



Mortgage Loan Servicing and Foreclosure Settlement Agreement; Servicing Standards Imposed

Executive Summary

The Department of Justice ("DOJ"), the Department of Housing and Urban Development ("HUD"), the Conference of State Bank Supervisors and 49 State Attorneys General ("AGs") recently announced they had jointly reached an agreement (the "Settlement Agreement") with the five largest mortgage servicers to address issues associated with mortgage loan servicing and foreclosures identified by investigations conducted at the Federal and State levels and, in part, previously subject to formal (Federal) enforcement actions taken in April 2011. The Settlement Agreement requires the five mortgage servicers to commit as much as \$20 billion in financial relief over the next three years to certain distressed homeowners and to pay \$5 billion directly to Federal and State governments to address a variety of housing and foreclosure-related relief programs. Among other things, the Settlement Agreement requires the mortgage servicers to: reduce principal balances and provide refinancings for certain underwater borrowers; implement new mortgage loan servicing standards; and conduct reviews for violations of the *Servicemembers Civil Relief Act* ("SCRA") and to provide compensation to servicemembers harmed by SCRA violations (such compensation would be in addition to the \$25 billion settlement amount).

Compliance with the Settlement Agreement will be overseen by an independent monitor that may impose penalties of up to \$1 million per violation (or up to \$5 million for certain repeat violations); and publish regular public reports that identify any quarter in which a servicer falls short of the standards imposed in the settlement.

Background

The State AGs were prompted to coordinate an investigation into the mortgage servicing industry in late 2010 and early 2011 to pursue allegations that legal and foreclosure documents had been submitted without verification, with false representation, and/or were signed outside the presence of a notary public (practices commonly referred to as "robo-signing"). At the time, the State AGs claimed such activities might constitute deceptive acts and/or unfair practices, and might otherwise violate State laws and court rules. Potentially deceptive practices related to the offering of loan modifications were also identified for investigation. The Settlement Agreement is a direct result of this investigation.

Like the State AGs, the Federal bank regulatory agencies (Federal Reserve Board

("Fed"), Office of the Comptroller of the Currency ("OCC"), Federal Deposit Insurance Corporation ("FDIC") and Office of Thrift Supervision ("OTS")) conducted on-site reviews at the mortgage servicing and foreclosure processing operations of 14 Federally-regulated mortgage servicers (including the five largest) to investigate concerns over the practice of robo-signing. The results of the reviews were released by the Fed, OCC and OTS in a joint report on April 13, 2011 entitled, *"Interagency Review of Foreclosure Policies and Practices"*. The Fed, the OCC and the OTS simultaneously entered into Consent Orders with the mortgage servicers and/or their holding companies to enhance oversight and address certain current industry practices. (Please refer to RPL 11-05.) Under the Consent Orders, to which the servicers consented without denying or admitting the identified issues, the servicers were required to make revisions to their practices to ensure they "treat customers fairly, are fully compliant with all applicable law, and are safe and sound". Civil penalties associated with the Consent Orders have only recently been announced.

Description

The DOJ, HUD, the Conference of State Bank Supervisors and 49 State AGs (Wisconsin did not participate) reached a Settlement Agreement in early February with the nation's five largest mortgage servicers to settle claims over alleged mortgage loan servicing and foreclosure deficiencies. The Settlement Agreement requires the servicers to commit as much as \$20 billion in financial relief over the next three years to certain distressed homeowners and to pay \$5 billion directly to Federal and State governments. The agreement primarily applies to mortgages owned and held by the servicers. It does not apply to mortgages of the government-sponsored entities ("GSEs"), such as Fannie Mae or Freddie Mac.

Terms of the Settlement Agreement

Relief for Struggling Homeowners

- Up to \$17 billion in assistance must be made available for borrowers who have the intent and ability to stay in their homes while making reasonable payments on their mortgage loans.
 - At least 60 percent of the \$17 billion (\$10.2 billion) must be allocated to reduce the principal balance of home loans for borrowers who are in default or at risk of default on their loan payments.
 - Up to \$7 billion must be allocated to other forms of homeowner assistance, including the facilitation of short sales and unemployed payment forbearance and relocation assistance for homeowners facing foreclosure, waiving of deficiency balances, and funding for remediation of blighted properties.
- At least \$3 billion must be provided to offer refinance programs to assist homeowners who are not delinquent on their payments but cannot refinance to lower rates because of negative equity.
 - To be eligible, a borrower must be current on mortgage payments, have a loan to value ratio in excess of 100 percent, and must have a current interest rate in excess of 5.25 percent. The refinanced rate must reduce monthly payments by at least \$100.

