COMMENTS
to the
Consumer Financial Protection Bureau
12 CFR Part 1026
[Docket No. CFPB-2012-0033][1]
RIN 3170-AA14
2012 Truth in Lending Act
(Regulation Z)
Mortgage Servicing Proposal

by the
National Consumer Law Center
on behalf of its low-income clients

as well as the
National Association of Consumer Advocates

October 9, 2012

The **National Consumer Law Center**[2] ("NCLC") submits the following comments on behalf of its low-income clients, as well as the **National Association of Consumer Advocates**.[3]

These comments exclusively deal with the proposed changes to Regulation Z (under the Truth in Lending Act,"TILA") in the CFPB's servicing proposal. Separately, we supply extensive comments on the proposed changes to Regulation X (under the Real Estate Settlement Procedures Act, "RESPA").

We appreciate the close attention to the details of the new statutory requirements that these proposed regulations evidence. Overall, we support all of the proposed changes to Reg Z included in this proposal, as they are simply required by the underlying statute. We have a number of substantive suggestions on how to improve the proposed regulations, however.

In addition, we have serious concerns with – what we believe to be – unintended consequences of the language in the proposed Payment Processing provisions (§ 1026.36(c)). The

[1] 77 Fed. Reg 57319 (Sept. 17, 2012).
[2] Since 1969, the nonprofit **National Consumer Law Center**® (NCLC®) has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness. NCLC publishes a series of consumer law treatises including Mortgage Lending, Truth in Lending, and Foreclosures. These comments are written by Margot Saunders and John Rao.
[3] The **National Association of Consumer Advocates** ("NACA") is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.

proposal will result in rolling back important protections for consumers unless it is changed to require that all payments – not just "full contractual payments" – be credited on the date of receipt and to clarify the rules for charging late fees.

I. The Proposed Periodic Billing Statements Will Be Helpful to Consumers But Should Include More Information and Apply to Certain Reverse Mortgages.

The proposed regulation follows the Dodd Frank Act's ("DFA") new mandate[4] that servicers of closed-end mortgages send periodic statements for each billing cycle, except when the loan has a fixed rate and a coupon book has been provided. The proposed regulation – § 1026.41 – conforms generally to both the statutory language and the intent behind it.

We particularly applaud the information required regarding partial payments in § 1026.41(d)(5), and the delinquency information in § 1026.41(d)(8). The information about partial payments will help consumers understand the effect of making partial payments. We do have serious concerns, however, regarding how partial payments are permitted to be treated under proposed § 1026.36(c)(1)(ii). These concerns are addressed in Section III(A) of these comments.

The delinquency information required in new § 1026.41(d)(8) will also be helpful to consumers dealing with late payments. There are, however, some important improvements that should be made to this information. These include:

1. The account history is only required "for the lesser of the past 6 months or the period since the last time the account was current, the amount due for each billing cycle, or if a payment was fully paid, the date on which it was considered fully paid; . . . ."[5] There are several problems with this. First, the account history should be provided for the previous *12 months* on all statements, or even back to the origination of the loan. All of this information is computerized and easily provided by the servicer. It is valuable information to the consumer to understand how all payments have been applied. Secondly, we assume that this information will be coordinated with the information required by the proposed new regulation under RESPA in § 1024.39 regarding an early intervention written notice after the consumer is late by at least 40 days. However, it is not clear how this coordination will take place.

2. The billing notice after a delinquency should include much more information about all of the loss mitigation options offered by the servicer, along with the eligibility requirements and how to apply for these options. Limiting the required information to "notice of any loan modification programs . . . to which the consumer has been accepted . . ."[6] is not nearly sufficient information. The purpose of this billing notice after delinquency has occurred is to provide *all* of the information the consumer needs to know about how to avoid foreclosure. This means that all of the programs offered by the servicer which could assist the consumer in avoiding foreclosure should be explained. This can be done in a substantive but summary manner and would not constitute a burden on the servicer.

[4] 15 U.S.C. § 1638(f).
[5] §1026.41(d)(8)(iii).
[6] §1026.41(d)(8)(iv).

