CFPB's New Foreclosure Limits Will Be Tough On Servicers

By **Allison Schoenthal and Matthew Sheldon** (July 1, 2021)

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With foreclosure moratoriums scheduled to expire at the end of July, the Consumer Financial Protection Bureau this week issued the finalized amendments to the federal servicing regulations, Regulation X.

The stated intent of the amendments is to include additional borrower protections, ease the transition as consumers exit forbearance plans and avoid a feared wave of foreclosures before the end of the year.

While the CFPB has emphasized that servicers and borrowers need to work together on foreclosure avoidance options post-pandemic, the rule puts a heavy burden on servicers. Implementing these changes will require an enormous effort — servicers will need to update compliance policies, call scripts, letter templates and record-keeping practices — with only weeks until the Aug. 31 effective date.

All regulatory changes bring risk, but especially those made quickly. There is little time for servicers to digest the amendments, create action plans, and test new policies and procedures. Moreover, some rules appear to lack clarity and that ambiguity brings further risk.

While the new rules are touted as paving the way for a smooth transition at the end of the federal foreclosure moratoriums, implementing the changes will be a rocky road for servicers. Although the final rule raises a host of issues, there are several key provisions in it that raise significant compliance considerations for servicers in the coming weeks.

The exemptions from the final rule are important — and tricky.

The final rule only applies to properties secured by a borrower's principal residence; the CFPB however declined to provide further clarity on the criteria to determine whether a mortgaged property is considered a principal residence.

It remains unclear whether the principal residence status must be at the time of the review, at origination or some other time during the life of the loan. Even if a determination could be made whether a property is a borrower's principal residence, there are still four other potentially applicable exceptions where the lender or servicer can commence a foreclosure before 2022.

While the exceptions seem straightforward, the implementation of them could pose significant challenges for servicers.

First, the CFPB took industry feedback to heart and expressly excluded abandoned homes when it had only said in the proposed rule, in a footnote, that an abandoned home was unlikely to be the borrower's principal residence. While the CFPB says servicers should look to state law for how the term abandoned is defined, if the servicer incorrectly applies state law it could violate Reg X.

Second, if the borrower was more than 120 days behind pre-pandemic, before March 1,

2020, an exemption would also apply. This is a change from the proposed rule and means that borrowers who have now been in default for almost two years may face foreclosure without further delay.

This exception makes sense and should ease the foreclosure backlog and allow servicers to focus their work-out efforts on borrowers with true COVID-19-related hardship.

The third exception is if the borrower is more than 120 days behind on payments and not responsive to servicer outreach for 90 days. In the final rule, the CFPB provides further and needed detail on the meaning of an unresponsive borrower. This exception should also allow servicers to focus their efforts on those interested in home retention or a graceful exit.

The fourth, and last, exception is if the borrower has been evaluated for all options other than foreclosure and there are no foreclosure avoidance options available.

It was suggested in the comments that this last exclusion should be expanded to include if a borrower was reviewed and offered an option but declined it, or if the borrower was approved for a modification but broke the plan or if the borrower consented to foreclosure.

The CFPB appears to have considered this feedback and made at least some responsive changes in the final rule; for example, a servicer can proceed with foreclosure before 2022 if a borrower was reviewed and deemed ineligible for any loss mitigation option and did not timely appeal or the appeal was denied, or the borrower rejected all loss mitigation options or the borrower did not perform under an option offered.

That doesn't mean though that if a borrower's circumstances have materially changed, or the borrower submits another complete package, the CFPB will not frown on a servicer declining to re-evaluate the borrower.

Finally, and significantly, if a servicer believes any of these exceptions apply, it will also need to retain evidence supporting its decision to proceed with foreclosure.

Streamlined modification options have been challenged in the past.

As anticipated, the amendments provide that a servicer can offer a streamline modification to borrowers with COVID-19-related hardship based on an incomplete package.

There are conditions to those modifications including that the modification cannot cause the principal and interest payment to increase, limits on extending the term and no fees can be charged in connection with the modification, among other restrictions. While this provision does not seem controversial, history suggests problems may be ahead.

Such a streamlined modification option is reminiscent of the streamline the Home Affordable Modification Program made available after the last financial crisis. Those resulted in customer complaints that they could have qualified for a better option than the streamline or that they were put into a modification that they could not afford.

And while streamline modifications increase modification take-up rates, some question the effectiveness of a streamline, positing that streamlines do not avoid foreclosure, but rather delay it or that streamline modifications redefault more than standard modifications.

The same issues and claims can be expected to be raised in response to streamlines offered as a result of the CFPB's final rule.

Early intervention duties are more robust.

The CFPB has amended the early intervention requirements to ensure servicers are communicating and explaining options to borrowers.

If the borrower is not in forbearance, once live contact is established, and the borrower has a COVID-19-related hardship, the servicer has to explain the forbearance programs available at the time the live contact is established and how the borrower applies.

The amended rule now requires that the servicer not only list the forbearance programs available, but describe them. This means that the servicer must describe all forbearance programs not just COVID-19-related forbearance programs.

The rule also requires that the servicer identify how the borrower can find a homeownership counseling service, a change that was added at the urging of legal aid organizations. While the CFPB had said it was considering expanding this proposal to require that servicers explain all loss mitigation options, not just forbearance options as well as the impact of forbearance on credit reporting, those proposals did not make it into the final rule.

If the borrower is already in forbearance due to a COVID-19-related hardship, then the requirement is somewhat broader.

During live contact, before the forbearance period ends, and if the forbearance end date is between Aug.31 and Sep. 10, then after Aug. 31, the servicer must advise: (1) the date forbearance ends, (2) list and describe each type of forbearance program extension and repayment option and other loss mitigation options available and how the borrower applies.

Note that this is not limited to COVID-19 specific programs but rather requires a description of all liquidation and retention options. To be sure, the CFPB will be looking for compliance with these requirements, and whether the communications with borrowers were timely and accurate.

Record retention is expanded.

The CFPB expanded on the record-keeping requirements in Section 1024.38(c)(1) and 1024.41(f)(3), reminding servicers to keep evidence of compliance, including if an exception applied or the servicer believed any exclusion released them from compliance obligations.

There can be no doubt that the CFPB will be looking for such documentation during audits and exams and ensuring that servicer policies and procedures were updated to reflect these requirements.

Concluding Thoughts

History teaches the days ahead will not be easy ones for mortgage servicers. After Regulation X was amended in 2013, and became effective on Jan. 10, 2014, the industry struggled with compliance issues resulting from the additional early intervention and loss mitigation requirements.

Litigation and enforcement actions then ensued. The same can be expected here.

These risks can be mitigated, however, by servicers carefully analyzing and understanding

the amendments, and updating their protocols and procedures accordingly. The CFPB will surely be looking at whether servicers complied with the technical requirements of the rule and its procedural safeguards, but also more globally whether servicers gave borrowers a meaningful opportunity to pursue loss mitigation options before commencing foreclosure.

The key will be clear communications in writing and calls with borrowers. Call scripts should be created explaining loss mitigation options, call centers adequately staffed and trained, letter templates created and vetted clearly explaining options to borrowers.

And, as always, servicers should look for borrower communications and complaints related to the amendments and nip any issues in the bud. This will be an enormous amount of work over a summer already jammed with other tasks emerging from COVID-19-related restrictions and issues.

We hope flagging some of the issues and concerns above will help in thinking through those implementation challenges.

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