June 30, 2023

Commissioner Julia Gordon
Federal Housing Administration (FHA)
U.S. Department of Housing and Urban Development
451 7th Street, SW
Washington, DC 20410

Payment Supplement Partial Claim Recommendation

Dear Commissioner Gordon:

The Housing Policy Council[1] and our member companies appreciate your leadership in pursuing a loss mitigation program that will allow for payment reduction for borrowers whose note rates are lower than the prevailing market rate. We recognize the need for a tool like the proposed Payment Supplement Partial Claim (PSPC) to be a permanent alternative in the FHA suite of loss mitigation tools. Nevertheless, we have significant concerns with the PSPC proposal described in the Draft Mortgagee Letter (Draft ML). As you know, HPC and our member companies have been proactive in supporting the FHA effort to design a program that will enable borrower payment reduction without a loan modification, to complement the existing loss mitigation options.[2] However, we respectfully submit that the complexity of the program as currently proposed presents meaningful operational challenges and heightened risk of borrower confusion that will result in an adverse customer experience. Our detailed feedback provided in the Draft ML Feedback Response Worksheet highlights over 40 complications, ambiguities, questions, and concerns that we believe need to be addressed in a revised program design.

While collectively the issues will pose a challenge to program execution, a subset of the issues are stand-alone problems with consequential impact; without resolution, these issues will impede implementation. In other words, without substantial revision to several complex terms and conditions of this program, it is not possible for most servicers to implement this program in time to help the large number of borrowers who are delinquent or in forbearance today and need payment reduction to resume monthly payments. Of greatest concern are the multiple variations for calculating the payment supplement, the ambiguities of managing the account for the borrower, and successful communication of the program terms to the customer. Given the extreme complexity of the arrangements, it will be critical for borrowers to receive clear and consistent disclosures, notifications, and monthly statements that track the funds. Even with a single set of simple program terms, this would be difficult, but the

[1] The Housing Policy Council is a trade association comprised of the leading national mortgage lenders and servicers; mortgage, hazard, and title insurers; and technology and data companies. Our interest is in the safety and soundness of the housing finance system, the equitable and consistent regulatory treatment of all market participants, and the promotion of lending practices that create sustainable homeownership opportunities in support of vibrant communities and long-term wealth-building for families. For more information, visit www.housingpolicycouncil.org.

[2] See HPC Letter to FHA re: Payment Supplement Account Recommendation on December 15, 2022.

variations proposed in the Draft ML render the execution unnecessarily formidable for borrowers and servicers.

The first section of this letter sets forth the nine most significant policy concerns we have identified in the Draft ML. The second section presents alternative policy ideas that embrace the use of a borrower payment supplement utilizing the partial claim without the need for multiple and on-going partial claim submissions.

Section 1: Payment Supplement Partial Claim Recommendations

This list reflects our top concerns with the PSPC and associated recommendations that we believe must be addressed before a new PSPC loss mitigation option is finalized:

- **Reduce Complexity:** To reduce some of the complexity described above, we recommend the following changes:
  - The term of the PSPC should be level. The borrower payment step-up adds significant operational complexity.
  - Only one term should be offered to all qualifying borrowers. Having two different terms, 3 or 5 years (and the range in between), adds significant operational complexity (both disclosure and model documents become more complex), and thus the program should be set at 3 years. We believe that a 3-year term is sufficient to provide borrowers relief for a meaningful period of time, while also maximizing the pool of borrowers who would qualify for the payment relief. A shorter term could also preserve some partial claim availability for use in the future, if necessary.
  - Step 7 of the PSPC waterfall should be removed. It adds significant complexity by requiring servicers to compare the savings achieved with the PSPC to the COVID-19 Recovery Modification. Further, calling on the borrower to choose between the PSPC and the COVID-19 Recovery Modification will lead to borrower confusion and servicer errors, similar to those cited in the recent HUD OIG report.[3]
  - Redefaults should terminate the payment supplement. The process for dealing with redefaults is overly complex and will pose significant operational risk because of the way systems like Neighborhood Watch display information on partial claims. Instead, we recommend terminating the monthly payment supplement if a borrower subsequently goes 60 days delinquent during the Payment Supplement Period.
- **Need for New Documentation / Borrower Agreement Developed by FHA:** We request that FHA promptly publish model language for the PSPC Borrower Legal Agreement (Rider), Subordinate Mortgage, and Note. All of these documents are necessary to properly execute the program. Individual servicer development of distinct legal agreements, security instruments, and informational materials for borrowers poses significant risk. Lack of standardization could result in varying interpretations of borrower rights and responsibilities, confusing borrowers and potentially jeopardizing the sustainability of the loss mitigation solution. This risk is amplified for borrowers whose loans are transferred to another servicer during the PSPC period, where servicers may have different documents/templates/disclosures if the Department does not provide such forms or sample language. The most recent HUD OIG report heavily criticized

[3] COVID-19 Loss Mitigation Report by the Office of Inspector General on June 13, 2023.

execution of FHA program changes and the inadequacy of materials that *were* available and being used by servicers related to far less complex loss mitigation programs.[4]

- **Clarity on how the Promissory Note works and is paid off:** The Draft ML is not clear about how the payoff of the note associated with the PSPC will work. Frankly, basic questions such as whether the PSPC note would be executed in a specific amount or more like an open-ended line of credit (like a HELOC) remain unclear. Without clear guidance on this core component of the program, servicers will be unable to operationalize the PSPC, and the chance for borrower confusion is high. Further, if the PSPC is structured as an open-ended line of credit, it is unclear whether the borrower will receive monthly statements indicating the increasing loan balance on the subordinate lien and how this information will be shared and continuously reconciled between the servicer, FHA, and FHA's contractor.
- **Implementation Date:** Due to the significant operational and technological challenges of implementing the PSPC, we strongly believe that the implementation period needs to be extended and mandatory effective date adjusted – to allow for at least 12 months from the program publication date. We support FHA granting permission for early adoption for those servicers who are able to do so. This would allow individual servicers to offer the new program prior to the mandatory date, yet give each company sufficient time for required implementation activities, including but not limited to: developing new disclosures, notifications, and monthly statements for consumers; training customer service, loss mitigation, and back-office staff; producing consumer-facing educational information and materials; updating technology platforms; reconfiguring internal processes and practices; performing standard development and testing of the new procedures; and establishing rigorous compliance controls. We note that if FHA accepts the industry recommendations to streamline and simplify the PSPC, it would greatly enhance servicers' ability to adopt the PSPC voluntarily earlier in the implementation window. However, without these changes, the risks of providing insufficient time to properly implement loss mitigation programs are very high, as clearly demonstrated by the recent OIG Report.[5] As this program is far more complex than the loss mitigation options that were the subject of the OIG Report, the risks here seem substantially higher.
- **Minimize Burden of Filing Partial Claims:** The multiple claim submission requirement, and the need to develop an initial and then an on-going, recurring process to file additional PSPC claims for funds to supplement the borrower payments, will require extensive and costly resources for both servicers and FHA. We request a firm commitment by FHA to automate as much of this process as possible and to design a process that will permit bulk requests for multiple cases to be submitted simultaneously. We also request that FHA establish a site for testing bulk uploading before the process goes live. FHA should also permit servicers to reimburse PSPC advances using funds from a Ginnie Mae MBS central P&I custodial account to alleviate the servicer's burden of financing advances prior to partial claim filing and claim payment by FHA.[6] This would help decrease servicer expense associated with the program. Lastly, we would encourage FHA to consider adopting a process that leverages FHA Catalyst, and which would

