GSE Activity Report

Tuesday, April 6, 2021

Forbearance, Foreclosure, and the Future of Mortgage Servicing

Summary

Just to be sure servicers got the message sent last week that the CFPB has them in its crosshairs, the agency yesterday proposed sweeping changes to provide far-reaching foreclosure protections on all forborne or delinquent mortgages, not just those subject to the statutory protection afforded federal loans. Servicers will struggle mightily with this new regime unless Fannie, Freddie, FHA, and private borrowers or investors agree or are told to waive rights to advances. A good deal more interest will now either accrue or be sacrificed in the course of the only streamlined loan-mods CFPB will tolerate. Delinquent loans the CFPB acknowledges are extra high-risk will surely be still more costly to close out as are the growing risk concentrations in the millions of loans still taking advantage of statutory and voluntary forbearance. MIs catch a big break, but how servicers handle all these new costs without the greater flexibility now afforded by the GSEs and marketplace remains very much to be seen.

Impact

First to what the CFPB wants to do:

- protect not just borrowers already in forbearance, but also those who are delinquent but might be eligible for forbearance if the servicers make this very, very clear to them;
- limit protection to principal residences;
- bar first-notice or similar foreclosure actions until January of 2022 in addition to current 120-day grace periods. This would apply even if the borrower isn't forbearance-eligible or is unresponsive, although the CFPB might be willing to grant exemptions in such cases;
- permit servicers to offer streamlined loan-mods based on COVID-related hardship even with an incomplete application. This is designed to save borrowers without also sinking servicers, although costs may well be formidable. Permissible loan mods could not increase payments or have maturities of more than forty years. Deferred payments could not accrue interest nor are loan-mod fees allowed. Outstanding fees or charges must also be waived and outstanding delinquencies are forgiven when the trial loan-mod turns into a permanent mortgage. Conditions apply if the borrower fails to perform under the trial modification; and
- ensure servicers tell borrowers all their possible outs through August 31, 2022. Servicers must also take action before the end of a forbearance program under an array of circumstances.

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Among things the Bureau wants to know about this proposal are:

- its operational challenges;
- borrower risks or harm;
- whether sunset dates make sense; and
- if forbearance options servicers must describe are sufficient. The NPR doesn't require servicers to disclose all loan-mod options, but the Bureau is tempted to mandate this.

Outlook

An a priori question is whether this NPR is within the CFPB's legal ambit. The Bureau says unequivocally that it is, but industry commenters may well differ, perhaps vociferously. They'll have to hurry; comment is due May 10.

Typical of most such rules, the Bureau's cost-benefit analysis looks at what data it can find on consumers and servicers, not also at resulting structural change and what that might do to whom. To make a judgment, one needs to look at both the immediate impact of these servicing changes and the systemic impact these might have on whom.

In the near term, the grace periods, additional loan-mod opportunity, and reduced foreclosure risk will clearly benefit consumers, servicers, lenders, insurers, and investors if the post-COVID economy improves, house prices remain robust, and borrowers that would default without added protection honor their new obligations. This is what would have happened in the 2008 crisis because reduced loss up front created far greater loss later on in areas (e.g., California) that made forbearance or even principal forgiveness a relatively easy option to obtain. However, if house prices collapse from current levels or even just weaken and/or the economic recovery is weak nationwide or in key sectors, then loss recognition delayed will be loss realized at still greater cost.

Even where the CFPB tacks numbers on to its CBA assessment, it emphasizes that its calculations could be wholly wrong. Still, the CFPB's CBA estimate for servicers is less speculative largely because the Bureau focuses on known operational costs (e.g., extra months of mail to borrowers or property inspections). The total estimate of added servicing time is said to be $178 per month – or that's what it is if the servicer has the capacity to handle costs and isn't required to advance P&I or escrow payments. The cost of all the new, presumably-streamlined applications is noted as likely significant, but also most uncertain.

Comment is sought on these cost-benefit assumptions and, less directly, on potential systemic risk, but the proposal provides no insight into the Bureau's thinking on critical systemic challenges. All of the extensions, grace periods, and protections provided to servicers by the GSEs and FHA have comforted both the banking agencies and FHFA following the acute scare thrown into systemic-risk deliberations as COVID hit last March. Much in the Bureau's proposal continues the most critical feature of these policies – delayed loss recognition. Weighing this against still longer periods of loss-recognition delays, resumed advances, and concentrated pockets of large numbers of high-risk borrowers is a complex task. Servicers may well be able to persuade FSOC and FHFA to weigh in with the CFPB if they can make a compelling systemic-risk and/or market-integrity argument to counter the Bureau's compelling borrower-and-neighborhood rationale, but gaining airtime with Treasury and the Fed and then countering the Bureau will still prove challenging.

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