National Consumer Law Center

Analysis of Servicing Provisions in Johnson-Crapo Discussion Draft

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We are glad to see the discussion draft address important servicing issues for housing finance reform. Below we offer some suggestions to make those protections stronger. These revisions would close loopholes and better assure intended outcomes. Effective servicing provisions in housing finance reform will help maintain the integrity of the Mortgage Insurance Fund by aligning the incentives of servicers with other market stakeholders. Until servicers' incentives are brought in line with investors', any government guarantee will continue to be jeopardized by servicer conduct. Additionally, fair servicing is an important part of access and affordability in the new FMIC system, particularly for special populations including successors in interest, borrowers with disabilities, and borrowers with limited English proficiency. Without a broader mandate for servicing to provide affordable modifications outside of the FMIC system, however, uneven outcomes and misaligned incentives will continue, leaving homeowners without an assurance that they can obtain proper loss mitigation, even where they qualify.

The draft bill includes provisions to:

- create a substantial system of servicer accountability,
- address the inefficiencies and costs caused by the dual tracking of foreclosures and loss mitigation reviews,
- ensure that affordable loan modifications are provided to qualified homeowners with loans in covered securities,
- promote efficient and fair transfers of servicing,
- establish the groundwork for improving transparency and accountability for loan documentation, and
- initiate reform of servicer compensation.

These provisions strengthen FMIC's ability to secure efficient mortgage servicing. Certain clarifications or additions would better promote fair servicing and also minimize losses to the Mortgage Insurance Fund.

Enhancing incentives for compliance. While the draft includes measures such as a process for certifying compliance with servicing requirements and associated penalties for false certification, as well as a system for revocation of servicing rights, it also must clearly empower the Corporation to assess penalties for material non-compliance. This would provide the Corporation with recourse for identified problems before they rise to the level of a revocation of servicing. An Office of the Homeowner Advocate or similar department inside the Office of Consumer and Market Access or elsewhere in the Corporation would provide a needed pipeline for homeowners and their representatives seeking oversight in real time for a particular case of non-compliance. Such office must have the ability to stop or seek reversal of wrongful foreclosures caused by material non-compliance with Corporation standards. This work could be coordinated with the CFPB complaints function, just as the draft contemplates coordination of supervisory duties, and would be particularly useful at FMIC where the non-compliance applies to FMIC requirements rather than CFPB servicing standards. Identification of individual borrower complaints is often the first and sometimes the only warning signal of larger systemic problems and thus would assist the Corporation in addressing problems early.

Revising the dual tracking limitations to better align servicer incentives with homeowner and investor/insurance fund interests. The factors considered in connection with issuance of a rule on dual tracking must address the costs and benefits to all stakeholders. Accordingly, the list of factors must include consideration of the costs to borrowers caused by the initiation or continuation of foreclosure. Dual tracking often leads to wrongful foreclosure, given the difficulty of coordinating loss mitigation and foreclosure sales. Not infrequently, even highly placed loss mitigation managers find themselves powerless to stop a foreclosure once entrained. Conducting a foreclosure during a loss mitigation review increases a servicer's opportunity to charge fees, whether or not earned, that the servicer can retain. These fees can add to a borrower's loan balance, thus making it harder for the homeowner to quality for an affordable loan modification or bring the mortgage current. In the event of foreclosure, these added fees reduce any recovery to investors and increase any deficiency judgment against borrowers, further hamstringing borrowers from rebuilding their credit. Incorporation of a borrower-related factor would result in more, and faster, loan modifications that also benefit the insurance fund. Additionally, any dual tracking requirement must be keyed to a borrower's submission of an initial package, as it is under HAMP. Submission of such a package demonstrates good faith by the borrower without creating an incentive for the servicer to elongate the paperwork submission phase.

Elaborating on the loss mitigation requirement to better ensure sustainable modifications. The loss mitigation requirement for covered loans, including affordable loan modifications, is an essential element of a final bill. The language would be more likely to yield a well-functioning loss mitigation system if it mandated that the Corporation define "affordable" and that the basis for loss mitigation decisionmaking, such as a net present value test, be transparent to the borrower. Clarity and transparency yield a more efficient system; borrowers who know their options can assess which options should be pursued and which abandoned. Additionally, the language addressing the treatment of advances should be clarified to more clearly promote modifications. Advances should no longer be required where a repayment plan or modification has been established (not only when full repayment has occurred). Servicers also should be able to recover advances upon permanent modification, to address the lopsided effect now of a faster recovery in case of foreclosure. These changes would encourage all parties to move quickly towards the most economically rational solution and would thus improve outcomes for all stakeholders.

Ensuring fair and efficient transfers of servicing. The discussion draft contemplates significant authority for FMIC to transfer servicing rights and the development of servicer succession plans. These powers will enable FMIC to secure more efficient conduct from mortgage servicers. In order to ensure that FMIC requirements are met through such a transfer, the succession plans should include a plan to achieve not only continuity of contact for borrowers but also continuity of the loss mitigation process that may already have begun, including submission of paperwork and review of requests. Routine servicing also is affected by transfers. The draft ensures transparency and accountability in that process by addressing acceptance of payments and imposition of fees in connection with transfers. Transfers done with such safeguards promote efficiency and accuracy in accounting, decrease disputes and litigation risk, and increase loan performance, thus benefitting homeowners and the insurance fund.

Balancing the registry provisions to better reflect borrower and community stakeholder concerns. The draft rightly defers to states with existing recordation systems while encouraging states to go online. The working group can be an effective mechanism for exploring a federal registry. However, any working group should equally include homeowner advocates and industry representatives. The current draft includes industry but not borrower representatives. This imbalance must be corrected to insure that the work of the group is balanced and effective. Moreover, any eventual registry must provide free access for homeowners to information about the ownership and the servicing rights for their loans. Non-confidential information about loan ownership and servicing should also be available without cost to the public.

Ensuring that compensation promotes an efficient mortgage servicing system. Servicing non-performing loans is more resource intensive than routine mortgage servicing. Compensation for such work must promote sustainable outcomes for the insurance fund, borrowers, and communities. The servicing compensation study required by the discussion draft should include recommendations that promote such conduct. In addition to structuring compensation to reduce risk to servicers while providing flexibility for guarantors, the system must promote the health of the insurance fund by incentivizing behavior that maximizes investor returns, rather than promoting liquidity, which generally results in unwarranted emphasis on expediting foreclosures at the expense of maximizing value.