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January 2013

A legal update from Dechert

U.S. Consumer Financial Protection Bureau Issues Rules on Mortgage Servicing; Creates New Rights for Borrowers, Raising Issues Regarding Legal Authority For Foreclosure Action Prohibition

On January 17, 2013, the Consumer Financial Protection Bureau (“Bureau”) took another major step in the restructuring of the U.S. residential mortgage sector by issuing final rules (collectively, the “Rule”) regarding mortgage servicing. The Rule implements provisions of the Dodd-Frank Act (“DFA”) that amended the Real Estate Settlement Procedures Act (“RESPA”) and Truth in Lending Act (“TILA”).

The Bureau received substantial comment from industry and consumer groups when it issued proposed rules to amend Regulation X, which implements RESPA, and Regulation Z, which implements TILA (collectively, the “Proposal”).¹ Industry representatives expressed concern regarding the costs and burdens associated with certain aspects of the Proposal and the potential for additional liability exposure.

Among other things, the Rule seeks to address concerns about efficient and effective communications between servicers and borrowers, especially in the case of borrowers experiencing difficulty making their payments. This OnPoint describes some of the key aspects of the Rule, which will become effective on January 10, 2014.

Summary

The Rule generally seeks to promote three objectives:

1. Providing borrowers with better information regarding the servicing of their loans;
2. Enhancing servicer response to borrower complaints and inquiries; and
3. Creating a strong regulatory framework for the operation and enforcement of servicer initiated loss mitigation.

The changes to Regulations X and Z are being made in response to a period of extraordinary challenge to the resources and capacity of the mortgage servicing sector. Increased costs related to complying with the Rule, and a perception that mortgage lenders and investors may face more difficulties in enforcing their rights under mortgage contracts, may impact the overall economics of the mortgage industry, especially when combined with other major initiatives such as the Bureau’s new rules on the Ability-to-Repay Requirement and Qualified Mortgages.²

Loss Mitigation Requirements

Some of the most significant aspects of the Rule involve requirements imposed under Regulation X on loan servicers that offer loss mitigation options. It is important to note that this aspect of the Rule does not impose any obligations on servicers that do not offer loss mitigation.

The Rule’s loss mitigation provisions are significantly more favorable to borrowers than the provisions that were contained in the Proposal. The Proposal allowed for “dual tracking” – where a borrower could pursue

loss mitigation options available from the servicer at the same time that the servicer pursued the foreclosure process. Under the Proposal, a servicer was prohibited only from **completing** the foreclosure process while the loss mitigation evaluation and appeal process remained underway.

The Bureau, by its own admission, departed sharply from this approach in the Rule, stating that it determined to implement restrictions on dual tracking beyond those set forth in the Proposal. The Rule includes three provisions in this regard.

First, the Rule prohibits a servicer from taking the **first** action in the foreclosure process, unless a borrower is more than 120 days late on a payment. The Proposal did not contain any restriction on a servicer's ability to commence the foreclosure process. To the contrary, the Proposal stated that it would not prohibit a servicer from taking steps in the foreclosure process, other than the foreclosure sale while the loss mitigation process was underway. The Proposal stated that:

The Bureau believes that addressing problems with concurrent loss mitigation application and evaluation and foreclosure proceedings requires a balanced approach that considers the needs of consumers, servicers and mortgage loan investors. This balance considers the interest of consumers in having servicers provide good faith evaluations and implementation of loss mitigation options as well as the interests of investors in obtaining timely recovery on assets for which losses cannot be mitigated consistent with investor requirements.³

An essential principle in administrative law governing the rulemaking process is that provisions of a final rule must be a logical outgrowth of the proposed rule. The Bureau's decision to depart from its proposed rule by imposing a nationwide prohibition on creditor's rights and remedies that might otherwise be available under contract and state law, without putting the public on notice of this potential change from the proposal and without giving interested parties a meaningful opportunity to comment on it, raises a significant issue upon which a judicial challenge may be brought.⁴

Second, if a borrower is 120 days delinquent, a servicer may issue the first notice or make the first filing required for a foreclosure process, unless the borrower has submitted a completed loss mitigation application. In the latter case, the servicer must complete the review and appeal process before starting the foreclosure process.

Third, if a borrower submits a completed loss mitigation application after the servicer has made the first notice or filing required for a foreclosure process, by more than 37 days before a foreclosure sale, the servicer must complete the loss mitigation process before proceeding to a foreclosure judgment, obtaining an order of sale for the property, or conducting a foreclosure sale.

The Rule establishes procedural and timing requirements for the loss mitigation evaluation process. The servicer must evaluate the borrower for all available loss mitigation options. If the borrower's application is denied, the servicer must provide the specific reasons for the denial for each loss mitigation option and, if applicable, explain the appeal process and the timing requirements for that process.

