epiq

WHITE PAPER

Periodic Statements for Bankrupt Borrowers:

What Loan Servicers Need to Know Now about the CFPB's New Rule

The Consumer Financial Protection Bureau recently finalized new regulations for loan servicers. Soon, mortgage borrowers who have filed for bankruptcy will have the right to demand greater transparency and more communication from the companies that service their loans.

This is a key change. Under the CFPB's former mortgage rule, servicers did not have to provide periodic statements or early intervention loss mitigation information to borrowers in bankruptcy.

Penalties for violating this requirement could add up quickly for servicers who are unprepared or underinformed. Here's what servicers need to know now to help avoid paying large penalties later.

Where Did the Rule Come From?

When the CFPB adopted a number of rules pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2013, it gave itself new powers to oversee consumer protection related to the mortgage market. The CFPB exercised its authority by proposing a number of amendments to its Mortgage Servicing Rules, including requiring creditors, assignees or servicers of any residential mortgage loan to provide a periodic statement to their borrowers for each billing cycle.

On Aug. 4, 2016, the bureau's massive 900-page final mortgage servicing rule went into effect. Among its many requirements are protections that require servicers to afford this greater transparency to debtors protected by bankruptcy.

The director of the Consumer Financial Protection Bureau, Richard Cordray, described the new rule's effect as "ensuring that homeowners and struggling borrowers are treated fairly by mortgage servicers and that no one is wrongly foreclosed upon."

What Does the Rule Require?

Specifically, the new rule states that servicers must provide periodic statements to borrowers in bankruptcy who intend to retain their home, but not to borrowers who intend to surrender it. These statements must contain specific information tailored for bankruptcy, as well as a modified written early intervention notice to let those borrowers know about loss mitigation options.

Two types of servicers are exempt from the requirements: small servicers, i.e., those servicing 5,000 or fewer mortgage loans yearly which they own or originated; and servicers of "charged-off" loans, where no additional charges will be made by the servicer.

In support of the rule, which was first proposed in 2013, the National Consumer Rights Bankruptcy Center (NCRBC) said at the time that the "CFPB found that the complexities of the bankruptcy scenario necessitated periodic statements for debtors."

The rule lets servicers "make changes in statements to reflect accurate payment obligations of the debtor, but [it puts] an end to servicers' practice of stopping monthly statements to borrowers who filed for bankruptcy," the NCRBC said. "Without statements, it is more difficult for homeowners to remain current on their mortgages post-petition."

What Does the Rule Require?

The new rule states that servicers must provide periodic statements to borrowers in bankruptcy who intend to retain their home, but not to borrowers who intend to surrender it.

What Does This Mean for Servicers?

Adjustments needed to satisfy the new rule may not be so simple to put into practice—and may add significant cost and require substantial advance preparation. The CFPB recognized that the mortgage servicing industry would incur additional costs to comply with the new rule. But it also stated that it "believes that the majority of the provisions in this final rule would impose, at most, minimal new compliance burdens."

The Mortgage Bankers' Association (MBA) is not so sure. After the Interim Final Rule was first announced, a joint letter sent by the MBA, the Consumer Bankers Association and the American Bankers Association expressed concern that "the CFPB's view does not take into consideration common limitations of existing servicing platforms and collections systems."

Meanwhile, private lenders such as Wells Fargo and Bank of America (BOA) have complained that the additional requirements for notices were overly burdensome and could cause confusion for borrowers. BOA stated it was unclear what the bank's obligation would be in situations where the bank maintains accounting on the loan pursuant to both the bankruptcy plan and to the borrower's loan documents. BOA argued that the changes to statements would involve procedural changes and training could cost an estimated $10 million, and that such expense was not justified by the benefit the new requirements would bring to consumers.

After the final rule was enacted Aug. 4, the MBA found that that the necessary system changes and staff training to implement the changes wrought by the Interim rule had proved "time-consuming and costly for the industry" and that "responding to CFPB investigations—often in conjunction with multiple state examinations—has required a significant resource commitment from servicers."

Aside from the cost of training staff and implementing a new system that complies with the rule's requirements, another challenge will be the accuracy of the information on the statement, as escrow shortages or overages could cause a mismatch between the servicer system of record and the trustee system of record.

The changes take effect 18 months after the 2016 Mortgage Servicing Rule's publication in the Federal Register, which means the clock started ticking Aug. 4, 2016. Servicers need to give themselves adequate time to execute the necessary technological and training adjustments that need to take place.

