



October 20, 2010

The Honorable David H. Stevens
Assistant Secretary for Housing and
Commissioner of the Federal Housing Administration
Department of Housing and Urban Development
451 7th Street, SW
Washington, DC 20410

Dear Commissioner Stevens:

The Mortgage Bankers Association (MBA) is writing to seek your support for revising the penalty structure for servicers who fail to initiate foreclosure by the HUD-prescribed deadline. Over the years, HUD has placed servicers under increased performance pressure by reducing the timeframe to initiate foreclosure from 12 months to 6 months. This change has provided HUD with significant cost savings, but has increased the risk for servicers that must now manage loss mitigation and foreclosure timelines concurrently. As partners with FHA, we believe it is appropriate and desirable to create a penalty structure that is commensurate with the loss to FHA. Servicers who fail to perform should be required to make FHA whole for any losses resulting from their delay in getting the property conveyed to HUD. Unfortunately, the current penalty is punitive in nature and arbitrary in its severity. A more equitable policy would be a maximum penalty of 30 days of interest for each month the initiation of foreclosure is delayed. A revision is appropriate in light of the increased complexity of managing both the loss mitigation and foreclosure timeframes and their competing objectives. We would like to take this opportunity to outline our recommendation in more detail.

Background

HUD regulations require mortgagees to meet a series of event-specific timeframes during the default, foreclosure, conveyance, and mortgage insurance claim cycles. Failure to timely meet any processing deadlines will result in the imposition of monetary penalties. The penalty provision withholds the accrual of debenture interest otherwise payable in satisfaction of a claim under the mortgage insurance contract. Because there are at least seven “events”¹ that lead to a cut-off of debenture interest, complexity is added to servicing and foreclosing on HUD loans, loss mitigation timing, and preparing accurate and timely claims submissions.

¹ The seven events are as follows:

1. Institution of foreclosure must occur within six months of the date of default; within 120 days from the date the property became vacant, was discovered vacant, or should have been discovered vacant; within 90 days of release of a legal impediment (such as bankruptcy), provided this impediment occurred prior to the expiration of the six-month timeframe; or within 90 days after loss mitigation failure. Mortgagees are granted an automatic 90-day extension if they have initiated but are unable to complete a special forbearance, modification or partial claim within the six-month period. (24 CFR 203.355; Mortgagee Letter 00-05)

HUD has adopted policies for imposing penalties if its deadlines are not met. The most damaging policy currently in place is the curtailment of debenture interest for a servicer's failure to initiate foreclosure² within six months of default (see footnote 1, #1). If this deadline is not strictly met, accrual of debenture interest is terminated from the date the foreclosure should have been commenced to the date of conveyance.

MBA's primary concern is with the arbitrary nature of the penalty. The amount of the servicer's penalty is not directly related to the severity of the delay or HUD's actual cost. Rather, the size of the penalty is dependent on unrelated factors such as whether the property is located in a judicial or non-judicial foreclosure state or whether an intervening event occurs, such as a bankruptcy, which is outside of the servicer's control. Penalties should not vary for the same offense and same duration of non-compliance. However, a one-day delay in initiating foreclosure in New York, New Jersey or Pennsylvania is much more damaging for mortgagees than missing the timeframe in Texas, Virginia or Alabama.

To illustrate, we compare the debenture interest loss associated with missing the foreclosure initiation threshold by one day in New York and Alabama using the states' average time to foreclose. Assume a \$150,000 unpaid principal balance and a 3.5 percent debenture rate. The following losses would be incurred for each state, respectively:

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2. Notice of foreclosure must be given to HUD within 30 days after the institution of foreclosure. (24 CFR 203.356) HUD has limited the loss of debenture interest to 30 days for each month in which a delay occurs.
 3. Foreclosure must be completed within the timeframe established for the state where the property is located. (24 CFR 203.356)
 4. The deed to HUD must be recorded within 30 days of acquiring possession of, and good marketable title to, the property. (24 CFR 203.359)
 5. Part A, HUD Form 27011, must be submitted within two business days of the date the deed to HUD is filed for record or mailed to the recording authority. (24 CFR 203.360; Mortgagee Letter 96-65)
 6. Title evidence must be submitted within 45 days after the deed is filed for record. (24 CFR 203.365)
 7. Part B, HUD Form 27011, must be submitted and received within the latter of 15 days after title approval or 45 days after the deed to HUD is filed to record. (24 CFR 203.365)