3. The total payment amount needed to bring the loan current, required in §1026.41(d)(8)(vi) needs to break down the amounts due for a) past due payments of interest and principal, b) payments past due for escrow, and c) a breakdown of the fees assessed, including late fees. When a lump sum is provided, a homeowner is unable to discern whether such amounts are accurate. Only a payment amount with a breakdown is meaningful.

Finally, reverse mortgages are exempted from the periodic notice requirement. We encourage the CFPB to consider requiring periodic notices whenever reverse mortgages have escrow accounts for the payment of taxes and insurance. We have recently recommended to the CFPB that escrow accounts be adopted for reverse mortgages whenever the full amount of the credit has already been withdrawn on the home, and there has not been an independent determination of the elderly homeowner's ability to afford the ongoing expenses of taxes and insurance.[7]

II. Requiring a Notice of Interest Rate Change for All ARMs, Not Just Hybrid ARMs, Makes Sense But the Notice Must Be Required for Payment Option ARMs.

The new statutory mandate in 15 U.S.C. § 1638a requires that a notice of the change in the interest rate and the monthly payment (as well as other information) be provided to consumers whose homes are secured by "hybrid adjustable rate mortgage[s]." The proposed regulation would extend this requirement to all adjustable-rate mortgages. We agree with and support all aspects of this proposal, except one.

The CFPB proposes to replace the annual notice which is applicable to all loans in which there is an adjustment in the interest rate – currently required by §1026.20(c) – with this notice triggered solely by interest rate adjustments. This replacement is fine – as to provide both the annual notice and the separate interest rate notice would indeed be duplicative. It also makes sense that there should only be one type of notice regarding the interest rate changes on a closed-end home secured mortgage. The information proposed to be included in the new interest rate adjustment notice is good, important, and comprehensive.

The problem is that the annual notice under the current version of § 1026(c) is required whenever there is an interest rate adjustment "with or without a corresponding adjustment to the payment in a variable-rate transaction . . . .." However, the proposed version of §1026(c) would not require any notice to be provided when the interest rate change does not result in a change in the consumer's payment. This needs to be rectified. Consumers with Payment Option ARM loans (which the CFPB should simply make illegal because they are inherently unfair) have loans with multiple interest rate adjustments which do not trigger a change in the immediate payment obligations. Under Payment Option ARM loans the interest rate changes often, while the consumer's payment obligations do not change until the loan resets (which occurs when the growth in principal equals the trigger amount – generally 115% or 125% of the original amount of the loan).

[7] *See,* Comments to the Consumer Financial Protection Bureau, on Request for Information Regarding Senior Financial Exploitation, 77 FR 36491 (June 19, 2012), Docket No. CFPB-2012-0018 , by the National Consumer Law Center On behalf of its low-income clients, August 20, 2012 http://www.nclc.org/images/pdf/debt_collection/cfpb-financial-exploitation-comments-aug-2012.pdf, 14 – 18.

Other loans may have this type of scheme in the future and it is imperative that the rule address this structure.

We recommend that the new version of § 1026.20(c) be amended to apply to any change in interest rates, regardless of whether the change also causes a corresponding adjustment in the consumer's payment obligations. All other parts of the proposed changes to §§ 1026(c) and (d) are positive and will assist consumers.

III. Payment Processing

A. Servicers Must Be Required to Credit All Payments, Whether Full or Partial, on the Date Received

The Dodd Frank Act also includes new mandates requiring servicers to "credit a payment to the consumer's loan account as of the date of receipt, ..."[8] This language is unambiguous. It requires <u>any batch of money</u> sent by the consumer to be immediately credited to the consumer's account. The exception in subsection (b) allows a delay of crediting if the consumer sends in a payment which does not follow the *manner* of making payments – such as if the consumer sends in a check and only certified checks are required, or sends the payment to the wrong address.

