Consumer Mortgage Coalition

November 11, 2014

William R. Breetz, Chairman
Uniform Law Commission
Home Foreclosure Procedures Act Committee
University of Connecticut School of Law
Knight Hall Room 202
35 Elizabeth Street
Hartford, CT 06105

Re: Draft Home Foreclosure Procedures Act

Dear Chairman Breetz:

The Consumer Mortgage Coalition ("CMC"), a trade association of national mortgage lenders, servicers, and service providers, appreciates the opportunity to submit comments on the draft Home Foreclosure Procedures Act ("Draft HFPA") being forwarded by the Uniform Law Commission. Mortgage lenders, servicers, and investors generally prefer uniform state mortgage and foreclosure laws. We welcome the Commission's efforts in the formidable task of drafting uniform home foreclosure rules.

Unfortunately, the November 2014 draft uniform law raises concerns about foreclosure delays and litigation, and would create assignee liability in addition to new liability that Congress created in the Dodd-Frank Act.[1] For the reasons we describe below, we cannot support the early resolution procedures, assignee liability, and good faith standards, that are presently in the draft uniform law.

Uniform state and federal laws would be enormously helpful to the mortgage markets. Uniform laws would improve fungibility and liquidity, as the Fannie Mae and Freddie Mac uniform security instrument did many years ago. Uniform and clear standards would reduce the costs of tracking and complying with myriad state laws, and would thereby reduce the cost of housing finance for consumers.

Early Resolution is Inconsistent with the CFPB's Loss Mitigation Requirements

The Draft HFPA would not replace the new Consumer Financial Protection Bureau ("CFPB") loss mitigation regulation; rather, both procedures would apply in states that adopt the uniform law. In these states, we believe new foreclosure delays would result, without change in the ultimate outcome.

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[1] The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat 1376 (2010).

The early resolution procedure in the Draft HFPA is designed to encourage creditors to meet with borrowers early in a default to reach a resolution. This is an eminently reasonable goal. However, the CFPB's loss mitigation procedure is not a negotiation procedure, and is designed to be thorough rather than rapid. The CFPB requires servicers to attempt to obtain a complete application from the borrower, then to consider the borrower for every available loss mitigation alternative.[2] The CFPB generally does not permit servicers to make a decision before a loss mitigation application is complete.[3]

With both procedures operating together, the servicer would need to seek to obtain a complete application, and consider the borrower for every available alternative, before making its loss mitigation decision. The Model Early Resolution Program Rules would require the servicer to provide notice of a loss mitigation decision before the resolution meeting may occur.[4] If the servicer is unable to "appear at the early resolution meeting with authority to act on any available loss mitigation alternatives," the early resolution meeting "shall" be postponed.[5]

For better or worse, the CFPB's procedure does not include a back-and-forth negotiation or resolution process. Under the CFPB's procedure, servicers apply the investor's loss mitigation "waterfall," or hierarchy, of options in their specified order:

> "[W]here an owner or assignee has established an evaluation criteria that sets an order ranking for evaluation of loan modification options (commonly known as a waterfall) and a borrower has qualified for a particular loan modification option in the ranking established by the owner or assignee, it is sufficient for the servicer to inform the borrower, with respect to other loan modification options ranked below any such option offered to a borrower, that the investor's requirements include the use of such a ranking and that an offer of a loan modification option necessarily results in a denial for any other loan modification options below the option for which the borrower is eligible in the ranking."[6]

By the time a resolution meeting is permissible, there would be no reason to meet because the servicer's decision would almost certainly be final. If the servicer denied loss mitigation, there would be nothing to discuss. If the servicer offered a loss mitigation option, the only question would be whether the borrower would accept the offer.

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[2] 12 C.F.R. § 1026.41(b)(1); comment 41(b)(1)-4.i.

[3] "[A] servicer shall not evade the requirement to evaluate a complete loss mitigation application for all loss mitigation options available to the borrower by offering a loss mitigation option based upon an evaluation of any information provided by a borrower in connection with an incomplete loss mitigation option." 12 C.F.R. § 1024.41(c)(2)(i).

[4] "At least [10] days prior to the early resolution session, the creditor must notify the neutral and homeowner of any decision to offer or not offer any loss mitigation options to the homeowner." Model Early Resolution Program Rule 16.

[5] Model Early Resolution Program Rule 19.

[6] 12 C.F.R. Part 1024 comment 41(d)-1.

