MORTGAGE BANKERS ASSOCIATION

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June 30, 2023

The Honorable Julia Gordon
Assistant Secretary for Housing and Federal Housing Commissioner
Federal Housing Administration
U.S. Department of Housing and Urban Development
451 7th Street, SW
Washington, DC 20410

Re: Draft Mortgagee Letter, *Payment Supplement Partial Claim*

Dear Commissioner Gordon,

The Mortgage Bankers Association (MBA)[1], American Bankers Association (ABA)[2], and the National Mortgage Servicing Association (NMSA)[3] (the Associations) appreciate the opportunity to comment on the Federal Housing Administration's (FHA) Draft Mortgagee Letter (Draft ML), *Payment Supplement Partial Claim (PSPC).* [4] The Associations agree with the need for a loss mitigation solution that provides payment relief to seriously delinquent FHA borrowers in a high-rate environment, while protecting Ginnie Mae issuers from losses. [5] However, as drafted, the complex and resource intensive PSPC would significantly increase the operational, compliance, liquidity, and reputational risk for mortgage servicers, while introducing potential harm to borrowers. [6]

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 330,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 1,700 companies includes all elements of real estate finance: independent mortgage banks, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies, credit unions, and others in the mortgage lending field. For additional information, visit MBA's website: www.mba.org.

[2] The American Bankers Association (ABA) is the voice of the nation's $23.7 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2.1 million people, safeguard $18.7 trillion in deposits and extend $12.2 trillion in loans.

[3] National Mortgage Servicing Association (NMSA), is a nonpartisan organization with member participation representing the nation's leading mortgage servicing organizations. NMSA was formed for the purpose of effecting progress and change while addressing key challenges and opportunities before the mortgage servicing industry. By bringing together decision makers and thought leadership, from across the nation, the NMSA drives the conversation on shaping the American housing industry for the benefit of homeowners.

[4] Per FHA Info #2023-44, available at https://www.hud.gov/sites/dfiles/SFH/documents/SFH_FHA_INFO_2023-44.pdf)

[5] Serious delinquencies are roughly 3.5% of FHA's portfolio according to FHA's Single Family Loan Performance Trends April 2023 Report, available at Version 9.4 SAS System Output (hud.gov)

[6] These risks are well illustrated by the very recent audit report by the Department of Housing and Urban Development's (HUD) Office of Inspector General (OIG) regarding the loss mitigation options that mortgage servicers provided to borrowers with FHA-insured loans after their COVID-19 forbearance ended. The OIG report measured loan servicers technical compliance with HUD's rapidly changing loss mitigation guidelines throughout the COVID-19 pandemic rather

To encourage the best execution of the PSPC for borrowers and establish a permanent program, we strongly urge FHA to make the following important adjustments to the proposed policy prior to finalizing the Draft ML:

1. Simplify and clarify the PSPC by creating a 3-year level payment term, prioritizing permanent relief over temporary relief, reinforcing FHA's traditional use of a prescribed waterfall, and addressing substantial documentation issues with the PSPC proposal;

2. Increase the allowable incentive to $3,500 to protect servicers' liquidity positions in today's market and the value of Ginnie Mae MSRs actively being transferred among program participants; and

3. Establish the mandatory compliance date for servicers at 12 months after the publication date of the Draft ML.

Please also accept the attached Feedback Response Worksheet collected from our members in response to the Draft ML.

I. Execution Requires Simplicity, Liquidity, and Time

The Associations support FHA's efforts to expand the loss mitigation solutions available for servicers and borrowers. The inability of loan modifications to provide meaningful payment reduction to borrowers whose loans were originated at rates well below current market rates is well known.[7] We agree that the creation and implementation of novel concepts within FHA's loss mitigation waterfall is appropriate and necessary to preserve homeownership for distressed borrowers and to protect the Insurance Fund from incurring additional losses from foreclosure. The unique approach proposed by FHA – using partial claim funds to temporarily supplement a portion of a borrower's monthly payment for 3 to 5 years – is promising but presents consequential challenges for servicers and borrowers that must be addressed before finalization.