Unfortunately, the language in proposed regulation § 1026.36(c)(1) on payment processing turns these statutory requirements completely on their head. There are four distinct problems with this proposed regulation: 1) partial payments should be required to be credited when received; 2) it appears that non-payment of the escrow portion of a mortgage payment is permitted to be a trigger for a late fee – which is beyond what mortgage notes and most state laws permit; 3) there are no specific protections for daily accrual loans; 4) there are no directions on how funds applied from suspense accounts should be handled.

The regulation first limits the protections of the statutory language to what is called a "full contractual payment." This concept of a "full contractual payment" is not grounded in existing terminology and has no support in the statutory language, and is affirmatively harmful to consumers. Under the regulation, a payment that does not include interest, principal *and* escrow is not considered a "full contractual payment" and need not be credited to the consumer's account. This conflicts with both the statute (15 U.S.C. § 1639f), which requires *any* payment to be immediately credited, and the definition of "payment" in most – if not all – notes and mortgages currently in effect. "Payment" under the uniform note only includes interest and principal. Here is an example of the payment definition in a uniform note:[9]

> **3. PAYMENTS**
> **(A) Time and Place of Payments**
> I will pay principal and interest by making a payment every month.
> I will make my monthly payment on the __________________ day of each month beginning on ___________________________________, ____________. I will make these payments every month until I have paid all of the principal and interest and any other charges

[8] 15 U.S.C. § 1639f(a).
[9] *See* Freddie Mac Uniform Instruments, http://www.freddiemac.com/uniform/.

described below that I may owe under this Note. Each monthly payment will be applied as of its scheduled due date and will be applied to interest before Principal. If on __________________________, 20______, I still owe amounts under this Note, I will pay those amounts in full on that date, which is called the "Maturity Date."

I will make my monthly payments at____ or at a different place if required by the Note Holder.

(B) Amount of Monthly Payments

My monthly payment will be in the amount of U.S. $______________________.

There is no reason for the proposed regulation to add a requirement on consumers that does not currently exist even in the industry-drafted Uniform Notes. The entire purpose of the language in 15 U.S.C. § 1639f is to force servicers to apply every dollar the consumer sends in to pay the mortgage to that consumer's mortgage immediately. The statute mandates: "no servicer shall fail to credit a payment to the consumer's loan account as of the date of receipt . . . ." There is no caveat that the payment has to be a full payment. There is no exception allowed for payments that do not include escrow.

Proposed § 1026.36(c) makes it appear that it would be acceptable for a servicer to impose a late fee when the consumer fails to pay the escrow portion of a payment. Generally, state laws do not permit the non-payment of anything other than the interest and principal portion of the payment to trigger a late fee.

One of the primary purposes of the new statutory language is to require the servicer to credit the consumer's loan with a partial payment when it is received. The language in the proposed regulation which only requires the crediting when the payment includes *all* of the interest, principal and escrow due, is not justified by the plain language of the statute and is contrary to the purpose of the provision.

B. Immediate Crediting of All Amounts is Required for Daily Accrual Loans to Avoid Improper Interest Charges

The importance of crediting any part of the payment to the loan the day it is received is especially critical for loans in which the interest is charged based on the exact amount of principal outstanding for the exact number of days since the last payment. Typical language governing the accrual of interest in these mortgage notes is generally something such as :

> Interest will be charged monthly on the outstanding balance for the number of days between payments.[10]

In daily accrual loans, to determine how much interest is due, the servicer calculates the number of days since the last payment, multiplies that number by the daily interest rate (which is 1/365th the annual rate of interest[11]) and then multiplies the result by the outstanding principal

[10] Other sample language for a daily accrual loan is: "Interest is calculated based on the simple interest method on actual unpaid balances of principal for the time outstanding. …. Each payment will be applied first to interest at the contract rate for the actual time outstanding and the remainder to the unpaid balance of principal."

[11] Occasionally, in some loans, the daily rate will be 1/360th of the annual rate. But this is rarer these days.

balance after the last payment was applied. Because of this monthly calculation, not applying even a partial payment can mean a very significant difference in the total amount of interest paid on the loan. To illustrate the effect of a daily accrual loan, consider the situation with such a loan when the payments are all made by the consumer on time – on the exact day required – but in just one month the payment is not credited properly. In this case, the payment is not credited for 9 days.

