

# The Regulatory Minefield Of Borrower Communications

From forming internal work groups that track regulations to updating technology, learn practical tips on handling a boatload of compliance mandates.

by **Martin Muoto**

**C**alifornia S.B.1137, Hawaii S.B.-2454, Illinois S.B.2513, Maryland S.B.216, Massachusetts H.B.4387, New Jersey S.1599, New York A.10817, Pennsylvania S.B.486, Idaho S.B.1392, North Carolina S.B.2623... the list goes on and on.

These are but a handful of new bills that have been enacted in the last several months that impact how servicers must interact with borrowers in the delinquency and default processes. These bills are the latest additions to an already complex landscape of federal, state and even municipal regulations that govern what lenders must do, say and offer to borrowers.

Today, the proliferation of these regulations feels like a regulatory minefield - a dangerous landscape waiting for servicers to trip on some overlooked technicality. It only takes a tiny grain of sand to bring a well-built Swiss watch to a grinding halt. The same can be said for today's default servicing operations. Interpreting these statutes is complicated enough, but actually operationalizing the statutes into servicers' notices

of intent (NOIs) and breach letters, IT systems, default management platforms and service providers is proving even more complex.

## Regulatory appeal

In most states with escalating foreclosures, legislators are turning their attention to slowing down the delinquency and foreclosure processes and requiring servicers to more explicitly provide borrowers with loss mitigation options. For servicers operating nationwide, it is helpful to understand commonalities among the various state statutes in order to prepare for emerging regulations. Many of the themes outlined below have migrated from one state to another. In some cases, legislators appear to be carbon-copying facets of what other states have adopted in their proposals. The following are examples of common elements found within new regulations:

- **Inclusion of Department of Housing & Urban Development (HUD) resources/ HUD-approved counselor lists.** There has been an almost universal requirement to include contact information for HUD-approved counselors on servicers' Web sites. More specifically, Pennsylvania Act 91 and New York A.10817 require the inclusion of regional lists of pre-approved HUD counselors (sometimes based on geographical proximity to the property or borrower) in servicers' notices.

- **Documentation of borrower contact/loss mitigation negotiations.**

States are increasingly requiring the documentation of multiple contact attempts and efforts to provide borrowers with options to avoid foreclosure. In addition, many bills allow borrowers to appeal to the state governing board to request an extension of the foreclosure process (e.g., New Jersey S.1599, California S.B.1137). Moreover, servicers are being required to facilitate in-person or telephone settlement conferences with a loss mitigation professional in an attempt to negotiate loan modifications. Among the most prescriptive bills, New York's A.10817/S.08143 requires that borrowers be able to request and receive some form of "mediated settlement conferences."

- **New or additional notices with specific language, formatting and inserts.** Several of the bills require various new or supplemental notices that are separate or in lieu of regular NOIs required by the deed of trust. In some cases, they call for new delivery methods, such as certified mail or registered mail. Illinois S.B.2513, New York A.10817 and California S.B.1137 all require several new certified and/or first-class letters.

In addition, they require that very specific language be included in various default notices, often dictating formatting (e.g., font size) and even paper color. For example, Idaho S.B.1392 requires the use of "canary yellow" paper. New York A.10817 and Illinois S.B.2513 call for 14-point, bold font, Pennsylvania Act 91 mandates at least 30-point type, and several others specify other font sizes and types. Perhaps no foreclosure prevention attorney has raised "incorrect font size" in an attempt to overturn a foreclosure, but there is always a first time.



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• **Disclosure of fees.** Also emerging are heightened requirements to disclose any fees (including detailed fee structures and history) assessed to borrowers. The most exhaustive and onerous has been enacted in North Carolina (H.B.2623), and it prevents servicers from collecting certain fees if they are not “clearly and conspicuously” explained and disclosed within 30 days of their assessment.

• **Reporting to state departments and agencies.** Across various states, there is a significant drive toward increased requirements to submit various reports or copies of notices on a quarterly, monthly or even daily basis to state departments (e.g., Department of Banking & Insurance, Commissioner of Banks). There are elements of this trend in most new bills, most noticeably in Maryland S.B.216, Massachusetts H.B.4387 and New Jersey S.1599. This trend will likely continue with new bills introduced this year.

The rationale for many of these new laws, albeit reasonable, sometimes proves difficult for servicers to actually turn into daily actions. In a recent example passed in early April, New Jersey S.1599 requires a servicer to indicate if a property is an “affordable unit,” which is typically only reflected in the deed restrictions of the mortgage documents - an arduous and expensive process if a servicer is required to look up the origination documents to retrieve this information.

A servicer’s response to these regulations should be one of acceptance, as such mandates will be an increasing part of default administration/loan servicing. Servicers, trustees and foreclosure attorneys should accept that regulatory compliance will be a large part of the delinquency and foreclosure process for the next several years. Rather than viewing this as a nuisance, servicers should determine how to make it a standard operating practice required of high-quality servicing. Additionally, investors will want to more deeply evaluate servicers’ compliance capabilities in the area of borrower communications.