Successful execution of the PSPC will require FHA to remove many hurdles to implementation. In addition to the complicated PSPC waterfall steps, FHA's proposal is especially concerning because servicers' engagement with borrowers is affected so heavily through multiple communication touch points in the process. Overall, the administratively challenging PSPC significantly increases the cost

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than the positive outcomes that servicers helped borrowers to achieve. The technical and overly complicated nature of FHA's Draft ML poses even greater risk to mortgage servicers than the iterative implementation of the COVID-19 loss mitigation waterfall that used existing tools within FHA's toolkit. Without simplifying the PSPC, the Associations believe that FHA risks further discouraging participation in its program or lessens the willingness of participants to be similarly responsive in future disaster situations under the threat of another public OIG report. The OIG's reports is available at https://www.hudoig.gov/reports-publications/report/servicers-generally-did-not-meet-hud-requirements-when-providing-loss.

[7] Ginnie Mae, Global Market Analysis Report, May 2023, available at Ginnie Mae Design Features (showing 74% of borrowers in a Ginnie Mae security originated their loan since 2019. The current weighted average coupon of Ginnie Mae-Backed Security is 3.21%)

to service a nonperforming FHA loan. This is ill-advised given the current state of the market. These challenges are more acute because the PSPC is only available through October 30, 2024.[8]

a. ***Simplify and Clarify the PSPC***

First, the Associations strongly recommend that FHA simplify and clarify the PSPC.

As constructed, the excessive complexity of the PSPC and its calculations inhibits servicers' ability to adopt effective processes that can be consistently provided to borrowers. To start, the Payment Supplement Period ranges from 3 to 5 years and is completely dependent upon the amount of partial claim that is available for borrowers. The maximum, of course, is 5 years, yet each borrower can have inconsistent terms. The PSPC's complexity is further compounded by the introduction of an unnecessary graduated payment feature in the last year of the Payment Supplement Period. To that end, FHA should improve the PSPC by creating greater consistency.

To simplify the PSPC, we recommend that FHA:[9]

1. Require servicers to offer the PSPC only if the COVID-19 Recovery Modification fails to achieve a minimum 10%, not 20%, P&I reduction. This change prioritizes the opportunity for borrowers to obtain permanent payment relief over temporary payment relief while protecting the target payment. The Associations maintain that a permanent target payment reduction of 20% or more leads to sustainable outcomes for borrowers.

2. Reduce the Payment Supplement Period to a Level 3-Year Payment Term only. Creating a 3-year level payment term without a graduated payment feature provides consistent terms for all borrowers and reduces the complexity of calculating the PSPC. Removing the graduated payment feature is also appropriate considering the exhaustive amount of communication and documentation a servicer would be required to provide to borrowers throughout the Payment Supplement Period. A level payment term also maximizes the number of borrowers eligible for the PSPC, creates potential savings to the Insurance Fund by saving two years of partial claim, and preserves the remaining partial claim for a potential future hardship.

3. Eliminate Step 7 of the PSPC Waterfall (Line 12, Page 12). Step 7 requires servicers to conduct a savings comparison with the COVID-19 Recovery Modification. Servicers are required to offer the COVID-19 Recovery Modification if a lower monthly payment is achieved. If not, and the PSPC achieves the same amount of monthly payment reduction, the servicer is

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[8] Per Mortgagee Letter 2023-03, *Expansion of the COVID-19 Recovery Loss Mitigation Waterfall*, the COVID-19 Recovery Loss Mitigation Waterfall is available for all hardships until October 30, 2024.

[9] In addition to the recommendations cited, the Associations also support continued efforts to provide access to early funding of the entire partial claim amount, such as been proposed by the Urban Institute. (*The Payment Supplement Partial Claim Offers a Great Vision but Is Operationally Burdensome,* available at The Payment Supplement Partial Claim Offers a Great Vision but Is Operationally Burdensome | Urban Institute). While risk is mitigated to some degree with a bulk claims feature, removing the need to file monthly claims simplifies the overall mechanics of the PSPC itself and reduces the administrative burden of the program. MBA supports continued efforts with Ginnie Mae and discussions with FHA to consider ways to make an early funding and implementation of a buydown program possible. The Associations also support efforts that would permit buydown accounts to be set up for delinquent loans held outside of Ginnie Mae pools.

required to allow the borrower to choose their preferred option. This optionality creates unnecessary risk for servicers without providing substantive value to borrowers.