$80,000 loan at **9.00%** interest, with **360** payments of **$669.91** each:

Payment Number	Days From Last Payment	Effective Interest Rate	Interest Due	Payment Amount	Amount to Principal	Principal Balance	Unpaid Interest	Cumulative Unpaid Interest
						$80,000.00		
1	31	0.764%	$611.51	**$669.91**	$58.40	$79,941.60	$0.00	$0.00
2	40	0.986%	$788.47	**$669.91**	$0.00	$79,941.60	$118.56	$118.56
3	31	0.764%	$611.06	**$669.91**	$0.00	$79,941.60	$0.00	$59.71
4	31	0.764%	$611.06	**$669.91**	$0.00	$79,941.60	$0.00	$0.86
5	28	0.690%	$551.93	**$669.91**	$117.13	$79,824.47	$0.00	$0.00

The effect of failing to credit this payment for 9 days will cause nine days of extra interest charges, or an additional $176.96 in interest (the difference between .76% on the balance of $79,967.81 and .99%). There are additional costs as well. Because the regularly scheduled payment is not sufficient to cover the interest due, the unpaid interest is carried over to be paid from the following month's payment.[12] In fact, it takes three months for the payments to cover the additional interest incurred by this extra 9 days (note that the there are no funds applied to principal until month 5, instead the difference between the payment and the interest due is applied to the previous month's unpaid interest). The effect of the failure to apply the payment on the correct day is that the balance for the ensuing months is higher than it would otherwise have been – triggering higher interest payments as well. Here is what this portion of the amortization would have looked like had payment # 2 been applied properly on day 31:

$80,000 loan at **9.00%** interest, with **360** payments of **$669.91** each:

Payment Number	Days From Last Payment	Effective Interest Rate	Interest Due	Payment Amount	Amount to Principal	Principal Balance	Unpaid Interest	Cumulative Unpaid Interest
						$80,000.00		
1	31	0.764%	$611.51	**$669.91**	$58.40	$79,941.60	$0.00	$0.00
2	31	0.764%	$611.06	**$669.91**	$58.85	$79,882.75	$0.00	$0.00
3	31	0.764%	$611.06	**$669.91**	$59.30	$79,823.45	$0.00	$0.00
4	31	0.764%	$611.06	**$669.91**	$59.75	$79,763.70	$0.00	$0.00
5	28	0.690%	$551.93	**$669.91**	$119.21	$79,644.48	$0.00	$0.00

12 This method of assessing interest is to avoid negative amortization, and is called the United States Rule. *See* NCLC, *The Cost of Credit*, (4th Ed. 2009) § 4.6.1.1.

After just 5 months, the balance would have been $79,644.48, or $179.99 lower, with the properly applied payment than it was with the improperly applied payment.

Under the proposed regulation if the second payment did not include escrow this payment would not be required to be credited. Or if the payment were a dollar short, this payment would not be required to be credited. Neither of these exceptions is permitted by the plain language of the statute. Yet the damage and cost to the consumer would be severe.

C. Immediate Crediting is Required on Scheduled Loans to Avoid Improper Default Status

The vast majority of home mortgages in the United States are not daily accrual loans. They are what is called "scheduled" mortgages. The language governing the assessment and accrual of interest generally reads something such as :

> Each monthly payment will be applied as of its scheduled due date and will be applied to interest before Principal.[13]

This method is much simpler – as the servicer charges the same amount of interest on the principal balance, regardless of the day the payment actually came in. So the day the payment is credited is far less important on these loans.

The day of crediting for scheduled loans becomes important because of the use of suspense accounts by servicers to deal with partial payments. The amount of interest assessed will not be affected when a suspense account is used – because the interest will be determined based on when the payment was *due*, not when the payment was actually *made* or *applied*.

However, the date of crediting is important for partial payments even in scheduled loans because it affects the default status of the loan. Generally – as the proposed regulation recognizes – a partial payment on a scheduled loan will be placed into a suspense account. We have no quarrel with servicers using suspense accounts to hold payments in scheduled mortgages before applying them to the mortgage, so long as the payments are treated as received for the determination of default status, and the application of payments from suspense follows the construct required by the contracts.