[4] Id.
[5] Id.
[6] Chapter 16 of the Ginnie Mae MBS Guide, Part 3, Section A, Treatment of Custodial Funds, 4(b) ("The Issuer may make withdrawals from a P&I custodial account . . . to reimburse itself for its previous advances that were made in accordance with MBS Guide, Ch. 15, Part 2, § E and Part 3, § C [if listed conditions are met."]); Chapter 15 of the Ginnie Mae MBS Guide, Part 3, Section C, Advances ("If necessary to cover shortfalls in collections, the issuer must advance its own funds into the central P&I custodial account in order to enable the CPTA to effect timely payment of all amounts due security holders.").

only require the minimum data fields for FHA to accept and pay the monthly principal reduction claims (with no additional required documentation):
  - Claim Type: Monthly Principal Reduction (MoPR)
  - Mortgagee Loan Number: (123456789)
  - FHA Case Number: (123-4565789)
  - Payment Due Date: (June 1, 2023)
  - Amount of MoPR: ($75.25)
- **Legal Enforceability:** We are concerned with the language requiring that servicers "must ensure the Partial Claim Agreement is legally enforceable and complies with all state and local requirements." If FHA implements the PSPC Program, it will be doing so with full understanding that it is a novel program with untested legal instruments. Servicers cannot bear responsibility for the enforceability of FHA's program under these circumstances, certainly not without reviewing and having the opportunity to provide input on the legal documents or model legal text that will be required.
- **New Bankruptcy Policy:** We are very concerned about the new bankruptcy policy requiring borrowers to reaffirm the FHA-insured Mortgage debt in order to be eligible for any partial claim (the Draft ML appears to change the policy for all partial claims, not just the payment supplement). This new language will significantly limit partial claims for borrowers who have received a Chapter 7 discharge without reaffirming their mortgage loan; this unexpected reversal in long-standing practice is concerning and is contrary to the aims of both the bankruptcy discharge and partial claims. We recommend dropping this unnecessary and time-consuming requirement.
- **Servicer Incentive Pay:** Servicer incentive pay needs to account for the long-term nature of the work servicers will have to do (required additional staffing and regulatory risk associated with this 3–5-year term plan). As a reference point, servicers currently receive $1250 plus expense reimbursement for a modification/partial claim combination, which is significantly easier to administer than the PSPC. To account for the ongoing complexities associated with the program we recommend an incentive amount of $3500.
- **Updating Partial Claim Regulations:** Given the level of effort required to execute the PSPC, FHA should make this program permanent, within the full suite of loss mitigation tools available. Therefore, we recommend that FHA amend 24 CFR § 203.371 (b) (3) of the FHA regulations to permanently strike the language requiring that borrowers be "able to resume making full monthly mortgage payments," since this provision is obviously in conflict with the proposal. Similarly, we recommend striking the requirement that the "amount of the arrearage has not exceeded the equivalent of 12 monthly mortgage payments," as that limits the availability of the program to borrowers who have had a COVID Forbearance.

Section 2: Alternate Option that FHA Should Consider to Multiple Partial Claim Submissions

As is clear from the list of recommendations above, we believe that the implementation of the PSPC as proposed will be difficult and protracted. Therefore, we continue to believe that it is in the interests of borrowers and FHA to continue to consider other policy ideas that have been identified and discussed. Our members believe that the following ideas have merit, and are worth pursuing:

A) **Pre-Funded PSA Account:** Similar to the idea described recently by the Urban Institute[7] we believe that FHA should design a simplified partial claim process that pays just two claims:

1. Arrearage Claim: a traditional partial claim where the servicer calculates and advances the past due amount and files a claim with FHA to recover the arrearage. When received from HUD, the proceeds are applied and passed through to the bondholder in the normal course of remittance.
2. Imminent Default/Payment Supplement Claim: In a simultaneous second transaction, the servicer submits a second claim, determining the amount needed to fund a PSPC advance payment account (similar to a buydown account) to assist with the principal portion of payments due in the future. The servicer submits this second claim to FHA to fund the advance account as a loss mitigation solution under an imminent default claim.[8] When the funds are received, they are retained by the issuer in their Principal and Interest (P&I) custodial account as required by GNMA for payments received in advance of their due date. Upon receipt of the required P&I portion of the payment from the customer, the servicer moves the money to the central P&I custodial account for drafting by GNMA.[9] This process would greatly simplify the liquidity and operational burden compared to multiple partial claim submissions and has the benefit of utilizing existing technology and processes that are already in place for most servicers.

