



## CONSUMER FINANCIAL SERVICES | New Rule Allows US Mortgage Servicers to Provide Faster Relief to Borrowers Impacted by Pandemic

The impacts of the COVID-19 pandemic are putting the Consumer Financial Protection Bureau's (the "CFPB" or "Bureau") Regulation X default servicing rules to the test. According to the Mortgage Bankers Association, as of June 28, 2020, nearly 4.2 million homeowners in the United States were in forbearance plans, representing approximately 8.4% of servicers' portfolio volume and demonstrating the significant impacts of the COVID-19 pandemic on the housing market.<sup>1</sup> As servicers and investors work to develop additional loss mitigation options to assist borrowers when they exit forbearance plans, it has become increasingly clear that the servicing rules do not adequately address emergency situations such as the COVID-19 pandemic. An interim rule promulgated by the CFPB, which became effective on July 1, loosens restrictions and gives servicers the flexibility to offer additional loss mitigation options to assist borrowers impacted by the pandemic.<sup>2</sup>

In this Legal Update, we describe the servicing rules' so-called "anti-evasion" requirement that restricts the loss mitigation servicers can offer in certain situations, discuss the new exception created by the CFPB's interim final rule, and consider whether additional flexibility is warranted.

### **Regulation X's Anti-Evasion Requirement**

The loss mitigation provisions of Regulation X provide that if a borrower submits a complete loss mitigation application,<sup>3</sup> the servicer must evaluate the borrower for all available options offered by the owner of the loan and must satisfy certain deadlines and notice requirements.<sup>4</sup> Regulation X further provides that servicers may not evade this obligation by offering loss mitigation based on an evaluation of an incomplete loss mitigation application.<sup>5</sup> This is known as the "anti-evasion" requirement.

It is worth noting that the servicing rules do not prohibit servicers from offering loss mitigation to borrowers when that offer is not based on any loss mitigation application.<sup>6</sup> However, the CFPB broadly conceives of what qualifies as a loss mitigation application. Even a phone call with a borrower in which the borrower speaks about their financial concerns can qualify as a loss mitigation application, triggering the anti-evasion requirement.<sup>7</sup>

According to the Bureau, the purpose of the anti-evasion requirement is to ensure that the loss mitigation evaluation process is streamlined and the borrower is evaluated for all available loss mitigation options at the same time, rather than being required to apply multiple times for different options.<sup>8</sup> While these are worthy goals, they trade off with the ability of servicers to get help to borrowers quickly. Completing a loss mitigation application can be time-consuming, and the requirement to evaluate all options could delay or even prevent a borrower's entry into a loss mitigation program. This is especially true during emergencies, when borrowers may face even greater difficulty completing a loss mitigation application. In addition, because of the sharp increase in the number of borrowers needing assistance, servicers may have less capacity to work with borrowers to obtain a complete application and subsequently review the application for all possible loss mitigation options.

Prior to the issuance of this interim final rule, the CFPB has twice amended Regulation X to allow servicers some flexibility to offer certain types of loss mitigation based on the review of an *incomplete* application. First, in 2013, the CFPB amended the rules to permit servicers to offer short-term forbearance programs based on the review of an incomplete application, explaining that the exception would allow servicers to address borrowers' short-term problems quickly and efficiently.<sup>9</sup> In 2016, the CFPB expanded the exception to allow servicers to offer short-term repayment plans based on the review of an incomplete application.<sup>10</sup>

These exceptions have enabled servicers to offer forbearances to borrowers impacted by the COVID-19 pandemic based only on a request for assistance, as required by the CARES Act for government-backed loans and as permitted by similar programs offered by private investors. But as borrowers begin to exit these forbearance plans, it is unclear exactly what loss mitigation options servicers are permitted to offer borrowers without requiring a complete application. For example, a deferral that moves the amount forborne to the end of the loan may be helpful to borrowers exiting COVID-19-related forbearances because even if these borrowers are able to resume making regular monthly payments, many may not be in a position to immediately repay the forborne amounts. However, a deferral does not fit neatly into the existing regulatory exceptions to the anti-evasion requirement.

