News Bulletin

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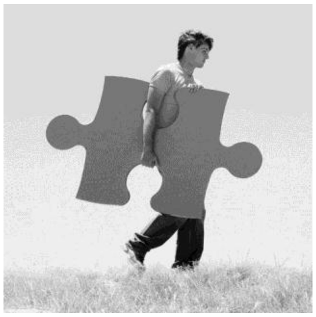

CFPB Proposes National Mortgage Servicing Rules

On August 10, 2012, the U.S. Bureau of Consumer Financial Protection (the "CFPB") released two proposed rules (the "Proposed Rules") intended to implement the mortgage servicing provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") enacted in July 2010. If adopted, the Proposed Rules would impose a broad new set of uniform loan servicing requirements on residential mortgage servicers across the U.S.

The first Proposed Rule (the "TILA Proposal")[1] consists of proposed amendments to Regulation Z,[2] the federal regulation that implements the Truth in Lending Act ("TILA").[3] The TILA Proposal would prescribe the information borrowers receive about their mortgage loans, and would require servicers to provide borrowers with regular statements that include a breakdown of payments by principal, interest, fees, and escrow, the amount of and due date of the next payment, recent transaction activity and warnings about fees. Servicers would also be required to provide earlier disclosures before the interest rate adjusts on adjustable-rate mortgages ("ARMs") and to provide increased borrower protections if the servicer purchases "force-placed" property insurance. The TILA Proposal would also require servicers to make "good faith efforts" to contact delinquent borrowers and inform them of their options to avoid foreclosure.

The second Proposed Rule (the "RESPA Proposal")[4] consists of proposed amendments to Regulation X,[5] the federal regulation that implements the Real Estate Settlement Procedures Act of 1974 ("RESPA).[6] The RESPA Proposal would impose requirements for handling borrowers' accounts, correcting errors and evaluating borrowers' options to avoid foreclosure. Servicers would be required to promptly credit payments, establish policies and procedures to maintain accurate and accessible documents and information, acknowledge the receipt of a notification of a potential error, investigate and inform the borrower of the resolution, and provide delinquent borrowers with direct and ongoing access to the servicer's employees. A servicer would also be prohibited from proceeding with a foreclosure sale until it has completed a review of the borrower's application for other loss mitigation options.

Comments on the Proposed Rules are due by October 9, 2012. The CFPB expects to issue final mortgage servicing rules by January 2013. The final rules would apply on a prospective basis only, and are expected to include an implementation schedule to permit servicers time to effect required changes to their systems and procedures.

[1] The TILA Proposal can be accessed at http://files.consumerfinance.gov/f/201208_cfpb_tila_proposed_rules.pdf.
[2] 12 CFR Part 226.
[3] 15 U.S.C. 1601 *et seq*.
[4] The RESPA Proposal can be accessed at http://files.consumerfinance.gov/f/201208_cfpb_respa_proposed_rules.pdf.
[5] 24 CFR Part 3500.
[6] 12 U.S.C. 2601-2617.

This client alert discusses the background of the Proposed Rules, provides a summary of the TILA Proposal and the RESPA Proposal, and concludes with some thoughts on the impact of the Proposed Rules on the servicing industry.

Background of the Proposed Rules

The Proposed Rules are the latest manifestation of the extraordinary federal and state regulatory attention to servicer practices triggered by the financial crisis. In the proposal, the CFPB recites a variety of concerns, arguing that servicers have routinely filed foreclosure documents without proper affidavits or notarizations, failed to ensure that proper endorsements and assignments were obtained, failed to devote sufficient resources to servicing activities, and failed to maintain adequate oversight and control over internal processes and external service providers. The CFPB issued a set of comprehensive servicing guidelines in 2011 to address several of these concerns. In addition, regulators have engaged in significant enforcement actions, including an April 2011 OCC/FRB action against 8 major servicers and, more recently, the February 2012 National Mortgage Settlement between 5 major servicers and a host of federal and state authorities. The Proposed Rules would build on many of the themes in these settlements and apply them broadly across the industry.

