Reclaiming the Rules: Solutions for Mortgage Servicing

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Summary

When I began my work as California Monitor for the National Mortgage Settlement (Settlement) in April 2012, mortgage servicing was at the forefront of public and government attention. The Settlement implemented 304 reforms aimed at improving the practices of the five largest servicers in the market. Activity continued at the federal and state level to improve servicing. In 2013, California's Homeowner Bill of Rights (HBOR) went into effect. In 2014, the Consumer Financial Protection Bureau (CFPB) issued extensive mortgage servicing rules. These were milestones for consumer protection.

Many of the regulations had visible effects in making homeownership more sustainable and helped homeowners get fairly reviewed for foreclosure prevention alternatives. Based on my years of direct engagement and analysis as Monitor, I can say with certainty that mortgage servicing has improved. But after reviewing over 5,000 complaints from California homeowners, I also know that the work is not done. Some servicing regulations cause confusion for homeowners and pointless work for servicers. Other issues should have been fixed by now, but have not been addressed.

Part of the problem is replication of the Settlement's servicing standards. The CFPB and other lawmakers have subsequently adopted mortgage laws, often without sufficient analysis of and data on how the Settlement was working on the ground.[1] Reforms that fell short were enshrined into permanent statutory law, rather than amended. In other cases, standards were tweaked in a way that ignored why they were inadequate. The most glaring example is the loan modification denial letter. While now very comprehensive, homeowners still cannot understand it; the text-heavy format and high literacy level are barriers to consumers knowing their rights. Regulators need to make improvements based on the expertise and analytics of the California Monitor Program and others, including leadership at servicers who implemented the National Mortgage Settlement. Rule writing is difficult, and mortgage servicing is complex. But these are the very reasons that it is imperative to revisit the rules with a stronger focus on the Settlement's successes and failures.

An important (and unappreciated) avenue for change in mortgage servicing is through government-sponsored enterprise (GSE) reform. At the very least, reforming the Fannie Mae and Freddie Mac servicing guidelines is key to large-scale improvements in the industry. New guidelines could push servicers to invest in technology, a critical solution to current problems in mortgage servicing. The market itself has very little incentive to invest in technology, particularly as loan defaults decline. Through GSE reform, servicers could be required to implement a common default servicing platform. Such technology would protect homeowners during a service transfer by ensuring that the new servicer has immediate access to all of a homeowner's loan information. This would reduce the anxiety that transfers cause for homeowners on the verge of losing their homes and the costs (including burden on nonprofits and HUD counselors) from unnecessary document requests. A common default servicing platform also reduces industry compliance costs.

Regulators and industry also should initiate pilot programs, harness technology that is currently unused, and develop multicultural, multilingual communications with homeowners. Regulators should be evaluating the letters servicers produce in response to a rule to determine if the rule is accomplishing its purpose. Servicers should conduct consumer testing and re-write uninformative and confusing letters. There is already precedent for this type of testing from the CFPB,

[1] California, Minnesota, and Nevada all enacted Homeowner Bills of Rights (HBOR) in the wake of the National Mortgage Settlement. CAL. CIV. CODE § 2923.4 et. seq. (West 2012) (California); MINN. STAT. ANN. § 582.043 (West 2014) (Minnesota); NEV. REV. STAT. ANN. § 107.400 et. seq. (West 2013) (Nevada). To be sure, California's HBOR was signed on July 11, 2012, in the immediate aftermath of the Settlement's announcement. This made it impossible to incorporate any knowledge of the efficacy of the Settlement's servicing reforms, which did not take force until October 3, 2012.

with impressive results. And of course, the financial services industry has remarkable marketing talent that could be deployed in servicing, not just customer acquisition.

The National Mortgage Settlement gave homeowners many crucial protections, and the industry has come a long way from the illegal and unfair conduct in the years before 2012. As Monitor, I know firsthand that thousands of families are still struggling to save their homes. As a consumer protection expert, I know the importance of redesigning law to address existing weaknesses and to adapt to future challenges and market conditions.

This report hopes to start a dialogue that keeps mortgage servicing moving forward.

Very truly yours,

Katherine Porter

This report reflects the views of the California Monitor Program. It does not necessarily reflect the views of the California Attorney General or the California Department of Justice.

Contents

Revisiting Rulemaking and Enforcement

Government and industry have poured effort and money into improving mortgage servicing over the past few years. Their task was formidable: to mitigate the damage caused by abusive practices and to help homeowners navigate the foreclosure crisis. Mortgage servicing from the consumer's perspective definitely has improved. Unlawful conduct no longer predominates, and consumers have significantly more rights. The lawsuits, national settlements, federal regulations, state laws, and a national monitor have contributed to the improved state of servicing. But well-intentioned reforms sometimes miss the mark, and the industry continues to evolve in response to market forces and compliance costs. Today, mortgage servicing is an ongoing area of policy concern. Bank of America still has 263,000 delinquent loans, which may take two years or even longer to work through.[2] The work is not done in creating an efficient and responsive servicing system.

The Consumer Financial Protection Bureau (CFPB) and other government actors, state and federal, need to stop looking backward and addressing minutiae. Regulators need to squarely tackle core structural tensions in servicing and get ahead of emergent issues with a forward-focused approach. Because mortgage servicers do not operate in a market driven by competition, effective regulations are the key mechanism to change servicer behavior and protect homeowners. But the CFPB and state lawmakers have not done their due diligence in rulemaking and have failed to measure the outcomes of servicing laws. As a result, they lack data to assess the success of their work. In some areas, they have replicated ineffective servicing rules and issued new ones that have worsened problems.

Regulators, attorneys general, and legislators should have identified the National Mortgage Settlement (Settlement) as a stepping-stone to more successful regulations and remedies. As the first major consumer protection effort post Dodd-Frank,[3] the Settlement certainly drove improvements in servicing. The California Monitor Program has documented steep declines in complaints about dual tracking and lost loan modification application documents. But some Settlement provisions failed to provide homeowners with adequate protections or transparency into the servicing process, and placed unnecessary operational burdens on servicers that did not lead to better outcomes. For example, the Settlement required the Settlement banks[4] to send notices to homeowners listing any missing or incomplete documents *within five days* of receiving a loan modification application document. This rule set an impractical timeline. The letters that banks produced in response to this rule did little to help homeowners get through the review process more quickly and imposed costs and risks on industry. Still, attorneys general and regulators have copied this rule (and other rules) verbatim in recent laws and settlements like California's Homeowner Bill of Rights (HBOR)[5] and the CFPB's new mortgage servicing rules (CFPB rules).[6] The CFPB's recent billion-dollar settlement with Ocwen for servicing violations contained almost no changes from the Settlement, even though it was signed two years later.[7] Learning is a key task of effective law making. This report identifies the failure to improve on, or even assess, laws.

