What It Means for the Defense Bar

# CFPB Final Servicing Rules

By Jason R. Bushby and Jonathan R. Kolodziej

**The defense bar should be cognizant of the unique opportunity to become even more valuable to clients by understanding fully all of the regulations before they become effective.**

Between now and January 10, 2014, while the mortgage servicing industry is preparing to comply with the plethora of regulations recently issued by the Consumer Financial Protection Bureau (CFPB), defense attorneys should begin both preparing for new mortgage servicing legal battles and advising their clients on ways to prevent them. Defense attorneys practicing in the mortgage servicing industry need to understand the applicable provisions fully to anticipate potential claims and to advise clients on the best ways to minimize litigation risk.

By fully understanding the intricacies of the final mortgage servicing regulations, members of the defense bar can provide invaluable service to their clients that will prepare them for the upcoming changes. A mortgage servicer may not have the staff expertise to read and to parse complex regulatory text, which can make understanding the final mortgage servicing rules a daunting task. Having able counsel to explain the meaning and the intent behind the rules can ease this burden. This is a service that is needed both now, while servicers scramble to implement the rules, and later, when borrowers begin to allege violations.

## Background

To understand where we are today, we must first understand where we came from. In 2010, as the country was beginning to crawl out of the deep recession of the late 2000s, Congress passed, and President Barack Obama signed into law, the Dodd-Frank Wall Street Reform and Consumer Protection Act. As the president put it, passage of the Dodd-Frank Act represented "the toughest financial reform since…the aftermath of the Great Depression." President Barack Obama, *Remarks by the President on Wall Street Reform* (Apr. 22, 2010), available at http://www.whitehouse.gov/the-press-office/remarks-president-wall-street-reform. Further, the Dodd-Frank Act "put in place the toughest consumer financial protections in our history [and created] an inde-


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pendent agency to enforce them." *Id*. The agency is the CFPB.

The CFPB is part of the Federal Reserve System and is considered an executive agency as defined in the United States Code. Among other enumerated powers, the CFPB is charged with "implementing the Federal consumer financial laws through rules, orders, guidance, interpretations, statements of policy, examinations and enforcement actions." 12 U.S.C. §5492(a)(11). To effectuate the consumer financial protection provisions of the Dodd-Frank Act, Congress granted the CFPB, through its director, rulemaking authority.

Exercising this power, on August 10, 2012, the CFPB released a proposal to amend certain provisions of both Regulation X, which implements the Real Estate Settlement Procedures Act of 1974 (RESPA), and Regulation Z, which implements the Truth in Lending Act (TILA). Specifically, these proposals sought to implement certain mortgage loan servicing rules as required by the Dodd-Frank Act. The public could comment on both proposals until October 9, 2012.

On January 17, 2013, the CFPB released the final versions of the amendments to both Regulation X and Regulation Z, together known as the "Final Servicing Rules." Along with releasing the Final Servicing Rules, the CFPB published a preamble to each regulation. Although quite voluminous, the preambles can be very useful tools when trying to understand the regulatory framework. Generally, each preamble summarizes the reasoning behind and the legal authority for each provision. They also briefly summarize each proposed rule, the comments that were received from consumers and industry participants about them, and the changes that the CFPB made as a result.

Finally, as a supplement to the Final Servicing Rules, the CFPB released a commentary interpreting the regulations. This commentary clarifies certain provisions of amended Regulation X and Regulation Z. For example, where a provision of Regulation Z states that a periodic billing statement must be provided "within a reasonably prompt time," 12 C.F.R. §1026.41(b), the commentary clarifies that "[d]elivering, emailing or placing the periodic statement in the mail within four days…generally would be considered reasonably prompt." Comment 41(b)-1 to 12 C.F.R. part 1026.

The Final Servicing Rules will go into effect on January 10, 2014. Altogether, the regulatory text, the accompanying preambles, and the official interpretations total over 1,100 pages. Between now and the effective date, mortgage servicers and other affected parties will have to digest, comprehend, and ultimately implement the requirements.

