

# Loss Mitigation: Fair Lending Implications in Servicing and Modifications

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# Overview

- Unprecedented levels of defaults and foreclosures have triggered heightened scrutiny of mortgage loan servicing by government agencies, legislators, consumer rights organizations, and private litigants.
  - Traditional enforcers (FTC, HUD, and State AGs).
  - Newer enforcers (DOJ's Fair Lending Unit, Office of the United States Trustee, Obama Administration's Financial Fraud Enforcement Task Force).
- Key legal and regulatory themes in servicing arena include:
  - Continued focus on unfair and deceptive servicing practices, particularly regarding loans in default.
  - New focus on “fair servicing” for protected classes, including loan modifications, foreclosures, and short-sales.

# Fair Servicing: The New Frontier

- Foreclosure crisis is seen as hitting minority communities harder.
- Significant public pressure to ensure that borrowers who are members of racial/ethnic minority groups have a fair opportunity to prevent foreclosure.
- Legislators and private parties pressing for public release disaggregated HAMP modification data.

# Fair Servicing: The New Frontier (cont.)

- Consumer advocacy groups shifting focus to race disparities in workouts.
  - Recent NCRC study suggests that among HAMP eligible borrowers 36.4% of white borrowers received loan modification approvals in contrast to 32.3% of Hispanic and 24.3% of African American borrowers.\*
- Studies are likely to serve as a springboard for private litigation alleging servicers engaged in discrimination with respect to servicing and modification practices. *See, e.g., Bojorquez v. Gutierrez*, 2010 WL 2925154 (N.D. Cal. Jul. 26, 2010).

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\* National Community Reinvestment Coalition, HAMP Mortgage Modification Survey 2010 (April 2010).

# Fair Servicing: The New Frontier (cont.)

- Significant factual impediments to the viability of fair servicing actions, but same challenges make self-policing difficult.
  - Servicers rarely have race and ethnicity data as a matter of course.
  - High non-compliance by borrowers with HAMP race data collection.
  - Numerous challenges to useful and reliable statistical analysis.
  - Borrower comparisons may be difficult. *All loan applicants want a loan, but all delinquent borrowers may not want to stay in homes.*

# Fair Servicing: The New Frontier (cont.)

- Discretion is a double-edged sword with respect to success of modification programs.
  - Some of the servicers with the most successful modification programs provide greatest discretion for customer service and workout personnel.
  - Historically, discretion has been used against financial institutions by regulators in fair lending context.
    - If past is prologue, the greater the level of discretion, the higher the potential for race-based disparities in outcomes.
  - Discretion will be key area of focus.

# Unfair and Deceptive Practices: State AGs

- Regulators also more generally challenging the sufficiency of workout procedures and other foreclosure prevention measures.
- State Attorneys General very active with respect to investigations and related litigation. Allegations of unfair and deceptive trade practices are primary legal vehicle in enforcement actions.
  - Ohio AG recently sued three mortgage loan servicers asserting that loan modification practices were unfair and deceptive.
  - Texas AG filed suit against major servicer in September 2010 challenging collection and processing of payments. Also alleged that servicer's modification practices failed to help enough borrowers.
- “Justice” being “Outsourced” with State AGs retaining private plaintiffs' firms on contingency fee basis.

# Unfair and Deceptive Practices: State AGs

- State AG activity will continue to rise.
  - US Supreme Court's *Clearing House* decision held states may enforce state law against national banks using judicial process (i.e., litigation).
  - Dodd-Frank Act repeals preemption for banks and expressly authorizes State AGs to enforce federal laws covered by new federal agency (ECOA, TILA, RESPA, etc).
  - Omnibus Appropriations Act of 2009 authorizes State AGs to enforce forthcoming FTC mortgage loan rules and TILA.
- State legislators are rapidly moving to enact new servicing legislation, often with little research. Will cause myriad compliance and enforcement complications.

# Unfair and Deceptive Practices: The FTC

- Federal Trade Commission continues to lead the charge against servicers building on landmark consent decrees involving Fairbanks and EMC Mortgage.
- Consent decree entered in *FTC v. Countrywide Home Loans, Inc.* (June 2010) focuses on default-related fees, use of affiliates, and procedures for bankrupt borrowers.
  - Unprecedented restrictions on default and bankruptcy servicing.
- Largest FTC settlement in a mortgage servicing case - \$108 million.

# Unfair and Deceptive Practices: The Road Ahead

- Foreclosure filings current hot button issue.
  - Being challenged by government regulators, judges, and private litigants, with document and data integrity issues at center of disputes.
- DOJ/Florida AG investigation of DOCX (LPS subsidiary) probing assignment integrity was precursor to current debt affidavit crisis.
- Challenges to debt affidavit preparation procedures have triggered nationwide scrutiny of foreclosure process.
  - Federal Multi-Agency Task Force, 50 State AG Task Force, and Banking Regulators examining these issues.
- Issues highlighted by foreclosure affidavit crisis likely to spark further scrutiny of bankruptcy practices.

# Risk Mitigation Strategies

- Carefully craft loss mitigation policies, especially where greater discretion is permitted.
  - Emphasis on robust documentation, particularly exception documentation.
- Prioritize procedural and fair lending compliance training for all personnel given new emphasis on loan life cycle.
  - Provide clear guidance on training expectations for third parties.
- Implement comprehensive internal procedures for monitoring legal and regulatory compliance.

# Risk Mitigation Strategies (cont.)

- Conduct privileged self-assessments of workout data.
  - Examine outcomes by race, national origin, and other prohibited bases.
  - Analysis should include range of workout possibilities.
  - Examine frequency, terms, and speed of outcomes.
- Monitor consumer complaints and litigation, analyze trends, and adjust practices in a timely manner.

# For Further Information

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