Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Ignore Borrower Choice In Loss Mitigation? CFPB Says Yes

By **Jeffrey Naimon, Jon David Langlois and Daniel Cheriyan**
September 29, 2017, 11:54 AM EDT

Jeffrey Naimon

Jon David Langlois

Daniel Cheriyan

Mortgage servicers should not listen to borrowers when it comes to loss mitigation. At least, that's what the Consumer Financial Protection Bureau says. More specifically, servicers should disregard when a borrower tells the servicer they do not want to keep their home. Officially, this has been the position since the bureau promulgated its final servicing rule in 2013 (effective January 2014), and despite feedback of borrower confusion and servicer frustration, the bureau reiterated its stance in recent amendments to those rules that take effect on Oct. 19, 2017.

The Final Servicing Rule

In January 2013, the bureau issued the final servicing rule to clarify and revise its rules implementing the Real Estate Settlement Procedures Act of 1974. Among other things, the final servicing rule established new loss mitigation procedures, which in part require servicers to "exercise reasonable diligence in obtaining documents and information to complete a loss mitigation application," and to "evaluate the borrower for all loss mitigation options available to the borrower" upon receipt of a completed application. In practice, these twin mandates require constant communication and cooperation between the servicer and the borrower — the borrower must work with the servicer to provide all requested information to complete the application, and the servicer must in turn diligently pursue the information and then evaluate the complete application for all available loss mitigation options.

What vexes many servicers is the following: Why and how do you proceed on things like loan modification options with a borrower who expressly tells you that they have no interest in one? As part of the basic intake of information from a borrower experiencing hardship, servicers often ask for the borrower's intentions regarding the property. It may be a part of discussions on the phone with a loss mitigation specialist, and it often is incorporated into the loss mitigation application itself. For instance, the standard government-sponsored enterprise (GSE) mortgage assistance application prompts the borrower to indicate whether they wish to keep or sell the property, along with an option for "undecided." Even the early versions of the required "Request for Modification and Affidavit" application for the federal Home Affordable

Modification Program (HAMP) included a similar selection. A borrower can affirmatively indicate, through the conversation and on the application, that they do not want to remain in their home, and would prefer to sell. Given this, it is poor customer service to continue to pursue and evaluate a borrower for all available loss mitigation options, including home retention options like loan modifications.

According to the bureau, however, the servicer must do just that. In its section-by-section analysis of the final servicing rule in 2013, the bureau stated that servicers must evaluate borrowers for all loss mitigation options, even with respect to "borrowers that, in theory, may only wish to obtain an evaluation for a specific type of loss mitigation option." The bureau summarily dismissed recommendations to the contrary, stating in the preamble to the rule that it "does not believe" that this requirement would "impose onerous application burdens on a borrower, require a servicer to provide confusing or unhelpful communications to borrowers" or otherwise frustrate borrowers. As a result, borrowers and servicers must slavishly forge ahead in finding, sending and evaluating documentation for options the borrower has no interest in using.

Servicers: Stuck Between a Rule and a Hard Place

Not surprisingly, the bureau's directive to disregard borrower preferences places servicers in a bind. On the one hand, servicers could ignore the borrower's stated preference, demand additional documentation in pursuit of unwanted loss mitigation options, confuse the borrower by telling them they were evaluated for home retention options they didn't ask for, and potentially frustrate the borrower's attempts to proceed with an option like a short sale. Alternatively, servicers could listen to the borrower, honor their preference and attempt to facilitate an efficient, effective exit from the property, but at the risk of violating the rule.

Comments submitted to the bureau as part of the finalization of the 2016 amendments evidenced this dilemma, as servicers reported differing approaches on how to navigate a borrower who expressed a clear preference to sell the property through the loss mitigation process. Servicers reported that a continuing obligation to collect documents and application materials for unwanted loss mitigation options created unnecessary burdens, and would often jeopardize borrowers' short sales or "cause borrowers to disengage, or would complicate the working relationship between borrowers and servicers." While some servicers continued to openly discuss other loss mitigation options with the borrower, or collect documentation for home retention options, others focused their efforts on facilitating the borrower's short sale, up to and including suspending collection of unrelated documentation. The majority of mortgage servicers, in an effort to listen to their customers, stated that they would honor a borrower's preference for as long as possible and would facilitate a short sale of the property, only turning to other home retention loss mitigation options if the short sale was ultimately unsuccessful.