Once the servicer receives the payment and puts it in its bank account, that payment has been received and must be counted as received by the servicer. Even though on a scheduled loan the assessment of interest is not affected, all the other consequences of failing to make a full payment on the due date are triggered: assessment of late fees, triggering of inspections and appraisals, and the count-down to foreclosure. *It is those other consequences of the partial payment which are intended to be changed by the statutory language, and which the proposed rule does not adequately capture.*

This is one reason that the new law requires that every payment be credited on the day it is received, even if the payment is not in full. If a consumer is making partial payments on a regular basis (which usually means that there is a misunderstanding or difference of opinion about the application of a new interest rate or an escrow charge), there is no reason for the servicer to order a

[13] *See* Freddie Mac Uniform Instruments, http://www.freddiemac.com/uniform/.

drive-by inspection to determine if the home is lived in – because the consumer *is* making payments. Thus the crediting of the payment as of the date it is received is an important consumer protection – which is now mandated by the statute.

The proposed regulation in §1026.36 also fails to instruct servicers on how to apply payments *from* suspense accounts. The payments must be applied from suspense exactly as required by the loan documents – which in post-2001 loans written on the uniform instruments will mean that the funds are first applied to interest, then to principal, then to escrow. Only after all payments due to date have been paid in full can any funds be applied to late fees. There is language exactly on this point in the AG Settlement with the five large bank servicers:

> Each monthly payment must be applied as of the scheduled due date, and will be applied first to interest than to principal, provided that where mortgage insurance premiums, taxes and insurance, or other payments must statutorily or contractually, be paid prior to interest and principal, such application shall continue.[14]

D. The Proposal Should Be Revised to Avoid Any Implication That Late Fees Can Be Charged When a Payment Covers Principal and Interest But Not Escrow.

The proposed regulation's use of the term "full contractual payment" to include interest, principal and escrow makes it appear that a late fee can be triggered when the payment does not include the escrow portion owed. There is no legal justification for this.

Many state laws on late fees permit a late fee to be triggered only for the non-payment of interest and principal. Consider DC's statutes on late fees:

> D.C. Code § 28-3310. Consumer protections.
> (b) No delinquent or late charge shall be contracted for or received which does not meet all of the following requirements:
> (1) the delinquency shall have continued for at least 10 calendar days;
> (2) a delinquent or late charge shall not have already been charged for the same delinquent or late periodic installment; and
> *(3) the delinquent or late charge shall not exceed 5% of the total amount of the delinquent or late periodic installment of principal and interest.* (Emphasis added).[15]

Moreover the terms of almost all – if not all – notes and mortgages currently in effect only consider a payment not to be in full if the interest and principal due are not paid. Indeed, the amount of the late fee is only permitted to be a percentage the unpaid amounts of principal and interest. The Uniform Note states:

> **6. BORROWER'S FAILURE TO PAY AS REQUIRED**
> **(A) Late Charge for Overdue Payments**
> If the Note Holder has not received the full amount of any monthly payment by the end of

[14]Settlement Term Sheet, Exhibit A (Servicing Standards), ¶ I.B.3.
[15] *Also see, e.g.* La. Rev. Stat. Ann. § 6:1097; Md. Code Ann., Com. Law § 12-105; Or. Rev. Stat. § 86.165; 17 Pa. Cons. Stat. Ann. § 509.

____________ calendar days after the date it is due, I will pay a late charge to the Note Holder. The amount of the charge will be _______________% of my overdue payment of principal and interest. I will pay this late charge promptly but only once on each late payment. (Emphasis added.)

Yet, the language in the proposed regulation which defines the "full contractual payment" as an "amount sufficient to cover principal, interest, and escrow" appears to require that all three of these be paid in order to avoid a late fee. This needs to be changed.