Regulation X defines a short-term forbearance broadly to mean "a loss mitigation option pursuant to which a servicer allows a borrower to forgo making certain payments or portions of payments for a period of time" and further provides that the option is short-term regardless of the amount of time a servicer allows the borrower to make up the missing payments.<sup>11</sup> The regulation does not expressly address deferrals. Thus, the question is, if a servicer wants to offer a borrower the option to come out of forbearance and defer paying back those forborne amounts until the end of their loan term—or pay those forborne amounts back over time—can the servicer do so without requiring the borrower to submit a complete loss mitigation application and evaluating all options?

Much like a short-term forbearance, a deferral “allows a borrower to forgo making certain payments.” And either option contemplates the servicer giving the borrower time to make up the payments. These similarities between a deferral and a forbearance make it seem logical that a deferral could qualify as a short-term forbearance plan under the rules. But the CFPB rules are simply not clear on this issue.

The question of exactly which loss mitigation options qualify for the exceptions under the servicing rules became particularly salient in the past several months as the Federal Housing Finance Agency (“FHFA”) and the Department of Housing and Urban Development (“HUD”) announced plans to offer borrowers deferrals and other loss mitigation options based on a review of an incomplete application.

In May 2020, FHFA announced that it would offer a COVID-19 deferral program designed to assist borrowers exiting COVID-19 forbearances who are able to resume making normal monthly payments. Under the program, the delinquent amount is moved into a non-interest bearing balance that is due and payable at the end of the mortgage loan or upon earlier payoff, resolving the borrowers’ delinquency. Other terms of the mortgage remain unchanged.<sup>12</sup> (For more detail, see our [Legal Update](#) discussing this program.) Similarly, in April 2020, HUD announced that it would permit servicers of loans insured by the Federal Housing Administration (“FHA”) to offer borrowers in a COVID-19 forbearance plan a loss mitigation option it termed a “COVID-19 National Emergency Standalone Partial Claim” that permits borrowers who meet certain criteria to defer mortgage payments covered by their forbearance plans.<sup>13</sup> (For more detail, see our [Legal Update](#) discussing this program.)

Borrowers are not required to submit a complete loss mitigation application to be eligible for either of these programs.

### **New Exception for Borrowers Impacted by the COVID-19 Pandemic**

The CFPB’s new interim final rule solved a conundrum for servicers. It provides an additional exception to the anti-evasion requirement, allowing servicers to offer loss mitigation to borrowers impacted by COVID-19 based on a review of an incomplete application—as long as the loss mitigation option offered meets the three criteria described below. With this new rule, the Bureau announced that the FHFA’s COVID-19 payment deferral and the FHA’s COVID-19 partial claim satisfy these criteria, although the exception is not limited to these programs.

*1. Moves Amounts Not Paid to End of Loan.* The option must permit borrowers to delay paying “covered amounts” until the mortgage loan is refinanced, the mortgaged property is sold, the term of the mortgage loan ends, or, for a mortgage loan insured by FHA, the mortgage insurance terminates.<sup>14</sup> “Covered amounts” generally includes all principal and interest payments forborne under a payment forbearance program made available to borrowers impacted by the pandemic as well as all other principal and interest payments that are due and unpaid by a borrower impacted by the pandemic. “The term of the mortgage loan” means the term of the mortgage loan according to the obligation between the parties in effect when the borrower is offered the loss mitigation option.

The CFPB explained that “covered amounts” do not include escrow payments, so the rule is flexible with respect to how servicers treat any forborne or delinquent escrow amounts. The rule also provides flexibility in the way servicers structure repayment requirements. A lump sum payment due at the end of the loan is permissible under the rule, and because the rule defines “the term of the mortgage loan” to mean the term in effect when the loss mitigation offer is made, repayment over a specified period at

the end of the loan term through additional periodic payments is also permissible under the rule. In addition, the rule does not address how borrowers indicate to servicers that they have been impacted by COVID-19. Presumably, servicers or the federal housing agencies have flexibility to establish these criteria.

