Insights

COVID-19 and the Mortgage Industry: Embracing the Virus on the Legislative and Regulatory Front

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The Coronavirus Aid, Relief and Economic Security Act, S. 3548 ("CARES Act"), was signed by the President on March 27, 2020. Grappling with the wide array of industries impacted by the CARES Act, and COVID-19, can be overwhelming. This holds true particularly for anyone in a consumer-facing industry, such as mortgage lenders and servicers. In addition to moratoriums on foreclosures and evictions, the federal government has implemented other programs that have an effect on the mortgage industry. The update below provides a brief overview of major considerations lenders and secured parties should bear in mind as a result of the sweeping CARES Act legislation.

Bankruptcy

The CARES Act amended the United States Bankruptcy Code in three (3) substantial ways. First, most Americans are receiving federal economic relief in the form of stimulus checks - "recovery rebates" in the language of the CARES Act. For debtors in cases under chapters 7 and 13 of the Bankruptcy Code, this additional income will not be counted in calculating the amount of their current monthly income, and consequently it has no bearing on their eligibility for relief under those chapters. Moreover, the federal recovery rebates payments are not counted as disposable income for purposes of a chapter 13 plan. Practically speaking, this means that secured parties cannot object to a proposed plan simply because it omits any recovery rebates payments received as part of the debtor's disposable income.

The CARES Act also includes a provision that permits modification of previously confirmed chapter 13 plans to include plan extensions for up to seven years from the time initial payment was due (the usual maximum length of a chapter 13 plan is five years). The obvious impact of this for lenders is that it draws-out bankruptcy plan payments for longer periods of time, which means creditors most likely will receive smaller monthly payments. The standard to be used in permitting a modification is whether a "debtor is experiencing or has experienced a material financial hardship, directly or indirectly, to the coronavirus disease 2019 (COVID-19) pandemic." This language has yet to be tested in the courts, but given its breadth, creditors should be prepared for courts allowing plan modifications liberally. It should be noted, however, that a chapter 13 debtor's proposed modification still must comply with sections 1325 and 1322 of the Bankruptcy Code. Thus, creditors still may object to modified plans on other grounds, just not on the basis that a debtor received federal recovery rebate payments.

The other main bankruptcy-related provision of the CARES Act is an amendment to the Small Business Reorganization Act ("SBRA"). SBRA created a new subchapter of the Bankruptcy Code, effective February 19, 2020, to streamline bankruptcy cases for businesses with less than $2,725,625 of debt. The CARES Act increased this debt limit to $7.5 million, making it more available to larger number of small businesses. The ultimate impact of this change has yet to be seen, but some experts predict that a large volume of distressed small businesses may flood the bankruptcy courts to take advantage of this temporary relief.

Collectively, all of the bankruptcy-related provisions in the CARES Act sunset after one year. However, the impact may last longer than that. For instance, it is foreseeable that debtors who recently had a chapter 13 Plan confirmed will take advantage of the CARES Act by modifying their plans to extend their payment schedules. As noted above, any extension of an already-confirmed chapter 13 Plan inevitably would lead to smaller payment amounts per month if the payments are spread out to seven years. Put simply, this provision alone may have a negative impact on any creditor's cash flow for up to seven years. Excluding the federal recovery rebates payments for chapter 7 eligibility purposes also may have an immediate impact on creditors, by broadening the number of debtors able to seek chapter 7 relief.

Loan Forbearances

The CARES Act also provides relief in the form of loan forbearances for borrowers with federally backed mortgages. The borrowers do not need to be delinquent to be eligible for the forbearance. Instead, as long as they have a federally backed mortgage, they simply need to affirm that they are experiencing a financial hardship, directly or indirectly, from the coronavirus 2019 pandemic. Once a request is received, the mortgage servicers must provide the relief and cannot charge fees or penalties during that period. The initial forbearance period is for 180 days, and if additional time is requested, it may be extended for another 180 days.

The forbearance provision of the CARES Act does not repeal the notice requirements in Regulation X, which regulates transactions covered by the Real Estate Settlement Procedures Act ("RESPA"). Although the CARES Act requires servicers and lenders to provide forbearances upon the borrower's affirmation, the request still constitutes an incomplete loss mitigation application. As such, servicers still must send an acknowledgement notice of an incomplete application. However, on April 3, 2020, various agencies, such as the Consumer Financial Protection Bureau ("CFPB"), Board of Governors of the Federal Reserve, and Federal Deposit Insurance Corporation, issued a Joint Statement regarding the CARES Act's impact on mortgage servicing rules. The Joint Statement acknowledged the problematic interplay the CARES Act will have with Regulation X and declared that the respective agencies will not take any supervisory or enforcement actions against mortgage servicers that fail to send the acknowledgement notice within five (5) days, provided the acknowledgement notice is sent by the end of the initial forbearance period. The CFPB also has prepared a useful Mortgage Servicing Rules FAQs that addresses many topics included in this update.