FHA should not incorporate a savings comparison, let alone require servicers to let borrowers choose their preferred option. FHA's traditional use of a prescribed waterfall is valuable because of the certainty and clarity it provides to borrowers. In this case, the COVID-19 Waterfall has already established that the COVID-19 Recovery Modification does not provide borrowers with the relief they need. We strongly urge FHA not to deviate from the value that its waterfall provides. Instead, the waterfall should simply require the servicer to provide the lowest payment over 3 years.

Additionally, the PSPC raises a number of serious documentation issues that FHA should address before finalizing the program. The proposal leaves the fundamental question of how the partial claim will be structured unclear, making it impossible for us to provide comprehensive feedback on the PSPC. Further, it appears to place enforceability risks for which FHA should be responsible on servicers.

To address these issues, we urge FHA to:

1. <u>Clarify the structure of the PSPC note.</u> The Draft ML leaves it unclear whether the PSPC note will be for a fixed amount or structured as a line of credit. Several aspects of the Draft ML are inconsistent with the traditional fixed-amount structure of an ordinary partial claim—but there is no explicit indication that FHA intends to use a line-of-credit style note for the PSPC. Stakeholders need more information about how the PSPC note will be structured in order to provide feedback to FHA on the program. If FHA intends to use a line-of-credit note, it should publish a model note for stakeholder review before finalizing the PSPC.

2. <u>Publish a draft of the PSPC rider/agreement for stakeholder feedback before finalizing the PSPC.</u> The Draft ML indicates that servicers will be required to use a "model" PSPC agreement or rider. [10] This will be a novel legal agreement and should be published for review and commentary by stakeholders prior to finalizing the PSPC.

3. <u>Eliminate the statement that servicers are responsible for the enforceability of the PSPC.</u> The PSPC is a novel loss mitigation product that will be based on an untested legal agreement. Like any innovation that requires a novel legal foundation, the PSPC will pose enforceability risks—risks that FHA cannot place on servicers. When FHA makes its decision as to whether to offer this novel loss mitigation product, FHA must assess the enforceability risk—and its willingness to bear that risk—as part of its cost-benefit analysis. Unfairly passing the enforceability risks of an untested legal agreement on to servicers will significantly impact willingness to participate in FHA programs.

The PSPC, while straightforward in theory and conceptual design, is unnecessarily complex. It is impractical for servicers to deliver to borrowers as a viable loss mitigation solution unless the changes

[10] We generally support this concept. Failing to establish standardized legal documents for the foundation of the PSPC would have significant negative impacts on the secondary market, because variations in legal agreements would impact purchaser confidence in enforceability.

outlined here are made. Standardizing the PSPC will help servicers clearly communicate and educate borrowers on how the PSPC works and the obligations a borrower is expected to meet throughout the Payment Supplemental Period.

b. ***Increase the Incentive Amount to $3,500***

Additionally, the Associations recommend that FHA increase the one-time incentive from $1,000 to $3,500. An increased incentive is merited by the increased cost it will take to implement the PSPC and the ongoing obligations of a servicer throughout the PSPC period, such as filing monthly claims. For context, a servicer could recover an incentive of up to $1,250 on an FHA-HAMP Modification with Partial Claim. Additionally, according to MBA data, the cost of a nonperforming loan is $1,862 as of the end of 2022.[11]

There is a robust market for Ginnie Mae Mortgage Servicing Rights (MSRs) and these MSRs are important incentives to participation in government housing programs. With the low origination volume, MSRs are a valuable asset to sell or to purchase. The expectation is that MSR servicing transfers will remain active for the foreseeable future. We expect Ginnie Mae MSRs would be priced lower for PSPC's within its pools precisely because of the additional challenge and cost of servicing a PSPC. To ensure competitive markets and robust program participation, we strongly advise FHA to increase the incentive to $3,500.

c. ***Allow 12 Months Implementation Time***

FHA proposes to require servicers to implement the Draft ML within six months. Instead, even with the recommended changes, we recommend a mandatory compliance deadline of 12 months after publication of the final ML. Considering the programmatic complexity and changes to the nature of the servicer-borrower relationship, a minimum of 12 months implementation time will ensure the industry can consistently provide the PSPC to borrowers.

