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Loan Forbearance: Preparing for Customer Relief Requests – April has begun

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"The real or supposed rights of man are of two kinds, active and passive; the right in certain cases to do as we list; and the right we possess to the forbearance or assistance of other men."
William Godwin

During these challenging times banks will be facing increasing liquidity pressures. Customers suffering through unemployment will be scrambling for sources of cash to meet their basic living expenses. Deposit outflows will doubtlessly increase and revenue from loan payments will be impacted by the CARES Act and State forbearance emergency laws and regulatory directives. Mark Zandi, chief economist for Moody's Analytic, predicts as many as 30% of Americans with home loans — about 15 million households — could stop paying if the U.S. economy remains closed through the summer or beyond. Thankfully, the banking system has strengthened its capital position and many banks have already increased their liquidity in the early stages of the crisis. However, many of the regulatory fail-safes constructed as a result of the last crisis were designed for a different kind of crisis. Regulators and legislators are not unlike generals preparing to fight the last war. The challenge now is not capital but liquidity. Aside from the $2 trillion dollars appropriated by Congress for COVID-19 relief, the Federal Reserve Board has announced a new TALF program committing over $4 trillion dollars to fund the facility. It is expected that it will mimic in many ways the TALF program created under TARP.

Congress has imposed a foreclosure moratorium and consumer right to request forbearance under Section 4022 of the CARES Act. That section covers the period beginning on January 31, 2020 and ending on the later of 120 days after March 27, 2020 or the date the Presidential COVID -19 Emergency Proclamation is terminated - "the covered period". It covers "federally backed mortgage loans" which are defined specifically to include government insured or guaranteed 1-4 family residential mortgage loans such as FHA loans, loans purchased or securitized by Freddie or Fannie among others. During the covered period, a borrower with a federally backed mortgage loan experiencing a financial hardship due, directly or indirectly, to the COVID–19 emergency may request forbearance on the federally backed mortgage loan, regardless of delinquency status, by submitting a request to the borrower's servicer and affirming that the borrower is experiencing a financial hardship during the COVID–19 emergency.

The law states:

> Upon receiving a request for forbearance from a borrower under subsection (b), the servicer shall with no additional documentation required other than the borrower's attestation to a financial hardship caused by the COVID–19 emergency and with no fees, penalties, or interest (beyond the amounts scheduled or calculated as if the borrower made all contractual payments on time and in full under the terms of the mortgage contract) charged to the borrower in connection with the forbearance, provide the forbearance for up to 180 days, which may be extended for an additional period of up to 180 days at the request of the borrower, provided that, the borrower's request for an extension is made during the covered period, and, at the borrower's request, either the initial or extended period of forbearance may be shortened.

The law imposes a foreclosure moratorium on servicers of federally insured mortgages prohibiting a servicer from initiating any judicial or non-judicial foreclosure process, moving for a foreclosure judgment or order of sale, or executing a foreclosure-related eviction or foreclosure sale for not less than the

60-day period beginning on March 18, 2020. The Act also requires a furnisher of forbearance granted to a consumer who is "affected by the coronavirus disease 2019 (COVID–19) pandemic" to report a loan as current if it is in compliance with the forbearance terms.

Also, various states have issued orders, guidance or advisory opinions in one form or another with the intention of effecting forbearance by lenders on enforcing loan payment obligations. For example, New York Governor Cuomo by Executive Order 202.9, dated March 21, 2020, modified the Banking Law to deem as an unsafe and unsound business practice a refusal to grant a forbearance to any person or business who has a financial hardship as a result of the COVID-19 pandemic. As public awareness of these varying authorities is limited to the general concept of forbearance rather than the technical aspects of which loans qualify for mandatory CARES Act forbearance, banks will be compelled to develop their own policies as to under what circumstances they will forbear from enforcing mortgage agreements.

The law regarding federally backed mortgages is relatively clear, and while doubtlessly lawyers will probe it for flaws once the crisis abates, the law as to conventional mortgages not federally backed is much more problematic. The CARES Act does not mandate forbearance on enforcement of these types of loans. On April 3, 2020, the federal financial institution regulatory agencies issued a joint policy statement that recognizes that mortgage servicers will offer short-term payment forbearance options, like the CARES Act forbearance, or short-term repayment plans (collectively "short-term options") to borrowers facing hardships related to the COVID-19 emergency. The joint policy statement is intended to clarify the application of the Regulation X mortgage servicing rules and the agencies' approach to supervision and enforcement related to the rules during the emergency, including those applicable to short-term options. Whether or not a servicer provides a CARES Act forbearance, servicers still must provide certain Regulation X notices if they receive any "incomplete loss mitigation application" from a borrower, but generally servicers do not have to exercise reasonable diligence to complete the application until near the end of the forbearance period. A CARES Act forbearance qualifies as a short-term payment forbearance program under Regulation X, so it is excluded from some of the otherwise applicable loss mitigation requirements. The CARES Act requires borrowers to make a request to the servicer for a forbearance and affirm that they are experiencing a financial hardship during the COVID-19 emergency. This request and affirmation constitute an incomplete loss mitigation application for purposes of Regulation X, so servicers must provide the notice required by Regulation X. However, if there is an incomplete application, the rules still require servicers to provide an acknowledgement notice within five days of receipt of that incomplete application, even if the borrower has been offered or is in a short-term option. The policy statement states that: "as of April 3, 2020, and until further notice, in evaluating compliance with Regulation X, 12 CFR 1024, if a mortgage servicer offers or provides a borrower a short-term option, including a CARES Act forbearance, the agencies do not intend to take supervisory or enforcement action against servicers for: failing to provide the acknowledgment notice described in Regulation X, 12 CFR 1024.41(b)." Without the this exception, mortgage servicers must follow certain procedures when a borrower applies for loss mitigation, including providing several different notices to borrowers on specific timelines. Further, if a borrower is delinquent, mortgage servicers are required to provide certain live contact and written early intervention communications on a specific timeline. The policy statement states that until further notice, the agencies do not intend to take supervisory or enforcement action against servicers for failing to do so whether or not a borrower is experiencing a financial hardship due, directly or indirectly, to the COVID-19 emergency. Regulation X does not however require forbearance.