## Summary of the Final Servicing Rules

The Final Servicing Rules touch upon many aspects of a mortgage servicer's day-to-day operations. Generally, however, they can fit into nine major categories, each of which will be explained in more detail below:

- Periodic billing statements;
- Interest-rate adjustment notices for adjustable rate mortgages;
- Prompt payment crediting and payoff statements;
- Force-placed insurance;
- Error resolution and information requests;
- General servicing policies, procedures, and requirements;
- Early intervention with delinquent borrowers;
- Continuity of contact with delinquent borrowers; and
- Loss mitigation procedures.

### Periodic Billing Statements: C.F.R. §1026.41

For any loan secured by a dwelling, Regulation Z requires that the mortgage servicer provide the borrower with a periodic statement at the end of each billing cycle. The regulations explain the content that the statement must include and the format that it must take. Among other things, a periodic statement must include information related to the amount due, a breakdown of past payments and other transaction activity, contact information, and general account information. It must be sent to a borrower "within a reasonably prompt time after the payment due date" for the previous billing cycle. And as mentioned previously, the official interpretations clarify that four days will generally qualify as a "reasonably prompt time."

### Interest-rate Adjustment Notices for Adjustable Rate Mortgages: C.F.R. §1026.20

Servicers are required by Regulation Z to send various disclosures to borrowers with adjustable rate mortgages (ARM). An ARM is defined as "a closed-end consumer credit transaction secured by the consumer's principal dwelling in which the annual percentage rate may increase after consummation." Under the amendments, a servicer will have to send a borrower a certain notification in advance of the first interest rate adjustment. Afterward, different rate adjustment notices are required whenever a subsequent change in interest rate results in a corresponding payment change. As with periodic billing statements, the regulations explain the timing, content, and format requirements of the ARM notices.

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### Prompt Payment Crediting and Payoff Statements: C.F.R. §1026.36

Under Regulation Z, servicers must credit payments received from a borrower that are sufficient to cover principal, interest, and escrow, if applicable, known as "periodic payments," as of the date of receipt. Crediting the account at a later date is permissible only if it does not result in a charge being assessed or a negative credit reporting. On the other hand, if a servicer clearly specifies, in writing, instructions for a borrower to follow when submitting payments, the servicer may credit a nonconforming payment within five days of receipt. If a borrower's payment is insufficient to qualify as a periodic payment, a servicer may credit the amount to a suspense or unapplied funds account. Additionally, the servicer may reject the payment and send it back to the borrower. If, however, a partial payment is placed in a suspense or unapplied funds account, upon accumulation of an amount sufficient to make it a periodic payment, the servicer must credit it to the borrower's account as such.

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Upon written request from a borrower, or a borrower's representative, servicers are also required to provide a payoff statement containing "an accurate statement of the total outstanding balance that would be required to pay the consumer's obligation in full as of a specified date." The rule further requires that a servicer send any such statement "within a reasonable time, but in no case more than seven business days" after receiving a request.

### Force-placed Insurance: C.F.R. §1024.17

Regulation X defines force-placed insurance as "hazard insurance obtained by a servicer on behalf of the owner or assignee of a mortgage loan that insures the property securing the loan." A servicer is only permitted to charge a borrower for force-placed insurance if the servicer "has a reasonable basis to believe" that the borrower has failed to maintain proper insurance, as required by the mortgage loan contract. Additionally, a servicer must send a notice to a borrower 45 days before assessing the charge and a reminder notice 15 days later. During this time, a borrower may submit evidence of continuous coverage.

If a servicer is seeking to renew or to replace previously purchased force-placed insurance, notice must once again be sent alerting a borrower that this is taking place. The regulations explain the required content and form of all force-placed insurance notices. If at any time a servicer receives evidence that a borrower has hazard insurance for the property, the servicer must cancel the force-placed insurance and remove all charges and fees for any period of overlapping coverage. Finally, the rule mandates that any charges relating to force-placed insurance that are assessed to a borrower must be for services actually performed and must be reasonably related to the actual cost of providing such services.

