

Similar to above, the Bureau is given broad authority to issue regulations that carry out the consumer purpose of RESPA, and to specifically determine what constitutes a reasonable form of written confirmation of insurance to establish that the borrower maintains property insurance, but the Act does not require those regulations. It would be

reasonable for the Bureau to ensure that similar provisions, such as the amendments to RESPA, would have common effective dates to allow systems and compliance processes to be modified by servicers in an orderly fashion.

Escrow Requirements

Regulation Z currently requires the establishment of an escrow account for taxes and insurance for certain “riskier” first-lien loans. For example, under Regulation Z, an escrow account is required for “higher priced loans” (a first-lien loan if the annual percent rate is 1.5 percentage points above Freddie Mac’s Primary Mortgage Market Survey (“PMMS”) for first-lien loans). The Mortgage Reform Act extends this requirement to a broader range of loans, and also expands on it.

Applicability

The new Section 129D of TILA will obligate borrowers of certain “riskier” first-lien loans to escrow funds for the payment of taxes and insurance, and imposes certain requirements on servicers for the administration of these escrow accounts. An escrow account would be mandatory at loan consummation if: (1) required by federal or state law; (2) a loan is made, guaranteed, or insured by a state or federal governmental lending or insuring agency; or (3) a first-lien loan has an annual percentage rate that exceeds the average prime offer rate for a comparable transaction, as of the date the interest rate is set: (a) by 1.5 or more percentage points, in the case of a first-lien residential mortgage loan having an original principal obligation amount that is equal to or less than the Freddie Mac conforming loan amount for a residence of the applicable size, as of the date the interest rate is set; (b) by 2.5 or more percentage points, in the case of a first-lien residential mortgage loan having an original principal obligation amount that is more than the Freddie Mac conforming loan amount for a residence of the applicable size, as of the date the interest rate is set.

Section 129D carves out from this requirement reverse mortgage loans, open-end loans, and any subordinate-lien loans. The Board (and upon transfer of authority, the Bureau) is authorized to exempt from the escrow requirement creditors that operate in rural areas, retain the mortgage in

portfolio, or meet asset or origination size thresholds, as prescribed by regulation. The Board (or the Bureau, upon transfer) is given greater flexibility to revise, add to, or subtract from the types of loans that require mandatory escrows if it is in the interest of consumers and the public. Like Regulation Z, Section 129D also provides a limited exemption for loans secured by shares in a cooperative, or in which an association must maintain a master insurance policy for the property. For these and other loans where an escrow account is not mandated, the Mortgage Reform Act provides that the borrower and lender may mutually agree to escrowing funds for taxes and insurance. Further, the Mortgage Reform Act does not preclude a lender or servicer, at its discretion, from establishing an escrow account if authorized by the loan contract.

Interestingly, consumer advocates and legislators have historically complained that it is inherently unfair for lenders to require borrowers to establish escrow accounts for future tax and insurance obligations. The proposed escrow requirements reflect a marked and continuing shift in public policy to have lenders and servicers act as *parens patriae* for borrowers, rather than assume that borrowers have the ability and discipline to put funds aside to pay the taxes and insurance when they become due.

Duration

There are, of course, legitimate reasons an informed borrower might not want an escrow account, such as the desire to manage cash flow (as might be the case with borrowers who receive bonuses at year end). The new Section 129D and Regulation Z each deal with this differently. Under Section 129D, the mandated escrow account would remain for at least five years unless and until the borrower: (1) has enough equity to no longer meet the requirements of maintaining private mortgage insurance; (2) is delinquent; (3) otherwise has not complied with the legal obligation, as established by rule; or (4) the underlying mortgage establishing the account is terminated. Under Regulation Z, a creditor is permitted, but not required, to offer the borrower the ability to opt out of escrowing funds after 12 months. Thus, a consumer with a mandated escrow account would not be able to opt out of escrow arrangements until, at the earliest, five years under

the new law, subject to certain exceptions described above, and possibly never under Regulation Z, if the creditor disfavors the option.

