CrossCheckCompliance

# The Mortgage Servicing Rule — Are You Prepared?

BY JIM SHANKLE, CFSA, AND LIZA WARNER, CPA, CFSA, CRMA

As seen in **ABA BANK COMPLIANCE**
COVER STORY
September-October 2017

# *The Mortgage Servicing Rule—Are You Prepared?*

Since the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) in July 2010, the regulatory environment has continued to impose many challenges on loan servicers. In addition to the servicing rules that became effective in January 2014, the Consumer Financial Protection Bureau (Bureau) has continued to provide additional clarifications and revisions resulting from industry and consumer feedback. The Bureau issued a final rule in August 2016 titled Amendments to the 2013 Mortgage Rules Under the Real Estate Settlement Procedures Act (Regulation X) and the Truth in Lending Act (Regulation Z), referred to as the 2016 Mortgage Servicing Rule (the Rule). The Bureau has staggered the implementation dates so that some provisions of the Rule will become effective on October 19, 2017, while others (rules addressing successors in interest and bankruptcy) will not be implemented until April 19, 2018. Now is a good time to step back and assess how prepared your organization is for these new provisions.

## The Impact of Servicing Transfers

When servicing of loans changes from one company to another, servicers must be mindful of the Bureau's requirements regarding transfers of servicing. In February 2013, the Bureau issued Bulletin 2013-01 which generally defined mortgage servicing transfers as situations where a mortgage owner sells the right to service its loans or when the mortgage owner outsources the servicing duties. With increased volume in loan servicing, and transfers involving hundreds of thousands of documents and customer histories, challenges abound.

One major issue has been brought to the forefront by the Bureau: the out-of-date servicing technology in place at many servicers, which has impacted their ability, among other things, to properly and accurately transfer mortgage loan information. This concern is not always evident until the new servicing entity works with customers who are in default or later stages of loss mitigation. Lack of system compatibility between the servicers involved in the transfer transaction is an obvious conversion issue, and one that project management teams identify as a priority. Depending upon the complexity of the loans transferred, 250 or more data fields may be involved. If the entity acquiring the servicing is limited in the number of specific loan characteristic fields that can be converted within their existing servicing platform, decisions need to be made on the scope of information that will reside in their system. Manual processes and storage systems are customarily required so that all critical data is properly captured to ensure transparency in the on-going servicing. With an increase in the number of independent and new servicers in the market, the lack of system compatibility is a significant risk that must be mitigated to prevent borrower harm.

> *When servicing of loans change from one company to another, servicers must be mindful of the Bureau's requirements regarding transfers of servicing.*

Loans are transferred in various stages of loss mitigation, foreclosure, or bankruptcy and must be properly identified as such. This ensures continuity of service and mitigates the risk of harm to the borrower than can result from dual tracking or inconsistent levels of service in the default/loss mitigation process. The Rule continues to emphasize the importance of ensuring servicing transfers are transparent to borrowers.

## Implementing the Changes

Though not as daunting as the initial 2014 servicing rules, the Rule requires servicers to properly plan for changes that impact various roles within the servicing function. Servicers should include third parties providing servicing support in their implementation planning, such as print vendors for disclosures and billing statements and third-party law firms. Significant changes are likely needed to update related internal procedures, and business-line training is needed to address the related revisions. This should include consideration of any state law requirements that may conflict with the Rule. A rigorous first line of defense, where there is a quality assurance process over the servicing function, will help identify issues early. It will also ensure any potential or inadvertent consumer harm is averted or addressed promptly. Lastly, establishing a cohesive "tone at the top" will reap benefits throughout the entire implementation process. The Rule provides additional clarifications and revisions resulting from industry and consumer feedback that address the following key areas.

*Live contact with a delinquent borrower is deemed critical to helping the borrower work through his or her payment issues and for the servicer to ultimately collect the deficiency.*

### *Definition of Delinquency*

Within the Rule, the Bureau clarified the definition of "delinquency" to facilitate consistency in how servicers address the various servicing disclosure requirements for delinquent loans. The early intervention, continuity of contact, and the 120-day foreclosure filing prohibitions are addressed within Regulation X, while required periodic payment statement disclosures on delinquency status are included within Regulation Z. This clarification directly impacts any of the revisions included in the Rule where there is a reference to delinquency period or status.