The PSPC touches on all aspects of servicing operations and the loan lifecycle from standard loan administration duties, including payment processing and routine borrower reporting obligations, through the entire default and claims process. The scale, depth, and detailed minutia of these changes and calculations increase the risk of noncompliance with FHA's policy. As a result, servicers will need to adjust and test each change to limit this risk. Servicers will be required to devote extensive technology and manual resources to the implementation of the PSPC, including thorough compliance controls. Each servicer will have varying access to those resources impacting their ability to confidently meet the compliance deadline. To highlight several resource intensive issues servicers are particularly concerned with, in addition to the overly complicated calculations for the PSPC, please note the need to:

i. Conduct default reporting on current loans.

ii. File monthly claims in FHA Catalyst if a bulk claims feature is unavailable. A recurring claim filing process will require extensive resources from servicers. FHA needs to automate and test a bulk claims feature in FHA

[11] MBA's Servicing Operations Study and Forum: www.mba.org/sosf

Catalyst before finalizing the policy to ensure the claims filing process of the PSPC is sustainable.[12]

iii. Develop effective reporting to reconcile the amount of partial claim available for the PSPC versus the amount that has been used through the Supplemental Period without access to similar reporting in FHA Connection. Reconciliation reporting is necessary to ensure loan servicing can be transferred, as well as to ensure that servicers are providing accurate updates to borrowers in their monthly statements.

Implementation is also challenged by the extensive communications that servicers will need to design and thoroughly review. In addition to communication scripts to help borrowers understand the PSPC in its most basic form and the annual disclosure, that challenge is further compounded by the fact that the model rider language for the PSPC and other relevant communication will need to be carefully developed since they remain unavailable for review on the drafting table.

II. Conclusion

The Associations and our members remain committed to partnering with FHA to deliver assistance to borrowers.[13] As highlighted in MBA's *Future of Loss Mitigation* white paper, "mortgage servicers are the most important conduit for relief for distressed borrowers and the primary means by which they can recover financially and remain in their homes. To accomplish this, servicers must have the resources to ensure borrowers receive timely and durable assistance to avoid foreclosure."[14]

To achieve the goal of creating a workable program that assists struggling borrowers, FHA must change the Draft ML by simplifying the PSPC, increasing the incentive amount, and providing more time to implement the PSPC. The Associations urge FHA to observe lessons learned from the pandemic where servicers successfully delivered loss mitigation assistance to borrowers throughout the pandemic because of the ability to implement scalable processes, including self-service technology.

The Associations appreciate FHA's commitment to transparency in its efforts to expand its loss mitigation toolkit through engagement with the industry and the use of the drafting table for feedback. We look forward to continuing the partnership with FHA and supporting ongoing work on these issues. The Associations welcome the opportunity to engage in additional discussions regarding the PSPC prior to finalizing the policy. Should you have any questions or wish to discuss these concerns further, please contact Brendan Kelleher at 202-557-2779 or via email at Bkelleher@mba.org.

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[12] Our understanding is that FHA Catalyst has a bulk claim feature available for servicers. If this is not true or a bulk claim feature will not be available for the PSPC, the lack of a sustainable claims feature would strongly discourage participation or result in a process that will not function well. Servicers cannot risk unreimbursed advances to cover a portion of a borrower's monthly payment for 3 to 5 years. Further, we recommend that FHA update the Claims Section of the Handbook to make this clear. To state the obvious, prompt and efficient payment of claims is the linchpin of FHA loss mitigation for servicers. If this program proves to result in delayed payments or inefficiency, it will result in serious challenges for servicers.

[13] See Mortgage Bankers Association, Drafting Table Expansion of Home Retention Options, available at https://www.mba.org/docs/default-source/residential-policy-letters/mba-letter-to-fha-on-partial-claim-buydown-proposal.pdf?sfvrsn=9b94f5a6_1

[14] See MBA's The Future of Loss Mitigation | MBA

Sincerely,

American Bankers Association
Mortgage Bankers Association
National Mortgage Servicing Association