United States Senate, Committee on Banking, Housing and Urban Affairs

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"Housing Finance Reform: Essentials of a Functioning Housing Finance System for Consumers"

By
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Good morning Chairman Johnson, Ranking Member Crapo, and members of the Banking Committee.

My name is Larry Platt. I am a consumer finance lawyer at the global law firm, K&L Gates, LLP. I have been involved in housing finance issues for over 30 years. Thank you for allowing me to participate in the consideration of this important subject. I am appearing today in my personal capacity and not on behalf of either my law firm or any client of my law firm. All views expressed today are my own.

I have been asked to discuss whether the Housing Finance Reform and Taxpayer Protection Act of 2013 (the "Proposed Act") should impose stringent loss mitigation standards on servicers and owners of securitized residential mortgage loans for the benefit of consumers. Mortgage loan servicers are independent contractors, which for a fee paid by the mortgage investor pursuant to a servicing agreement, collect and remit mortgage loan payments and enforce the mortgage loan documents.

I understand that the Proposed Act presently addresses loan servicing in two ways. First, a newly created Federal Mortgage Insurance Company ("FMIC") would establish servicing standards for the residential mortgage loans within its purview. Second, a uniform securitization agreement with uniform servicing standards would be created for use by the FMIC and potentially by investors in private securitizations. Neither provision presently imposes detailed loss mitigation requirements for the benefit of borrowers in default. I believe the newly enacted loan servicing regulations of the Consumer Financial Protection Bureau are sufficient for this purpose and no new law is required.

Over the last four years, the federal government has imposed increased obligations on residential mortgage loan servicers to avoid home foreclosures. For example, in March 2009, the U.S. Department of Treasury implemented President Obama's Home Affordable Modification Program requiring eligible borrowers to be provided loan modifications for loans originated prior to the financial crisis. The federal banking agencies imposed loss mitigation obligations on the 14 banks that signed servicing-related consent orders in 2011. Fannie Mae and Freddie Mac expanded the loss mitigation requirements in their new default servicing guidelines in 2011. The April 2012 global foreclosure settlement between and among the five largest banks, the Department of Justice, 49 state attorneys general and various other branches of federal and state government incorporated detailed default loan servicing standards, including loss mitigation requirements.

Drawing on all of these initiatives as well as provisions in the Dodd Frank Act, the Consumer Financial Protection Bureau (the "CFPB") earlier this year promulgated final loan servicing regulations (the "CFPB Regulations") that take effect in January 2014. Of course, there is a myriad of new state laws also requiring servicers to offer loss mitigation to delinquent borrowers, including California's recent Homeowner's Bill of Rights, which codifies into state law various provisions from the global foreclosure settlement's national servicing standards. The result is that defaulting borrowers

already have or will have significant government protections to seek to avoid foreclosure under federal law.

The CFPB Regulations are complex and comprehensive. They materially expand the national standards for the residential mortgage servicing industry by amending Regulation X under the Real Estate Settlement Procedures Act ("RESPA") and Regulation Z under the Truth in Lending Act ("TILA") on nine major topics.[1] Enforcement by the CFPB and in some cases by individual consumers in private rights of action ensures that the new provisions have sharp teeth.

The CFPB Regulations directly address common complaints of consumers and regulators that led to claims of wrongful or unfair foreclosures. Imposing procedural requirements for responding to written information requests or complaints of errors is one example. The rule requires servicers to comply with the error resolution procedures for ten types of errors:

- Failing to accept a conforming payment;
- Failing to apply an accepted payment;
- Failing to credit a payment to a borrower's account in violation of TILA requirement;
- Failing to pay taxes and insurance in a timely manner as required by RESPA or failing to refund an escrow account balance;
- Imposing a fee or charge that the servicers lacks a reasonable basis to impose upon a borrower (i.e., not bona fide fees);
- Failing to provide an accurate payoff balance;
- Failing to provide accurate information regarding loss mitigation and foreclosure (in accordance with other provisions of the rule);
- Failing to transfer accurately and timely information to transferee servicer;
- Making the first notice or filing for foreclosure in violation of other provisions of the RESPA rule;
- Moving for foreclosure judgment or sale in violation of other provisions of the RESPA rule; or
- Any other error relating to the servicing of a consumer's mortgage loan.