> Regulators need to squarely tackle core structural tensions in servicing and get ahead of emergent issues with a forward-focused approach.

[2] Kate Berry, *Bank of America's Next Big Countrywide Problem*, AMERICAN BANKER, Aug. 27, 2014.
[3] The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, 124 Stat. 1376 (2010).
[4] These banks are Bank of America, Citi, JPMorgan Chase, Wells Fargo, and Ally (formerly GMAC).
[5] CAL. CIV. CODE § 2924.10 (West 2012).
[6] 12 C.F.R. § 1024.41(b)(2)(i)(B) (2014). The CFPB's final mortgage servicing rules went into effect on January 10, 2014. Real Estate Settlement Procedures Act (Regulation X), 12 C.F.R. § 1024 (2014); Truth in Lending Act (Regulation Z), 12 C.F.R. § 1026 (2014).
[7] The Ocwen settlement was approved by the U.S. District Court for D.C. on February 26, 2014.

Recycling the Settlement has resulted in some mortgage servicing rules that continue to leave homeowners vulnerable to deceptive and unfair servicing practices. Regulators' prioritization of efficiency over effectiveness in drafting rules has stifled continued progress in mortgage servicing. Reusing ineffective rules will never lead to better outcomes. Regulators, particularly the CFPB, must have a deeper understanding of how mortgage servicers operate and which current rules are weak or failing. The best approaches are data-driven and cooperative with industry. The needed conversations are between experts in consumer complaints and customer service, between experts in technology and operations, and between experts in communication and marketing. We have reached the limits of where even well-intentioned lawyers—lobbyists for industry and rule makers for government—can take mortgage servicing.

The CFPB should also review the communications servicers produce, not just to ensure compliance with CFPB rules, but additionally to evaluate consumer response to these communications. Finally, the CFPB and other actors, including the Federal Housing Finance Agency, should research how servicers are currently using technology in their operations, and consider regulation that presses servicers to leverage technology to improve the loan modification review process and to communicate better with homeowners. This is the level of care and practice that the CFPB and other lawmakers must exercise to transform servicing.

Transforming the Regulation of Consumer Communication

The Settlement aimed to improve consumer communications, but many rules that seemed protective of homeowners have left them more confused. Each new round of regulations has compounded the language and organization problems that these communications have. In fact, servicers routinely point out that their communications, however unintelligible, do in fact comply with the law. The CFPB should carefully assess both the amount and the type of information that benefits homeowners. It should evaluate communication not merely for legality, but also for efficacy. Does the communication help consumers understand their next steps and reduce time lost in the back-and-forth with servicers during the loan modification application process? This outcome-oriented approach should guide refinements and simplifications of laws.

Government Speak

Regulators ostensibly provide sample language to help servicers better communicate with homeowners. However, the proposed language is often unclear, excessively wordy, and far too complex for even a sophisticated homeowner to understand. Government actors like the Department of Treasury (Treasury) and the CFPB perpetuate, and even sanction, poor communication through their own poorly written sample language. Servicers feel safe copying and pasting this language into their letters because it came directly from a supervising government entity. In fact, servicers actually take on compliance risk when they draft better language in response to consumer complaints and inquiries.

Incomprehensible loan modification denial letters are often a product of regulators' sample language. In the Making Home Affordable handbook, Treasury included sample language for servicers to use in communicating denial reasons to homeowners for the Home Affordable Modification Program (HAMP).[8] Servicers frequently copy Treasury's language verbatim in letters denying homeowners not only for the HAMP program, but also for their proprietary loan modification programs.

[8] Making Home Affordable Program Handbook for Servicers of Non-GSE Mortgages, v4.3, Exhibit A: Model Clauses for Borrower Notices, p. 217-221, https://www.hmpadmin.com/portal/programs/docs/hamp_servicer/mhahandbook_43.pdf.

One denial reason Treasury lists is "Post Modification DTI Outside of Acceptable Range." This is the explanation Treasury suggests servicers give homeowners:

MAKING HOME AFFORDABLE®

We are unable to offer you a HAMP Modification because, in performing our underwriting of a potential modification, we determined that the proposed modified monthly payment which we could offer you, which includes a modified monthly principal and interest payment on your first lien mortgage loan plus property taxes, hazard insurance premiums, and homeowners dues (if any) was outside the of the range of [insert as appropriate:] [10% - 55%] OR [insert Servicer's DTI Range] of your monthly gross income (your income before taxes and other deductions which we verified as $___________. Your modified monthly housing expense must be within this range in order for you to be eligible for HAMP. If you believe the verified income figure we have is incorrect, please contact us at the number provided below.

The denial language Treasury provides here is troubling for many reasons. A homeowner will likely read this several times and still not understand the reason for denial from the program because the explanation is convoluted and contains technical terms like "underwriting." The denial explanation scores at a 25th grade reading level,[9] well above the reading level of most homeowners.[10] And, the explanation is far too wordy. The first sentence alone contains 80 words and three clauses. Indeed, the letter even contains a typographical error ("outside the of the range"). This poor communication will frustrate the homeowner, rather than further his or her understanding. It also feeds consumers' anxieties that modifications are so complex that they should either pay (often a scammer) for help or give up.

Compare Treasury's version with the California Monitor Program's re-write. Which version is easier to understand?

Words: 125-127 Reading level: 25th grade Typographical errors: 1	**MHA VERSION** We are unable to offer you a HAMP Modification because, in performing our underwriting of a potential modification, we determined that the proposed modified monthly payment which we could offer you, which includes a modified monthly principal and interest payment on your first lien mortgage loan plus property taxes, hazard insurance premiums, and homeowners dues (if any) was outside the of the range of [insert as appropriate:] [10% - 55%] OR [insert Servicer's DTI Range] of your monthly gross income (your income before taxes and other deductions which we verified as $___. Your modified monthly housing expense must be within this range in order for you to be eligible for HAMP. If you believe the verified income figure we have is incorrect, please contact us at the number provided below.
Words: 67 Reading level: 10th grade Typographical errors: 0	**CALIFORNIA MONITOR REVISION** We are unable to offer you a HAMP modification because your new monthly payment would be more than [X percentage] of your gross monthly income (your income before taxes and other deductions). This monthly payment is larger than the program guidelines allow. We determined your gross monthly income to be $___. If you believe this income number is incorrect, please contact us at the number provided below.