Overview

The division of the Proposed Rules into two separate proposals reflects the approach adopted by Congress in enacting the Dodd-Frank Act. The Dodd-Frank Act frames its servicing reforms as distinct amendments to TILA and RESPA. Sections 1418, 1420 and 1464 of the Dodd-Frank Act each adds new sections to TILA addressing notices for ARMs, periodic statements, and prompt crediting of mortgage loan payments and provision of payoff statements. Section 1463 of the Dodd-Frank Act amends RESPA to require increased borrower protections with respect to force-placed property insurance, error resolution, and responding to borrower requests for information. Section 1463 also provides the CFPB with broad authority to adopt additional servicing regulations it finds "to be appropriate to carry out the consumer protection purposes of [the Dodd-Frank Act]."

The Dodd-Frank Act provides that its mortgage servicing provisions will become effective automatically on January 21, 2013 if final rules to implement the provisions are not issued on or before that date. Accordingly, it is important to the mortgage servicing industry that final rules be adopted before the January 2013 deadline to ensure the availability of the delayed implementation schedule expected to be included in the Proposed Rules.

The Proposed Rules represent only one of a number of significant rulemakings currently underway at the CFPB involving both disclosures and substantive lending practices. In July, as part of its "Know Before You Owe" initiative, the CFPB issued a proposal to integrate the origination-related disclosures required under RESPA and TILA and to expand the current definition of the TILA "finance charge." Moreover, proposals are currently under consideration to expand the loan originator compensation restrictions adopted by the Federal Reserve Board in 2011, to implement "ability to repay" provisions that would include a controversial definition of a "qualified mortgage," and to establish new rules governing the appraisal process. In their totality, these proposals, when finalized, will completely revamp federal law governing mortgage disclosure and lending practices.

Summary of the TILA Proposal

The TILA Proposal would amend Regulation Z to implement sections 1418 (initial ARM interest rate adjustment), 1420 (periodic statements) and 1464 (prompt crediting of payments and provision of payoff statements) of the Dodd-Frank Act. The new rules would generally apply to closed-end mortgage loans, except that the prompt crediting and payoff statement requirements would apply to both closed-end and open-end loans.

Periodic Billing Statements. The Dodd-Frank Act generally mandates that servicers of closed-end residential mortgage loans must send a periodic statement for each billing cycle. Virtually all residential mortgage loans in the U.S. provide for monthly payments, so this provision in effect requires the provision of monthly statements to borrowers. The TILA Proposal sets forth the timing, form, and content requirements for periodic billing statements and contains sample forms that servicers may use.

These statements would have to include, among other things:

- A summary of the mortgage loan terms such as the interest rate and the amount of principal owed;
- A breakdown of payment amounts into principal, interest, fees, and escrow;
- The amount and due date of the next payment;
- Recent transaction activity, including an itemization of fees and charges; and
- Late fee warnings.

The periodic statement requirement generally would not apply to fixed-rate loans if the servicer provides the borrower a coupon book, so long as the coupon book contains certain information specified in the rule and certain other information is made available to the borrower. The proposal would exempt reverse mortgages and timeshare loans from the periodic billing statement requirement in accordance with exemptions included in the statute. The proposal also includes an exemption for servicers that service 1,000 or fewer mortgage loans and service only mortgage loans that they originated or own.

ARM Interest Rate Adjustment Notices. Existing disclosure requirements for ARM interest rate adjustments require a prescribed adjustment notice at least 25 but no more than 120 days before a payment at a new level is due. These provisions would be revised to expand required disclosures and to require servicers to provide earlier disclosure in advance of interest rate adjustment for most ARMs. Servicers would have to provide a borrower whose mortgage has an adjustable rate with a notice 60 to 120 days before an adjustment which causes the payment to change. The servicer would also have to provide an earlier notice 210 to 240 days prior to the first rate adjustment. This first notice may contain an estimate of the rate and payment change. Other than this initial notice, servicers would no longer be required to provide an annual notice if a rate adjustment does not result in an increase in the monthly payment. The proposal contains sample forms that servicers could use as models for their notices.

These new disclosures would include:

- An explanation of how the new interest rate and payment will be determined and when the adjustment will take effect;
- A good-faith estimate of the amount of the new loan payment;
- The date of future interest rate adjustments;
- A list of alternatives that the borrower may pursue if the new loan payment is unaffordable;
- Information on how to contact housing counselors; and
- The amount of any prepayment penalty.