In other words, this arrangement treats the claim dollars for principal payments as scheduled payments made in advance of their due dates, which the issuer would hold in their P&I custodial account for payment to security holders or deposited into the central P&I custodial account when due under the security. Under this arrangement, the funds would not be subject to the traditional requirement that unpaid recovery of principal be remitted to the bondholder within 48 hours, because these funds are directed to be accessed only in conjunction with the borrower-effectuated monthly payments and only in accordance with the scheduled due dates. This arrangement permits the FHA partial claim funds to be used to prevent the imminent default from becoming an actual default.

B) **Partial Claim that is Paid in Full with One Claim:** For FHA loans that are held with private investors, and that are not in Ginnie Mae pools, we request that FHA develop a loss mitigation option that would allow the full partial claim under the PSA to be requested by the servicer up-front (in one claim) versus the monthly claim process described in the Draft ML. If FHA included this option in the final policy, it would not have to issue another ML if the agency were to determine in the future that such an arrangement was permissible for loans in Ginnie Mae pools.

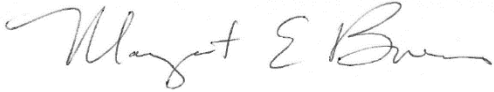
Conclusion

We thank you in advance for consideration of our recommendations and request that the FHA leadership team continue to engage with the industry and other stakeholders as you develop and implement any new loss mitigation programs. We recognize the need for a solution to address the challenging market conditions that are likely to persist for the foreseeable future, with market rates exceeding note rates on mortgages in Ginnie Mae pools. Yet, we also know that executing a new programmatic solution is complicated and ask that FHA communicate with the industry and other stakeholders throughout the process, to assess the impact of various features and options on servicer

[7] Urban Institute, The Payment Supplement Partial Claim Offers a Great Vision But is Operationally Burdensome, by Laurie Goodman and Ted Tozer, on June 21, 2023.
[8] See Attachment 1 for FHA statutory and regulatory text that supports this approach.
[9] See Attachment 1 for Ginnie Mae Guide text that permits this approach.

operations and customer experience. In fact, we recommend that FHA post a revised version of the policy (including model language for the PSPC Borrower Legal Agreement (Rider), Subordinate Mortgage, and Note) to the Drafting Table that incorporates changes from this round of feedback. Should you have any immediate questions regarding this set of recommendations, please do not hesitate to contact us.

Sincerely,



Meg Burns
Executive Vice President
Housing Policy Council

Attachment A

As described in our letter, the FHA statute regarding partial claims and the Ginnie Mae guidance regarding unscheduled recoveries of principal permit the servicer to accept receipt of the full amount needed to supplement the borrowers' payments over the term of the program. Similar to other scheduled mortgage payments, these funds, collected in advance of their due date, would be retained by the issuer in their P&I custodial account for payment to the security holder and/or deposited into the central P&I custodial account during the month in which the payments are required to be passed through to security holders.