Furthermore, on April 1, 2020, the U.S. Department of Housing and Urban Development ("HUD") issued Mortgagee Letter 2020-06 ("Letter"), which outlines the various changes in Loss Mitigation Home Retention Options, as defined by the Federal Housing Authority, available to Single Family borrowers. In addition to loan forbearances, servicers are required to evaluate every borrower for a COVID-19 Emergency National Standalone Partial Claim ("Partial Claims") at the end of the forbearance period. The Partial Claims are insurance payments paid by HUD to lenders to cover the arrearages, fees, and costs accrued during the forbearance period, and are similar in some respects to the existing Disaster Standalone Claims available to borrowers in a Presidential-Declared Major Disaster Area. However, servicers only are required to evaluate owner-occupant borrowers. The specific eligibility requirements for the COVID-19 Emergency National Standalone Partial Claim can be found on HUD's website.[1]

On a related note, HUD also released Mortgagee Letter 2020-09 on April 10, 2020, which addresses multi-family borrowers with FHA-insured mortgage loans. Multi-family borrowers also are eligible for forbearances if they were current on their mortgage loan as of February 1, 2020. Once a request is received, servicers must grant a forbearance period of up 30 days. The period also may be extended for two additional 30-day periods. HUD's Mortgagee Letter stressed that HUD will not partake in any negotiations between Lender and Borrower, but a copy of the agreement must be sent with anything requiring HUD approval.

Loan Originations

In another effort to encourage lending and access to credit, on April 14, 2020, the Federal Reserve Board, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency issued an interim final rule that defers appraisal requirements for certain real-estate transactions.[2] Under the new rule, required appraisals could be deferred up to 120 days following the transaction's closing date. Fannie Mae and Freddie Mac have issued several statements as well, which detail the flexible approach they are taking to encourage lending.[3] For instance, for purchase loans that will be secured by a borrower's principal residence, Fannie Mae and Freddie Mac are temporarily permitting "desktop appraisals" and "exterior-only appraisals" in lieu of the traditional interior appraisals.[4] Many income-verification rules have been amended as well, such as permitting an email from an employer verifying the borrower's employment and income instead of the standard pre-closing procedures. It should be noted that most of the temporary relaxed rules are inapplicable to development, refinance, and construction projects, and lenders are encouraged to visit the relevant regulatory agency's website for the most recent updates.

Credit Reporting

A final issue of which lenders and servicers should be mindful is credit reporting. If a borrower is enrolled in a CARES Act forbearance program, servicers may not report the borrower as delinquent to the credit bureaus. Lenders and servicers still must comply with the Fair Credit Reporting Act ("FCRA"), but on April 1, 2020, the CFPB issued a Policy Statement advising that it would be taking a "flexible supervisory and enforcement" approach during the pandemic. Specifically, with regards to disputes under the FCRA, the CFPB reminded that furnishers, such as lenders, can extend the initial 30-day dispute response period to 45 days if the consumer provides additional information.[5] More importantly, even if a furnisher does not respond within the required time period, CFPB stated that it would "a furnisher's individual circumstances and does not intend to cite in an examination or bring an enforcement action," provided the furnisher is making good faith efforts to investigate the disputes as quickly as possible.[6]

Liquidity

The CARES Act inevitably creates liquidity concerns for mortgage servicers who unfortunately will bear the financial burdens of the loan forbearances. Initially, it was reported that Fannie Mae and Freddie Mac, the government-sponsored mortgage entities, would not be providing support to mortgage servicers in the form of buying the loans in forbearance from servicers. Recent reports, however, suggested that may be changing in the imminent future.[7] In fact, on April 20, 2020, the Federal Housing Finance Agency announced a new plan where mortgage servicers only would have to pay investors for four months while borrowers were in forbearance, and then Fannie Mae and Freddie Mac would assume the obligations for up to eight (8) months thereafter.[8]

On March 23, 2020, The Federal Reserve established the Term Asset-Backed Securities Loan Facility ("TALF") to promote the flow of capital among consumers and businesses. In the Federal Reserve's initial Term Sheet, residential mortgage servicing advance receivables were among the "eligible collateral" for the asset-backed securities. Though this would have benefited mortgage servicers, the Federal Reserve amended its Term Sheet on April 9, 2020, and residential mortgage servicing advance receivables are no longer "eligible collateral" for the program. Aware of the pressure this puts on mortgage servicers, several Congressional members wrote a letter to the Federal Reserve, urging it to change course.[9]

The above discussion is by no means an exhaustive list of all the new legislative changes, nor is it a comprehensive discussion of all new mortgage servicer requirements. Every case and borrower have unique circumstances, and lenders and servicers should be mindful and creative in crafting solutions. As the nation continues to grapple with the effects of COVID-19, lenders and servicers should stay abreast of the various guidance published by regulations authorities.

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[1] *Available at* https://www.hud.gov/sites/dfiles/OCHCO/documents/20-06hsngml.pdf.

[2] *Available at* https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200414a.htm.

[3] *See generally* https://singlefamily.fanniemae.com/media/22321/display; https://guide.freddiemac.com/app/guide/bulletin/2020-5.

[4] *Id.*

[5] *Available at* https://www.consumerfinance.gov/about-us/newsroom/cfpb-issues-credit-reporting-guidance-during-covid-19-pandemic/.

[6] *Id.*

[7] Andrew Ackerman, *Fannie, Freddie May Soon Buy Home Loans in Forbearance to Help Mortgage Firms*, Wall Street Journal (April 20, 2020).

[8] Matthew Goldstein, *Mortgage Firms Get a Reprieve on Paying Investors*, The New York Times (April 21, 2020).

[9] *Available at* https://www.findknowdo.com/sites/default/files/news/attachments/2020/04/letter-federal-reserve-mbs-talf-eligibility-april-6-2020.pdf.