DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Parts 203 and 206

[Docket No. FR–4032–F–04]

RIN 2502–AG72

Single Family Mortgage Insurance—Loss Mitigation Procedures

AGENCY: Office of the Assistant Secretary for Housing—Federal Housing Commissioner, HUD.

ACTION: Final rule.

SUMMARY: This rule implements as final an interim rule that amends 24 CFR part 203 to eliminate the Mortgage Assignment Program and to provide that HUD may: Recompense mortgagees for using mortgage foreclosure alternatives, such as special forbearance, loan modifications, and deeds in lieu of foreclosure; pay the mortgagee a partial claim which would be applied to the arrearage of a defaulted mortgage; and accept assignment of a mortgage which the mortgagee has modified to cure the default.

EFFECTIVE DATE: February 1, 1998.

FOR FURTHER INFORMATION CONTACT: Joseph McCloskey, Director, Single Family Servicing Division, Room 9178, Department of Housing and Urban Development, 451 7th Street, SW., Washington, DC 20410, (202) 708–1672, or, TTY for hearing and speech impaired, (202) 708–4594. (These are not toll-free numbers.)

SUPPLEMENTARY INFORMATION:

I. Paperwork Reduction Act Statement

This rule's information collection requirements have been submitted for approval to the Office of Management and Budget under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520). An OMB control number, when assigned, will be published in the **Federal Register**. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a valid control number.

II. Background

On July 3, 1996 (61 FR 35014) the Department published an interim rule to implement loss mitigation procedures under section 407 of The Balanced Budget Downpayment Act, I (Pub. L. 104–99, approved January 26, 1996) (Downpayment Act). Public comments on the interim rule were invited for a period of 60 days, until September 3, 1996. Delayed implementation dates of March 1, 1997, were included for provisions in two sections of the interim rule (24 CFR 203.355(a) and 203.402(f)) so that the Department would be able to consider any public comments on these provisions before making them effective in a final rule. The March 1, 1997 implementation date for these sections was suspended until the issuance of a final rule by an amendment published on March 5, 1997 (62 FR 9930). On November 12, 1996, HUD issued Mortgagee Letter 96–61. This letter provides information regarding changes to special forbearance, mortgage modification, pre-foreclosure sales procedures and deeds-in-lieu of foreclosure, and introduces the use of partial claims, measurement of lender performance and provisions for incentive payments and reimbursements. Included as attachments to the mortgagee letter are a checklist of eligibility criteria for each of the loss mitigation procedures and instructions required to file a claim. HUD also issued Mortgagee Letter 97–17, May 1, 1997, regarding loss mitigation clarification of procedures, and Mortgagee Letter 97–21, May 16, 1997, regarding Performance Scores.

III. Changes in the Final Rule

A number of changes from the interim rule are made in this final rule. They are described briefly below in this section, and more fully in section IV. of this preamble, in the discussion of the public comments received on the interim rule.

—The final rule has added a new § 203.341 to explicitly state that mortgage insurance remains in force after payment of a partial claim.

—The titles of §§ 203.342 and 203.616 are changed from ''Recasting of mortgage'' to ''Mortgage modifications.''

—HUD has amended the final rule at § 203.355(a) to clarify that the loss mitigation provisions may be used in combination.

—HUD has rewritten § 203.355(g), (h) and (i) to provide 90 days for the lender to try another loss mitigation tool or to proceed to foreclosure after the failure of any loss mitigation tool.

—The effective dates of the foreclosure timing and cost reimbursement provisions in §§ 203.355 and 203.402, respectively, are changed to February 1, 1998.

—To be consistent with the other paragraphs under § 203.371(b), the reference to ''The mortgage'' in paragraph (b)(1) is changed to read ''the mortgagor''. The reference in paragraph (b)(5) to ''financially able'' is clarified to ''financially qualified'' to reflect more accurately instances in which a mortgagor may have the funds but not the equity to support a modification.

—The words ''accumulated during the forbearance period'' are deleted from § 203.414(a) to more accurately reflect the authorizing statute and avoid a potential technical limit on the amount recoverable under a partial claim.

—Section 203.552 is also clarified to provide that mortgagees may collect fees from mortgagors to the extent not reimbursed by HUD.

