

September 3, 2020

Lender's Beware: Compliance Traps in Lending and Servicing in a COVID World

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**OUR EXTRAORDINARY
NEW ECONOMIC
REALITY**



Catastrophic Economic Collapse

- > Unemployment numbers skyrocket
 - 26M new unemployment claims in first five weeks
 - 4.4M new weekly unemployment claims in one week
 - Previous weekly high was 695,000 (October 1982)
- > Nearly 80% of American Workers are living paycheck to paycheck
- > Nearly 40% of Americans could not afford a \$400 repair
- > So far – Six months of pandemic and economic malaise



Federal Agencies Take Action

> March 2018

> Loan Modifications

> Forbearance Offers

- Fannie Mae - Homeowners in a forbearance plan will not incur late fees; After forbearance, a servicer must work with the borrower on a permanent plan to help maintain or reduce monthly payment amounts as necessary, including a loan modification
- Freddie Mac – Expansion of forbearance plans - provide borrowers with payment relief for up to 12-months and suspend borrower late charges and penalties. Suspends credit reporting of past due payments of borrowers who are in a forbearance plan as a result of hardships attributable to this national emergency.
- HUD – Long term and short term forbearance options

> Credit Reporting Holds

CARES Act (Coronavirus Aid, Relief, and Economic Security Act)

- > Enacted March 27, 2020, PL 116-136, H.R. 748
- > Title IV, Coronavirus Economic Stabilization Act of 2020 (CESA)
- > Key default mortgage servicing sections:
 - § 4021 - Credit Protection During COVID-19 (15 U.S.C. §1681s-2(a)(1)(F))
 - § 4022 - Foreclosure Moratorium and Consumer Right to Request Forbearance (15 U.S.C. §9056)
 - § 4024 - Temporary Moratorium on Eviction Filings (15 U.S.C. §9058)





DEFAULT SERVICING IMPACTS: **Credit Protection**

§ 4021 – “Credit Protection During COVID-19”

- > Amends Fair Credit Reporting Act for all furnishers and sectors
 - Adds subsection (F) to 15 USC § 1681s-2(a)(1): “Reporting Information During COVID-19 Pandemic”
- > Borrower Accommodation
- > “Covered Period” Unclear
- > Reporting As If Payment Made
- > Temporary Flexible Enforcement
- > Many New Uncertainties

§ 4021 – Borrower Accommodation

- > Accommodation – “includes an agreement to defer 1 or more payments, make a partial payment, forbear any delinquent amounts, modify a loan or contract, or any other assistance or relief granted to a consumer who is affected by the coronavirus disease 2019 (COVID-19) pandemic during the covered period.”
- > Compliance trap: Must consumer receiving “accommodation” be affected by COVID-19 at time of accommodation or must basis of accommodation be related to COVID-19?

§ 4021 – “Covered Period” Unclear

> Covered Period

- Begins: January 31 (prior to enactment of the CARES Act)
- Ends: 120 days after date emergency terminates

> Compliance trap:

- “Covered Period” (Date of reporting or payment)?;
- Gap: January 31 (CARES Act enacted March 27)

§ 4021 – Reporting As If Payment Made

- > Furnisher's obligation depends upon pre-accommodation status:
 - If account was **current**, report as **current**
 - If the account was **delinquent**, report as delinquent, unless account brought current
- > Reporting cannot get worse - only get better
 - Exception – charged off account
- > Credit reporting codes
 - **Compliance trap**

§ 4021 – Many New Uncertainties

- > **Compliance traps:**
- > Conflicting state guidance/obligations
 - Preemption – no private right of action
 - More regulatory scrutiny
- > Can servicers: delete tradelines, suppress reporting
- > Can loans be charged off during covered period?
- > Proper response to dispute issues minimizes risk of litigation
- > CFPB's FAQs – June 16, 2020