Payments to Federal and State Governments

In addition to the \$20 billion of financial relief to be committed to homeowners, the Settlement Agreement provides that approximately \$5 billion must also be paid

directly to the Federal and State governments. This amount will be allocated between:

- The creation of a \$1.5 billion Borrower Payment Fund to compensate borrowers who were foreclosed on between January 1, 2008 and December 31, 2011 and meet certain criteria (e.g., they were not properly offered loss mitigation or who were otherwise improperly foreclosed on). These borrowers will be notified of their right to file a claim.
 - The program is separate from but complimentary to the Independent Foreclosure Review being conducted by the Fed and the OCC. Borrowers who receive payments through the Borrower Payment Fund will not have to release any claims and will be free to seek additional relief in the courts. The borrowers may also be eligible for a separate restitution process administered by the Federal banking regulators.
- Funds to be paid to the participating States and the Federal government. The funds may be distributed by the State AGs for foreclosure relief and housing programs, including housing counseling, legal assistance, foreclosure prevention hotlines, foreclosure mediation, community blight remediation and other similar purposes. A portion of the funds may also be designated as civil penalties for robo-signing misconduct. The funds distributed to the Federal government will go toward the Federal Housing Administration Capital Reserve Account, the Veterans Housing Benefit Program Fund and the Rural Housing Service.

Monitoring and Enforcement

The Settlement Agreement has been filed as a Consent Judgment in the United States District Court for the District of Columbia and remains in effect for three years. It will be enforceable as a court judgment and as such, compliance with the financial obligations and the servicing standards can be ultimately enforced through the court process. Compliance will be overseen by an independent monitor (already named) who will report to the State AGs and the court.

The servicers will be required to report on their compliance in the form of agreed-upon metrics and outcome measures, including compliance metrics for proper documentation of foreclosures, loss mitigation offers and proper evaluation of loan modification applications. Testing must be performed to ensure that borrowers' account information is accurate and that fees are not excessive and are properly assessed.

To encourage the servicers to provide relief quickly, incentives are provided for relief made available within the first 12 months and targets and deadlines have been set throughout the settlement period. Civil penalties may be assessed for failure to meet the targets or deadlines or other violations.

Release of Claims

With the Settlement Agreement, the State AGs and the Federal regulators have preserved their authorities with respect to the mortgage servicers to:

- Pursue criminal enforcement actions.
- Pursue actions related to mortgage-based securitizations.
- Recover losses and assess penalties against all but one of the servicers (because of a previously reached agreement) related to loan underwriting of certain government-insured or government-guaranteed loans.

Separately, individuals and entities may still pursue claims on their own.

New Mortgage Servicing Standards

In addition to providing the required borrower relief and making the payments to the Federal and State governments, the Settlement Agreement requires the five mortgage servicers to implement new mortgage loan servicing standards. The mandated standards cover all aspects of mortgage servicing, from consumer response to foreclosure documentation.

The new mortgage servicing standards include, among many others, the following specific requirements:

- Information in foreclosure affidavits must be personally reviewed and based on competent evidence.
- Holders of loans and their legal standing to foreclose must be documented and disclosed to borrowers.
- Borrowers must be sent a pre-foreclosure notice that will include a summary of loss mitigation options offered, an account summary, description of facts supporting lender's right to foreclose, and a notice that the borrower may request a copy of the loan note and the identity of the investor holding the loan.
- Borrowers must be thoroughly evaluated for all available loss mitigation options before foreclosure referral, and banks must act on loss mitigation applications before referring loans to foreclosure; i.e. "dual tracking" will be restricted.
- Denials of loss mitigation relief must be automatically reviewed, with a right to appeal for borrowers.
- Banks must implement procedures to ensure accuracy of accounts and default fees, including regular audits, detailed monthly billing statements and enhanced billing dispute rights for borrowers.
- Banks must adopt procedures to oversee foreclosure firms, trustees and agents.
- Banks will have specific loss mitigation obligations, including customer outreach and communications, time lines to respond to loss mitigation applications, and e-portals for borrowers to keep informed of loan modification status.
- Banks are required to designate an employee as a continuing single point of contact to assist borrowers seeking loss mitigation assistance.
- Military personnel who are covered by the *Service Members Civil Relief Act* will have enhanced protections that go beyond the current SCRA provisions.
- Banks must maintain adequate trained staff to handle the demand for loss mitigation relief.
- Application and qualification information for proprietary loan modifications must be publicly available.
- Servicers must expedite and facilitate short sales of distressed properties.
- Restrictions are imposed on servicing fees such as default fees, late fees, third-party fees, and force-placed insurance.

