Client Alert

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CFPB Issues Guiding Principles for Loss Mitigation after HAMP

By Donald C. Lampe and Ryan J. Richardson

On August 2, 2016, the Consumer Financial Protection Bureau ("CFPB") published a new guidance document titled CFPB's Principles for the Future of Loss Mitigation (the "Guidance"), which outlines a recommended framework for new, industry-driven foreclosure relief programs. The Guidance largely follows the July 25, 2016, white paper jointly issued by the U.S. Department of the Treasury ("Treasury"), the U.S. Department of Housing and Urban Development ("HUD"), and the Federal Housing Finance Agency ("FHFA") (collectively, the "Agencies"), in which the Agencies called for industry stakeholders to design and implement a loss mitigation framework tailored to the post-crisis mortgage market (the "White Paper"). Importantly, both the Guidance and the White Paper come as Treasury's Home Affordable Modification Program ("HAMP") is set to expire on December 31, 2016.

HAMP was established in 2009 as part of the Making Home Affordable ("MHA") Program, which Treasury and HUD created under the broad authority of the Emergency Economic Stabilization Act of 2008, 12 U.S.C. 5201 *et seq.* The MHA Program, particularly through HAMP, established uniform standards for loss mitigation and loan modification policies and procedures across the mortgage servicing industry. Over time, the MHA Program expanded significantly. The responsible federal agencies refined borrower eligibility criteria for HAMP loan modification options, and other stakeholders (e.g., the FHFA) set up companion programs designed to serve borrowers that were ineligible for HAMP. According to the White Paper, an estimated 10.5 million modifications and mortgage assistance arrangements were completed through HAMP and related programs between April 2009 and May 2016.

Pursuant to a 2015 budget law, the MHA Program, including the core components of HAMP, will terminate effective December 31, 2016. Specifically, beginning January 1, 2017, HAMP modification options will no longer be offered to borrowers, with the exception of borrowers whose loans are insured by the Federal Housing Administration, the U.S. Department of Veterans Affairs, or the U.S. Department of Agriculture ("USDA"). The MHA Program's second lien modification program, called 2MP, will also expire on December 31, 2016. The FHFA's Streamlined Modification Program, which is available only to borrowers whose loans are insured or guaranteed by a government-sponsored enterprise (Fannie Mae or Freddie Mac) ("GSE"), will remain available, as will the USDA's Special Loan Servicing program. Moreover, the FHFA recently announced that the Home Affordable Refinance Program ("HARP") offered by the GSEs, previously set to expire on December 31, 2016, will continue through September 1, 2017.

With the MHA Program sunset date approaching, the Guidance and the White Paper call on industry stakeholders to build on HAMP's successes by adopting uniform standards for loss mitigation and loan modification options that are reasonable for today's post crisis market. To guide this effort, the Guidance and the White Paper articulate four core principles that the CFPB and the Agencies believe should underpin future loss mitigation and loan modification frameworks: accessibility, affordability, sustainability, and transparency. The White Paper includes a fifth core principle—accountability—that the Guidance acknowledges but does not discuss in detail.

According to the Guidance, the CFPB's mortgage servicing rules provide the necessary standards for accountability in situations where servicers offer loss mitigation programs. Each of the five principles is discussed below.