IV. Response to Public Comments

Thirteen comments were received in response to the July 3, 1996 interim rule. Four of the comments were from mortgagees; four were from public interest groups; two were from State housing finance agencies; two were from individuals; and one was from an industry association. HUD has reviewed the comments received in response to the interim rule and decided that some changes should be made in the final rule. The following discussion addresses the changes or additions to the rule and the administrative issuances, in response to the public comments received on the Loss Mitigation (''LM'') interim rule. The discussion is organized by the section of the interim rule that is being commented on, with specific subject headings under each rule section, as warranted.

Section 203.342 Recasting of Mortgage

One comment observed the rule does not define, here and in § 203.471, ''circumstances beyond the control.''

Response: Please note the response to this comment in the discussion under § 203.471, below.

Section 203.350 Assignment of Mortgage

Assignment Program Grace Period. Two comments stated a grace period needs to be implemented between the termination of the Assignment Program on April 26, 1996, and the implementation of alternative procedures.

Response: The statute established April 26, 1996 as the ending date for the Assignment Program and provided for processing of applications submitted before that date. HUD continues to process all assignment applications received prior to April 26, 1996.

Assignment of modified mortgage. One comment stated HUD should positively commit to accepting assignment of a mortgage upon fulfillment of the requirements of § 203.350.

Response: The statement that HUD ''may'' accept an assignment in paragraph (a) of this section repeats the statutory language, which establishes the circumstances under which HUD is permitted to accept the assignment of a mortgage. Since HUD has worked with GNMA to change the repooling requirements (*see* Mortgagee Letter 96–32, June 28, 1996) HUD foresees no occasion when a mortgage will not be able to be repooled or when assignment to HUD will be necessary. Nevertheless, the authority to accept assignments in rare and unforeseen circumstances remains available.

Section 203.355 Acquisition of Property

Lender's Final Determination and Needs of Mortgagors. One comment stated that the over-arching flaw of these alternatives is that their use is left entirely to the discretion of lenders. Another comment argued that lenders who hold HUD-insured mortgages have no significant incentives to work with homeowners to avoid foreclosure, and they do not do so. This comment went on to say the regulations fall short in designing a reasonable response to the needs of low-income homeowners for foreclosure prevention and relief.

Response: Under the Loss Mitigation program the lender will have the final determination on the use of LM measures and will have incentives to try to use them where appropriate. Unlike the Assignment Program, none of these LM measures is an entitlement, and thus the lender has more discretion with regard to administering these measures. Lenders must use their judgement in deciding which LM measure is appropriate for a particular mortgagor. The language that the interim rule adds to § 203.501 and Mortgagee Letter 96–61 provides a process through which a borrower's eligibility for loss mitigation is determined. The statute provides that the lender will be given the discretion to decide which LM measures will be used in a particular case.

FHA programs are meant to be self-sustaining, and an essential element of these loss mitigation measures is that they must decrease the insurance funds' prospective losses (or at least not increase the funds' prospective losses). Thus, HUD must balance the needs of mortgagors with the need to mitigate losses to the mortgage insurance funds. These measures are designed for mortgagors who prospectively can recover from their financial difficulties. If the mortgagor has not recovered financially within 18 months, HUD analysis and experience indicate that the prospects for recovery are poor. Two reasons for a cap on the term of forbearance are to limit the level of losses to the insurance fund and to prevent borrowers from getting too deeply into arrears.

Training Lenders and Housing Counseling Agencies in LM Program. One comment noted that without better training programs, manuals, and instructions, coupled with meaningful FHA oversight, the benefits of these alternatives will not be realized by either HUD or homeowners. Another comment strongly recommended that, with HUD implementing these changes, more training be provided to Housing Counselors across the country.

Response: HUD will promote mortgagee participation in LM, and provide training to lenders and monitor their performance. HUD has already provided Loss Mitigation training to some lenders and housing counseling agencies and will provide additional training in the near future.

Shorter Foreclosure Initiation Period. Three comments supported the reduction of the foreclosure initiation period from nine to six months as realistic and consistent with conventional loan servicing procedures. One of these comments was pleased that the implementation of the reduced period was delayed in the interim rule. Three other comments opposed reducing the time frame of foreclosure to six months as too short to allow mortgagors to work out plans with mortgagees and resolve circumstances.