It is important to note that the Rule provides borrowers with a private right of action in regard to the loss mitigation provisions.

Other Provisions Under Regulation X

Early Intervention with Delinquent Borrowers

In order to prevent foreclosure, the Rule requires servicers to make two notifications once a timely loan payment is not made:

- First, a servicer must make a good faith effort to make a live contact (which may include telephone or in-person meeting) with the borrower by the 36th day of the borrower's delinquency and, subject to the servicer's discretion, inform the borrower of loss mitigation options that may be available.
- Second, by the 45th day of the borrower's delinquency, the servicer is generally required to provide written notice to the borrower (i) encouraging the borrower to contact the servicer, (ii) providing a specific point of contact at the servicer, (iii) describing loss mitigation options, if applicable, and how to pursue them and (iv) indicating how to get in contact with counselors at the related State housing

finance authority.

Borrower Contact

The Rule requires servicers to maintain policies and procedures to ensure that delinquent borrowers are assigned personnel at the servicer by the time they receive a written early intervention notice, but in no event later than the 45th day of the borrower's delinquency. A servicer's policies and procedures must also be reasonably designed to ensure that assigned servicer personnel perform certain functions, including providing accurate information regarding: (i) loss mitigation options that may be available to the borrower; (ii) actions the borrower must take to be eligible for loss mitigation options; (iii) the status of any loss mitigation application the borrower has submitted; (iv) the circumstances under which the servicer may make a referral for foreclosure; and (v) information about submitting a notice of error or an information request to the servicer.

Assigned personnel must be able to retrieve in a timely manner (i) a complete record of the borrower's payment history, and (ii) all written information that the borrower has provided to the servicer in connection with a loss mitigation application.

Error Resolution

The Rule requires servicers to abide by specific error resolution procedures, if the borrower provides notice of an error to a servicer in writing. The Bureau responded to industry objections by deleting the option for borrowers to provide oral error notices as provided in the Proposal.

The Rule includes a list of eleven circumstances that qualify as "covered errors," including the failure to provide accurate information for loss mitigation options and foreclosure, and the failure to suspend a scheduled foreclosure to the extent required by the Rule. In a change from the Proposal, the Bureau, in response to comments from consumer groups, added an eleventh "catch-all" category that covers "any other error relating to the servicing of a borrower's mortgage loan."

A servicer may establish an address that borrowers must use in order to submit a notice of error. Once a borrower has done so, the servicer must acknowledge receipt of the notice within five business days. Following receipt of a notice, a servicer must either:

- Correct the error and notify the borrower; or
- Conduct a reasonable investigation and provide the borrower with a written statement as to why no error occurred, and a notification that the borrower may request the documents relied on by the servicer.

Generally, a servicer must comply with these requirements within 30 business days after receipt of a notice of error. In some circumstances, a servicer is not required to respond, but it must notify the borrower of its determination not to respond.

A servicer may not charge a fee or require the borrower to make a payment owed on the account as a condition of responding to a notice of error. Following receipt of a notice of error, a servicer may not, for 60 days, furnish adverse information to a consumer reporting agency regarding any payment that is the subject of the notice. The Rule provides that the error resolution requirements do not limit or restrict a servicer from pursuing any remedy it has under applicable law, including foreclosure. Exceptions to this provision are an alleged error involving a servicer making a first notice or filing for foreclosure in violation of the loss mitigation provisions of the Rule, or moving for a foreclosure judgment or conducting a foreclosure sale in violation of the loss mitigation provisions of the Rule.

Requests for Information

The Rule requires servicers to follow a specified process when a borrower makes a written request for information related to the servicing of the borrower's loan. A servicer may establish an address that a borrower must use to submit a request. Once a request has been received, a servicer must acknowledge its receipt within five business days. Further, following receipt of a notice, a servicer must either:

- Provide the requested information; or
- Conduct a reasonable search for the information and provide the borrower with a notification that the information is not available to the servicer.

A servicer must respond within 10 business days for requests regarding information concerning the owner of a loan, and generally within 30 business days for all other requests. In some circumstances, the Rule does not require a servicer to respond, including irrelevant requests and unduly burdensome requests, but it must notify the borrower of its determination not to respond. Finally, a servicer may not charge a fee or require the borrower to make a payment owed on the account as a condition of responding to a valid request, provided that a servicer may charge an otherwise permissible fee for a beneficiary notice.

As with the error resolution provisions, the Bureau, in response to industry and consumer group comments, decided to omit oral requests for information from the scope of the Rule.

Servicing Policies and Procedures

The Rule requires servicers to establish reasonable policies and procedures for maintaining and managing loan accounts. The objectives of these policies and procedures must be to:

- Provide timely and accurate information;
- Support loss mitigation options;
- Facilitate oversight of, and compliance by, service providers; and
- Facilitate servicing transfers.