Prompt Crediting of Payments and Provision of Payoff Amounts. As provided in the Dodd-Frank Act, the TILA Proposal requires servicers to promptly credit loan payments from borrowers, generally on the day of receipt. If a servicer receives a payment that is less than a full contractual payment, the servicer may hold the payment in a suspense account. When the amount in the suspense account covers a full installment of principal, interest, and escrow (if applicable), the proposal would require the servicer to apply the funds to the earliest delinquent payment owed. Fees owed to the servicer may not stop the crediting of payments. A servicer would also be required to send an accurate payoff balance to a borrower no later than 7 business days after the servicer receives a written request from the borrower for the payoff amount.

Summary of the RESPA Proposal

The RESPA Proposal would amend Regulation X to implement Section 1463 of the Dodd-Frank Act with respect to force-placed insurance, error resolution and responding to borrower requests for information. The RESPA Proposal also contains a number of provisions not specifically mandated by the Dodd-Frank Act, but proposed by the CFPB pursuant to the broad rulemaking authority accorded it under the Act. These include the provisions described below that would require services to establish reasonable information management policies and procedures; undertake early intervention with delinquent borrowers; provide delinquent borrowers with continuity of staff contact; and, in certain cases, follow prescribed procedures when evaluating loss mitigation applications.

"Force-Placed" Insurance. As required by the Dodd-Frank Act, the RESPA Proposal would prohibit a servicer from charging a borrower for force-placed insurance coverage unless the servicer has a reasonable basis to believe the borrower has failed to maintain hazard insurance and the servicer has provided required notices. One notice to the borrower would be required at least 45 days before charging for forced-place insurance coverage, and a second notice would be required no earlier than 30 days after the first notice. The proposal contains model forms that servicers may use for these notices.

If a borrower provides proof of hazard insurance coverage, the servicer would be required to cancel any force-placed insurance policy and refund any premiums paid for periods in which the borrower's policy was in place. The service would be required to accept from the borrower any reasonable form of confirmation that the mortgaged property is insured. In addition, if a servicer makes payments for hazard insurance from a borrower's escrow account, the servicer would be required to continue making payments under the borrower's policy rather than force-placing a separate policy, even if there are insufficient funds in the escrow account for the separate policy. The Proposed Rules would also provide that, with limited exceptions, charges related to force-placed insurance must relate to a service that was actually performed. Additionally, such charges would have to bear a reasonable relationship to the servicer's cost of providing the service.

Early Intervention with Delinquent Borrowers. The RESPA Proposal would require servicers to make good-faith efforts to contact delinquent borrowers and inform them of loss mitigation options, including options to help avoid foreclosure. Specifically, if a borrower is 30 days late, the servicer would be required to make a good faith effort to notify the borrower orally and to let the borrower know that loss mitigation options may be available. If the borrower is 40 days late, the servicer would be required to provide the borrower with a written notice with certain specific information, including examples of loss mitigation options available, if applicable, and information on how to obtain more information about loss mitigation options. The notice would also provide information to the borrower about the foreclosure process. The proposal also contains model language servicers may use for these notices.

Information Management Policies and Procedures. Servicers would be required to establish reasonable information-management policies and procedures designed to improve operations, minimize errors and facilitate prompt error correction. The reasonableness of a servicer's policies and procedures would take into account the servicer's size, scope, and nature of its operations. A servicer's policies and procedures would satisfy the rule if the servicer complies with the document retention and servicing file requirements and achieves certain other objectives specified in the rule. Examples of such objectives include providing accurate and timely information to borrowers and the courts and enabling servicer personnel to have prompt access to documents and information submitted in connection with loss mitigation applications. In addition, a servicer must retain the records relating to each mortgage loan until one year after the loan is discharged or servicing is transferred to another servicer, and must create a mortgage servicing file for each loan containing certain specified documents and information.