[9] This was determined using the Flesch-Kincaid readability test.
[10] According to the 2003 National Assessment of Adult Literacy (NAAL), the average adult reads at a 9th-grade level. *Know Your Readers*, IMPACT INFORMATION, http://www.impact-information.com/impactinfo/literacy.htm (interpreting the results of the 2003 NAAL, available at http://nces.ed.gov/NAAL/kf_demographics.asp).

Our explanation is concise and avoids providing more information than is actually helpful. It brings the reading level down to a 10th grade reading level. Our revised version also cuts the number of words nearly in half and is easier to understand.

When homeowners do not understand why their servicer will not approve them for a loan modification, many are unwilling to accept that they need to consider their remaining options. Unintelligible letters contribute to homeowners' belief that servicers' decisions are entirely arbitrary. Homeowners often repeatedly appeal or submit new applications after receiving denial letters with reasons like the example given above. This wastes the time and resources of homeowners and servicers. Better language explaining denials would help homeowners understand and accept that they do not qualify for a modification, and allow time for a meaningful evaluation of other options.

Dictating what a servicer should tell a homeowner may not always be the best approach. It provides no incentive for servicers to draft language that is most helpful to homeowners. Regulators should consider eliminating standardized language and establish best practices, including that servicers use their marketing teams to craft their own language. The financial services industry is excellent at communication in competitive profit-driven departments such as credit card marketing and mortgage origination. The CFPB should then carefully scrutinize servicer-designed communications to ensure the language is not deceptive, and also that it is written in clear, plain language. Servicer testing of the letters would allay any such concerns. If government does decide to post sample language or letters, it is critical that they are clear, concise, and of an appropriate reading level. They will be copied.

The CFPB should revise its own sample letter regarding service transfers to better inform homeowners, especially those who are delinquent, of what to expect with the transfer and of their rights. The CFPB issued new requirements for letters that both the old and new servicer are obligated to send under the Real Estate Settlement Procedures Act (RESPA) during a service transfer.[11] These letters must convey certain information to the homeowner whose loan is being transferred, such as the effective date of transfer and the date the former servicer will stop accepting mortgage payments.[12] The CFPB designed a model form letter (*below)* for servicers.[13]

APPENDIX MS-2 to PART 1024—NOTICE OF SERVICING TRANSFER

NOTICE OF SERVICING TRANSFER

The servicing of your mortgage loan is being transferred, effective [Date]. This means that after this date, a new servicer will be collecting your mortgage loan payments from you. Nothing else about your mortgage loan will change.

[Name of present servicer] is now collecting your payments. [Name of present servicer] will stop accepting payments received from you after [Date].

[Name of new servicer] will collect your payments going forward. Your new servicer will start accepting payments received from you on [Date].

Send all payments due on or after [Date] to [Name of new servicer] at this address: [New servicer address].

If you have any questions for either your present servicer, [Name of present servicer] or your new servicer [Name of new servicer], about your mortgage loan or this transfer, please contact them using the information below:

Current Servicer:	New Servicer:
[Name of present servicer]	[Name of new servicer]

The CFPB's form letter presents multiple problems. First, it assumes a fairly sophisticated understanding on the part of the homeowner. The letter fails to explain the difference between a mortgage servicer and the investor, for instance. Second, it contains misleading information. The letter states that "nothing else about your mortgage loan will change," but fails to indicate that the new servicer may not offer the same foreclosure relief that was offered by the previous servicer. Third, it hides important information, such as the 60-day ban on late fees following a loan transfer, at the bottom of the letter. Finally, the letter fails to account for the most

[11] 12 C.F.R. § 1024.33 (2014).
[12] 12 C.F.R. § 1024.33(b)(4).
[13] 12 C.F.R. § 1024, Appendix MS-2 to Part 1024.

vulnerable population during service transfers—delinquent homeowners.[14] Those at high risk of foreclosure need different communication at the time of transfer.

Service transfers can cause homeowners to panic, especially if they are already in the foreclosure process or in the midst of a loan modification review. The CFPB's one-size-fits-all letter has become part of the problem, rather than part of the solution. The CFPB should place important information up front and explain terms that may cause confusion. It should also require differentiated communication for delinquent homeowners. These homeowners need more attention and they need information earlier. The letter targeting delinquent homeowners should require servicers to explain that the loan transfer process takes time and that a homeowner may need to send in updated versions of documents that expired during the transition. It should notify homeowners that their new servicers may not offer the same loan modification programs as their previous servicers and give more guidance to homeowners in the middle of a trial modification. Not only would such requirements help alleviate the anxieties of delinquent homeowners by setting expectations, they would also reshape industry practice to require servicers to note and engage delinquent homeowners from the earliest point in transfer.[15]