A servicer also must:

- Retain records that document servicing of a loan until one year after payoff or transfer to another servicer; and
- Be able within five days to compile a servicing file that includes: a schedule of payments and debits; a copy of the mortgage note and deed of trust; any collection notes made by servicer personnel; and copies of certain information provided by the borrower.

In response to industry commenter concerns about the Proposal's requirement that a servicer provide a borrower with the servicing file, the Bureau deleted this provision from the Rule.

The Proposal would have provided a safe harbor for servicers if they did not engage in a pattern or practice of failing to achieve any of the objectives or failing to ensure compliance with any of the standard requirements. The Bureau restructured the Rule so that it neither provides a safe harbor from liability nor provides for private rights of action.

Force-Placed Insurance

The Rule prohibits servicers from charging for force-placed hazard insurance unless the servicer (i) has a reasonable basis to believe that the borrower has failed to maintain hazard insurance, (ii) has provided the required notices, and (iii) has not received evidence demonstrating that the borrower has had acceptable insurance coverage in place.

An initial notice must be provided at least 45 days before charging the borrower for force-placed insurance. The notice must, among other things, request that the borrower promptly provide information regarding an applicable hazard insurance policy and information on the force-placed insurance that has or will be put in effect if the borrower does not obtain insurance. A second notice must then be sent no earlier than 30 days after the first notice. If the borrower provides inadequate evidence of insurance then the servicer must provide notice to the borrower of the deficiency. The Rule contains model notice forms.

If the borrower makes hazard insurance premium payments from an escrow account, the Rule provides that a servicer may not, with respect to a borrower whose mortgage payment is more than 30 days overdue, purchase force-placed insurance, unless the servicer is unable to disburse funds from that escrow account to ensure that the hazard insurance premium payment is made in a timely manner. A servicer will be considered to be unable to disburse payments only if it has a reasonable basis to believe that insurance has been terminated for reasons other than nonpayment, or that the borrower's property is vacant. A servicer will not be considered to be unable to disburse payments from a borrower's escrow account because the escrow account contains insufficient funds. To the extent that a servicer advances funds to an escrow

account, the servicer may seek repayment of such advances from the borrower, except to the extent prohibited by law.

Provisions Under TILA

Periodic Billing Statements

Servicers must provide a periodic billing statement for each billing cycle, and the statement must meet certain timing and form requirements. Among the items the statement must include are the amount due accompanied by an explanation, recent payments and how they were applied, recent transaction activity, information regarding delinquencies (if applicable) and contact information for the servicer. This information must be in writing and placed in the mail within a reasonably prompt time after the payment due date or the end of any grace period for the previous billing cycle. A servicer may deliver the statement electronically if the borrower consents.

The Rule exempts reverse mortgages, timeshares, and servicers that deliver coupon books that meet certain specifications. In addition to these exemptions, a servicer that services 5,000 or fewer mortgages, as to all of which the servicer or an affiliate is the creditor or assignee, is also exempt.

The Bureau rejected industry comments objecting to the proposed periodic statement requirements. Their objections argued that the requirements went beyond the requirements contained in the DFA, that the information was otherwise available, and that compliance with the requirements would be too costly.

ARM Adjustment Notices

The Rule requires a servicer to notify the borrower of adjustments in an interest rate that causes a change in the borrower's payment obligations, between 60 and 120 days before such adjustment takes effect. Previously, the minimum time for notice was 25 to 120 days. Prior to the first adjustment, the borrower must receive between 210 and 240 days' notice.

Prompt Payment Crediting

Servicers must credit the borrower's account on the day of receipt of full periodic payment. A payment will be considered a "full periodic payment" if it covers the full principal, interest, and escrow fees (if applicable) amount. It does not have to include any late fees or other fees. If the payment is only a partial periodic payment, then the servicer may place the insufficient payments in a suspense account until a full payment is accumulated.

Under the Proposal, once a full payment is accumulated, the servicer would have had to credit that payment to the oldest outstanding delinquency. Commenters contended that this requirement could conflict with certain state laws. This provision was deleted from the Rule.

Footnotes

1. For further information on the Proposal, please refer to Dechert OnPoint, [U.S. Consumer Financial Protection Bureau Proposes Mortgage Servicing Reforms](#).

2. For further information on these rules, please refer to Dechert OnPoint, [U.S. Consumer Financial Protection Bureau Issues Rules on Qualified Mortgages and Ability to Repay](#).

3. 77 Fed. Reg. 57200, 57267 (Sept. 12, 2012).

4. See *CSX Transp., Inc. v. Surface Transp. Bd.*, 584 F.3d 1076, 1079-82 (D.C. Cir. 2009) (holding that a final rule based on four years of comparison data failed to qualify as logical outgrowth of proposed rule where the notice of proposed rulemaking did not indicate that the agency might use data from periods prior to the most recent year).



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