² Initiation of foreclosure means the first legal action, which varies by state, but includes publication in the newspaper, filing of a petition or complaint, etc. See ML 2005-30, Attachment 1. (July 12, 2005)

	Unpaid Principal Balance	Debenture Interest Rate	Daily Debenture Interest*	Initiation of Foreclosure Required on or before	Foreclosure Initiated	Property Conveyed to HUD	No. of Days of Debenture Interest Curtailment	Debenture Interest Curtailment
New York ³	\$150,000	3.5%	\$14.38 per day	2/1/2010	2/2/2010	3/1/2011	393**	\$5,652.74
Alabama ⁴	\$150,000	3.5%	\$14.38 per day	2/1/2010	2/2/2010	6/1/2010	120***	<u>\$1,726.00</u>
							Difference	\$3,926.74
<p>*($\\$150,000 \times 3.5\% = \\$5,250$ [annual interest])</p> <p>$\\$5,250/365 = \\14.38356 [Daily Interest]</p> <hr/> <p>**In the New York example, we are assuming that foreclosure is completed in 12 months, and that it takes an additional month to convey the property to HUD.</p> <hr/> <p>*** In the Alabama example, we are assuming the foreclosure is completed in 3 months, and that it takes an additional month to convey the property to HUD.</p> <hr/> <p>NOTE: Since the Part B interest curtailment will be the same in both scenarios, we did not include the Part B interest curtailment in either example.</p>								

Another way to look at the inequity of this situation is that a servicer who misses the initiation of foreclosure timeframe by only one day on a New York loan will suffer the same debenture interest curtailment as a servicer who misses the initiation of foreclosure timeframe by 305 days on a Texas loan. In both instances, the servicer is curtailed 425⁵ days of interest.

One can see that missing the deadline by one day results in an extreme penalty for the mortgagee. An intervening bankruptcy could double or triple these losses. Failure to start foreclosure timely creates a more significant loss than the failure to meet any subsequent event. In fact, the failure to meet HUD's timetable for early events (such as initiation of foreclosure) will result in serious losses for mortgagees, even if HUD's timelines for completing foreclosure sale or conveying property are met or reduced.

There is currently no relationship between HUD losses as a result of delays and the penalties assessed to mortgagee participants for failing to initiate foreclosure timely. In fact, it is unclear how HUD is harmed at all by a short delay in the initiation of foreclosure.

³ Assumes the servicer complied with New York's 13-month reasonable diligence timeline.

⁴ Assumes the servicer complied with Alabama's four-month reasonable diligence timeline.

⁵ This example assumes three months to complete foreclosure in Texas (HUD's allowable timeframe) and 13 months to complete foreclosure in New York (HUD's allowable timeframe), and one month to convey in both instances.

The table below illustrates how the severity of the penalty increases between non-judicial and judicial states, when the unpaid principal balance (UPB) and the debenture interest rate increases. A loan in New York, with a UPB of \$300,000 and debenture interest rate of 9 percent, will be curtailed nearly \$30,000 more than a loan with identical attributes in Texas, for missing the initiation of foreclosure by one day.