Protections under the Servicemembers Civil Relief Act

The *Servicemembers Civil Relief Act* provides consumer financial protections to active duty military personnel and their families, and to Reservists and members of the National Guard while on active duty. The Settlement Agreement requires the servicers to specifically provide financial relief to certain servicemembers harmed by violations of the SCRA and to implement certain new enhanced protections for military personnel covered by the SCRA. In particular:

- Separate from the \$25 billion Settlement Agreement amount, certain servicemembers will receive compensation for wrongful foreclosures.
 - Four of the five servicers have agreed to conduct a full review, overseen by the Department of Justice's Civil Rights Division, to determine whether any servicemembers were foreclosed on in violation of the SCRA since Jan. 1, 2006. Three of them will be required to provide any service-member who was a victim of a wrongful foreclosure a minimum payment of \$116,785 plus the service-member's lost equity and interest. Based on an earlier agreement, one servicer will provide any service-member who was a victim of a wrongful foreclosure either his or her home free and clear of any debt or the cash equivalent of the full value of the home at the time of sale.
 - Three of the servicers will conduct a review, overseen by the Department of Justice's Civil Rights Division, to determine whether any service-member, from January 1, 2008 to the present, was charged interest in excess of 6 percent on his or her mortgage, after a valid request to lower the interest rate (as provided for in the SCRA). Servicemembers who wrongly paid more than 6 percent must be paid a refund equal to the excess of the 6 percent plus interest plus triple the amount or \$500, whichever is larger.
- Additional measures include:
 - SCRA training for employees and agents.
 - Developing policies and procedures to ensure compliance with SCRA and the new mortgage servicing standards, including:
 - Protecting certain servicemembers receiving Hostile Fire/Imminent Danger Pay from foreclosures without court orders (new expanded protection).
 - Providing access to loan modifications or short sale agreements and deficiency waivers for certain servicemembers subject to Permanent Change of Station orders (new expanded protection).
 - Repairing negative credit report entries.

Servicemembers and their dependents who believe that their SCRA rights have been violated are instructed to contact an Armed Forces Legal Assistance office.

Other Settlements

The Fed separately released a statement indicating it had reached an agreement in principle with the same five mortgage servicers subject to the Settlement Agreement. The Fed's agreement imposes monetary sanctions totaling \$766.5 million to address unsafe and unsound processes and practices in residential mortgage loan servicing and foreclosure processing identified by examiners in their 2010-2011 reviews. Corrective measures for these issues were required as part of the April 2011 formal enforcement actions and the \$766.5 million in monetary sanctions is included in the \$25 billion required by the Settlement Agreement.

Similarly, the OCC announced it had reached an agreement in principle with the four national bank mortgage servicers subject to the Settlement Agreement that imposes civil money penalties of \$394 million in connection with unsafe and unsound processes and practices in residential mortgage loan servicing and foreclosure processing identified during earlier reviews and identified in the April 2011 enforcement actions. The OCC states that it will hold in abeyance imposition of the penalties provided the servicers make payments and take other actions under the Settlement Agreement with a value equal to at least the penalty amounts.

Commentary

Although the magnitude of the financial relief provided by the Settlement Agreement is significant, the scope is limited to only mortgages held by the five named mortgage servicers covered by its terms. It is possible, however, that additional and similar settlements could be completed with other mortgage servicers. It is also notable that GSE-loans, which comprise the majority of outstanding mortgage loans in the U.S., are not covered by the Settlement Agreement - though the participating Federal and State authorities suggest that although homeowners with GSE-controlled mortgages "won't directly benefit from settlement-related programs... [they] will still see benefits through reduced foreclosures, stabilizing home values and significant new mortgage servicing standards and consumer protections."

National mortgage servicing standards have been actively discussed for several years among the regulators and in Congress and a proposal has been anxiously anticipated. The Fed and the OCC have each supported the development of national servicing standards and it is likely that, although the new Mortgage Servicing Standards included with the Settlement Agreement are applicable only to the servicers covered by the agreement, examiners will, over time, expect all servicers (bank and nonbank) to meet many if not all of these requirements. It is equally possible the standards may actually be rolled into any forthcoming proposed guidance or rulemaking. Similarly, the standards of the Settlement Agreement may ultimately override actions taken by servicers to meet the requirements of the April 2011 Consent Orders, because the Settlement Agreement standards are much more prescriptive than the provisions in those Consent Orders, which generally set expectations for the covered servicers but permitted them to "customize" their responses to existing operations.

Compliance with the Settlement Agreement will likely be considered in the areas of 1) Consumer Relief (identifying harmed borrowers and providing relief), 2) Servicing Standards and Metrics (implementing regimented policies and procedures as well as addressing the required measurement framework), and 3) Monitoring/Compliance (ensuring that efforts to meet the Consumer Relief and Servicing Standards and Metrics requirements are done so in accordance with the Settlement Agreement and within the designated timeframes). Servicers not affected by the Settlement Agreement are encouraged to evaluate their operations in light of the new mortgage servicing standards, including the provisions affecting servicemembers (an area of particular interest to the Bureau of Consumer Financial Protection) and make adjustments as needed for consistency.

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