### Error Resolution and Information Requests: C.F.R. §§1024.35 and 1024.36

Regulation X requires that servicers follow certain procedures for responding to a borrower's written notice of error. This section amends and supplements the current qualified written request provisions of Regulation X. Various categories and types of errors that a borrower may assert are specified in the rule, but generally any error relating to the servicing of a borrower's loan may be claimed. Upon receiving a notice of error, a servicer must first, within five business days, send a written acknowledgement that it received the notice. It must then conduct a reasonable investigation into whether or not a servicing error occurred. Generally, a servicer has 30 days to report its findings to a borrower. If an error was found, a servicer must correct the error and notify a borrower. If a different error other than one alleged by a borrower is discovered during an investigation, a servicer must also correct it and notify the borrower.

Generally, the procedures for handling a notice of error are the same for responding to a request for information. A servicer must acknowledge receipt within five business days and provide the desired information within 30 days. Servicers are not required to produce information not directly related to a borrower's account, or information that is confidential, privileged, or proprietary. Further, if a request for information is unduly burdensome in that a servicer would be forced to incur unreasonable costs or dedicate unreasonable resources to comply, the formal response requirements are not applicable.

Compliance with the formal procedures is not required for both notices of error and requests for information if a borrower submits a notice or request that is duplicative, overly broad, or untimely. In such a scenario, a servicer merely is required to notify a borrower of the reasons why the notice or the request does not require compliance. Servicers may designate an address where borrowers should submit these types of notices. However, if a servicer chooses to do so, it must use the same address for both notices of error and requests for information.

### General Servicing Policies, Procedures, and Requirements: C.F.R. §1024.38

Under Regulation X, servicers must create and maintain policies and procedures that are reasonably designed to achieve specified objectives. Generally speaking, servicers must establish policies to ensure that they can access and provide timely and accurate information; properly evaluate loss mitigation applications; facilitate oversight of, and compliance by, service providers; facilitate the transfer of information during servicing transfers; and inform borrowers about the formal error resolution and information request procedures. Instead of containing specific procedural requirements, the CFPB designed this section to allow flexibility and has provided objectives that servicers must reasonably comply with.

### Early Intervention with Delinquent Borrowers: C.F.R. §1024.39

Mortgage servicers are required under Regulation X to make live contact with delinquent borrowers no later than the 30th day of the borrower's delinquency. "Live contact," for the purposes of this provision, means initiating either an inperson meeting or a telephone conversation. Further, a borrower is considered delinquent once a payment is due and not made, regardless of any grace period offered by the servicer. Once contact is made, the servicer must, if applicable, inform the borrower of available loss mitigation options. Section 1024.39 of the Code of Federal Regulations grants a mortgage servicer the discretion to determine if notifying a borrower about loss mitigation is appropriate at this point given the borrower's circumstances. Regardless, by the 45th day of a borrower's delinquency, the mortgage servicer must send a written notice to the borrower encouraging the borrower to contact the servicer. This notice must also contain information about how to apply for loss mitigation assistance.

**Continuity of Contact with Delinquent Borrowers: C.F.R. §1024.40**

By the 45th day of a borrower's delinquency, Regulation X requires the servicer to make assigned personnel available to the borrower to respond to inquiries and to assist in the loss mitigation application process. If a borrower attempts to contact the assigned personnel and does not receive a live response, the personnel must "provide a live response in a timely manner." The person, or team of people, must remain assigned to a delinquent borrower until two consecutive mortgage payments are made timely in accordance with a permanent loss mitigation agreement. Although the CFPB uses the phrase "assigned personnel," this idea is akin to the single point of contact concept of the National Mortgage Settlement framework and various other mortgage servicing guidelines.