The CFPB does permit appeal of loan modification denials in some cases.[7] If the borrower appeals, an early resolution meeting while the appeal is pending would be premature because the servicer would not yet know what loss mitigation might be available. After the appeal is decided, as after a servicer's initial decision, there would be no point in a meeting because the only question would be whether the borrower would accept a loss mitigation offer, if there is an offer.

That is, as long as the CFPB's regulation remains in force, the early resolution procedure would not result in resolution any earlier than is currently possible. Unfortunately, the draft procedural rules would create an open-ended timeline. They would provide that "the court or early-resolution agency [may] direct the parties to continue early resolution."[8] The early resolution process could continue indefinitely.

In some states, the early resolution procedure may not be permitted to begin until after the servicer initiates foreclosure. Under CFPB rules, foreclosure may not be initiated until after the CFPB's loss mitigation procedure has run its course. At this late point in a foreclosure, loss mitigation has failed, so it is too late for a resolution meeting.

Finally, and significantly, the early resolution procedure would not result in different loss mitigation outcomes than under the CFPB's regulation. The early resolution meeting would occur only after the servicer makes a final loss mitigation decision, and given the CFPB rules, the meeting would not alter that decision.

Unless the CFPB were to repeal its loss mitigation regulation, the Draft HFPA early resolution procedure would not be helpful in resolving mortgage defaults, and for this reason we are unable to support it.

The Dodd-Frank Act Created Assignee Liability

Section 706 of the Draft HFPA would create liability for assignees for a claim or defense a borrower has against the initial holder of the obligation in connection with the original loan transaction based on fraud, material misrepresentation, or fundamental breach of promise. This potential liability would lapse when an applicable statute of limitations runs, or if it has not run, after six years from origination or, for adjustable-rate loans ("ARMs"), one year after the servicer sends a rate-reset notice. Relief would be limited to reformation of the obligation and recoupment.

This new liability would be in addition to liability created under the Dodd-Frank Act, and we are unable to support it.

The intent of assignee liability is to impose liability on an assignee who did *not* commit a fraud, as a means to prevent a lender from committing fraud then selling the loan to shift liability when the fraud comes to light.

The Dodd-Frank Act applies substantial liability to mortgage lenders, servicers, and

[7] 12 C.F.R. § 1024.41(h).
[8] Draft HFPA § 305(c).

investors for faulty loan originations, so much so that a new source of assignee liability would not serve its intended purpose. This Dodd-Frank Act liability attaches for acts that do not rise to the level, in Draft HFPA § 706(b), of fraud, material misrepresentation, or fundamental breach of promise. Dodd-Frank Act liability can arise merely as a result of a default.

Two Dodd-Frank Act provisions are important in this discussion. One is the ability-to-repay rule, otherwise known as the qualified mortgage ("QM") rule, which the Dodd-Frank Act added to the Truth in Lending Act ("TILA"). The other is the risk-retention rule.

Under the ability-to-repay rule, lenders must document a borrower's ability to repay a loan, under penalty of draconian damages.[9] Lenders have some protection from liability if the loan is a QM loan. As a result of the potential TILA liability for violations of the ability-to-repay rule, there is essentially no primary or secondary market for non-QM loans, if the loans would be subject to the ability-to-repay rule.

The risk-retention rule exempts qualified residential mortgage ("QRM") loans, which are defined the same as QM loans. This category of loans is therefore subject to the ability-to-repay rule and is exempt under the risk-retention rule.

Some consumer mortgage loans, especially reverse loans and open-end credit, are not subject to the ability-to-repay rule but are subject to the risk-retention rule. The risk-retention rule requires securitizers to retain five percent of the credit risk of the loans they securitize. (Lenders can avoid risk-retention by retaining their loans, in which case assignee liability does not arise.)

That is, consumer mortgage loans largely are subject to one of the two rules. Under either, the liability for faulty loan origination is severe enough that adding a new source of assignee liability would not serve its intended purpose.

The Ability-to-Repay Rule Creates Life-of-Loan Assignee Liability

The ability-to-repay rule creates life-of-loan liability. A borrower may assert violations of the ability-to-repay rule as a defense to foreclosure at any time during the life of the loan. Borrowers facing foreclosure have a strong incentive to assert ability-to-repay violations, with little or no basis, for two reasons. First, litigation over the allegations would delay a foreclosure, and would extend the time the borrower may remain in the property without making loan payments. Second, the potential TILA damages are so draconian – greater than the potential profit on a loan – that servicers would be forced into a settlement that favors a borrower, even if the allegations are baseless.