*2. Does Not Charge Interest or Fees.* Second, to be eligible for the exception, any amounts that the borrower may delay paying, as described above, must not accrue interest.<sup>15</sup> The FHFA's COVID-19 payment deferral and the FHA's COVID-19 stand-alone partial claim, which the CFPB has stated comply with these requirements, accomplish this by moving the deferred balance to a non-interest bearing balance or second lien, respectively. What is less clear, however, is whether other COVID-19 loan modifications that capitalize the unpaid interest would also meet this criterion. We understand that certain servicers have received informal guidance from the CFPB suggesting that such COVID-19 loan modifications would satisfy this requirement; however, servicers and investors may wish to submit comments to the CFPB requesting clarity on this point.

In addition, the servicer may not charge any fee in connection with the loss mitigation option and must waive all existing late charges, penalties, stop payment fees, or similar charges promptly upon the borrower's acceptance of the loss mitigation option.<sup>16</sup> The CFPB emphasized that these restrictions allow borrowers to be in a better position to address other financial needs that may arise during the pandemic.

*3. Resolves Delinquency.* Finally, to qualify for the exception, the borrower's acceptance of the loss mitigation offer must end any preexisting delinquency on the mortgage loan.<sup>17</sup> Importantly, this requirement not only addresses amounts forborne due to the COVID-19 emergency but also more broadly applies to *any* pre-existing delinquency. Because the servicing rules generally prohibit servicers from initiating foreclosure unless the borrower is over 120 days delinquent, this requirement provides borrowers with some protections against foreclosure.<sup>18</sup>

In addition, depending on the underlying agreements, servicers and investors should consider the implications this requirement may have for repurchase obligations. In many cases, a servicer will not be required to advance amounts the borrowers do not pay if the borrowers are considered current.

### **Waiver of Other Requirements**

The interim rule provides that if a borrower accepts an offer pursuant to the new exception, the servicer is not required to comply with Regulation X's requirement to send a letter within five days of receipt of a loss mitigation application that acknowledges receipt of the application, and, if the application is incomplete, lists the additional information the borrower must submit to complete the application. However, because the rules require the letter to be sent within five days of receipt of an application, in order to take advantage of the waiver of this requirement, the servicer necessarily must obtain the borrower's acceptance no later than five days after receiving the application. The rule does not define what constitutes an acceptance, but it seems reasonable to interpret the rule to allow for an oral acceptance.

In addition, if a borrower accepts an offer pursuant to the new exception, the servicer is not required to comply with the requirement to exercise reasonable diligence to obtain a complete application from

the borrower.<sup>20</sup>

## A More Permanent Solution

The new interim rule is limited to borrowers impacted by the COVID-19 pandemic, but the pandemic is not the only emergency situation for which additional flexibility in the loss mitigation process could be useful. Smaller-scale federally declared natural disasters and emergencies, such as hurricanes or wildfires, occur with some regularity. Currently, when faced with these emergencies, servicers must choose between offering loss mitigation that fits the regulatory definitions of a short-term forbearance or a short-term repayment plan and requiring a full application. These two options are not necessarily always in the best interests of the borrower, depending on the nature and urgency of the borrower's need. Additional flexibility in the rule could allow servicers and investors to offer loss mitigation to borrowers that is both expeditious and tailored to the particular emergency.

Those submitting comments to the rule may consider suggesting that the CFPB amend the interim final rule so that it is not limited to borrowers impacted by the COVID-19 pandemic but applies more broadly to federally declared national disasters or emergencies.

## Comment Period

The CFPB promulgated the rule pursuant to the good cause exception of the Administrative Procedure Act. This exception generally allows agencies to publish a final rule without going through the usual notice and comment process before finalizing a rule where notice and comment are impractical, unnecessary, or contrary to the public interest. The rule went into effect on July 1, 2020, and the Bureau is accepting comments through August 14, 2020. The Bureau will evaluate comments received to determine whether to make revisions to the rule. We are available to assist entities in drafting comments to submit to the Bureau.

## Authors

- [Krista Cooley](#)
- [Stephanie C. Robinson](#)
- [Christa L. Bieker](#)

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As the COVID-19 national emergency continues to disrupt the residential mortgage market, we can expect the CFPB and the federal housing agencies to continue to update the programs and guidance discussed in this Legal Update, as well as announce new requirements designed to address the unique circumstances presented by the pandemic.

Our prior Legal Updates discussing federal regulators' ongoing response to the COVID-19 crisis can be found on our Financial Regulatory COVID-19 Portal. We will continue to issue Legal Updates to keep you up-to-date on any significant future announcements.