FHA Statute:

§ 1715u. Authority to assist mortgagors in default
(a) Loss mitigation . . .
(b) Payment of partial claim (1) Establishment of program The Secretary may establish a program for payment of a partial claim to a mortgagee that agrees to apply the claim amount to payment of a mortgage on a 1- to 4-family residence that is in default or faces imminent default, as defined by the Secretary. (2) Payments and exceptions Any payment of a partial claim under the program established in paragraph (1) to a mortgagee shall be made in the sole discretion of the Secretary and on terms and conditions acceptable to the Secretary, except that— (A) the amount of the payment shall be in an amount determined by the Secretary, not to exceed an amount equivalent to 30 percent of the unpaid principal balance of the mortgage and any costs that are approved by the Secretary; (B) the amount of the partial claim payment shall first be applied to any arrearage on the mortgage, and may also be applied to achieve principal reduction; (C) the mortgagor shall agree to repay the amount of the insurance claim to the Secretary upon terms and conditions acceptable to the Secretary; (D) the Secretary may permit compensation to the mortgagee for lost income on monthly payments, due to a reduction in the interest rate charged on the mortgage; (E) expenses related to the partial claim or modification may not be charged to the borrower; (F) loans may be modified to extend the term of the mortgage to a maximum of 40 years from the date of the modification; and (G) the Secretary may permit incentive payments to the mortgagee, on the borrower's behalf, based on successful performance of a modified mortgage, which shall be used to reduce the amount of principal indebtedness.

Ginnie Mae 5500-3, Rev. 1 Chapter 15: Payments to Security Holders

15-4: BOTH GINNIE MAE I AND II MBS PROGRAMS: COMPUTATION OF PAYMENT OR DEPOSIT

Section B. Scheduled Principal

Generally, scheduled principal payments due on the securities each month are the scheduled amounts of principal due on the pooled mortgages (a) for concurrent date pools, on the first day of the month in which the principal payments on the securities are due, or (b) for internal

reserve Ginnie Mae 5500.3, Rev. 1 15-5 ginniemae.gov Ginnie Mae MBS Guide pools, on the first day of the month preceding the month in which the principal payments on the securities are due.

Scheduled mortgage payments collected in advance of their due dates are to be retained by the issuer in the P&I custodial account for payment to security holders or deposited into the central P&I custodial account, as appropriate, during the month in which the payments are required to be passed through to security holders.

Section C: Unscheduled Recovery of Principal

In addition to the regular monthly scheduled principal payments referred to in paragraph (B), each monthly payment to security holders or deposit to the central P&I custodial account must include all unscheduled recoveries of principal received by the issuer or due through the monthly reporting cut-off date (see Section 17-3) preceding the day on which principal payments on the securities are due.

(1) Unscheduled recoveries of principal are proceeds received in connection with or that become due on the mortgage or the property securing the mortgage, other than scheduled principal and interest payments and miscellaneous collections, defined below. Unscheduled recoveries of principal include, but are not limited to, the following:

(a) curtailments (excluding scheduled payments made in advance of their due dates, which the issuer is to hold in the P&I custodial account and either pay to security holders or deposit in the central P&I custodial account, as appropriate, in connection with the scheduled security payment date);

(b) mortgage or title insurance and mortgage guaranty claim settlement proceeds;

(c) hazard insurance and condemnation proceeds, to the extent not used to repair the collateral;

(d) proceeds from foreclosure or repossession sales and any payments received in lieu of foreclosure or collateral repossession;

(e) any principal amount of a mortgage finally discharged by a bankruptcy court;

(f) proceeds from any disposal or transfer of a pooled mortgage, except for authorized transfers of issuer responsibility or pledges of servicing;

(g) payment from the issuer’s own funds as required in (b) below; and

(h) all other payments or proceeds that reflect the recovery of principal on a mortgage.

The entire amount of any such payment, whether or not actually received by the issuer, will be considered an unscheduled recovery of principal.

(2) Unscheduled recoveries of principal must, as appropriate, be passed through to security holders or deposited into the central P&I custodial account in their entirety, as noted above, so long as funds are due under the security, except as specifically approved in the instructions to the Issuer's Monthly Accounting Report, form HUD 11710-A (Appendix VI-4); advances previously made by the issuer may not be recovered from these funds until the security holders have been paid in full. Any deduction from an unscheduled recovery of principal made by third parties must be replaced by the issuer prior to pass through or deposit.