TILA violations are subject to consumer actions, state attorneys general actions, and regulatory actions including CFPB actions. Notably, beyond TILA damages, the CFPB can obtain all of the following forms of relief:

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[9] Damages for ability-to-repay violations under TILA include actual and statutory damages, costs of bringing an action, plus all finance charges and fees a borrower paid.

- Rescission or reformation of contracts;
- Refund of moneys or return of real property;
- Restitution;
- Disgorgement or compensation for unjust enrichment;
- Payment of damages or other monetary relief;
- Public notification regarding the violation, including the costs of notification;
- Limits on the activities or functions of the person; and
- Civil money penalties of $5,000 per day a violation continues, or $25,000 per day if the violation was reckless and $1 million per day if the violation was knowing.[10]

The CFPB may bring actions under TILA.[11] The CFPB may also intervene in "any" TILA actions that another party brings,[12] such as "any" action contesting a foreclosure based on alleged TILA violations under the QM life-of-loan liability. That is, when TILA liability lasts for the life of a loan, so does the CFPB's authority to intervene in a TILA action.

Moreover, § 706(b) of the Draft HFPA would base assignee liability on a "material misrepresentation[.]" TILA permits homeowners an extended period to rescind a mortgage loan based on failure to deliver required disclosures.[13] It appears that failure to deliver a TILA-required disclosure could be a § 706(b) "material misrepresentation" even though the draft does not explicitly mention TILA or rescission.

Creating yet more bases for liability under a new state law would not prevent inappropriate loans from being made because the present liability is already more than enough to accomplish that purpose.

The Risk-Retention Rule Requires Investors to Ensure Sound Lending

The risk-retention rule generally requires securitizers to hold five percent of the credit risk of loans they securitize. For single-family mortgage loans, the risk-retention requirement stays in force for five to seven years, or until the unpaid principal balance of the pooled loans is reduced to 25 percent of its aggregate balance at securitization.

For consumer mortgage loans subject to the risk-retention requirement, adding new assignee liability before the risk-retention requirement sunsets would not improve the quality of loan originations because the risk-retention requirement already accomplishes that purpose. After the risk-retention requirement sunsets, there would be no purpose for adding new assignee liability for the same reason – a loan that does not default during its first five to seven years was, probably by definition, a sound loan at origination.

New state laws creating additional assignee liability for mortgage originations would not improve lending standards.

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[10] Dodd-Frank Act § 1055, 12 U.S.C. § 5565.
[11] Dodd-Frank Act § 1054(a), 12 U.S.C. § 5564(a).
[12] Dodd-Frank Act § 1054(g) and (g)(2), 12 U.S.C. § 5564(g) and (g)(2).
[13] TILA § 125(f), 15 U.S.C. § 1635(f).

Unclear Lending, Servicing, and Purchasing Standard

Mortgage investment requires clear standards for liability, for lenders, servicers, and investors. The Draft HFPA would create a duty for creditors to "comply in good faith" with the Draft HFPA, including throughout the foreclosure process.[14] This duty would apply to creditors, their assignees,[15] and to servicers.[16] The draft HFPA defines good faith as "honesty in fact and the observance of reasonable commercial standards of fair dealing."[17] Drafters have not yet decided whether the duty would create an independent cause of action for the failure to act in good faith.

Good faith is a subjective and fact-intensive standard, and would therefore likely create litigation. Lenders, servicers, and investors would not be able to protect themselves from liability under such an uncertain standard, and would therefore need to reduce their presence in markets where such a standard is adopted.

Conclusion

The mortgage industry appreciates the efforts of the Home Foreclosure Procedures Act Committee in undertaking the complex task of drafting uniform home foreclosure procedures. Uniform lending and servicing standards generally benefit mortgage borrowers.

However, as presently drafted, the home foreclosure procedures would create delays in the foreclosure process, given the CFPB's new loss mitigation requirements. The draft assignee liability would not serve the intended purpose of improving loan underwriting practices, especially in light of the Dodd-Frank Act. The subjective good faith lending and servicing standard would create uncertainty about what the law requires. For these reasons, we cannot support these aspects of the present draft.

We continue to strongly support clear and uniform nationwide lending and servicing standards because clear and uniform standards would make loans more fungible and liquid, while reducing the cost of housing finance.

Sincerely,

Anne C. Canfield
Executive Director

[14] Draft HFPA § 104(a).
[15] Draft HFPA § 102(3).
[16] Draft HFPA § 107(b)(2).
[17] Draft HFPA § 104(a).