Irrelevant Information

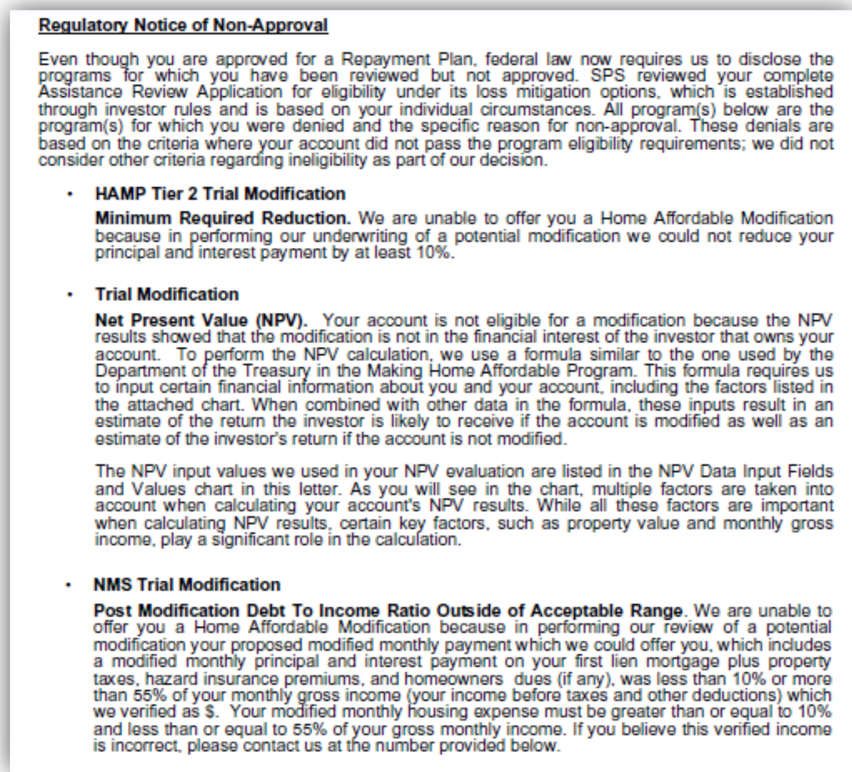
The CFPB rules require mortgage servicers to provide homeowners with more information than ever before. But if the rules do not result in readable communication from servicers, quantity is of little use to a homeowner. Regulators need to remember that more information can actually cause harm. At each turn in regulating, government must evaluate whether it is increasing transparency or increasing confusion.

Under the Settlement, servicers are required to send letters to homeowners "identifying the reasons for denial and the factual information considered."[16] The provision does not explicitly state that a servicer must detail the denial reasons for each different modification program.[17] Expanding the reform in the Settlement, the CFPB now requires servicers to send homeowners more comprehensive notices explaining their loan modification review results. The applicable rule states that when a servicer denies a homeowner for a loan modification, the notice must include "the specific reason or reasons for the servicer's determination for *each* . . . loan modification option."[18]

With this revised rule, the CFPB recognized that the denial letters that servicers were sending out were insufficient. The typical two-page letter generated in compliance with the Settlement often did not specify the modification programs that the servicer reviewed and denied the homeowner for. Many homeowners whom the California Monitor Program assisted expressed grave concerns that their servicers had not actually reviewed them for *all* available programs. Our program attorneys reviewed hundreds of denial letters and found that most failed to describe the factual basis for the denial. They frequently omitted the homeowner's verified income (which often provides the only basis for a successful appeal) and gave the homeowner inaccurate investor information. Homeowners were highly dissatisfied and felt that they had received a form letter that did not apply to their individual situations.

[14] We thank Dana Dillard, EVP and Chief Customer Officer at Nationstar, for raising this point to us and for sharing Nationstar's bifurcated approach to service transfer for current and delinquent customers.
[15] Another protective measure would be freezing the foreclosure process during the 60 days after the effective date of transfer. This would be a substantive protection, but the two approaches can be deployed in tandem.
[16] Exhibit A, p. A-27, IV.G.2.a.
[17] *Id.*
[18] 12 C.F.R. 1024.41(d) (2014) (emphasis added).

But the CFPB's new rule has worsened the situation. Homeowners are now receiving denial letters from their servicers that routinely run from 12 to 20 pages. Despite containing more information volume, these letters have done little to assure homeowners they have been fairly reviewed for a loan modification. Because the letters still contain the poorly worded denial reasons discussed above, homeowners now have five explanations that they do not understand instead of one.



Regulatory Notice of Non-Approval

Even though you are approved for a Repayment Plan, federal law now requires us to disclose the programs for which you have been reviewed but not approved. SPS reviewed your complete Assistance Review Application for eligibility under its loss mitigation options, which is established through investor rules and is based on your individual circumstances. All program(s) below are the program(s) for which you were denied and the specific reason for non-approval. These denials are based on the criteria where your account did not pass the program eligibility requirements; we did not consider other criteria regarding ineligibility as part of our decision.

- **HAMP Tier 2 Trial Modification**

  Minimum Required Reduction. We are unable to offer you a Home Affordable Modification because in performing our underwriting of a potential modification we could not reduce your principal and interest payment by at least 10%.

- **Trial Modification**

  Net Present Value (NPV). Your account is not eligible for a modification because the NPV results showed that the modification is not in the financial interest of the investor that owns your account. To perform the NPV calculation, we use a formula similar to the one used by the Department of the Treasury in the Making Home Affordable Program. This formula requires us to input certain financial information about you and your account, including the factors listed in the attached chart. When combined with other data in the formula, these inputs result in an estimate of the return the investor is likely to receive if the account is modified as well as an estimate of the investor's return if the account is not modified.

  The NPV input values we used in your NPV evaluation are listed in the NPV Data Input Fields and Values chart in this letter. As you will see in the chart, multiple factors are taken into account when calculating your account's NPV results. While all these factors are important when calculating NPV results, certain key factors, such as property value and monthly gross income, play a significant role in the calculation.

- **NMS Trial Modification**

  Post Modification Debt To Income Ratio Outside of Acceptable Range. We are unable to offer you a Home Affordable Modification because in performing our review of a potential modification your proposed modified monthly payment which we could offer you, which includes a modified monthly principal and interest payment on your first lien mortgage plus property taxes, hazard insurance premiums, and homeowners dues (if any), was less than 10% or more than 55% of your monthly gross income (your income before taxes and other deductions) which we verified as $. Your modified monthly housing expense must be greater than or equal to 10% and less than or equal to 55% of your gross monthly income. If you believe this verified income is incorrect, please contact us at the number provided below.

The excerpt at left is from a 20-page denial letter a servicer sent to a homeowner whom the California Monitor Program assisted. Some denial reasons are too short; others are excessively wordy. All are confusing. For instance, the HAMP Tier 2 Trial Modification explanation is lacking context and uninformative. It leaves out key information that the servicer used to reach its decision—the gross monthly income. The only message that a homeowner takes away from such an explanation is that the servicer is not modifying the payment even though it is unaffordable. The NMS Trial Modification explanation attempts to give the homeowner her gross monthly income but does not get there. It states the servicer "verified [the gross monthly income] as $." No dollar figure was provided to this homeowner, who submitted copious income information to the servicer. The letter also contains two separate Net Present Value (NPV) charts containing information used to evaluate the homeowner for HAMP and non-HAMP options. The charts list the exact same categories of financial, loan account, and property information, but contain slightly different inputs based on different program guidelines. The CFPB must evaluate letters like the example provided to see how its rule *in practice* falls far short of its goal of aiding homeowner understanding.