Under Regulation X, the assigned personnel must be able to perform various functions. For example, they must be able to provide a borrower with accurate information about loss mitigation, including what options may be available, how to apply, and the status of a pending application. They must also have access to a borrower's account information and be able to view all written loss mitigation information that the borrower has submitted.

**Loss Mitigation Procedures: C.F.R. §1024.41**

Regulation X specifies procedures that a servicer must follow throughout the loss mitigation process. The official interpretations state that any time that a borrower "expresses an interest in applying for a loss mitigation option and provides information the servicer would evaluate in connection with a loss mitigation application," it shall be deemed an application. An application is complete once servicer has all information required to evaluate loss mitigation options. As soon as a servicer receives an application, whether it is complete or not, certain notice requirements and timelines specified in Regulation X guide the process. For example, a mortgage servicer generally must acknowledge receipt of the application within five business days and must also provide a borrower with a determination of whether or not the application is complete. If the application is incomplete, the rule imposes a duty on servicers to approach obtaining missing documentation from borrowers proactively. Once an application is complete, generally a mortgage servicer has 30 days to evaluate the borrower for all available loss mitigation options and provide a determination. Depending on the circumstances, a borrower may then be eligible to appeal the determination. Appeals must be conducted by personnel that did not evaluate the application the first time and generally must be completed within 30 days.

The rule also establishes various dual tracking restrictions. For example, Regulation X prohibits a servicer from making the first filing or notice required for a foreclosure process until the borrower is at least 120 days delinquent. Dual tracking is also restricted if the foreclosure process has already started, but how this restriction applies depends on how far ahead a foreclosure sale is scheduled when the complete application is submitted.

## Private Right of Action

Before the CFPB released the Final Servicing Rules, borrowers already had the right to enforce various provisions of RESPA and TILA. Borrowers retained this right of action in those sections. The CFPB, in an attempt to expand consumer protections, sought to give borrowers a private right of action to enforce certain provisions of the Final Servicing Rules that were new to Regulations X and Z. To do this, it relied upon its authority to implement section 6 of RESPA. Specifically, §6(f) grants individuals the right to bring an action for damages for a servicer's failure to comply with the requirements of §6.

In the *proposed* rules, the CFPB invoked this authority for three of the new regulatory provisions. The authority was used to promulgate the general mortgage servicing policies, procedures, and requirements in C.F.R. §1024.38, and also C.F.R. §§1024.39 and 1024.41, dealing with early intervention and loss mitigation procedures. However, after considering comments submitted by the mortgage servicing industry, the Final Servicing Rules only relied upon §6 authority for the latter two sections, C.F.R. §§1024.30 and 1024.41, relating to early intervention and loss mitigation.

In the preamble to Regulation X, the CFPB acknowledged that C.F.R. §1024.38 consists of objectivesbased standards, and reversing course, the final regulation eliminated the ability of borrowers to enforce its terms that was originally proposed. Many of the comments submitted by industry participants warned that private litigation over these standards would increase the cost of servicing, and as a result would decrease the availability of credit. Although consumer comments generally favored a private right of action, the CFPB ultimately determined that these types of rules generally are not suitable for private enforcement. The bureau reasoned that "courts potentially would interpret [them] inconsistently, which would have created compliance challenges for servicers." Preamble to Regulation X, at 303.

As such, the Final Servicing Rules only create a private right of action for the procedural provisions relating to early interven-

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tion and loss mitigation, though it is worth noting that the CFPB or other prudential regulators may still enforce those provisions not subject to private enforcement.

## How to Prepare for, and Defend Against, Future Claims

After analyzing the early intervention and loss mitigation sections of Regulation X, it is clear that certain areas are more likely than others to generate claims by delinquent borrowers. First, these two sections impose many specific timelines upon a servicer. The timelines require a servicer to take or to complete a certain action within a specified time period in many situations. In other situations, a servicer must wait to take a certain action until after a specified time period has expired.