Administration

Under proposed Section 129D of TILA, there would be substantive regulation of mandated escrow accounts, including maintenance of the account in a federally insured depository institution, administration of the account in accordance with RESPA and the law of the state where the real property securing the loan is located, if applicable, and payment of interest to the consumer if prescribed by applicable federal or state law. So while TILA would not require servicers to pay interest to consumers on their escrow accounts, it would affirm the requirement to do so if required by other applicable federal or state law. Whether intended or not, the Mortgage Reform Act might be construed to subject servicers' noncompliance with state laws regarding the administration of accounts and the payment of interest on escrow accounts to a federal cause of action under TILA.

Finally, under Section 129D of TILA, lenders would be required to deliver to borrowers one type of disclosure if they are required to escrow funds (advising them of that fact), and another type of disclosure if no escrow is provided or if the borrower opts out (advising them of their responsibilities to pay taxes and insurance).⁴ Regulation Z does not currently impose a similar disclosure requirement.

The Board (or Bureau) is authorized to issue regulations that would: exempt creditors from the escrow requirements; revise, add to, or subtract from the types of loans that require mandatory escrows; and require additional information in the disclosures that it deems necessary.

Payoff Statement

Regulation Z currently requires a servicer to deliver "accurate" payoff statements within a reasonable time of a payoff request. Proposed Section 129G would impose the same requirement. However, the proposed new TILA section and Regulation Z differ as to the meaning of "reasonable" and how the borrower's request must be sent. For example, Section 129G requires the servicer to deliver a

payoff statement within seven business days of a written request, while the Commentary to Regulation Z suggests that a reasonable time frame is generally five business days after *any* request, but permits a longer timeline when refinancing volume is high. Hopefully, the Board (or the Bureau) will use its authority in Section 105 in TILA to issue regulations or guidance addressing this inconsistency. Under the Mortgage Reform Act, the Board and Bureau are not expressly required to promulgate implementing regulations for Section 129G.

In addition, RESPA will be amended to require that a servicer credit or return to the borrower any balance in an escrow account that is within the servicer's control within 20 business days of payoff. The Mortgage Reform Act does not specifically require the Bureau to issue implementing regulations on this requirement.

Credit of Payments on Date Received

Proposed Section 129F is identical to Regulation Z's requirements on prompt crediting of payments. They both provide that the obligation to credit a payment on the date received applies only when a delay in crediting would result in a charge or in the reporting of negative information to a consumer reporting agency. Both Section 129F and Regulation Z contemplate that if a servicer specifies in writing requirements for a consumer to follow in making payments, but accepts a payment that does not conform to the requirements, the servicer must credit the payment as of 5 days after the receipt. There is a significant exception to the prompt payment posting rule. The Commentary to Regulation Z obligates a servicer to credit a consumer's full periodic payment as of the date received, but would not require an early payment to be credited before its due date. Significantly, the Commentary also provides that whether a partial payment must be credited depends on the legal contractual obligations between the parties. The combined effect of these various statutory and regulatory provisions is to prohibit servicers from holding a payment that would send a borrower into default or result in a late charge, unless the borrower fails to make that payment in accordance with the terms of the loan documents.

Periodic Statements and Other Servicer Disclosures

The Mortgage Reform Act would amend Section 128 of TILA to require that the servicer, creditor or assignee provide a statement to a borrower of a residential mortgage loan for each billing cycle disclosing the following eight pieces of information (to the extent applicable) in a conspicuous and prominent manner: (1) the remaining principal; (2) the current interest rate; (3) the date of the next interest rate reset or adjustment; (4) the amount of any prepayment fee; (5) a description of any late payment fee; (6) a telephone number and electronic email address that the borrower may use to obtain information regarding the mortgage; (7) the names, addresses, telephone numbers, and Internet addresses of counseling agencies or programs reasonably available to the consumer that have been certified or approved and made publicly available by the Department of Housing and Urban Development or a state housing finance authority; and (8) any other information as the Board may prescribe in regulations. The Mortgage Reform Act requires the FRB to develop and prescribe a standard form for the periodic statement, taking into account that the statements may be transmitted in writing or electronically. The periodic statement requirement will not apply to any fixed rate residential mortgage loan where the servicer, creditor, or assignee provides the borrower with a coupon book that includes substantially the same information as required in the periodic statement, but would apply to adjustable-rate mortgages.