The wide variety in servicers' approaches — rooted in pragmatic experience in how the conversations actually occur — presented an opportunity to the bureau to reduce burden and provide clarity to the requirement by amending the rule to a more common-sense approach. So long as a borrower is informed of and aware that home retention options are available to them, it would seem that the practical solution would be to allow the parties to pursue a nonretention option unimpeded by lengthy, ultimately pointless dialogue and document collection for retention options, frustrating the borrower and reducing efficiency. Nevertheless, the bureau held firm.

The Bureau Digs In…

In the 2016 amendments, the bureau stated that a servicer "may not stop collecting documents and information for any loss mitigation option based solely upon the borrower's stated preference but may stop collecting documents and information for any loss mitigation option based on the borrower's stated preference in conjunction with other information, as prescribed by any requirements established by the owner or assignee." Put another way, a servicer may only stop collecting documents and information for a particular loss mitigation option once it determines the borrower is no longer eligible for that option due to criteria set by the owner, and not based on the borrower's desire.

Consequently, the paternalistic model and Byzantine process of loss mitigation persists, and it remains true under the rule (including as amended) that if a borrower states a preference for a short sale, the servicer cannot simply honor it. Instead, the servicer, who remains subject to an obligation to "exercise reasonable diligence in obtaining documents and information to complete" borrowers' loss mitigation applications, must continue to request documentation from the borrower relevant to other, unwanted loss mitigation options and evaluate the borrower for those options. A servicer can only honor the borrower's preference if the servicer obtains additional information that is sufficient to allow the servicer to determine that the borrower is no longer eligible for the retention options.

…But With an Escape Route?

Nonetheless, the bureau did leave a bread crumb in the amendments that may lead the industry out of the woods. Although borrowers still cannot steer the loss mitigation evaluation to fit their preference, and servicers still would not be able to honor those wishes anyway, the owners (and assignees) of the loan do appear to possess that power. In particular, it is the owner that can set eligibility criteria for each individual loss mitigation option. Indeed, there is nothing preventing the owner from establishing as a criteria for a retention option like a loan modification that the borrower must indicate a desire to retain the home (and to not be "undecided"). Regrettably, it cannot be the only criteria — the bureau anticipated and rejected this argument in the amended rule, noting that "guidelines established by owners or assignees of mortgage loans similarly generally do not allow borrower preference alone to drive the servicer's conduct …" However, the bureau did leave open the solution where the borrower's expressed preference, coupled with the submission of additional information, could allow the borrower and servicer to cease the fruitless pursuit of an unwanted modification.

For example, an owner or assignee may set its loss mitigation criteria such that borrowers are ineligible for home retention loss mitigation options if they (1) state a preference for a short sale and (2) provide evidence of another applicable hardship, such as orders for a military permanent change of station or employment transfer, or additional documentation such as a listing agreement for a short sale. Under these requirements and the bureau's amendments, so long as a borrower meets these two elements, the servicer could suspend its document collection for all available home retention loss mitigation efforts and focus its efforts appropriately on fulfilling the borrower's request.

In the end, the best solution to an aggravating problem likely lies in the hands of loan owners instead of with the parties that are actually living it — borrowers and servicers. Although the solution is imperfect, since it still requires borrowers to paper their preferences before servicers can honor them, it does provide servicers with some amount of protection to pursue what common-sense and good customer service would otherwise dictate. In this respect, although the bureau rebuffed the calls to make the process truly pragmatic and helpful, it is also true that the amendments likely stand as an improvement on the confusion and aggravation resulting from the 2013 final rule.

Jeffrey P. Naimon and Jon David D. Langlois are partners, and Daniel Cheriyan is an associate at Buckley Sandler LLP. The authors represent financial institutions on a variety of regulatory and enforcement matters relating to mortgage lending and servicing, among other consumer financial services and products.