- **Accessibility**. Servicers should make foreclosure alternatives like loss mitigation and loan modification options available to as many borrowers as possible, and such options should be easy for borrowers to understand. To maximize accessibility, servicers should simplify and streamline operations wherever possible. Specifically, the Guidance and the White Paper recommend using uniform application documents and application review procedures; eliminating overlapping and superfluous supporting document requirements; engaging trusted third parties to provide housing counseling to borrowers; and ensuring that borrowers interact with a single point of contact at the servicer throughout the review process.
- **Affordability**. Servicers should offer meaningful payment reductions to meet the needs of a borrower's particular hardship. Borrowers can achieve lower periodic payments by adjusting the interest rate on a loan, extending the term of a loan, and/or reducing the principal balance owed on a loan, among other modifications. To optimize affordability, the White Paper specifically advocates using a "waterfall" decision flow, by which the servicer (i) considers the available options in a specific order determined by the facts of the borrower's hardship, and (ii) identifies the option or combination of options that best suits the borrower's circumstance. In any event, the type and degree of relief should account for the borrower's complete financial picture; it should not examine borrower's mortgage obligation in a vacuum.
- **Sustainability**. Servicers should endeavor to offer solutions that succeed on the first try. No one with an interest in a mortgage repayment obligation (i.e., the borrower, the servicer, or the investor) is served by the servicer knowingly offering the borrower a temporary solution that is certain to fail. The most critical factors in achieving a sustainable solution are (i) the amount of the payment reduction; (ii) the timing of the intervention (i.e., the earlier the modification, the greater the likelihood of success); and (iii) whether the borrower seeks housing counseling.
- **Transparency**. Servicers should ensure the loss mitigation process is clear and understandable by all parties involved. In communications with borrowers, servicers should plainly explain loss mitigation options and their respective consequences, and servicers should readily offer referrals to housing counselors. Servicers should also publish their loss mitigation processes, including eligibility and approval criteria, to the public. Industry stakeholders should endeavor to collect and aggregate the data necessary to monitor the availability and effectiveness of loss mitigation and loan modification programs, and to improve such programs based on identified shortcomings.
- **Accountability**. Stakeholders should design and effectuate a system to oversee the administration of foreclosure alternative programs industry-wide, and to enforce agreed-upon standards for servicer performance. The Agencies highlight that accountability relies heavily on transparency. Servicers must report or publish certain metrics on their loss mitigation programs and performance of their modified loans in order for stakeholders to identify deficiencies and develop remediation plans. Likewise, stakeholders require the same data to determine the effectiveness of their accountability standards.

The five core principles for loss mitigation and loan modification framework are closely intertwined; each relies on one or more of the others. Throughout the discussion of these interrelated principles, three distinct themes emerge:

- **Success of Waterfall Decision Flows.** First, in the White Paper, the Agencies repeatedly emphasize the success of uniform, so-called waterfall decision flows to help servicers make critical decisions in the loss mitigation or loan modification process. The waterfall is specifically highlighted in the context of determining the amount of a payment reduction, but, throughout the White Paper, the Agencies identify situations in which a waterfall decision flow may be appropriate and helpful. For example, a uniform, waterfall decision flow is particularly appropriate in the context of determining whether to offer a borrower traditional modification options, a short sale, or a deed in lieu of foreclosure.
- **Significance of Homeownership Counseling.** Second, throughout the Guidance and White Paper, the CFPB and the Agencies emphasize the significance of homeownership counseling in helping borrowers understand their loss mitigation options and the consequences of such options. According to the White Paper, the likelihood of a borrower proactively approaching the servicer to explore loss mitigation or loan modification options increases dramatically if the borrower consults a housing counselor. As mentioned in the discussion of sustainability above, the timing of the intervention is critical to the likelihood the intervention will succeed.
- **Utility of Data.** Third, the CFPB and the Agencies stress the utility of data as the best tool to keep the process transparent and hold stakeholders accountable.

The CFPB makes clear that the Guidance is not legally binding on mortgage servicers and that, under the current mortgage servicing rules, mortgage servicers are not required to offer loss mitigation options beyond those offered by the investor. Thus, the question remains open as to agency enforcement of these guidelines in default servicing and loss mitigation after HAMP expires. For the time being, the approach of the CFPB and the Agencies appears to center on discussion of the common goal—positive, sustainable outcomes for homeowners, investors, and servicers. That said, the Guidance and the White Paper demonstrate the federal government's firm belief that, in order to achieve the common goal, loss mitigation practices should be streamlined, uniform, and transparent across the servicing industry.

Market participants generally have welcomed the White Paper, noting that HAMP has provided meaningful relief to both borrowers and investors. While the Agencies appear to lack the statutory authority to renew or replace HAMP industry-wide, the Guidance and the White Paper may be intended to lay the groundwork for future federal agency initiatives, particularly action by the CFPB. The CFPB, for example, could view its Guidance as a tool in supervision and examination of mortgage servicers and, in a related fashion, the grounds to allege unfair, deceptive, or abusive loan servicing acts or practices under the agency's UDAAP authority.[1] It is also conceivable that the CFPB will expect larger servicers to continue to gather and report data similar to the data reported under HAMP. Stay tuned!

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[1] *See, e.g., In re Flagstar Bank, F.S.B.*, No. 2014-CFPB-0014 (Sep. 29, 2014).

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