Early preparation is also key. Understandably, today’s servicers are dealing with so many priorities that it

is difficult to plan ahead; however, not being in compliance can bring your delinquency process to a standstill. Groups such as the California Mortgage Bankers Association are taking more active leadership roles in preparing their members for upcoming regulations through conferences, training sessions and workshops.

Servicers should be aware of what other firms are doing and share best practices. Unlike innovative marketing, product development or customer acquisition strategies, compliance is not a competitive advantage. Regulatory compliance is binary: Either you are in compliance or you are not.

In addition, this is an area where one servicer’s lack of performance may negatively affect other servicers. The more that all servicers are uniformly adhering to the same or similar business practices, the less chance there is for legal cases to help sharpen regulation through case law.

Compliance is an area in which sharing best practices and learning what

other servicers are doing and how they are interpreting the new regulations help keep everyone out of trouble.

**Compliance by any name**

Focus on both “content” and “process” compliance. Many servicers’ compliance groups and law firms have focused on the content compliance aspect of new regulations (i.e., what the regulations say and what borrower communications and notices should state). An equally important - and often more difficult - aspect is developing processes to translate these regulations into the day-to-day default management environment.

For example, New York A.10817/S.08143 requires a notice be sent “by regular mail and certified mail to the last known address of the borrower and, if different, to the residence which is the subject of the mortgage.” In order to ensure compliance, many servicers are currently mailing extra notices - and incurring unnecessary cost - because of the difficulty to precisely compare and “deduplicate” these addresses.

Sample of New State Requirements	Maryland SB 216	Idaho SB 1392	Massachusetts HB 4387	California SB 1137	New York A10817/ S8143A	Pennsylvania Act 91/5B 486	North Carolina HB 2623
Date Effective	4/08	5/08	5/08	9/08	9/08	9/08	11/08
Requires contact-attempt documentation	✓	✓	✗	✓	✓	✗	✓
Requires additional certified mail	✗	✗	✗	✓	✓	✗	✗
Borrower can require a face-to-face meeting	✗	✗	✗	✓	✓	✓	✗
Requires counseling	✓	✓	✗	✓	✓	✓	✓
Specifies font sizes/color paper	✗	✓	✗	✗	✓	✓	✗
Requires notification to state agencies	✓	✗	✓	✗	✗	✓	✓
Mandates or strongly encourages settlement efforts	✗	✗	✗	✗	✓	✓	✓
Enables regulator to delay, lengthen or invalidate foreclosure	✓	✗	✓	✓	✓	✓	✓
Estimated days by which foreclosure process is lengthened	90+	-	90	30	90	30-120	45
Source: Walz Group	Legend ✓ = Yes ✗ = No						

Servicers must also determine strategies for returned-mail management. A February 2009 survey of state laws conducted by the National Consumer Law Center, titled "Foreclosing a Dream," points out that most servicers do not specifically handle mail that is returned as "refused" or "unclaimed" any differently than notices that are accepted. Returned mail should call for business rules to automatically escalate these notices to skip tracing or personal service contact strategies. While these processes are not currently legally required (except in particular stages of the foreclosure process in certain states), servicers would be prudent to ensure that they differentiate and document their contact strategies based on specific feedback - or lack thereof - with borrowers.

Flexible technology systems that utilize Extensible Markup Language (XML) and MISMO should be developed. Traditional loan servicing platforms, often "big iron" mainframe systems, were not designed with today's complex default servicing environment in mind. Many servicers with large nonprime portfolios recognized this early and built their own propri-

etary default management platforms. These systems are often more flexible and able to adjust to the new environment. However, they also come with some level of internal cost to maintain.

Today, servicers increasingly focus on their core competencies and outsource a number of critical but non-core functions. As a result, their systems must exchange data with a host of business partners and third-party systems, vendors and platforms. MISMO has been working toward voluntary data standards and schema (MISMO Standards) across the mortgage industry. Use of XML generally and a servicing-oriented version of MISMO's XML standard provide a uniform way of sharing this data across diverse platforms.

Shops may want to consider forming internal regulatory compliance working groups that are made up of various departments, including information systems/technology (IS/IT). The biggest facilitators - and potentially, biggest impediments - to process compliance are internal IS/IT groups that are coping with heavier workloads and increased numbers of enhancement requests.

As outlined above, new regulations will continue to come quickly, and despite all the preparation and planning, at some point, a system has to be changed, a data feed has to be developed or a query must be written. IS/IT should be proactively included as early as possible. The most nimble servicers generally ensure that their IS/IT groups stand shoulder-to-shoulder with their business counterparts to understand the context of compliance, and they work hand-in-hand to develop operational solutions.

The current regulatory landscape is rapidly changing and poses one of the most relevant risks in borrower communications. Consumer advocacy lawyers are increasingly looking for technical violations to significantly delay and, in some cases, overturn, standard delinquencies and foreclosures. They are playing to even more polarized consumer groups, regulators and legislators, as well as sympathetic judges. Servicers must be diligent, proactive and strategic in response and work independently and collectively to ensure regulatory compliance. **SM**