CFPB's FAQs – June 16, 2020

- > Left open whether a servicer can provide accurate information regarding the status of a borrower's account that is in forbearance while also complying with the CARES Act's mandate that furnishers report an account as "current" while subject to a CARES Act-required accommodation
 - QUESTION 8: Can a furnisher comply with the requirements of the CARES Act relating to reporting of accommodations simply by using a special comment code to report a natural or declared disaster or forbearance?
 - ANSWER (UPDATED 6/16/2020): As discussed in FAQ #3 above, the CARES Act requires a furnisher to report a credit obligation or account as current if it was current prior to the accommodation or not to advance the level of delinquency if it was delinquent prior to the accommodation. **Furnishing a special comment code indicating that a consumer with an account is impacted by a disaster or that the consumer's account is in forbearance does not provide consumer reporting agencies with this CARES Act-required information and therefore furnishing such a comment code is not a substitute for complying with these requirements.**



DEFAULT SERVICING IMPACTS: **Forbearance**

§ 4022 – Unprecedented Forbearance Rights

- > “During the covered period, a borrower with a Federally backed mortgage loan experiencing financial hardship due, directly or indirectly, to the COVID-19 emergency may request forbearance of the Federally backed mortgage loan, regardless of delinquency status, by submitting a request to the borrower’s servicer; and affirming that the borrower is experiencing a financial hardship during the COVID-19 emergency.” (§ 4022(b)(1))
- > **Compliance Trap: “Covered period” undefined in § 4022**
 - § 4023 – 3/27/20 to earlier of date emergency terminates or 12/31/20
 - § 4021 – 1/31/20 to 120 days after date emergency terminates

§ 4022(a) – Covered Loan Criteria

- > Requires “Federally Backed Mortgage Loan”
 - Secured by First or Subordinate lien, and
 - Residential Real Property (1 to 4 families), and either
 - Insured/Guaranteed/Made by
 - FHA under Title II of NHA
 - Section 255 of NHA
 - Housing and Community Development Act Loans
 - Department of Veterans Affairs
 - Department of Agriculture, or
 - Purchased/Securitized by Fannie Mae or Freddie Mac
- > Separate multifamily properties provision (§ 4023)
- > **Compliance trap: Does not impact private or state loans**

§ 4022(b) – Minimal Borrower Forbearance Requirements

> Borrower who:

- “During the Covered Period”
- “Has Federally Backed Mortgage Loan”
- “Experiencing a financial hardship due, directly or indirectly, to COVID-19 emergency”
- “Regardless of delinquency status”
- Submits request to servicer for forbearance
- Affirms experiencing financial hardship during COVID-19 emergency

> Shall be granted forbearance

> Up to 180 days; extended up to additional 180 days

> Compliance Traps: “Financial hardship”?; “Directly or Indirectly”?; “Submits”?; “Affirming”?; “Timing”?

§ 4022(c)(1) – Strict Servicer Forbearance Requirements

- > Shall provide forbearance upon request
 - “up to 180 days”, and
 - additional “up to 180 days” if requested during covered period
- > No additional documentation beyond borrower’s “attestation” to financial hardship caused by COVID-19 emergency
- > No accrual of fees, penalties, or interest
 - (beyond scheduled or contractual amounts due)
- > Forbearance = foreclosure hold?
- > Compliance traps: “Covered period”; Additional request = extension of original request?; “Attestation”?

Forbearance – A Life Line

> Nationwide Forbearance Statistics (from the MBA)

- 0.25% as of March 2, 2020
- 3.74% as of April 5, 2020
- 5.95% as of April 12, 2020
- 6.99% as of April 19, 2020 (\$780.6B)
- 7.54% as of April 26 (3.8M homeowners)
- 7.91% as of May 3 (4.0M homeowners)
- 8.16% as of May 10 (4.1M homeowners)
- 8.36% as of May 17 (4.2M homeowners)
- 8.46% as of May 24 (4.2M homeowners)
- 8.53% as of May 31 (4.3M homeowners)
- 8.55% as of June 7 (4.3M homeowners)