Delinquency begins "on the date a periodic payment sufficient to cover principal, interest, and escrow (if applicable), becomes due and unpaid, until such time as no periodic payment is due and unpaid". The delinquency begins at the unpaid due date, regardless of whether the servicer provides a grace period or assesses a late fee.

The Rule does not prohibit a servicer from accepting a payment that does not fully cover principal, interest, and escrow (partial payment) as timely. However, if the servicer regards a partial payment as a timely remittance, then the servicer cannot report the borrower as delinquent for the applicable payment period. The servicer can continue to collect deficient balances, but cannot, at any time, rescind or revise the decision to treat the accepted partial payment in the servicer's calculation of the delinquency period for the borrower. Since many servicers tend to accept payments that differ slightly from the scheduled payment amount, the Rule does not specify that payment differences need to be within a required dollar range. To ensure consistency in customer treatment, the institution should establish and communicate its procedures, including acceptable dollar ranges for payment differences, to servicing personnel.

In the case where the borrower is more than one-month delinquent, the industry commonly applies a borrower's payment to the oldest outstanding payment due. While the Rule does not require servicers to adopt this practice, if they do, servicers must advance the date the borrower's delinquency began, regardless of any additional periodic payment that may be due and unpaid. For example, if payments are due on the first of the month and the borrower does not make the January 1 payment, the borrower is 30 days delinquent as of January 31. A payment is received on February 3 that the servicer applies to the January 1 outstanding payment. Assuming the February 1 payment was not made, on February 4, the borrower is three days delinquent.

Servicers (except small servicers as defined in Regulation Z) must ensure that a delinquent borrower is assigned a servicer contact no later than the 45th day of delinquency. Continuity of contact will ensure the borrower receives accurate and complete information regarding their loan and related loss mitigation efforts.

All servicers, including small servicers, must comply with the Rule's definition of delinquency when referring foreclosures based upon the 120-day delinquency period as it relates to the initial filing or first notice requirement applicable to either the judicial or non-judicial foreclosure process.

### *Periodic Statements*

Once a borrower is more than 45 days delinquent, servicers must notify the borrower of the length of delinquency dependent on how the servicer provides payment information to the customer. Disclosures must be included in periodic statements if one is provided. Alternatively, if the servicer relies on coupon books, it must provide a written notice. The length of delinquency disclosed in either the periodic statement or written notice, must comply with the definition of delinquency in the Rule.

### *Prompt Payment Crediting*

For *permanent* loan modifications, the periodic payment due is the amount stated in the executed modification agreement. In the case of a *temporary* loss mitigation agreement, the existing loan contract dictates the periodic payment amount. The borrower can continue to be considered delinquent per the terms of the prior loan agreement throughout a temporary loss mitigation arrangement.

### *Requests for Information*

If the servicer receives a request for ownership information on a loan owned by Fannie Mae or Freddie Mac, or where these entities are the trustee of the securitization trust holding the loan, the servicer may respond differently based on the request. Borrower inquiries that do not specifically request the name and number of the pool or trust involved, only require the servicer to provide the name and contact information for Fannie Mae or Freddie Mac. Should the borrower specifically request the name or number of the trustee of the securitization in which their loan is held, then the name of the trust, trustee's name, address and contact information must be included in the servicer's response.

For requests for ownership where Fannie Mae or Freddie Mac is not the owner of the loan, or is not the trustee of the securitization trust in which the loan is held, then the servicer should provide the name of the trust and the trustee's name, address, and appropriate contact information.

### *Force-Placed Insurance*

The Rule includes a revision of the force-placed insurance disclosures and model forms for those situations where the servicer plans to force-place insurance due to insufficient hazard insurance coverage, rather than lapsed coverage or pending expiration of coverage. In addition, the servicer now has the option to include the borrower's loan account number on all force-placed insurance notices.

### *Early Intervention*

Live contact with a delinquent borrower is deemed critical to helping the borrower work through his or her payment issues and for the servicer to ultimately collect the deficiency. The Rule provides additional guidance for the early intervention live contact and timing of the required written notices.