One comment argued the requirement in § 203.355(h) to initiate foreclosure within 90 days of a borrower's failure to meet the terms of a special forbearance agreement is not a sufficient time period, given that mortgagees may not proceed with foreclosure until a borrower's failure has continued for 60 days. Sixty days from the 60-day failure, a total of 120 days, would be more workable. Another comment on this section recommended § 203.355(h) should clarify that foreclosure must be initiated within the time period of paragraph (a)—nine or six months from the date of default—or within 90 (or 120) after the borrower's failure to meet the special forbearance requirements, whichever is later.

Response: HUD considers the six-month period for initiating foreclosure to be adequate. The industry standard is four months. If HUD continues to use a nine-month period, the Department will incur additional expense. Also, the longer foreclosure is delayed, the less likely it is that a mortgage will be cured. The final rule is being amended by adding a new paragraph (i) at § 203.355 to clarify that if a lender enters into a loss mitigation relief measure and it fails, the six-month requirement is extended by an additional ninety days to allow the lender to try another loss mitigation tool or go to foreclosure. It is also to be expected that if after six months no loss mitigation measure is workable, then foreclosure is inevitable.

HUD believes that the ''window'' for initiating foreclosure provides the lender with adequate time in special forbearance cases. The lender determines when LM fails or no other LM tool is applicable. In each instance, the lender must initiate foreclosure within 90 days. There is no need to expand this 90-day deadline in the rule, since the lender is able, in any case where additional time would facilitate mitigating loss, to request an extension from HUD.

Simultaneously Considering LM and Pursuing Foreclosure. The preamble to the interim rule states that HUD will ''generally'' permit mortgagees simultaneously to consider loss mitigation actions and to proceed with foreclosure to meet the new six-month time period. One comment requested HUD to clarify its use of the term ''generally,'' because mortgagees need to understand the specific circumstances under which HUD would find it appropriate and acceptable to stop or delay foreclosure for mortgagors who are actively negotiating or paying under a loss mitigation plan.

Response: The final rule at § 203.355 has clarified that lenders may use loss mitigation tools and take foreclosure action in combination. The prospect of foreclosure is an effective incentive to borrowers in negotiating workouts and the rule is intended to allow flexibility in this interrelationship. As stated in the preamble to the interim rule (at 61 FR 35015, column 2 and 3), HUD believes that early intervention—before six months of delinquent payments—is necessary for effective LM, and the lender may make timely preparations for initiation of foreclosure while pursuing LM actions. In addition, on a case-by-case basis, the lender may request an extension to the 6-month deadline from the field office.

HUD has rewritten § 203.355(g) and (h) to provide 90 days to try another loss mitigation tool or to proceed to foreclosure after the failure of any loss mitigation tool.

Using LM tools in combination. One comment requested that the regulation be explicit in informing lenders and homeowners that the loss mitigation tools may be used singly or in combination. Although the preamble explains that the servicing actions or strategies may be used in combination, § 203.355(a) implies just the opposite by

saying that ''the mortgagee shall take one of the following actions within [nine or] six months of the date of default . . .''

Response: The LM provisions may be used in combination and HUD has amended the final rule at § 203.355(a) accordingly. This is discussed on page 2 of Mortgagee Letter 96–61, where HUD says that the LM strategies ''may be used singly or in combination, as required on a case-by-case basis.'' In accordance with the explicit legislative intent, HUD will defer to the discretion of the lender in applying loss mitigation measures.

Section 203.371 Partial claim

Partial Claim and Special Forbearance. One comment asked if the forbearance agreement at § 203.371(a) must meet the requirements of a ''special'' forbearance agreement.

Response: The forbearance discussed in § 203.371(a) need not be ''special forbearance'' under § 203.471 to qualify for a partial claim.

Special Forbearance Period of 18 Months. One comment argued the planned 18 month limit on special forbearance is an arbitrary period of time and is too short. HUD has put all authority to provide assistance in the hands of the mortgagee. Only if the mortgagee decides to provide special forbearance (which HUD intends to limit to 18 months), and the homeowner is then able to make full mortgage payments, will HUD provide a partial claim to the mortgagee at the end of the special forbearance period.