[1]The nine major topics included in the final rule are:

1. Periodic Billing Statements
2. Interest Rate ARM Adjustments
3. Payment Crediting and Payoff
4. Force-placed Insurance
5. Error Resolution and Requests for Information
6. General Servicing Policies and Procedures
7. Early Intervention Continuity of Contact
8. Loss Mitigation

Establishing or making good-faith efforts to establish live contact with borrowers by the 36th day of their delinquency and promptly informing such borrowers, where appropriate, that loss mitigation options may be available is a second requirement of residential mortgage servicers. This early intervention requirement also mandates that a servicer provide a borrower a written notice with information about loss mitigation options by the 45th day of a borrower's delinquency.

A third requirement under the CFPB Regulations is continuity of contact with delinquent borrowers, commonly referred to as "single point of contact." This requires residential mortgage servicers to maintain reasonable policies and procedures to provide delinquent borrowers with access to designated personnel to assist them with loss mitigation options where applicable.

Residential mortgage servicers also are required to follow certain procedural requirements regarding their evaluation of borrowers for loss mitigation under the CFPB Regulations. "Dual tracking" (where a servicer is simultaneously evaluating a consumer for loan modifications or other alternatives at the same time that it prepares to foreclose on the property) is prohibited. Loss mitigation requirements include:

- If a borrower submits an application for a loss mitigation option, acknowledging the receipt of the application in writing within five days and informing the borrower whether the application is complete and, if not, what information is needed to complete the application.
- Exercising reasonable diligence in obtaining documents and information to complete the application.
- For a complete loss mitigation application received more than 37 days before a foreclosure sale, evaluating the borrower within 30 days for all loss mitigation options for which the borrower may be eligible in accordance with the investor's eligibility rules.
    - This includes both options that enable the borrower to retain the home (such as a loan modification) and non-retention options (such as a short sale).
    - Servicers are free to follow "waterfalls" established by an investor to determine eligibility for particular loss mitigation options.
- Providing the borrower with a written decision, including an explanation of the reasons for denying the borrower for any loan modification option offered by an owner with any inputs used to make a net present value calculation to the extent such inputs were the basis for the denial.
- Authorizing a borrower to appeal a denial of a loan modification program so long as the borrower's complete loss mitigation application is received 90 days or more before a scheduled foreclosure sale.
- Prohibiting a servicer from making the first required foreclosure notice or filing until a mortgage loan account is more than 120 days delinquent.

- Even if a borrower is more than 120 days delinquent, prohibiting a servicer from starting the foreclosure process if a borrower submits a complete application for a loss mitigation option before a servicer has made the first required foreclosure notice or filing unless:
    - The servicer informs the borrower that the borrower is not eligible for any loss mitigation option (and any appeal has been exhausted);
    - A borrower rejects all loss mitigation offers; or
    - A borrower fails to comply with the terms of a loss mitigation option.
- If a borrower submits a complete application for a loss mitigation option after the foreclosure process has commenced but more than 37 days before a foreclosure sale, prohibiting a servicer from moving for a foreclosure judgment or order of sale, or conduct a foreclosure sale, until one of the same three conditions has been satisfied.

The CFPB went to great pains to focus on the procedures that need to be followed rather than on the result in any one case. <u>The CFPB Regulations do not require servicers to offer specific forms of loss mitigation at all or on any specific terms</u>. During the notice and comment period for the CFPB Regulations, many consumer advocacy groups asked the CFPB to (i) mandate specific home-saving strategies, with affordable loan modifications ranked first and with an order of priority among types of modifications; (ii) require all servicers to offer affordable, net present value-positive loan modifications to qualified homeowners facing hardship; and (iii) establish rules for determining what constitutes an affordable modification by establishing a maximum or target debt-to-income ratio. The CFPB declined to be this prescriptive. The preamble to the final CFPB Regulations explains why.