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The early intervention section of the regulation, for example, requires servicers to make a first live contact with a borrower by the 36th day of delinquency and then to follow up with a written notice by the 45th day of delinquency. It seems highly likely that borrowers will assert claims that servicers did not make live contact or that contact was not made within the appropriate timeframe. With this in mind, a servicer's defense counsel should find ways to minimize the inevitable risk.

In this scenario, the official interpretations provide useful guidance on alternative ways that a servicer may be able to comply with the regulation. First, the CFPB clarifies that a servicer may rely upon contact initiated by a borrower to satisfy the initial contact requirement. Further, a servicer may also satisfy the live contact requirement by making "good faith efforts" to reach a borrower. According to the official interpretation, making a good faith effort means taking "reasonable steps under the circumstances to reach a borrower and may include telephoning the borrower on more than one occasion or sending written or electronic communication encouraging" the borrower to contact the servicer. Comment 39(a)-2 to Regulation X.

When a borrower alleges that he or she never received a phone call from a servicer, defense counsel must be able to counter that assertion by showing how the servicer did, in fact, comply with the rule's requirements.

As in all scenarios when a specified timeframe is at issue, servicers should keep consistent, accurate, and detailed records of all actions taken. The importance of doing this becomes heightened when communicating with borrowers. Being able to provide business records that demonstrate that a servicer called a borrower multiple times in compliance with the requirements will avoid the inevitable "he said, she said" dilemma. Advising a mortgage servicer of these general best practices will also help avoid needless litigation.

Further, many provisions of the early intervention and loss mitigation sections of the regulation require that borrowers receive various notices. The rules generally prescribe the content that the notices must include, how a servicer must format that content, and when the servicer must send the notices. Delinquent borrowers probably will attack compliance with these provisions at every possible chance.

For example, the early intervention section requires that a servicer send a notice to a borrower by the 45th day of delinquency. Further, it must include, among other things, a statement encouraging the borrower to contact the servicer. Again, borrowers may allege either that they never received the notice, the notice did not include certain required content, or both.

The CFPB has provided model forms and clauses in an appendix to the regulatory text. These can be used to comply with the requirements of the Final Servicing Rules. In the official interpretations, the CFPB specifies how servicers should use these forms and clauses: "Although use of the model forms and clauses is not required, servicers using them appropriately will be in compliance with [the corresponding] disclosure requirements." Comment MS-1 to Regulation X. Further, servicers are permitted to make changes, but any edits that affect the "substance, clarity, or meaningful sequence of the forms and clauses" will remove any guarantee of compliance. In short, using the model forms and clauses provides protection against liability. Therefore, even though they are optional, counsel should strongly encourage their clients to use this added protection to minimize the chances of litigation.

Again, it is important that servicers maintain thorough records of all communications with delinquent borrowers. A servicer may be required at some point to prove that it mailed a notice by the 45th day of delinquency. If the servicer can present mailing receipts, or other forms of proof, it will minimize the potential damage caused by a borrower's claims.

When the Final Servicing Rules go into effect, the provisions with specific timeframes and those requiring specific notices will be easy targets for delinquent borrowers. Whether used legitimately to enforce a borrower's rights, or simply as a stall tactic to delay foreclosure proceedings, the private right of action that the CFPB has granted in the early intervention and loss mitigation sections of the Final Servicing Rules will create constant headaches for mortgage servicers.

## Conclusion

In the coming months, the defense bar should be cognizant of the unique opportunity to offer legal services due to the Final Servicing Rules. Clients will need these services greatly. The mortgage servicing industry is faced with a daunting task. In many cases servicers essentially will need to overhaul policies, procedures, and organizational structures completely. Lawyers can become even more valuable to their clients by understanding fully all of the regulations before they become effective on January 10, 2014, anticipating potential areas of concern, and counseling clients on the steps that they can take to prevent needless litigation.