Response: HUD has determined that an 18-month period for special forbearance is sufficient to allow the mortgagor to recover financially. In addition, this limit is reasonable in view of the statutory limit (amended § 230(a) of the National Housing Act, 12 U.S.C. 1715u(a)) that partial claims may not exceed 12 monthly mortgage payments (PITI) and any costs related to default that are approved by HUD.

Partial Claim Filing. A comment asked if the mortgagee may choose when to file a partial claim under § 203.371(b)(1) after the mandated default period has passed.

Response: Mortgagee Letter 96–61, in the claims instructions for partial claims, specifies the window of time for filing the claim, namely, between the time the subordinate lien to HUD has been executed and 60 days after it has been recorded.

Repooling Modified Loans. One comment stated the rule does not indicate whether GNMA or non-GNMA investors have approved or considered the requirement that to file a partial claim, the mortgagor must not be able to support monthly mortgage payments for a modified loan in which the total arrearage is included. If investors prohibit loan modification under circumstances in which the rule requires such activity, servicers could be caught in the middle. HUD should establish underwriting criteria for eligibility of mortgagors for the proposed loan modification program. Another comment asked if HUD will provide definitive guidelines for making determinations of a borrower's financial capacity under § 203.371(b) (4) and (5) to refinance or support a modified mortgage.

Response: HUD has worked out an understanding with GNMA for revised pooling requirements to assure repooling and minimize this problem. HUD expects that in almost all cases, mortgage modifications can be effected in such a way as to be repoolable, that is, at an interest rate and with a new term (*e.g.*, 360 months) that will meet GNMA pooling requirements. Nevertheless, in the limited circumstances where a modified mortgage cannot be repooled, HUD will establish criteria for accepting a modified mortgage for assignment, and provide guidance in a future Mortgagee Letter.

Servicing the HUD-held Second Mortgage. Three comments recommended the rule should state that a mortgagee is entitled to a fee for servicing when HUD accepts assignment and requires a mortgagee to continue servicing the loan under § 203.371(d). One of these comments argued that given the low balances, a percentage based servicing fee would not be sufficient. Another comment stated the vast majority of mortgagees are not experienced in servicing ''soft seconds,'' the subordinate lien arising from payment of a partial claim, and most computer systems are not programmed to handle such unique debt instruments. This comment recommended that HUD solicit a limited number of servicers to service the subordinate liens on behalf of HUD. On a related issue, one comment recommended that the guidelines should make clear that the subordinate mortgage may call for repayment of the partial claim amount at a future date or at the time of transfer of property or payoff of the insured mortgage. HUD should also specify that subordinate mortgages will be at zero percent interest.

Response: HUD intends to continue to reserve the right to require lenders to service second mortgages executed in connection with partial claims. However, as noted in Mortgagee Letter 96–61, since the subordinate mortgage carries no interest or monthly payments and is due only when the first mortgage is paid in full, foreclosed, or when the borrower no longer occupies the property, HUD has decided to hold and service these mortgages at this time.

Mortgagee Advances—Reimbursement in the settlement of the Partial Claim. One comment asked if a partial claim payment will include mortgagee advances on behalf of the borrower.

Response: Mortgagees will be reimbursed, in accordance with Mortgagee Letter 96–61 instructions for Item 107 in the claims instructions for a Partial Claim. Item 107 provides for reimbursement of the total arrearage that accumulated during the forbearance period, including PITI and necessary advances for assessments, but excluding late fees and foreclosure costs.

Loan Insurance After a Partial Claim. One comment stated the rule should clarify that if a default occurs after payment of a partial claim, the full amount of remaining principal, advances and accrued debenture interest with applicable costs is payable in a subsequent foreclosure and conveyance claim.

Response: After a partial claim, the remaining loan remains insured. The final rule has added a new § 203.341 to explicitly state that mortgage insurance remains in force after payment of a partial claim, as is already done in existing LM actions such as special forbearance and loan modification.

Using the Partial Claim Procedure to Erase Excess of Debt Over Current Market Value. One comment suggested HUD might consider using the partial claim process to pay out insurance coverage on any gap between the loan balance and the market value. This would pay down the debt to a market value, make the lender whole, and allow the mortgage payments to be reduced to a lower amount on the net balance of the remaining rate and term.