Nonetheless, depending on what jurisdiction a bank is subject to, it may have a state law issue if it fails to grant forbearance. Moreover, a grant of forbearance not clearly mandated by law should be carefully constructed, lest the bank be deemed to waive its rights after the forbearance period terminates. Notwithstanding the joint agency statement of relaxed enforcement under Regulation X, a servicer considering a borrower request for forbearance on enforcement of loan terms on a loan not classified as federally backed under the CARES Act, would be wise to use its best efforts to comply with that regulation. Relaxed standards of enforcement are not a grant of immunity from failure to comply.

For portfolio lenders that rely on the Federal Home Loan Banks ("FHLBanks") for liquidity, there are issues of what type of forbearance will disqualify a loan as eligible collateral for advances. The Federal

Housing Finance Agency ("FHFA") announced that it will not object to the 11 Federal Home Loan Banks it regulates allowing residential mortgage loans in forbearance to be used as collateral for advances to members during the COVID-19 crisis. To be eligible, FHLBanks must confirm that members seeking the advances have extended forbearance to the borrowers and are not requiring the borrowers to make payments on the pledged mortgage loans. This flexibility will remain in effect for the duration of any forbearance assistance provided by the individual mortgage lenders. FHFA also said the FHLBanks may accept e-signatures for short-term payment deferral agreements on loans pledged to the Bank during this crisis. The attached chart summarizes results of a survey of the policies of the various FHLBanks pertaining to the eligibility of a mortgage loan as collateral that has been granted forbearance. Most of the policy statements are similar in wording.

For example, the Federal Home Loan Bank of Boston statement reads:

> Although FHLBank Boston's collateral delinquency exclusions will remain in place, FHLBank Boston will not consider as delinquent any loan that is subject to and performing under a forbearance agreement entered into as a result of a COVID-19 hardship. This will remain in effect for the duration of any forbearance assistance provided by the member and applies to one- to four-family mortgage loans, multifamily loans, and commercial real estate loans.

This language is much broader than the CARES Act language, as it is not limited to federally backed mortgage loans but includes conventional and non-conforming loans held in portfolio to the extent they would otherwise be eligible. It would appear that most FHLBanks will not accept loans under forbearance as collateral which were determined to be classified as delinquent prior to any modification resulting from COVID-19. Loans classified as substandard or doubtful, even after the modification or forbearance, will most probably be considered ineligible. The devil is in the details as the phrase "COVID-19 Hardship" is not a defined term and lends itself to varying and broad interpretation. The meaning of this term will be argued for years to come. What is a hardship can be highly subjective as applied to forbearance not mandated by the CARES Act. In the interim, bank servicers granting forbearance should be careful to treat such actions as a loan modification and make sure a written agreement is signed by the borrower or by e-sign and contains the relevant terms, using their best efforts to comply with Regulation X, documenting extenuating circumstances that make such compliance impractical under the current emergency. Generally, the forbearing bank will email the forbearance Agreement to the borrower. If the borrower is unable to e-sign, some of the FHLBanks have specified that the borrower may acknowledge its acceptance via email (without any signature) if the following steps are taken:

- A member includes the text of the entire Agreement into an email message to the borrower(s) (i.e., The Agreement cannot be in an attachment to the email).
- The email message must include FHLBank's electronic/facsimile signature clause noted above.
- The email message must conclude by asking the borrower(s) to: Please acknowledge and agree to the terms and conditions set forth in this email by replying to this message: "I agree to the terms and conditions set forth in the email below." Each Borrower must then type his or her name below such statement.

Banks should avoid terms that are based on form agreements designed to comply with the CARES Act forbearance requirement if the loan is not subject to that law as such agreements can be open ended. Moreover, every state forbearance authority is different and should be carefully considered. Some state policies may not have legal efficacy. Also, a loan granted forbearance not federally or state mandated should not be considered a performing loan for purposes of resale.

Finally, the loans treated by the CARES Act as current for credit agency reporting purposes are not limited to those required to be granted forbearance under that same Act. In short, while a bank that has a generous COVID-19 forbearance policy based on the public exigencies and its desire to assist borrowers should not lose sight that once the crisis is over compliance with the legal niceties will once again become paramount. Stockholders, creditors and regulators will all review how a bank servicer handled forbearance in hindsight, particularly in what promises to be a partisan environment. Finally, compliance

with locale real estate laws is necessary to assure the protection of the lien. There will most certainly be new issues arising with forbearance in the coming days and banks should stay alert as requests for forbearance are received. With April monthly payments due, there will be numerous borrower inquiries at a time when the bank's staff is already under extraordinary stress.

For more information on the matters discussed in this *Locke Lord QuickStudy*, please contact the author.

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