Decline in Forbearance

- > Nationwide Forbearance Statistics (from the MBA)
 - 8.48% as of June 14 (4.2M homeowners)
 - 8.47% as of June 21 (4.2M homeowners)
 - 8.39% as of June 28 (4.2M homeowners)
 - 8.18% as of July 5 (4.1M homeowners)
 - 7.80% as of July 12 (3.9M homeowners)
 - 7.74% as of July 19 (3.9M homeowners)
 - 7.67% as of July 26 (3.8M homeowners)
 - 7.44% as of August 2 (3.7M homeowners)
 - 7.21% as of August 9 (3.6M homeowners)
 - 7.20% as of August 16 (3.6M homeowners)
 - 7.20% as of August 23 (3.6M homeowners)



Mortgage Delinquency Rates

> MBA National Delinquency Survey

> 8.22% 2020-Q2

> 4.36% 2020-Q1

> 3.77% 2019-Q4

> 3.97% 2019-Q3

> 4.53% 2019-Q2

> 4.42% 2019-Q1

> 4.06% 2018-Q4

> 4.47% 2018-Q3

> 4.36% 2018-Q2

Federal Agency Forbearance Guidance

- > Joint Interagency Guidance (CFPB, FRB, FDIC, NCUA, OCC, CSBS)
 - Provide borrowers with timely assistance
 - All borrowers treated fairly
 - All borrowers assisted as needed
 - Focus on placing consumers in short-term forbearance programs
 - Must offer CARES Act forbearance, if eligible
 - May offer similar programs if not CARES Act eligible
- > Forbearance Scripts – Fannie Mae and Freddie Mac

Guidelines and Servicer Scripts

- > Federal agencies and GSEs have developed publically available guidance and mortgage servicer call scripts to help servicers discuss forbearance with borrowers.
- > The CARES Act is silent regarding servicer requirements to disclose information to borrowers and does not clearly state which party is to determine the term of the forbearance period.
- > Scripts outline forbearance qualification requirements, state that the borrower is entitled to determine the period of forbearance, and make clear that when a servicer provides forbearance plan options to a borrower, it must make the parameters of the forbearance plan known to the borrower.
- > Scripts are intended to put borrower on notice that their payments have only been delayed, not forgiven and, once the forbearance is completed, there are options available to the borrower beyond making one lump sum payment to bring mortgage current (e.g., loan modifications).
- > **Compliance Traps**



Forbearance and Borrower Outreach

> Contact - Establish QRPC

> Scripts

- Hardship, needs, options
- Offer forbearance up to 6 months, extended for up to 6 months

> In Forbearance - Reach out to borrower

- Discuss hardship, payment resumption, options

> End of Forbearance

- Extend, other options, no contact



Post-Forbearance Options

- > Immediate and full reinstatement, resume payments
- > Resume payments
 - Payment deferral plans
 - Special CFPB rules
- > Workout Options
 - Loss Mitigation Application and Consideration
 - Decision and Appeals
- > Non-Possessory Options
 - Deed in Lieu
 - Short Sale
- > Foreclosure

Federal Agency – Post-Forbearance

- > Fannie – contact borrower to determine best assistance program - reinstated, borrower approved for a new workout option, extend mod, cap and extend mod, flex mod, mortgage paid in full, or refer to foreclosure
- > Freddie – contact borrower to determine best assistance program - full repayment, repayment plan, payment deferral or modification, adding the missed payments to the end of the mortgage, modifications including extend mod, cap and extend mod, Freddie Mac Flex mod, short sale, deed in lieu, or refer to foreclosure
- > FHA – Partial claim, and then all other loss-mitigation options
- > VA – Other loss-mitigation options, including disaster options
- > USDA – Other loss-mitigation options, including extending loan term