This provision requires the Board (and upon transfer, the Bureau) to prescribe regulations to implement the provision, and it appears that it would become effective upon the date of finalized regulations. Other amendments to TILA, however, do not require implementing regulations. We believe it would be reasonable for the Board (or the Bureau) to ensure that similar provisions, such as the amendments to TILA, would have common effective dates to allow systems and compliance processes to be modified by servicers in an orderly fashion.

New Section 128A of TILA would require additional disclosures with respect to the servicing of a “hybrid adjustable rate mortgage” (a consumer credit transaction secured by the consumer’s

principal residence with a fixed interest rate for an introductory period that adjusts or resets to a variable interest rate after such period).⁵ Under the Mortgage Reform Act, the Bureau is not expressly required to promulgate regulations on the “hybrid adjustable rate mortgage” disclosure, although the Bureau has general authority under Section 105 of TILA to issue regulations and publish model disclosure forms.

Penalties

The Mortgage Reform Act will amend the penalty amounts for violations of Section 6 of RESPA, which includes the provisions on force placed insurance, refunding escrow accounts upon payoff, QWRs and other borrower requests, by increasing (a) the maximum statutory damages from \$1,000 to \$2,000 in the case of a pattern or practice of noncompliance, for both individual and class actions, and (b) the ceiling on the total amount of damages in class actions from \$500,000 to \$1,000,000 (or one percent of the net worth of the servicer, whichever is less).

The Mortgage Reform Act provides penalty coordination with RESPA, stating that any action or omission that constitutes a violation of RESPA for which a person has paid any fine, or other damages, may not give rise to any additional penalty under the escrow provisions, unless the act or omission also constitutes a direct violation of the escrow requirements.

A servicer would also have liability for violations of the new TILA periodic statement (Section 128(f)), escrow account for higher-risk loans (Section 129D), prompt crediting of payments (Section 129F), and timely payoff statement (Section 129G) requirements, although it is not clear whether liability would be limited to administrative penalties. According to the civil penalty provisions of TILA, except as otherwise provided, Section 130 of TILA imposes liability on the creditor, which is defined as the named payee in the note. As such, a servicer who is not the named payee may not be considered to be a creditor. We note, however, that Section 130 would apply to a mortgage originator that is not a creditor if the originator fails to comply with the Mortgage Reform Act’s new requirements (i.e., qualification requirements, unique identifier requirements, anti-steering, restructuring of

compensation). A violation of these sections of TILA would not appear to subject the servicer to special enhanced damages (equal to the sum of all finance charges and fees paid by the consumer), as they are triggered by violations of Section 129, and, as amended by the Mortgage Reform Act, paragraph (1) or (2) of Section 129B(c), or Section 129C(a).

In addition to the remedies describe above, the Bureau will have the authority to enforce RESPA and TILA, and under the CFPA, may order remedies such as rescinding or reforming contracts, civil money penalties, disgorgement for unjust enrichment, and restitution upon violations of these federal consumer financial laws. The CFPA, however, does not appear to provide a private right of action.

Mortgage Resolution and Modification

Home Affordable Modification Program

The Mortgage Reform Act would impose new requirements on Treasury in connection with HAMP that will impact loan servicers. Treasury would be required to amend the HAMP supplemental directives and guidelines to implement these changes, but under no fixed deadline. The Act does not alter a participating servicer's contractual obligation to comply with HAMP, or the contractual remedies for its failure to do so. There is no private right of action under the Mortgage Reform Act for a servicer's noncompliance with HAMP.

In particular, the Mortgage Reform Act would require that Treasury establish and maintain an Internet site that provides a Net Present Value ("NPV") calculator, based on Treasury's methodology for calculating the NPV, that borrowers can use to input their information to determine whether the mortgage would be accepted or rejected for modification under HAMP. While the purpose of providing the NPV is to promote transparency, there is a concern that it could be ripe for abuse and borrower fraud (assuming that borrowers may be tempted to use the NPV calculator to determine NPV positive scenarios, and modify their documentation accordingly). The website would also be required to disclose that each participating servicer may use a method for calculating NPV that is different from the method used by the calculator.

