

Lenders Compliance Group

Friday, December 16, 2011

OCC Issues Foreclosure Guidance - Part II

In yesterday's newsletter, Part I of this two-part series, I outlined the role of the bank as owner and servicer of foreclosed property, as described in the recent guidance issued by the Office of the Comptroller of the Currency (OCC) with respect to a bank's obligations and risks related to foreclosed property. (See OCC 2011-49)

A bank's obligations with respect to foreclosed residential properties may differ depending upon the bank's role in the foreclosure. For instance, a bank may be (1) an owner of the foreclosed property, or (2) a servicer and/or property manager, or (3) a securitization trustee.

Additionally, there are specific obligations when lenders release a lien securing a defaulted loan rather than foreclose on a residential property.

In today's newsletter, Part II of this two-part series, I outline the role of the bank as trustee of a securitization trust, and also releasing a lien rather than foreclosing.

For detailed information and guidance, please consult with us or a regulatory compliance professional.

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Safety and Soundness

As a matter of safety and soundness banking practices, banks should have robust policies and procedures in place to address risks associated with foreclosed (or soon to be foreclosed) properties.

Acquiring title to properties through foreclosure - either for the bank or as servicer for another mortgagee - results in new or expanded risks, including operating risk (which may include market valuation issues), compliance risk, and reputation risk.

Banks should be sure they have identified all the risks, and have policies and procedures for monitoring and controlling these risks. In each risk management consideration, it is critical to establish and implement policies and procedures, and bank management and the Board of Directors should consider, at a minimum, the role of the bank in foreclosure procedures and obligations.

Bank as Trustee of Securitization Trust

The securitization trustee is primarily responsible for holding a lien on the trust assets for the benefit of the investors who purchase securities issued pursuant to the securitization and administering the trust in conformance with requisite agreements.

The trustee's duties and responsibilities are established by a PSA, trust agreement, or indenture. These agreements direct a securitization trustee to perform various complex administrative functions. Such functions usually include ensuring the timely receipt of payments from the servicer, calculating payments, remitting payments to the investors, circulating information to investors, monitoring compliance, and determining if an event of default is triggered.

As permitted by the PSA, the trustee should work with the servicer to ensure the performance of its responsibilities. The securitization agreements may require a trustee to appoint a successor servicer or to take over servicing in the event the original servicer fails to perform its duties or defaults. These agreements generally do not grant the trustee any powers or duties with respect to the foreclosure or with the maintenance, sale, or disposition of foreclosed properties. Instead, these responsibilities typically reside with the servicer.

Nevertheless, to the extent a servicer undertakes foreclosure actions in the trustee's name as the secured party, a bank trustee should be aware of potential reputation and litigation risks. (See my comments in Part I, relating to reputation risk.)

Additionally, if the securitization agreements require a bank trustee to act as a replacement servicer until a successor servicer is appointed, the bank trustee would also be exposed to credit risk.

Releasing a Lien Rather Than Foreclosing

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At times, lenders may release a lien securing a defaulted loan rather than foreclose on the residential property.

This decision is often based on financial considerations when the bank or servicer and/or investor determines that the costs to foreclose, rehabilitate, and sell a property exceed its current fair-market value. When this decision is made after a bank or servicer has initiated foreclosure, the borrower may have already abandoned the property or discontinued the care and maintenance of the property, increasing the chance of a blighted property in the community.

Because the decision to release a lien is typically a financial decision, banks and servicers should ensure that their valuation of the property provides the best information practicable, while complying with investor requirements, before initiating foreclosure and subsequently deciding to release the lien. While the financial risk must be considered, banks and servicers should also consider the potential for reputation and litigation risk arising from their position as a prior mortgagee or servicer of a now-abandoned property.

If the decision is made to forego foreclosure and release the lien, the bank or servicer should notify, or attempt to notify, the borrower of the decision. Borrowers should be notified that (1) the mortgage holder is not pursuing foreclosure and has released the mortgage lien, (2) the borrower may continue to occupy the property, and (3) the borrower is obligated to maintain the property consistent with all local codes and ordinances and to pay property taxes and the debt owed. The bank or servicer should also make appropriate notifications to the local jurisdiction when it makes the decision to release a lien in lieu of foreclosure.

Library



Office of the Comptroller of the Currency (OCC)
Foreclosed Properties
Guidance on Potential Issues
With Foreclosed Residential Properties
OCC 2011-49
December 14, 2011

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