The CFPB is also hurting, not helping, homeowners by inundating them with information in its January 2014 guide "Help for Struggling Borrowers."[19] The CFPB implemented hundreds of servicing rules to prevent abusive practices by servicers. Its guide should be a tool to empower homeowners as they navigate the protections available to them under the new servicing rules. But the CFPB guide is anything but simple. It is 104 pages long. The guide often directly quotes the rules or comments to the rules instead of distilling them. This forces homeowners to wade through the language of the rules themselves. Yet surely the CFPB would reject the notion that it crafts its rules using language and concepts at the level of most Americans. Ostensibly, the guide reflects CFPB's knowledge of this point, but at execution, its staff regurgitated the rules rather than offering digestible explanations.

Some of the headers are helpful in directing homeowners where to look within the guide for their particular problems. For example, "What happens if the borrower submits a complete loss mitigation application after foreclosure has been filed?" is a clear and specific header. However, many headers do not do enough to help homeowners know where to look to

[19] Available at the CFPB's website under the "Understanding our mortgage rules" section, http://www.consumerfinance.gov/mortgage/#homeowners.

understand the available protections for their issues. Headers like "Liability for failure to comply with 12 C.F.R. 1024.41" and "General" are not helpful. Based on the table of contents, the guide appears to be geared towards servicers, not struggling homeowners.

One clear example of the shortcomings of CFPB's guide is section 1.3 "Identifying key dates for loss mitigation and foreclosure." First, the CFPB's audience is unclear from the first sentence. The CFPB starts by stating that "Several key dates have to be identified . . ." but does not say who has to identify them. The servicer? The borrower? A foreclosure trustee? The CFPB should rephrase this to say, "A homeowner should note the following key dates. These dates are important because they are the start or stop dates of protections of your rights during the loan modification and foreclosure process." This makes the homeowner the subject and actor in the sentence and directly explains why a homeowner should pay attention to these dates. Second, the section states "These crucial dates are:" and lists a series of dates. But the CFPB provides no explanation to homeowners for why these dates are so "crucial." Homeowners are told to look out for day 36 after a missed payment or day 120 after becoming delinquent without any explanation of what occurs on each of these dates. Without this information, the guide is unlikely to move the homeowner to take action or be a useful tool.

Unrealistic Expectations

Servicers produce poor-quality communications in part because the CFPB has created impractical timelines to deliver information to homeowners. The CFPB essentially presses a servicer to forego an opportunity to provide homeowners quality feedback to meet timeframes. Yet, these timeframes are not based on data assessing what consumers find fair or just. They are the arbitrary creations of lawyers. The CFPB, along with other regulators, should author workable standards for servicers to ensure homeowners get easy-to-understand, streamlined, and tailored communications.

The "five-day letter" is a clear example of a well-intended rule hampered by a major shortcoming. The CFPB requires servicers to notify homeowners of any missing documents within five days of getting application documents from a homeowner.[20] The CFPB copied this rule from the Settlement,[21] despite overwhelming evidence of the rule's ineffectiveness among those (including industry) who have worked on the Settlement for years. The California Monitor Program has analyzed complaints over the last two years about the specific problems caused by this rule. Homeowners who receive this letter within five days can expect several more when the servicer discovers that a page is missing from a bank statement, that the homeowner did not sign a tax form, or that a necessary document was never submitted. By the time the homeowner complies with all of the servicer's document requests, documents sent early in the process expire, and the homeowner has to begin again. Multiple, repetitive, and overlapping requests for documents lead homeowners to believe servicers are putting up roadblocks to prevent them from saving their homes. And because the CFPB has passively allowed servicers to produce poor communications in response to its rules, servicers have no incentive to devote resources to improving their letters. Homeowners have come to distrust not only their servicer for sending incomprehensible communications, but also government for not making the system better.

In mimicking this rule from the Settlement, the CFPB ignored the fact that loan modification applications can be complicated and that a thorough review requires time. Even if a homeowner has a "simple" financial situation, the servicer will require a variety of documents. If, for example, a homeowner owns a business, the application—and its review—becomes increasingly complex. It is unreasonable for the CFPB to expect a servicer to review an entire application for both missing documents and incomplete information—and to send a notification letter—within five days. Simply making the

[20] 12 C.F.R. § 1024.41(b)(2)(i)(B) (2014).
[21] Exhibit A, p. A-25, IV.F.2.

deadline fifteen days to review and correspond about the completeness of an application would eliminate many of these issues.

Imprecise Language

The failure to define vague terms weakens homeowner protections and makes laws difficult (if not impossible) to enforce. When federal and state regulators fail to be precise in rulemaking, they force consumers and industry to wait for courts to decide the bounds of the protection. This can take years and produce conflicting interpretations. The Settlement, state legislation, and the CFPB rules all exhibit lack of clarity in key respects.

The Settlement's dual tracking provisions protected homeowners from foreclosure only if their loan modification applications were considered "complete." The drafters of the Settlement offered no definition explaining *when* an application could be considered complete. Many servicers took the approach that an application was complete when the underwriter evaluated it and either approved or denied relief. The only time homeowners could be sure they had complete applications submitted was upon receipt of modification approval or denial letters. This defeated the purpose of the protection, to ensure the foreclosure process be put on hold while a homeowner was actively engaged in the loan modification process. The drafters should have required servicers to notify homeowners when an application was deemed complete and when the application had been submitted for final review to an underwriter.

The CFPB passed on the opportunity to correct the self-policing nature of the definition in its new rules. It basically parroted the Settlement. Now, an application is complete when "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."[22] In other words, an application is not complete until the servicer decides it is. The CFPB implemented a definition that is no better than having no definition at all. The CFPB had adequate time to come up with a workable definition of "complete" as its rules came out years after the Settlement went into effect. There was even public awareness around the issue. The California Monitor Program issued a widely distributed report that proposed a solution to this very problem months before the CFPB mortgage rules came out.[23]

BUILDING BETTER SOLUTIONS

Lawmakers continue to miss the mark in fixing mortgage servicing problems like those identified above. Their replication of existing rules will not drive change. Those working on the ground to implement the Settlement such as the California Monitor Program and certain industry executives knew of the need to tweak certain Settlement approaches, but were not consulted in the Federal Register rulemaking process. Rulemaking was not influenced by site visits, nuanced complaint data, or interviews. Federal regulators should rethink how oversight of servicing is structured and offer new solutions rooted in servicer investment in technology and consumer testing. These investments will not only result in a better experience for homeowners, but also will likely help industry save time and money in the long run.

