California loss-mitigation bill creates more problems than it solves

Here are 8 unclear and dangerous provisions of bill

Robert Finlay
April 29, 2016

California continues its effort to pass a law that would require loan servicers to work with successor's to borrowers on loss mitigation options.

The same effort failed last year, but just passed through the Senate Banking Committee last week on the narrow margin of 4-3 (see attached). According to one source, the hearing was long and contentious, with senior citizen groups, consumer groups and the State Attorney General sending representatives to argue in favor of the bill.

Consumers also testified as to the problems they experienced with banks allowing widows and widowers to assume mortgage loans and modify the loans.

At the same time, the **California Mortgage Bankers Association**, **California Bankers Association**, **Credit Union League** and others testified to the many problematic provisions and the harm the bill will cause for borrowers, lenders and the housing market.

Despite the strong opposition, the bill passed out of committee with a proposed amendment that would require a successor seeking to assume/modify the mortgage loan to make payments on the loan while seeking assumption/modification. The proposal was not in writing and is supposed to be crafted in the Senate Judiciary Committee.

One of the points made by the proponents is that the bill only allows for assumption/modification for assumable loans. However, the bill itself states that the servicer must allow the assumption of the loan if a successor qualifies for available foreclosure prevention alternatives, which directly contradicts proponents' statements and exemplifies just one of the problems with the wording of this bill.

As with any proposed bill, and especially this one, the problem is not the concept but the details, implementation and impact on all parties. Unfortunately, SB 1150, while well intended, has the potential to create more problems than it solves.

Adding to the potential problems with the wording of SB 1150 is how the **Consumer Financial Protection Bureau** plans to weigh in on the issue. As you may recall, in 2013, the CFPB issued guidance stating that "servicer[s] must have policies and procedures reasonably designed to ensure that, upon notification of the death of a borrower, the servicer promptly identifies and facilitates

communication with a successor in interest of the deceased borrower with respect to the property that secures the deceased borrower's mortgage loan."

More recently, in November 2014, the CFPB issued Proposed Amendments to the Servicing Rules, proposing to substantially enhance the rights of successors in interest and the obligations of servicers with respect to successors under the rules.

In a nutshell, the proposed amendments sought to expand the definition of successor to all protected transfers in the Garn-St. Germain Act, require servicers to confirm whether an interested party qualifies as a successor under applicable law and, once confirmed, apply all servicing rules to the confirmed successor.

While the comment period ended in March of 2014, the CFPB has yet to issue final amendments on this and other controversial issues. It is anticipated that final amendments will be issued early this summer. How those rules, if and when they are released, will compare to SB 1150, could add to the complexity when working with borrower's successors.

Some of the key provisions and the corresponding potential issues are set forth below:

1. *Proposed 2920.7(a)* provides that the servicer cannot record a NOD until it does both of the following: (1) provides the claimant a reasonable period of time, not less than 30 days, to provide proof of the BR's death; and (2) provides the claimant with a reasonable period of time, not less than 90 days, to provide proof of that person's interest in the real property. In addition to adding at least 90 days to the pre-foreclosure process, the proposed language leaves the servicer exposed to several potential problems. For example: (i) although the legislature attempts to define "reasonable documentation", it is still left for interpretation, which welcomes litigation; or (ii) what if the loan is in probate and the reasonable documentation could take years.

2. *2920.7(b)(1) and (2)* provide that, once the claimant provides the above required proof, he or she is defined as a "successor in interest" ("SIT"). The statute specifically states that there can be more than one SIT. How is a servicer supposed to handle multiply SITs – can it require all that all the SITs assume the loan? What if one SIT qualifies and another doesn't. What is one wants a loan mod and one doesn't. The statute provides no guidance.

3. *2920.7(c)* provides that, within 10 days of the claimant becoming a SIT, the servicer must provide the SIT with key information on the loan. The statute does not contemplate whether providing any of that information would violate applicable Federal Law.

4. *2920.7(d)* provides that the servicer "shall" allow a SIT to either: (1) assume the loan, unless assumption is prohibited by the terms of the loan; or (2) where the SIT of an assumable loan also wants a foreclosure prevention alternative, simultaneously apply for both. As drafted, there is no requirement that the SIT ***qualify*** to assume the loan. In addition, the statute is unclear on whether the servicer can require that the SIT assume personal responsibility for the loan and what happens if the SIT refuses or delays in signing the documents. SB 1150 does not provide any guidance on how long the servicer must give the SIT to assume the loan or apply for loss mitigation.

Perhaps the biggest concern with this provision is the language "unless assumption is prohibited by the terms of the loan". The uniform DOTs include a due-on-sale clause. Applicable law (i.e. Garn St. Germain) prohibits a lender from accelerating all amounts owed under a due-on-sale clause if a relative (i.e. surviving spouse or child) occupies the property. In this circumstance, the relative is permitted to make payments but the lender is not required to allow them to assume the mortgage. This OPTION remains with the lender. *Proposed SB 1150(d)* mandates that a servicer SHALL allow the SIT to assume the loan, "**unless such assumption is prohibited by the terms of the loan"**. Arguably, if the surviving spouse/child does not occupy the property or someone other than the surviving spouse is seeking to exercise its right to assume under *SB 1150(d),* the loan is not assumable. However, since the DOT does not expressively prohibit assumption, any servicer exercising the due-on-sale clause would expose itself to *potential*liability under *SB 1150(d).* It's a no-win situation for the servicer.

5. *2920.7(e)(1)* gives the SIT all the same rights under HOBR as a BR has. But, what happens if the servicer had already complied with the provisions of HOBR as to the BR and then the BR passes on the eve of recording the NOD? The statute is unclear whether the servicer must re-comply with all same provisions as to the SIT or, can it pick up mid-stream?

6. *2920.7(e)(1)* uses a similar definition of "owner-occupied" to the one in HOBR, i.e., "that the property was the principal residence of the deceased borrower and is security for a loan made for personal, family, or household purposes." Like under HOBR, the definition is not indicate whether the property had to be the principal residence at the time of origination or at some point later. In addition, as drafted, the servicer would be required to let the SIT assume the loan and provide all HOBR protections even if the SIT never intends to occupy the property.

7. *2920.7(e)(2) thru (4)* give the SIT the same private right of action afforded to BRs, including the right to an injunction (pre-sale), damages (post-recording of the TDUS) and attorneys' fees.

8. *2920.7(f)(4)* defines who can be a SIT. But, those definitions include a "personal representative" under Probate Code 58 or a trustee of the deceased BR's trust. That begs the question – who is entitled to assume the loan or qualify for a loan mod – the representative or trustee?

These are just some of the unclear and dangerous provisions of the SB 1150. While there is a chance that some of these provisions can be cleaned up, time is running out. The bill will next be heard by the Senate Judiciary Committee, perhaps as early as May 3.

Robert Finlay is one of the three founding partners of Wright, Finlay & Zak. Since 1994, Finlay has focused his legal career on consumer credit, mortgage and real estate litigation and compliance

matters. Finlay has authored several amicus briefs on key issues impacting the mortgage and finance industry.