Error Resolution and Information Requests. As provided in the Dodd-Frank Act, the RESPA Proposal would require servicers to satisfy certain procedural requirements for responding to information requests from borrowers or borrower notifications of errors. A borrower could assert an error either orally or in writing. Servicers could designate a specific phone number and address for borrowers to use for error notices. A servicer would be required to acknowledge the request or complaint within five days of receipt. The servicer would have to correct the error or respond to the borrower with the results of the investigation, generally within 30 to 45 days. Shorter timeframes would be imposed with respect to errors relating to foreclosures or payoffs. Further, servicers generally would be required to promptly acknowledge borrower requests for information and either provide the requested information or explain why the information is not available within either 10 or 30 days depending on the type of request. A servicer would not, however, be required to delay a scheduled foreclosure sale to consider a notice of error unless the error relates to the servicer's improperly proceeding with a foreclosure sale during a borrower's evaluation for alternatives to foreclosure. The proposal defines nine specific categories of claims which constitute an error, including:

- Failure to accept or to promptly or properly apply payments;
- Assessing an improper fee;
- Payments (or non-payments) of taxes and insurance out of escrow accounts;
- Failure to provide accurate payoff balances upon request;
- Inaccurate information about how a borrower can avoid foreclosure; and
- The servicer proceeding with a foreclosure sale when the borrower is in the process of being evaluated for, appealing a decision about, or performing under, a loss mitigation option.

Continuity of Contact with Delinquent Borrowers. The RESPA Proposal would require servicers to provide delinquent borrowers with direct, ongoing access to staff who are dedicated to assisting borrowers with loss mitigation options, including options to avoid foreclosure. The proposal would require servicers 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's personnel perform certain specified functions where applicable, such as accessing the borrower's records and providing the borrower with information about how to apply for a loss mitigation option and inquire about the status of a loss mitigation application. Servicers would also be required to provide contact personnel access to underwriters who could evaluate whether the borrower is eligible for a loan modification or another option to avoid foreclosure. Servicers would be required to continue to follow these procedures until a loss mitigation plan is finalized, the borrower pays off the loan, or title is transferred by short sale, deed–in-lieu, or foreclosure.

Loss Mitigation Procedures. Servicers that offer loss mitigation options to borrowers would be required under the RESPA Proposal to implement procedures to ensure that complete loss mitigation applications are reasonably evaluated before proceeding with a scheduled foreclosure sale. The framework is quite similar to that provided for under Regulation B in connection with the original underwriting of requests for credit. The proposal would require servicers to exercise reasonable diligence to secure information or documents required to make an incomplete loss mitigation application complete. In certain circumstances, this could include notifying the borrower within five days of receiving an incomplete application. Within 30 days of receiving a borrower's complete application, the servicer would be required to evaluate the borrower for all available options and notify the borrower of its determination. If a servicer's denial pertains to a requested loan modification, the servicer must 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.

The proposal would require that appeals be decided within 30 days by different personnel than those responsible for the initial decision on the application. A servicer that receives a complete application for a loss mitigation option could not proceed with a foreclosure sale unless (i) the servicer had denied the borrower's application and the time for any appeal had expired; (ii) the servicer had offered a loss mitigation option which the borrower declined or failed to accept within 14 days of the offer; or (iii) the borrower failed to comply with the terms of a loss mitigation agreement.

The RESPA Proposal would require that the deadline for submitting a loss mitigation application be no earlier than 90 days before a scheduled foreclosure sale.

Implementation

The statutory provisions of the Dodd-Frank Act take effect on January 21, 2013 unless final rules are adopted on or before that date. The CFPB is permitted to make such rules effective up to 12 months after they are issued. In the proposal, the CFPB indicates that it believes that the rules should take effect as quickly as possible given the problems that have been identified with servicing practices. At the same time, the CFPB recognizes that the final rules will involve a variety of changes to existing practices at many companies. Accordingly, it has solicited detailed comment on the nature and length of the implementation process to assist it in establishing the final effective date.

Conclusion

As noted earlier, the Proposed Rules are but one of many new requirements that will challenge industry technology, operational and compliance efforts for the foreseeable future. Much has been made of the argument that the industry failed to devote sufficient resources to servicing in the past. Implementing and complying with the new requirements will demand such resources going forward and reward those entities capable of making the required investment. Servicers will be forced to revise existing disclosures and develop new ones. Moreover, they will be required to develop and maintain significant new policies and procedures and hire the staff necessary to effectuate them. The Bureau has attempted to mitigate the impact on very small entities by exempting from the periodic statement requirement entities that service 1,000 or fewer loans that they own or that were initially payable to them. Nevertheless, given the weight of compliance responsibilities that would result from the Proposed Rules coupled with the extraordinary regulatory and reputational risks associated with shortfalls, it is difficult to see how the Proposed Rules cannot fuel further industry consolidation in this area.

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