Servicers are not required to provide the borrower more than one written notice within a 180-day period. If the borrower is 45 days *or more* delinquent at the end of the 180-day period, an additional written notice must be provided no later than 180 days after the initial notice was provided. For borrowers who are *less than* 45 days delinquent at the end of any 180-day period, the servicer must provide an additional written notice no later than 45 days after the payment due date. This requirement does not apply to borrowers in bankruptcy, or for borrowers who invoked cease communication protection under the Fair Debt Collection Practices Act (FDCPA) for the subject loan. In such cases, the servicer also does not need to send the required written notice if no loss mitigation options are available. However, if any loss mitigation option is available, the servicer must comply with the written notice requirements for the loan unless both exemption conditions are met.

### *Loss Mitigation*

The Bureau revised several loss mitigation requirements included within Regulation X, that require the servicer to do the following:

## MORTGAGE SERVICING AND THIRD PARTIES

While the business reasons for transferring servicing are justified, the responsibility for compliance with servicing rules cannot be delegated if servicing activities are out-sourced to a third party. Pursuant to the March 2016 GAO Study—Nonbank Mortgage Servicers, the Bureau estimates that over 1,300 non-depository servicers are now actively servicing mortgages, and market share projections are increasing. As this shift continues, servicers must not only anticipate additional regulatory focus brought about by the Rule, but they must also ensure any third parties involved in its servicing activities comply with all the rules. A recent Bureau enforcement action of one of the country's largest non-bank mortgage loan servicers addressed failures at nearly every stage of the mortgage servicing process.

- Execute loss mitigation requirements more than once during the life of the loan for borrowers that become current, but subsequently submit a loss mitigation application.
- Join the foreclosure action of either a superior or subordinate lienholder.
- Select a reasonable date for the borrower to provide documents and information to complete a loss mitigation application.
- If a borrower provides a completed loss mitigation application more than 37 days prior to the foreclosures sale, do not proceed with foreclosure activities unless the borrower's loss mitigation application is denied, withdrawn, or the borrower fails to perform on a loss mitigation agreement. The servicer must also inform foreclosure counsel not to move

forward unless one of the three conditions is met.

- Provide a prescribed written notice to the borrower within five days (excluding Saturdays, Sundays and legal holidays) after it receives a completed loss mitigation application. The notice must include specific information and disclosure statements outlined in the Rule.
- Exercise reasonable efforts to obtain documents and information that must be provided by third parties. This includes giving the borrower a written notice within 30 days of receiving the borrower's application, if the servicer lacks the required third-party information and therefore cannot determine what loss mitigation options to offer the borrower. All steps in the evaluation process must be completed within 30 days (even with the lack of third party information) and the borrower must be promptly notified of the loss mitigation decision upon receipt of the third-party information that was lacking. A servicer cannot deny a borrower's loss mitigation request solely because it lacks the third-party information.
- Consider offering a short-term payment forbearance program or short-term repayment plan upon evaluation of an incomplete loss mitigation application. The notification to the borrower of this short-term arrangement must include the payment terms and duration of the program as well as other pertinent information related to the arrangement.
- If the servicer subsequently determines the borrower is not eligible for a loss mitigation option, the servicer can stop collecting documents and information from a borrower.
- Adhere to the loss mitigation procedures and timelines when the servicer receives a loan with a pending loss mitigation application at the time of transfer.

### *Successors in Interest*

The Rule added similar clarifying definitions for successors in interest to Regulation X (RESPA) and Regulation Z. Use of the term "borrower" in RESPA and "consumer" in Regulation Z accounts for the slight definitional variation. A successor in interest is a person to whom a borrower transfers an ownership interest in a property securing a mortgage loan by means of five different types of transfers.

Mortgage servicers (except small servicers) are required to maintain updated policies and procedures that specify the following for successors in interest:

- Required documentation needed to confirm status; and
- Borrower notification process related to inquiries (acceptance, need for additional information, or that they are not a successor in interest).

A person does not have to assume the mortgage, or be liable on the mortgage loan to be a successor in interest under the Rule.