E. The Protections Against Pyramiding of Late Fees Need to Be Improved.

The proposed regulation is correct in its reiteration of the FTC Credit Practices Rule's prohibition against charging a late fee for the non-payment of a late fee.[16] This is accomplished in both § 1026.36(c)(1)(i) and § 1026.36(c)(2).

The proposed regulation is also correct in stating that a full contractual payment cannot be considered to be not full based on the consumer's failure to pay other fees. But further clarification of "other fees" is necessary. The regulation needs to clearly state that other fees cannot be collected from moneys sent in by the consumer for payments and that late fees cannot be assessed for the nonpayment of other fees. One of the most serious problems contributing to unnecessary foreclosures has been the collection of fees from suspense accounts before applying the funds to payments. This practice makes the consumer appear much further in default than is actually the case.

In addition, the proposed regulation could be read to conflict – in a way that harms consumers – with some more protective state laws. Proposed section 1026.36(c)(ii)(B) requires that the funds held in suspense be applied to the *oldest* outstanding payment first. This has the effect of triggering multiple late fees when there has been a single missed payment. And, this is the rule in some states. However, in other states, the rule is the opposite. A single missed payment triggers one late fee, rather than multiple ones. The late fee trigger does not affect the "delinquency clock" used by servicers. The mortgage is still considered delinquent based on the number of payments the mortgage is behind.

For example, assume that the payment due for January is missed altogether, but the February, March, and April payments are all made on time and in full. If the proposed regulation is in effect, the February payment will be applied to January, making the February payment late as well. The same will occur in March, and April. So with the scheme set out in the proposed rule, the January missed payment triggers late fees for every month until the missed payment is made up – even though it was only one payment missed. Yet in the states with the alternative – more protective rule – the January missed payment would trigger a late fee, but the payments made in February, March and subsequent months would all be considered timely, so no late fee would be charged for those months.

There are at least eleven states that have these greater consumer protections: Colorado, Idaho, Indiana, Iowa, Kansas, Louisiana, Mississippi, Oklahoma, West Virginia, Wyoming and

[16] 16 C.F.R. § 444.4.

Wisconsin.[17] In each of these states the late fee is triggered only once in this scenario. The January payment is considered missed, but the February, March and April payments are not considered late. This is obviously a critical difference.

Moreover, the proposed regulation is at odds with the traditional delinquency clock used by servicers. In the scenario above, the mortgage would continue to be considered just one month behind – not multiple months as suggested by the number of late fees triggered.

The proposed regulation should either mandate the more consumer-friendly way of treating payments (applying them to the most recent payment due) or should be silent on the matter.

E. Recommendations: The following changes should be made to the Payment Processing regulation:

1. All payments, not just "full contractual payments," must be credited on the date received.
2. All payments made on a loan which uses the daily accrual method of assessing interest must be credited as of the day received, unless the exception in 15 U.S.C § 1639f(b) applies.
3. All payments made on a loan using the scheduled method of calculating interest should be treated as paid for purpose of triggering default servicing activities (such as inspection activities and the count-down to foreclosure).
4. When partial payments are placed in suspense accounts, the payments must be applied to the loan first to interest, then to principal, and only to late fees once all past due payments have been paid.
5. It should be clarified that late fees can only be triggered by the non-payment of interest and principal, and state law limits on the amount of the late fees must be complied with (unless these laws are not applicable under an otherwise-applicable preemption).
6. The proposed regulation should either mandate the more consumer-friendly way of treating payments (applying them to the most recent payment due) or should be silent on the matter.

IV. Payoff Statements.

The proposed regulation in § 1026.36 on payoff statement is in compliance with the statutory requirements. We have no suggestions for improvements.

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[17] Colo. Rev. Stat. § 5-2-203; Idaho Code Ann. § 28-42-301; Ind. Code § 24-4.5-3-203.5; Iowa Code § 537.2502; Kan. Stat. Ann. § 16a-2-502; La. Rev. Stat. Ann. § 9:3527; Miss. Code Ann. § 75-17-15; Miss. Code Ann. § 75-17-15; Okla. Stat. tit. 14A, § 2-203; W. Va. Code § 46A-3-113; Wis. Stat. § 138.052.