Forbearance Immediately After Origination

- > To promote liquidity - HUD and FHFA now allow loans that entered COVID-19 forbearance shortly after origination to be eligible for FHA insurance endorsement and to be purchased by Freddie Mac and Fannie Mae.
- > HUD requires ([Mortgagee Letter 2020-16](#)) mortgagees to:
 - Execute a two-year [partial indemnification agreement](#), indemnifying HUD for 20 percent of the initial loan amount; and
 - Ensure that already-provided forbearance complies with or is converted to comply with FHA requirements for CARES Act forbearance.
- > [FHFA extended Fannie Mae's and Freddie Mac's authority to purchase mortgage loans in forbearance](#) until at least September 30, 2020.
- > **Compliance trap: Pre-closing attestation**



Investor Considerations

- > Forbearance - enormous strain on lenders and servicers.
- > Fannie Mae and Freddie Mac – After four months of payment pass-throughs, no more obligation to advance
- > Ginnie Mae - Pass-Through Assistance Program as if natural disasters
- > GSE Adverse Market Fee for Single Family Sellers for limited cash-out refinances and cash-out refinances – now effective 12/1/2020
 - Implements a loan level price adjustment (LLPA) of 50 basis points (0.500%)
 - Some loans exempt



DEFAULT SERVICING IMPACTS: FEDERAL LEVEL

Foreclosure

§ 4022(c)(2) – Foreclosure Moratorium

- > “Except with respect to a vacant or abandoned property, a servicer of a Federally backed mortgage loan may not initiate any judicial or non-judicial foreclosure process, move for a foreclosure judgment or order of sale, or execute a foreclosure-related eviction or foreclosure sale for not less than the 60-day period beginning on March 18, 2020.”
- > COVID-19 hardship may not be required
- > Agency guidance – hold from March 18, 2020
- > Litigation Trap: “Vacant or abandoned”?; “initiate”; “process”; Gap: March 18 (CARES Act enacted March 27)?

Federal Agencies – Extension to December 31, 2020

> Specific milestones:

- Fannie Mae: “initiate any judicial or non-judicial foreclosure process, move for a foreclosure judgment or order of sale, or execute a foreclosure sale”
- VA: “initiation of foreclosures, and to the completion of foreclosures in process”
- USDA: “Initiation of foreclosures or completion of foreclosures in process”

> Full Foreclosure Moratorium:

- Freddie Mac: “This includes [specific acts]”
- HUD: “the initiation of foreclosures and to foreclosures in process”

Florida Executive Orders – Foreclosure Moratorium

- > Originally (4/02): “Suspend and toll any statute providing for a mortgage foreclosure cause of action under Florida law.”
- > Now (7/29): “Suspend and toll any statute providing for final action at the conclusion of a mortgage foreclosure proceeding under Florida law solely when the proceeding arises from nonpayment of mortgage by a single-family mortgagor adversely affected by the COVID-19 emergency.”
- > EO 20-94 (4/02/20) EO 20-121 (5/14/20)
- > EO 20-137 (6/01/20) EO 20-159 (6/30/20)
- > EO 20-180 (7/29/20) EO 20-211 (8/31/20)



Florida Executive Orders – Eviction Moratorium

- > Originally (4/02): “Suspend and toll any statute providing for an eviction cause of action under Florida law solely as it relates to non-payment of rent by residential tenants due to the COVID-19 emergency.”
- > Now (7/29): “Suspend and toll any statute providing for final action at the conclusion of an eviction proceeding under Florida law solely when the proceeding arises from non-payment of rent by a residential tenant adversely affected by the COVID-19 emergency.”



**HIGH RISK OF CLAIMS AND
LITIGATION AHEAD AGAINST
DEFAULT SERVICERS**



Sources of Claims and Litigation

- > Borrower complaints – Agencies, Servicers, CFPB Complaint Database
- > Individual Actions and Counter-Claims
- > Class Actions
- > CFPB/Other Federal Investigations and Enforcement Actions
- > State AG/Regulator Investigations and Enforcement Actions

Expect “Kitchen Sink” Nature of Claims, Litigation, Risks

- > Claims Arising From “Litigation Traps”
- > Wrongful Foreclosure State-Law Claims/Counter-Claims Arising From
 - CARES Act/other federal foreclosure moratoria
 - CARES Act Forbearance protections
 - State/Local foreclosure moratoria
 - “Old Normal” foreclosure requirements
 - Settlement dynamics with Pro Se Borrowers
- > Suits for Foreclosure-Related Evictions Under Similar Theories