The RESPA provisions included in the 2014 servicing rules will continue to apply as the Rule considers a confirmed successor in interest a "borrower and/or consumer" for purposes of disclosure and ongoing servicing. Hence disclosures, statements, and notices would apply in the same way they apply to another borrower or consumer. The Rule does not mandate that servicers send specific written disclosures to a confirmed successor in interest if the same disclosures have been provided to the borrower/consumer or other confirmed successors in interest. The example provided by the Bureau is if the servicer provides a force-placed insurance disclosure to a borrower, it does not need to send the same force-placed insurance disclosure to a successor in interest. A successor in interest may request information not initially provided to them through the request for information process.

RESPA's loss mitigation requirements apply to successors in interest who submit a loss mitigation application on a loan if they reside in the property securing the loan. The servicer (unless exempted) must evaluate the application even if the application was received prior to confirming the eligibility of the successor in interest. The servicer is prohibited from requiring the confirmed successor in interest to assume the loan prior to making a decision on the loss mitigation application. However, the Rule does not prevent a servicer from offering a loss mitigation option on the condition that the successor in interest assume the loan as permitted by state law.

Servicers are required to send modified periodic statements or written notices to consumers who have filed for bankruptcy. The content of the statements or written notices will vary depending upon whether the consumer is a debtor in a Chapter 7, 11, 12 or 13 bankruptcy case. The Rule provides sample forms for the various types of bankruptcies to ensure servicer compliance with these requirements.

Along with the Rule, the Bureau also issued an interpretive rule under the FDCPA. Among other things, it provides safe harbor from liability for servicers acting in compliance with mortgage servicing rules in three specific situations:

1) When communicating information about a mortgage loan with confirmed successors in interest;
2) When providing the written early intervention notice required by RESPA; and
3) When responding to borrowers who initiate communication related to loss mitigation after the borrower has invoked the cease communication right within the FDCPA.

*Training is the key to ensuring compliance and providing the best customer service in mortgage loans.*

As a result of industry concerns over mid-week implementation of the Rule, the Bureau issued non-binding policy guidance on June 27, 2017. This guidance allows servicers to begin complying with the new provisions three days early. This will allow institutions to implement changes during the preceding weekend. The non-binding guidance states that the Bureau does not intend to take any supervisory or enforcement actions for violations of existing Regulation X or Regulation Z provisions resulting from a servicer's compliance with the 2016 Rule, that occurs between the beginning of the week and the actual effective date of the new rules. This is true for both sets of new rules with effective dates of October 19, 2017 and April 19, 2018.

## Conclusion

Since the Bureau's mandate requires a review of rules within five years of their effective date, continued changes are inevitable. Financial institutions must foster a culture and organizational structure that will facilitate efficient and effective implementation of future regulatory changes. Clear and transparent internal communications are essential. The efforts put forth and lessons learned by mortgage servicers, to comply with the 2014 rules, can provide for smoother implementation of the upcoming regulatory changes. Avoiding the “silo approach” and involving third parties as early as possible (such as systems providers who are crucial to the process), will ensure a smoother transition. Training is the key to ensuring compliance and providing the best customer service in mortgage loans. Training should provide the entire organization with understanding of the regulatory changes, and further in-depth training should be created for the lines of business responsible for execution.

With a good understanding of these changes, how they apply to your servicing function, and a measured approach to implementation by the effective date, you will be prepared! ■

**ABOUT THE AUTHORS**

**Jim Shankle, CFSA,** is a managing director at CrossCheck Compliance. He provides firm clients with over 30 years of experience in regulatory compliance and internal audit with specific expertise in mortgage origination and servicing. Jim held positions in consulting, as chief audit executive at an Ohio-based thrift, and spent three years in the former Soviet Union on bank privatization efforts in the newly formed independent states. Jim is a Certified Financial Services Auditor (CFSA). Jim can be reached at jshankle@crosscheckcompliance.com.

**Liza Warner, CPA, CFSA, CRMA,** is a managing director at CrossCheck Compliance and a bank internal audit, compliance, and risk management executive with over 30 years of experience in the financial and professional services industries. Previously, Liza was the chief compliance and operational risk officer for a mid-size regional bank and has consulted with institutions of all sizes on their internal audit and compliance needs. She started her career in the internal audit function of what is now one of the largest national banks. She is a CPA, a Certified Financial Services Auditor (CFSA), and she holds a Certificate in Risk Management Assurance (CRMA). Liza can be reached at lwarner@crosscheckcompliance.com.