If you have any questions about the CFPB's interim final rule, please contact Stephanie Robinson at

202.263.3353 or srobinson@mayerbrown.com, Krista Cooley at 202.263.3315 or kcooley@mayerbrown.com, or Christa Bieker at 202.263.3438 or cbieker@mayerbrown.com.

In addition, if you wish to receive regular updates on the range of the complex issues confronting businesses in the face of the novel coronavirus, please [subscribe](#) to our COVID-19 “Special Interest” mailing list.

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<sup>1</sup> Mortgage Bankers Association, Share of Mortgage Loans in Forbearance Decreases for Third Straight Week to 8.39%, July 7, 2020, available at: <https://www.mba.org/2020-press-releases/july/share-of-mortgage-loans-in-forbearance-decreases-for-third-straight-week-to-839>.<sup>2</sup> Treatment of Certain COVID-19 Related Loss Mitigation Options Under the Real Estate Settlement Procedures Act (RESPA) (Regulation X), 85 Fed. Reg. 39055, June 30, 2020.

<sup>3</sup> A complete loss mitigation application is defined as “an application in connection with which a servicer has received all the information that the servicer requires from a borrower in evaluating applications for the loss mitigation options available to the borrower.” 12 C.F.R. § 1024.41(b)(1). Generally, servicers have the flexibility to determine what information is needed to constitute a complete loss mitigation application.

<sup>4</sup> 12 C.F.R. § 1024.41(c)(1).

<sup>5</sup> *Id.* § 1024.41(c)(2)(i).

<sup>6</sup> Comment 41(c)(2)(i)-1.

<sup>7</sup> *Id.* § 1024.31 (defining loss mitigation application to mean “an oral or written request for a loss mitigation option that is accompanied by any information required by a servicer for evaluation of a loss mitigation option”). See Consumer Financial Protection Bureau, Supervisory Highlights, Issue 21 (Feb. 2020) at 5-6, available at: [https://files.consumerfinance.gov/f/documents/cfpb\\_supervisory-highlights\\_issue-21\\_2020-02.pdf](https://files.consumerfinance.gov/f/documents/cfpb_supervisory-highlights_issue-21_2020-02.pdf) (stating that the CFPB considered oral conversations in which borrowers spoke to servicers about their financial concerns to be loss mitigation applications).

<sup>8</sup> Amendments to the 2013 Mortgage Rules Under the Equal Credit Opportunity Act (Regulation B), Real Estate Settlement Procedures Act (Regulation X), and the Truth in Lending Act (Regulation Z), 78 Fed. Reg. 60382, 60298, Oct. 1, 2013.

<sup>9</sup> *Id.*

<sup>10</sup> Amendments to the 2013 Mortgage Rules Under the Real Estate Settlement Procedures Act (Regulation X) and the Truth in Lending Act (Regulation Z), 81 Fed. Reg. 72160, Oct. 19, 2016.

<sup>11</sup> Comment 41(c)(2)(iii)-1.

<sup>12</sup> Fannie Mae, Lender Letter 2020-07, updated June 10, 2020, available at: <https://singlefamily.fanniemae.com/media/22916/display>. Freddie Mac, Bulletin 2020-15, May 13,

2020, available at: [https://guide.freddiemac.com/ci/okcsFattach/get/1003811\\_7](https://guide.freddiemac.com/ci/okcsFattach/get/1003811_7).

<sup>13</sup> Department of Housing and Urban Development, Mortgage Letter 2020-06, April 1, 2020, available at: <https://www.hud.gov/sites/dfiles/OCHCO/documents/20-06hsngml.pdf>.

<sup>14</sup> 12 C.F.R. § 1024.41(c)(2)(v)(A)(1).

<sup>15</sup> *Id.* § 1024.41(c)(2)(v)(A)(2).

<sup>16</sup> *Id.*

<sup>17</sup> *Id.* § 1024.41(c)(2)(v)(A)(3).

<sup>18</sup> *Id.* § 1024.41(f)(1)(i).

<sup>19</sup> *Id.* § 1024.41(c)(2)(v)(B).

<sup>20</sup> *Id.*