The Mortgage Reform Act would require Treasury to make reasonable efforts to include on a website with the NPV calculator a method for homeowners to apply for a mortgage modification under HAMP. In addition to the NPV test, Treasury would be required to include the methodology and computer model, including all formulae used in the computer model, used for calculating the NPV, and all non-proprietary variables used in the NPV analysis. Treasury has been apprehensive about providing the NPV calculator publicly, even to mortgage counselors, arguing that the sensitivity of the model to certain inputs such as LTV (a value which will likely be different for the borrower and the servicer and that can lead to dramatically different results) leads to a high rate of false positives and false negatives. For servicers, these "false" results may lead to upset borrowers who are more susceptible to sue. Further, although already required under HAMP, the Mortgage Reform Act provides that Treasury must revise its HAMP guidance to require servicers to deliver to each borrower who was denied a modification all borrower-related and mortgage-related input data used in any NPV calculation.

Under the Mortgage Reform Act, a borrower would not be eligible under HAMP if the borrower, in connection with a mortgage or real estate transaction, has been convicted within the last 10 years of any of the following: (a) felony larceny, theft, fraud, or forgery; (b) money laundering; or (c) tax evasion. The Secretary of Treasury must establish procedures to ensure compliance.

Lastly, the Mortgage Reform Act would attempt to ensure that the servicer's HAMP data is publicly available. Not more than 14 days after each monthly deadline that a servicer is required to submit data to Treasury, Treasury would be required to make available to the public, via a report to Congress and the Internet, reports on each servicer regarding the number of modification requests the servicer received, processed, approved, and denied. The Mortgage Reform Act would also require Treasury to make "data tables" available to the public at the "individual record level," which could subject servicers to more scrutiny, and potentially more criticism. Treasury must issue regulations prescribing the procedures for disclosing this data to

the public, which may include deletions, as appropriate, to protect any privacy interest in any modification applicant.

Protecting Tenants At Foreclosure Act

The Mortgage Reform Act would also amend provisions of the Protecting Tenants At Foreclosure Act of 2009 (“PTFA”) which was enacted as part of the Helping Families Save Their Homes Act of 2009. The PTFA created a 90 day, pre-eviction foreclosure notice requirement for tenants in foreclosed properties throughout the country. This section of the Mortgage Reform Act does not expressly require implementation by regulation.

First, in any foreclosure action on a federally related mortgage loan or involving a dwelling or residential real property, the PTFA requires the immediate successor in interest to provide a “bona fide” tenant 90 days’ notice prior to eviction. To be a “bona fide” lease or tenancy: (1) the tenant must not be the mortgagor or a family member thereof; (2) the lease or tenancy must be the result of an arm’s-length transaction; and (3) the lease or tenancy must require rent that is not substantially below fair market, unless it is reduced as the result of a federal, state, or local subsidy. The Mortgage Reform Act does not impact that requirement.

Second, the PTFA provides that a successor in interest of a property assumes interest subject to the rights of certain bona fide tenants. Thus, a new owner of residential rental property who takes title through foreclosure must honor existing “bona fide” leases entered into prior to the date on which notice of foreclosure was given, through the end of the lease term. (Exceptions are made if the tenancy is at will or is not pursuant to a lease, or if there is an existing term lease and (1) the new owner wants to occupy the foreclosed property as his or her personal residence before the end of the lease term; or (2) there are fewer than 90 days before the end of the lease term, such as in a month-to-month lease agreement.)

The Mortgage Reform Act would make two substantive changes to existing requirements. It would remove the qualifier that tenants be bona fide as of the date on which notice of foreclosure is given in order to be entitled to complete their lease terms. It also would clarify that the date on which notice of

foreclosure is given is “deemed to be the date on which complete title to a property is transferred to a successor entity or person as a result of an order of a court or pursuant to provisions in a mortgage, deed of trust, or security deed.” The Mortgage Reform Act also would extend the effective repeal of the PTFA from December 31, 2012, to December 31, 2014.

Conclusion

Loan servicing has long been the subject of customer complaints, many of which are actionable under RESPA, and more recently under Regulation Z. In recent years, however, many of the putative class actions involving servicing have been brought under state unfair and deceptive practices acts because of the lack of coverage under federal law. Generally speaking, these class actions address one of three common issues: the mishandling of payments, the permissibility and timing of specific fees, and the improper imposition of lender placed insurance. A fourth issue giving rise to servicing concerns is limited to the subprime world—namely, the need for tax and insurance escrow accounts to ensure that mortgagors have sufficient funds to pay these obligations. Not surprisingly, the Mortgage Reform Act (and Regulation Z) addresses many of the same issues, but does not generally impose restrictions on servicing fees. Overall, the changes required by the Mortgage Reform Act would not appear to fundamentally alter the nature of the loan servicing business, which is in contrast to the substantial changes the Act imposes on the residential mortgage loan origination side of the business.