GSE Servicing: The Best Platform for Further Reform

Government-sponsored enterprises (GSEs) like Fannie Mae and Freddie Mac (Fannie and Freddie) remain the essential (and often only) source of liquidity for families to purchase homes. The Federal Housing Administration (FHA) serves a

[22] 12 C.F.R. § 1024.41(b)(1) (2014).
[23] The report titled "The 'Complete' Application Problem: A Solution to Help Homeowners and Banks Work Together" proposed that servicers must halt the foreclosure process (put in place dual tracking protections) once they receive the documents required under the HAMP guidelines. Available at http://californiamonitor.org/resources/.

similar role exclusively for low- and moderate-income families. FHA's, Fannie's, and Freddie's market dominance *also* makes them significant players in mortgage servicing. Indeed, many of the troubling servicing practices addressed in the Settlement had their origins in GSE servicing guidelines, which imposed tight timelines and discouraged modification. The outsize influence Fannie and Freddie possess offers the potential for reform throughout the entire mortgage servicing industry.

The sheer size of Fannie's and Freddie's mortgage portfolios necessitates that virtually all servicers are in compliance with their servicing guidelines or baseline requirements. Because noncompliance with the Fannie and Freddie requirements excludes companies from servicing GSE mortgages ($5 trillion in potential servicing rights), servicers have every incentive to build their business models, operations, and compliance regimes around GSE standards. Changing Fannie's and Freddie's servicing guidelines provides an ideal path to industry-wide reform.

Fannie's and Freddie's tremendous influence on mortgage finance required Congress to think about ways to improve government-sponsored lending. Proposals in Congress have come from both sides of the aisle, with the most promising bill being the Housing and Finance Reform and Taxpayer Protection Act of 2014. Known as the Crapo-Johnson GSE reform proposal, it would replace Fannie and Freddie with a Federal Mortgage Insurance Corporation (FMIC) modeled after the Federal Deposit Insurance Corporation (FDIC). The Crapo-Johnson proposal mandated broad oversight of the FMIC and the creation of a number of offices dedicated to managing specific problems with the mortgage industry. Despite the proposal's purpose of ensuring "fair treatment of customers," however, mortgage servicing was ignored in the current proposal.[24]

To advance the state of mortgage servicing, any GSE reform (whether by Congress or the Federal Housing Finance Agency (FHFA)) should require the FMIC to address mortgage servicing reform. Specifically, the FMIC should include experts on its advisory committee with experience in mortgage servicing. Further, the FMIC also should establish an Office of Mortgage Servicing to oversee compliance with its mortgage servicing guidelines. This office also can promulgate servicing guidelines that focus on larger issues than CFPB's rules. For example, GSE guidelines could drive investment in technology by imposing reporting requirements on loss mitigation, or could broaden outreach to vulnerable populations by requiring Spanish-language communications or permitting text messaging over paper letters for certain purposes. Because tomorrow's mortgage servicing issues are likely to be quite different from today's, having an office monitoring the implementation of mortgage servicing creates better responses to emerging problems. As our next section lays out in detail, a central area in which the FMIC (or barring structural reform, the GSEs through their servicing guidelines) can create lasting and meaningful change is through the establishment of a common servicing platform.

Consumer Protection Through Technology

Servicer unwillingness to spend money improving their loan-servicing technology represents the most significant reason that homeowner assistance problems persist. The roadblock here is one of incentive, not awareness. Servicers know that better technology would significantly improve the way they service loans, but such an undertaking would be expensive and time-consuming. Because homeowners cannot choose their servicers, there is no external incentive driving the deployment of new technology. Investors have failed entirely to reward strong loss mitigation programs, which could also drive technological investment. As a result, servicers continue to use archaic computer systems that lead to inaccurate processes and uninformative communication between servicers and homeowners.

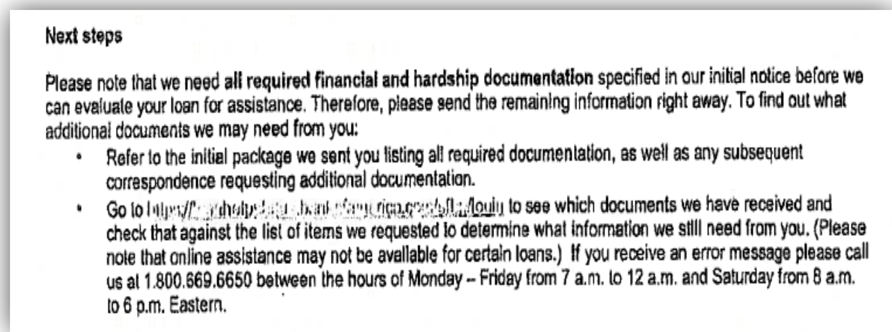
Improvements in technology could close many of the gaps in mortgage servicing, especially for loans in default. Document collection remains a serious problem for homeowners under review for loan modification options. When a servicer's system

[24] Housing Finance Reform and Taxpayer Protection Act of 2014

does not understand a homeowner's income situation, the system may generate a letter asking for every possible document, regardless of relevance.

Consider a recent missing items letter the California Monitor Program examined, in which a major mortgage servicer requested nineteen different categories of information. The servicer stated the homeowner still needed to submit documentation regarding unemployment benefits, self-employment income, and public assistance benefits, as well as pay stubs. It is the rare homeowner who has all these forms of income (pay stubs tend to vitiate unemployment). The language was inconsistent and confusing. The letter failed to distinguish when the servicer was missing a document entirely versus when a document was incomplete or incorrect and needed to be re-submitted with the appropriate changes. Over 18 months ago, the California Monitor Program developed model communications to specify deficiencies with the documents.[25] But CFPB's rules allow servicers to send vague letters—a step backward from where the California Monitor Program had negotiated some servicers to before CFPB's rules were released.