In deciding to reject prescribed modifications, the CFPB focused on the nature of a mortgage loan, the legitimate needs of mortgage investors, the difficulty in developing a "one size fits all" approach, and the potential impact on credit availability. For example, the CFPB acknowledged that, as with any secured lending, those who take the credit risk on mortgage loans do so in part in reliance on their security interest in the collateral. Indeed, what separates lower-interest residential mortgage loans from higher-interest unsecured consumer loans is that a mortgage loan is secured by the borrower's home. While it may be in the interest of the holder to explore loss mitigation alternatives, foreclosure needs to remain a viable option.

Different creditors, investors, and guarantors have differing perspectives on how best to achieve loss mitigation, explained the CFPB, based in part on their own individual circumstances and structures and in part on their market judgments and assessments. The CFPB did not believe it presently could develop rules that are sufficiently calibrated to protect the interests of all parties involved in the loss mitigation process. Expressing its concern that an attempt to do so may have unintended negative consequences for consumers and the broader market, the CFPB concluded that mandating specific loss mitigation programs or outcomes might adversely affect the housing market and the ability of consumers to access affordable credit.

The CFPB emphasized that overreaching loss mitigation requirements could have a material adverse impact on the availability and cost of credit. It speculated that creditors who were otherwise prepared to assume the credit risk on mortgages might be unwilling to do so or might charge a higher price (interest rate) because they would no longer be able to establish their own criteria for determining when to offer a loss mitigation option in the event of a borrower's default. Purchasers of whole loans and mortgage-backed securities might similarly reduce their purchases or prices, posited the CFPB, which could result in creditors charging higher interest rates to maintain the same yield. The burden of complying with prescribed criteria for evaluating required loss mitigation outcomes could substantially increase the cost of servicing. Under these circumstances, the CFPB declined to prescribe specific loss mitigation criteria and instead required servicers to maintain policies and procedures reasonably designed to identify all available loss mitigation options of their principals and properly consider delinquent borrowers for all such options.

Other federal agencies have shared in this public policy reluctance to obligate specific loss mitigation outcomes. On August 28, 2013, a consortium of U.S. banking, housing, and securities regulators (the "Agencies") re-proposed the joint regulations to implement the risk retention rules under Section 15G of the Securities Exchange Act of 1934, including the exemption for "Qualified Residential Mortgages." When first proposed in 2011, the Agencies conditioned the "Qualified Residential Mortgage" exemption on the inclusion of loss mitigation requirements in the underlying mortgage loan documents. Specifically, the proposed provision called for the "Qualified Residential Mortgage" loan documents to require the servicer to take loss mitigation actions, such as engaging in loan modifications, in the event the estimated net present value of such action exceeds the estimated net present value of recovery through foreclosure, without regard to whether the particular loss mitigation action benefits the interests of a particular class of investors in a securitization. Several commentators objected to this proposal, which effectively would have given a defaulting borrower a contract right to a permanent principal reduction regardless of the willingness of the loan owner to do so at the time of the default. In the re-proposal the Agencies abandoned this requirement.

Other than requiring servicers to offer specific forms of loss mitigation on specific terms, it is not clear what more the Proposed Act would or could do in the area of loss mitigation. The CFPB and the Agencies explicitly rejected this approach in their 2013 rulemaking activities. Issued pursuant to notice and comment rulemaking, the robust requirements of the CFPB Regulations go live in a little over two months. While I may not agree with all of the provisions in the CFPB Regulations, they were fully vetted and reflect substantial input of virtually all interested stakeholders. Given the potential for the undesired consequences identified by the CFPB if its regulations were to mandate loss mitigation outcomes on mortgage loan investors, I believe the Proposed Act does not need to impose additional loss mitigation requirements for the benefit of consumers.

Thank you again for the opportunity to appear today.