Most importantly, servicers must ensure that their system of record is accurate and should implement a series of adjustments that include programming changes, address standardization changes (the rule require that the debtor's address be accurate), and new systems for filings and mailings.

What Do Violators Stand to Lose?

The final rule does not prescribe a specific penalty scheme for violators. But a September 2016 federal bankruptcy court ruling may provide the first insight into how courts may assess fines for mortgage servicers who fail to comply with the new periodic statement rule. If it survives appeal, the ruling may even set the standard penalty for non-compliance with the CFPB periodic statements rule: $25,000 per loan.

In *In re Gravel*, a trustee in bankruptcy filed a motion for contempt against a residential mortgage servicer, PHH Mortgage Corp., for non-compliance with Rule 3002.1 of the Federal Rules of Bankruptcy Procedure. Rule 3002.1 requires that a creditor secured by a lien on the debtor's home must provide to the debtor, the trustee in bankruptcy, and the debtor's counsel notice of any change in the payment amount (including changes in escrow accounts) at least 21 days in advance plus any post-petition fees, expenses or charges within 180 days of their occurrence. The creditor must also file a statement indicating whether the debtor has paid off their debt plus related expenses within 21 days of the trustee's notice of final cure payment.

The United States Bankruptcy Court for the District of Vermont noted that in connection with three separate loans, PHH issued electronic invoices that included fees and charges that had not been included in a Rule 3002.1-compliant notice. The court assessed sanctions totaling $375,000 against PHH. This amount included a fine of $25,000 for each instance in which PHH failed to comply with the notice requirements of Rule 3002.1.

While the decision in *Gravel* has not yet been tested in other courts, if *Gravel* does indeed become the standard sanction for noncompliance, it will become more important than ever for servicers and their law firms to know everything they need to know to avoid errors and discrepancies between periodic statements and post-petition fee notices, and to have a systematic means by which to maintain compliance. At a prospective cost of $25,000 or more per failure, a misstep could be crippling at worst and meaningfully impair value at best.

How Can Servicers Protect Themselves?

The new rule creates a potential Gordian Knot of challenges for servicers. To assist with unraveling the requirements, AACER, the leading provider of court data automation and processing services, suggests the following best practices, among others, for servicers to stay compliant with the new mortgage servicing rule:

- Ensure that bankruptcy systems can guarantee that statements are sent timely and accurately and can provide the level of detail required by the CFPB. In many instances, these systems will need to be automated to manage the effort required for compliance.
- Create an audit process to ensure that payments and fees received from the trustee and the debtor are applied correctly. This may require servicers to reorganize or enhance internal audit functions or outsource to a trusted loan audit partner.
- Set up a system for customers who don't want to receive periodic statements to opt out. Ensure language is simple and jargon-free for customers to understand.
- Partner closely with local attorneys who represent the servicer in these cases to make sure they fully understand the information on the statements and have a channel to request copies of recent statements. Lawyers can help mitigate issues before they escalate into litigation.

The CFPB's new rule may materially impact a servicer's reality considering the rock pile of operations and legal issues and costs created in satisfying it. Though, it is likely all justified if enforcement of the new rule helps debtors timely make payments, consummate a bankruptcy plan and receive a discharge. And, to be sure, a servicer's advance, thoughtful preparation to comply, including teaming with the right partner as may be advantageous, should mitigate any difficulties in avoiding fines and other repercussions from non-compliance.

About AACER

AACER is a leader in court data automation and processing services, including for helping servicers reduce the risk and cost of managing non-performing loan portfolios. With AACER's loan audit, statements automation and other platforms, servicers conveniently and cost-effectively maintain compliance with rules and regulations, onboard portfolios and service loans. Additionally, using AACER, lenders, servicers, investors, law firms and others easily and efficiently identify debtors in bankruptcy, monitor bankruptcy cases and events, and search across and within cases, driving up their bottom lines. AACER's case search and monitoring services, including its user-friendly online platform, give automated, periodic and on-demand access to electronic court records from every court in the country. Users leverage AACER's case monitoring work queues, proprietary algorithms and crowd-sourced cost reduction model to realize savings and best manage their portfolios, all through one reliable, on-demand connection point. And our expert special projects team stands at the ready. See how AACER, a division of Epiq, can help you today by visting us online or contacting Noah Ornstein at +1 312-971-3474 or nornstein@epiqsystems.com.