[This client alert is part of a series of alerts focused on monitoring financial regulatory reform.](#)

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¹ The Dodd-Frank Act, which has been making its way through Congress over the past year, is not yet law. The bill that emerged from the conference committee on June 25 passed the House of Representatives on June 30. Senate Majority Leader Harry Reid stated that the Senate will vote on the measure in the near future. Although the vote is likely to be close—supporters may get exactly the 60 they need to avert a filibuster—Chairmen Dodd and Frank are publicly confident that the President will sign the bill by mid-July.

² Jonathan Jaffe and Kerri M. Smith, *Imposing Material Liabilities on Servicers and Investors for Immaterial Mistakes*, Mortgage Banking & Consumer Credit Alert, March 10, 2008, available at:

<http://www.klgates.com/newsstand/Detail.aspx?publication=4460>

³ Under the Mortgage Reform Act, force placed insurance is defined as hazard insurance coverage obtained by a servicer of a federally related mortgage when the borrower has failed to maintain or renew hazard insurance on such property as required of the borrower under the terms of the mortgage.

⁴ The notice advising borrowers that an escrow fund is mandated must include:

- The fact that an escrow will be established at consummation of the transaction.
- The amount required at closing to initially fund the escrow account.
- The amount, in the initial year, of the estimated taxes and hazard insurance and any other required periodic payments or premiums that reflect the taxable assessed value of the real property securing the transaction, including the value of any improvements on the property or to be constructed on the property (whether or not such construction will be financed from the proceeds of the transaction).

- The estimated monthly amount payable for taxes, hazard insurance and any other required periodic payments or premiums.
- The fact that if the consumer chooses to terminate the account in the future, the consumer will become responsible for the payment of all taxes, hazard insurance, and flood insurance, if applicable, as well as any other required periodic payments or premiums on the property unless a new escrow or impound account is established.
- Such other information as the Board determines necessary for the protection of the consumer.

The notice advising the borrower of her responsibilities to pay taxes and insurance if no escrow is provided or if the borrower opts out must include:

- Information concerning any applicable fees associated with the subsequent closure of any such account.
- A clear and prominent notice that the consumer is responsible for personally and directly paying the non-escrowed items, in addition to paying the mortgage loan payment, in the absence of any such account, and the fact that the costs for taxes, insurance, and related fees can be substantial.
- A clear explanation of the consequences of any failure to pay non-escrowed items, including the possible requirement for the forced placement of insurance by the creditor and the potentially higher cost (including any potential commission payments to the servicer) or reduced coverage for the consumer in the event of any such creditor-placed insurance.
- Such other information as the Board determines necessary for the protection of the consumer.

⁵ According to Section 128A of TILA, during the one-month period that ends 6 months before the date on which the interest rate in effect during the introductory period of a hybrid adjustable rate mortgage adjusts or resets to a variable interest rate (assuming no reset within the first six months), the servicer must provide a written notice, separate and distinct from all other correspondence to the consumer, that includes the following: (1) Any index or formula used in making adjustments to or resetting the interest rate and a source of information about the index or formula; (2) An explanation of how the new interest rate and payment would be determined, including an explanation of how the index was adjusted, such as by the addition of a margin; (3) A good faith estimate, based on accepted industry standards, of the creditor or servicer of the amount of the monthly payment that will apply after the date of the adjustment or reset, and the assumptions on which this estimate is based; (4) A list of alternatives consumers may pursue before the date of adjustment or reset, and descriptions of the actions consumers must take to pursue these alternatives, including: (A) refinancing; (B) renegotiation of loan terms; (C) payment forbearances; and (D) pre-foreclosure sales; (5) The names, addresses, telephone numbers, and Internet addresses of counseling agencies or programs reasonably available to the consumer that have been certified or approved and made publicly available by HUD or a state housing finance authority; and (6) The address, telephone number, and Internet address for the state housing finance authority for the state in which the consumer resides.