Expect “Kitchen Sink” . . . (Page 2)

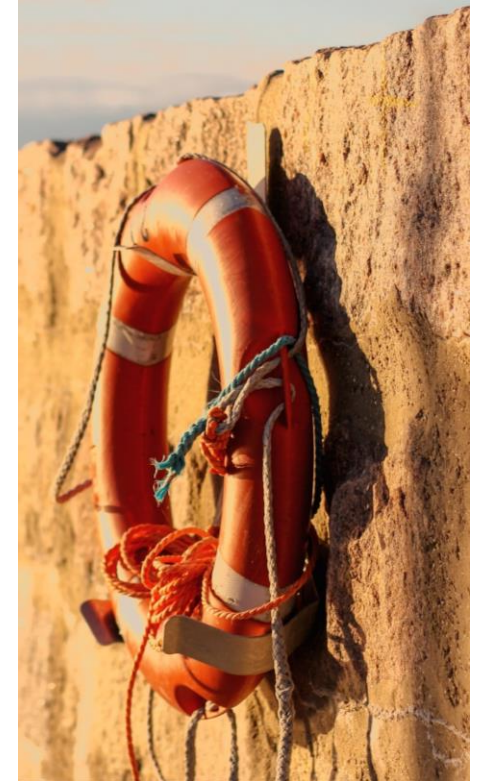
- > Claims That Foreclosures violate state/local emergency/essential services/shelter in place orders
 - *Meador v. U.S. Bank* – VA borrower action to enjoin May foreclosure sale because state shelter in place order offered bidders Hobson’s choice: miss sale or attend and face misdemeanor charge
 - Similar theories spreading to California and other states
- > Federal Law Claims for Violating CARES Act/Agency Guidance
 - No Private Right of Action
 - But Allegations of Implied Right of Action
- > State Law UDAP “Piggyback” Claims for Violating CARES Act/Agency Guidance

Expect “Kitchen Sink” . . . (Page 3)

- > CFPB Claims for Federal UDAAP Violations Under Dodd-Frank for COVID-19 related conduct
- > State AG/Regulator Concurrent Jurisdiction Claims For Federal UDAAP Violations Under Dodd-Frank for COVID-19 related conduct
- > Borrower/State AG Claims Under FCRA for CARES Act Credit Protection Violations
- > Fair Lending/Servicing Claims for Disparate Impact of Forbearance/Loss Mitigation Practices

Actively Minimize Risk of Claims

- > Assess Default Loan Portfolio
 - Identify CARES Act and High Risk Matters
 - Special High Risk Case Tracking
- > Rethink “Old Normal” Default Litigation Strategies
 - Pandemic Has Changed Everything
 - Although Lawful, May Be Deemed Unfair/Abusive
- > Develop “New Normal” Default Litigation Best Practices
 - Are Actions Fair and Reasonable?
 - “Working with” borrowers, in litigation?
 - Does Borrower Understand?
- > Enhance Employee Training
- > Increase Borrower Early Intervention





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Sandy Shatz is a member of the firm's Commercial Litigation and Consumer Financial Services sections. He has been a licensed attorney in California for more than three decades, during which time he has actively litigated cases in the areas of commercial law, real estate, and consumer financial services, specializing in mortgage-related issues. In 1998, he joined Countrywide Home Loans where he organized and established that company's California In-House Litigation Group. Mr. Shatz focused on all aspects of mortgage-related litigation, and has tried numerous cases to verdict. In 2008, after Bank of America acquired Countrywide, he managed outside counsel on a pool of several hundred litigation cases, and helped to develop case-resolution strategies. In 2010, he returned to private practice, where he works on litigation, appeals, and regulatory issues. Mr. Shatz is active in the American Bar Association's Consumer Financial Services Committee, the Mortgage Bankers Association, and the California Mortgage Bankers Association. He has published journal articles and papers, and organized and presented seminars on various aspects of current events in the consumer financial services and mortgage world.