Interest Curtailment Scenarios					
Unpaid Principal Balance	Debenture Interest Rate	Texas (3 months)	Virginia (6 months)	New York (12 months)	New York (16 months) Delay Due to Chapter 13 Bankruptcy
\$100,000.00	3%	\$750.00	\$1,500.00	\$3,000.00	\$4,000.00
\$100,000.00	5%	\$1,250.00	\$2,500.00	\$5,000.00	\$6,666.67
\$100,000.00	7%	\$1,750.00	\$3,500.00	\$7,000.00	\$9,333.33
\$100,000.00	9%	\$2,250.00	\$4,500.00	\$9,000.00	\$12,000.00
\$150,000.00	3%	\$1,125.00	\$2,250.00	\$4,500.00	\$6,000.00
\$150,000.00	5%	\$1,875.00	\$3,750.00	\$7,500.00	\$10,000.00
\$150,000.00	7%	\$2,625.00	\$5,250.00	\$10,500.00	\$14,000.00
\$150,000.00	9%	\$3,375.00	\$6,750.00	\$13,500.00	\$18,000.00
\$200,000.00	3%	\$1,500.00	\$3,000.00	\$6,000.00	\$8,000.00
\$200,000.00	5%	\$2,500.00	\$5,000.00	\$10,000.00	\$13,333.33
\$200,000.00	7%	\$3,500.00	\$7,000.00	\$14,000.00	\$18,666.67
\$200,000.00	9%	\$4,500.00	\$9,000.00	\$18,000.00	\$24,000.00
\$250,000.00	3%	\$1,875.00	\$3,750.00	\$7,500.00	\$10,000.00
\$250,000.00	5%	\$3,125.00	\$6,250.00	\$12,500.00	\$16,666.67
\$250,000.00	7%	\$4,375.00	\$8,750.00	\$17,500.00	\$23,333.33
\$250,000.00	9%	\$5,625.00	\$11,250.00	\$22,500.00	\$30,000.00
\$300,000.00	3%	\$2,250.00	\$4,500.00	\$9,000.00	\$12,000.00
\$300,000.00	5%	\$3,750.00	\$7,500.00	\$15,000.00	\$20,000.00
\$300,000.00	7%	\$5,250.00	\$10,500.00	\$21,000.00	\$28,000.00
\$300,000.00	9%	\$6,750.00	\$13,500.00	\$27,000.00	\$36,000.00

MBA Recommendation

If HUD revised the claim system to limit interest penalties only to the degree of delay caused by the mortgagee, the respective interests of mortgagees and HUD would be more equitably balanced.

MBA recommends that HUD limit the curtailment of debenture interest to 30 days for each month that the servicer is delayed by one or more days in initiating foreclosure in that month. For example, if first legal action is required by September 1, 2010, but the servicer does not perform this task until September 2, 2010, debenture interest would be curtailed by 30 days. If first legal action does not occur until October 10, the servicer's right to receive debenture interest would be curtailed by 60 days. The penalty would be imposed even if the reasonable diligence timeframe was met or bettered. If as a result of the delay, the servicer also failed to meet the state reasonable diligence timeframe, HUD would curtail interest for this reasonable diligence failure according to its current policy.

The recommended policy is identical to the penalty imposed on servicers for failing to timely report the initiation of foreclosure. See Mortgagee Letter 96-65 (December 02, 1996). Under that policy, a servicer is considered in non-compliance for each reporting cycle that the notification of foreclosure is delayed. If reporting is delayed by one day (one cycle), the mortgagee's claim would nonetheless require a self-curtailment of an amount equivalent to 30 days of interest.

Our recommended penalty when imposed in connection with a failure to timely initiate foreclosure will over-compensate HUD for any costs or losses it incurs because most servicers will go to extraordinary lengths to ensure that reporting and reasonable diligence timeframes are met despite the delay in starting foreclosure. Assuming state timeframes for completing foreclosure and conveying title are met, there would be no delay in marketing the property.

We believe this policy adjustment could be achieved through a regulation change or merely through a Mortgagee Letter utilizing the existing regulatory framework.

Conclusion

Providing a more equitable penalty for missing FHA's initiation of foreclosure deadline will enhance the FHA program and make it more attractive to service FHA loans. Making the program less expensive to administer will ensure that FHA remains a dynamic housing program.

The Honorable David H. Stevens

October 20, 2010

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We welcome the opportunity to discuss our recommendations with you and your staff at your earliest convenience. Please contact Vicki Vidal, Associate Vice President of Loan Administration, at vvidal@mortgagebankers.org or (202) 557-2861.

Most sincerely,

A handwritten signature in black ink that reads "John A. Courson". The signature is written in a cursive style with a large initial "J".

John A. Courson

President and Chief Executive Officer

cc: Vicki Bott
Vance Morris
Sarah Martin
Leslie Bromer