Poor internal technology has also contributed to letters like the example at right, which goes to the other extreme and does not list a single missing document. Rather, the servicer directs the homeowner to "[r]efer to the initial package we sent you listing all required documentation, as well as any subsequent correspondence requesting additional documentation" to determine what is missing. With this letter, the servicer places the burden entirely on the homeowner to figure out what documents the servicer has and does not have. This task is impossible for a homeowner to execute successfully, given that the homeowner cannot see what information the servicer has saved in its system and what the servicer has deemed incomplete. A homeowner faxing in a document (yes, fax technology still reigns at servicers) does not necessarily equate with a servicer receiving a document. With better technology, a servicer would not have such difficulty producing a letter that specified each document as received, missing, or incomplete, as well as any expiration dates.


Next steps

Please note that we need **all required financial and hardship documentation** specified in our initial notice before we can evaluate your loan for assistance. Therefore, please send the remaining information right away. To find out what additional documents we may need from you:

- Refer to the initial package we sent you listing all required documentation, as well as any subsequent correspondence requesting additional documentation.
- Go to [illegible] to see which documents we have received and check that against the list of items we requested to determine what information we still need from you. (Please note that online assistance may not be available for certain loans.) If you receive an error message please call us at 1.800.669.6650 between the hours of Monday – Friday from 7 a.m. to 12 a.m. and Saturday from 8 a.m. to 6 p.m. Eastern.

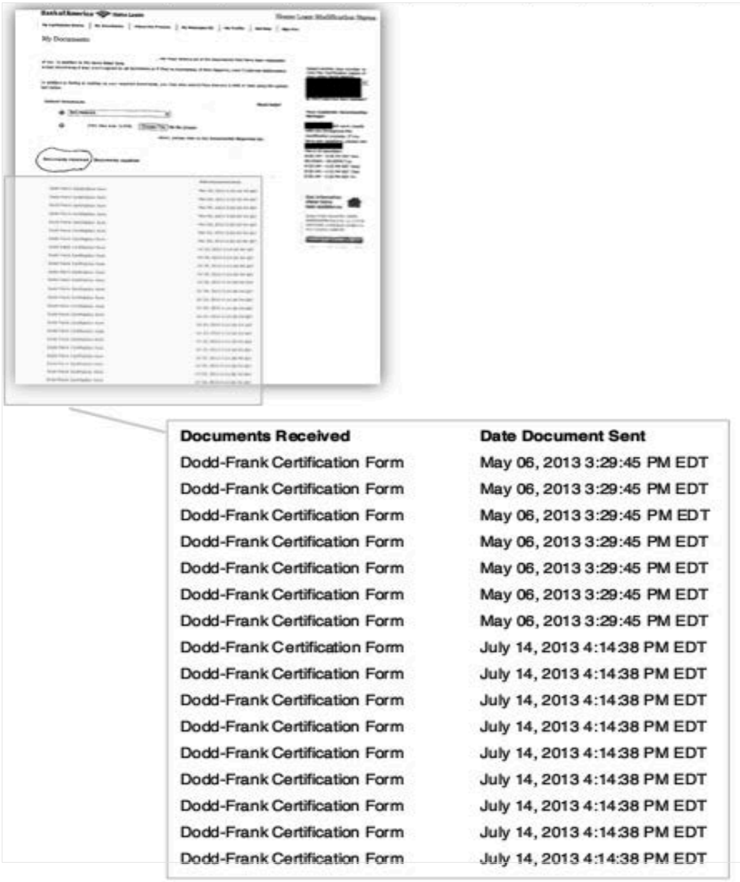
Our program pushed this particular servicer on why its letters were not better tailored to each individual homeowner. The servicer responded by stating that to generate accurate letters, it would have to revamp its technological systems. We have had follow-up meetings and have seen no sign of an effort to fix its outdated systems. From a cost-benefit analysis, the servicer has no reason to make these changes. Regulators or investors (or the GSEs) need to push technology on servicers and raise the stakes.

One technology-based solution to fix the document collection process is for the GSEs to require that servicers use a common, well-designed, and interactive web portal.

Existing portals often fail to guide a homeowner through the application process successfully. A homeowner whom our program assisted was struggling to get reviewed by his servicer even though he complied with the servicer's numerous document requests. He sent us copies of the servicer's web portal, downloaded from the servicer's website at the end of 2013. Under the "Documents received" tab, the servicer listed ten pages of documents received, most of which were duplicate entries (*see next page*). For instance, the servicer stated on its web portal that it received the Dodd-Frank

[25] California Monitor Program, The "Complete" Application Problem: A Solution to Help Homeowners and Banks Work Together Appendix A (2013) (proposed sample notification of missing documents letter for servicers). Available at http://californiamonitor.org/resources/.

Certification Form 35 times. In another part of the servicer's web portal, the servicer listed it had received "Workout Other" 350 times. This is completely useless to a homeowner since it is unclear what "Workout Other" means and what specific documents the servicer received.



Documents Received	Date Document Sent
Dodd-Frank Certification Form	May 06, 2013 3:29:45 PM EDT
Dodd-Frank Certification Form	May 06, 2013 3:29:45 PM EDT
Dodd-Frank Certification Form	May 06, 2013 3:29:45 PM EDT
Dodd-Frank Certification Form	May 06, 2013 3:29:45 PM EDT
Dodd-Frank Certification Form	May 06, 2013 3:29:45 PM EDT
Dodd-Frank Certification Form	May 06, 2013 3:29:45 PM EDT
Dodd-Frank Certification Form	May 06, 2013 3:29:45 PM EDT
Dodd-Frank Certification Form	July 14, 2013 4:14:38 PM EDT
Dodd-Frank Certification Form	July 14, 2013 4:14:38 PM EDT
Dodd-Frank Certification Form	July 14, 2013 4:14:38 PM EDT
Dodd-Frank Certification Form	July 14, 2013 4:14:38 PM EDT
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Existing portals often fail to guide a homeowner through the modification application process successfully. This is an example of one homeowner's portal report on Documents Received by the servicer.

With a well-designed portal a homeowner could see what documents the servicer has received and the date each document will expire. More importantly, the portal could help a homeowner identify whether a document is missing or needs to be re-submitted with corrections. In the latter case, the servicer could upload an image or PDF of the homeowner's document that needs to be corrected, circling or highlighting areas that need the homeowner's attention, and explaining what action needs to be taken in a comment box. For example, if the homeowner forgot to sign a tax form, the servicer would circle the signature line and tell the homeowner to sign and date the form. If one portion of a form was illegible, it could be highlighted to avoid the homeowner using the same penmanship on the form the next time.