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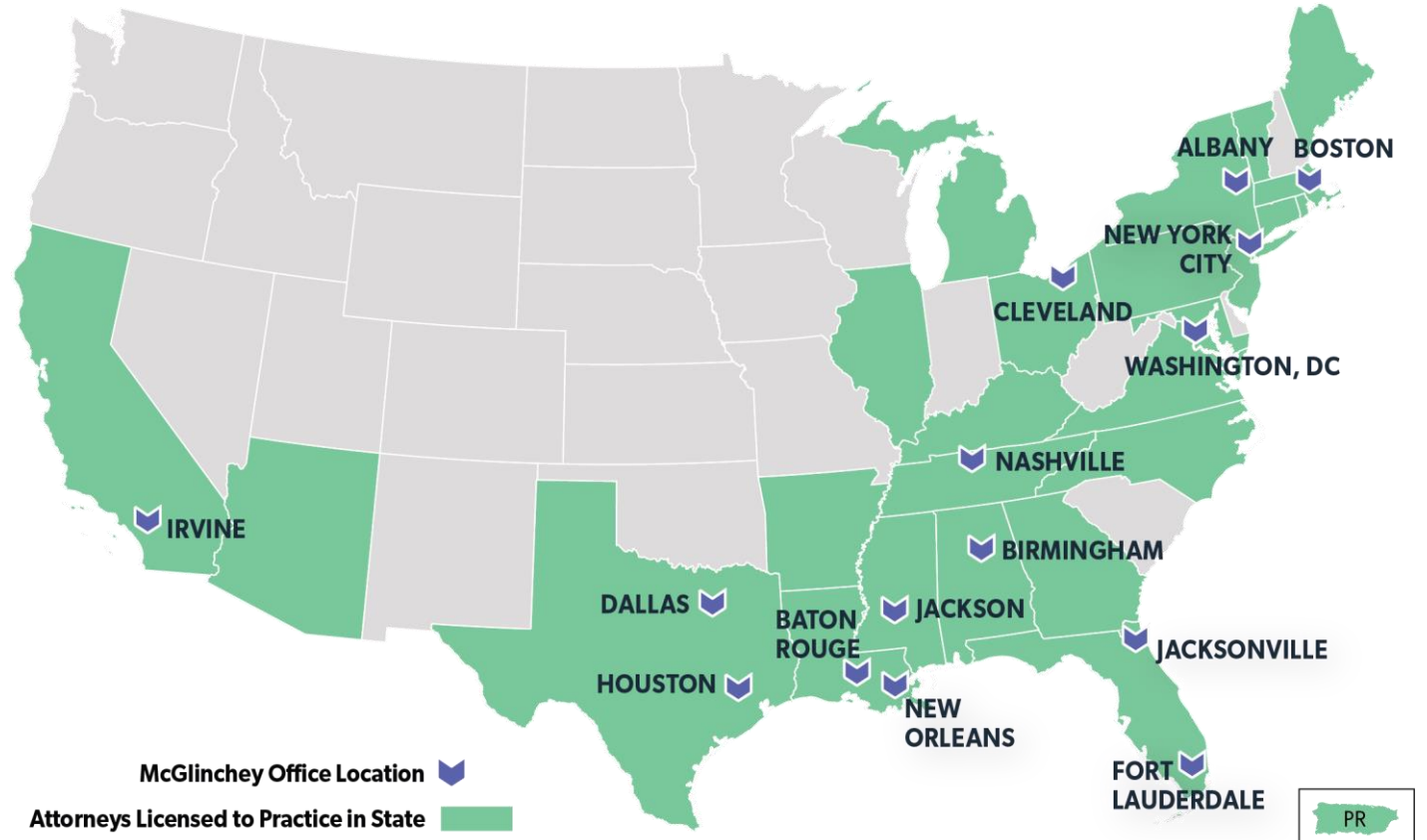


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nationwide recognition



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