By requiring servicers to have better-designed and more informative web portals, GSE servicing guidelines could in turn shift some responsibility back to the homeowner. Instead of waiting for the servicer to send multiple, often unintelligible "five-day letters," homeowners could proactively check the portal to understand the status of their applications and upload any documents still needed. Servicers could replace the "five-day letters" with periodic updates to homeowners via email or text (or even mobile app). Such technology would result in a faster, more transparent process.

Better technology is also critical to helping both homeowners and new servicers deal with a service transfer. Although service transfers are presumptively legal, recent deals involving major banks have been scrutinized and even halted by state regulators. Some servicers are just not equipped to handle the volume of loans, especially delinquent loans, for which they purchased servicing rights. New GSE servicing guidelines could unify technology platforms, making service transfers much more manageable for both servicers and homeowners.

Currently, a service transfer requires that all of a homeowner's account information be manually transferred from the old servicer's platform to the new servicer's platform. This "boarding" process can take weeks, preventing the new servicer from accessing a homeowner's loan modification documents for a long time after the transfer. The new servicer is supposed to continue reviewing active loan modification applications after the transfer. The California Monitor Program, however, has observed that the new servicer commonly fails to receive necessary information or documents, and has no way of identifying if something is missing without physically calling the prior servicer.

If GSE reform or GSE servicing guidelines required servicers to implement a common servicing platform for delinquent loans, the problems associated with service transfer would be dramatically reduced. With a standardized servicing database, transferring a homeowner's information from servicer to servicer would be as simple as electronic transmission of data. There could still be some delays due to proprietary documents and differences in modification programs, but such delays would be minor compared to the consumer harm, expense, and regulatory risk that exist now. The new servicer would also be able to communicate with a homeowner about his or her account from the start of the service transfer period. If coupled with a GSE-mandated universal web portal, a homeowner could follow his or her application directly from servicer to servicer, and quickly determine if any documents will need to be resubmitted.

The move to a standardized servicing platform *must* be driven by top-down GSE reform. Whatever incentive exists for servicers to improve their servicing platforms of their own accord provides no incentive to share these developments with their competitors. The GSEs can guarantee that all servicers collect consistent information, which will help the CFPB evaluate the compliance and performance of servicers. Finally, the implementation of a standardized servicing platform will help address equity issues inherent in homeowners not having a choice in their servicers. By mandating a technological baseline, regulators can guarantee that no homeowner in default is left in the lurch—and at the risk of preventable foreclosure—by servicers' outdated and substandard technology.

Consumer Testing to Improve Communications

To evaluate whether communications are working or not, regulators should be going directly to homeowners and understanding their perceptions. Only by soliciting this type of feedback can the CFPB know whether servicers are making information about a mortgage accessible to the homeowner.

The CFPB already has the capacity and experience to conduct consumer testing and design award-winning plain language consumer communications. Consider the CFPB's work on creating mortgage loan disclosure to help consumers shopping for a mortgage. There were already several required forms in existence, but the CFPB was tasked with designing fewer and simpler forms by Congress. The CFPB turned two complicated forms (the Good Faith Estimate designed by the Department of Housing and Urban Development under RESPA and the "early" Truth-in-Lending disclosure designed by the Board of Governors of the Federal Reserve System under the Truth in Lending Act (TILA)) into a single Loan Estimate Form. Not only did the CFPB reduce the amount of paperwork that a consumer receives, it created shorter and clearer disclosure. The Loan Estimate Form eliminates the overlapping and inconsistent language contained on the other forms. It is easier for consumers to understand and for lenders to provide and explain.

The CFPB engaged in extensive consumer testing and industry feedback on this project. Before issuing its proposal, the CFPB spent over a year analyzing public feedback through qualitative usability testing and its "Know Before You Owe" public initiative. The CFPB continued to engage consumers in the process through testing after it issued its proposal. It found that its newly created disclosure performed better on average than the current TILA and RESPA disclosures in a study involving 858 consumers. The Center for Plain Language awarded the CFPB a 2014 ClearMark Award for the Loan Estimate Form, recognizing the form as an excellent communication for consumers.

Regulators know how to do consumer testing. Frankly, industry does too. When selling financial products, mortgage servicers rely on consumer testing to determine effectiveness of different types of communications. The heavily researched and consumer-tested packaging of credit card gets consumers to act. Communication with a delinquent borrower should have the same goal—getting a consumer to act. Because servicers rely on form language created by government, like the HAMP sample language discussed on pages 6-8 of this report, those communications are not researched and tested for effectiveness. The CFPB should put the servicers' resources to work and require the servicer to conduct consumer testing on the effectiveness of mortgage servicing communications before mass implementation. This shifts the burden from the

CFPB to servicers, who likely can better afford the time and cost of such testing and have experts on permanent staff. The CFPB could require servicers to report the test results and the final proposed communication for the CFPB's approval.

More resources should go to this side of servicing. Good communication builds trust. It also saves money. Servicers will not have to waste resources explaining a poorly written letter to a homeowner. If homeowners understand why they are being asked for a certain document, they will be less likely to call their single points of contact for help. If they understand why they did not qualify for a modification, they will be less likely to send in numerous appeals and new applications expecting a different result. Advocates and counselors will have fewer clients, leaving resources for the most needy. Well-explained rights and communication that prompts consumers to act will expand consumer protection law and reduce industry costs.

The Future of Mortgage Servicing

The best and brightest in industry, government, and advocacy have abandoned mortgage servicing prematurely. There is still work to be done. Because the California Monitor Program is coming to an end, there will be one less force to identify and push improvements to mortgage servicing. Our program has dedicated the past two and a half years to identifying systemic servicing issues. More importantly, we have spent significant time and resources on developing *innovative solutions* to the issues we identified. Our goal was to help servicers with best practices, because that in turn, helps struggling homeowners. The direct assistance that the program provided to thousands of homeowners and our constant dialogue with the biggest mortgage servicers informed these solutions. With acknowledgment of the good work of the past, regulators and advocates should revisit mortgage servicing. A deep knowledge of servicing operations and a rich appreciation of homeowner perceptions are key tools to pushing servicing ahead. The crisis is over, but the desired state remains elusive.