Response: FHA mortgages, even when LM is to be considered, are not meant to be ''shared-depreciation mortgages.'' While the Pre-Foreclosure Sale procedure accomplishes something similar to this (although the mortgagor necessarily loses the property), the negative equity position is not an appropriate reason for using the Partial Claims procedure. The mortgagor remains liable for the full amount of the debt even if there is negative equity, just as the mortgagor would benefit if the property were to appreciate in value.

Section 203.402 Items Included in Payment

Tying Reimbursement to LM Success Rates. A number of comments stated they were opposed to the change that would permit HUD to vary the percentage of foreclosure and acquisition expenses through an administrative issuance rather than through the rulemaking process. Setting the reimbursement levels for these costs is important enough to be addressed through a notice and comment rulemaking process rather than administrative issuance. One comment suggested that the rule should specify a level of reimbursement (*e.g.,* up to 100 percent and not less than 50 percent) for foreclosure costs or costs of acquiring the property, rather than state that the percentage reimbursed will be determined by HUD. Another comment argued HUD should not tie the reimbursement of foreclosure fees and costs to loss mitigation performance, because loss mitigation success is influenced by a number of factors, such as the age of the portfolio, geography, and whether the loan was acquired, that are independent of mortgagee efforts. The level of reimbursement should take into consideration the percentage of loss mitigation cures versus the percentage of foreclosures, reinstatements, servicing acquisitions and peer performance. HUD should work with the mortgage industry to develop a fair and equitable performance model. Another comment also questioned the ability to develop a fair and equitable calculation methodology that would accurately measure mortgagee performance without incorporating factors over which mortgagees have little or no control. The comment concluded that even the best of loss mitigators cannot overcome origination and underwriting deficiencies.

Response: In the interim rule, HUD specifically requested public comment and provided for a delayed implementation date to allow for consideration of comments received for both the foreclosure timing and cost reimbursement provisions in §§ 203.355 and 203.402, respectively. With the March 5, 1997 publication of the suspension of these provisions, they will not take effect until a minimum of sixty days after publication of this final rule in the **Federal Register**. The rule satisfies the concerns expressed in relation to reimbursement reductions, since the lowered rate of reimbursement for foreclosure costs at § 203.402(f), will apply only to mortgages endorsed on or after February 1, 1998. Lenders have had an opportunity to comment on this point, and these provisions are not going into effect without the opportunity for prior notice and comment. The other changes to § 203.402 do not constitute reductions.

HUD has undertaken an effort to streamline its rules, and that policy is being followed in this rule. Minimizing the detail put into the rule will give HUD the flexibility to make appropriate amendments in a timely manner in response to the experience of lenders and HUD with LM procedures, and to vary the reimbursement for LM measures according to lender performance. HUD will address the reimbursement of foreclosure costs in future mortgagee letters.

HUD's ranking model was announced in Mortgagee Letter 97–21, May 16, 1997. In developing this model, HUD considered these comments, met with industry representatives, and adopted some of the comments. As a result, HUD believes the model provides a fair basis for ranking lenders.

HUD contends that LM has a significant impact upon losses to FHA insurance funds based on foreclosure avoidance. HUD has and will continue to work with industry to provide equitable performance measurements. HUD is creating an incentive for lenders to intervene early in the default cycle to address delinquencies.

Tying the foreclosure cost reimbursement to lender performance is part of the LM incentive structure. Not only do lenders receive cash incentives for performing LM, but lenders must accept some risk, in the form of absorbing foreclosure costs, for their LM decisions or failure to use LM tools. Mortgagee Letter 97–21, on page 2, provides that lenders in the top 25% of each of the performance groups (high, medium and low volume) will receive 75% reimbursement of foreclosure costs.

HUD believes that LM is a win-win-win proposition for borrowers, lenders and HUD. Borrowers get an opportunity to retain home ownership; lenders can better manage their inventory losses through early default intervention; and HUD can better protect the insurance funds to continue providing affordable housing opportunities.

How Reimbursement for LM Will be Made. One comment stated the rule needs to clarify if HUD will reimburse for loss mitigation efforts in the event a mortgage insurance claim is filed or whether a separate transaction driven claim process is envisioned.

Response: Mortgagee Letter 96–61 and the claims instructions attachments explain how the reimbursement is accomplished. Generally, lenders may submit a claim for each LM tool when it is put in place. Should the loan go to foreclosure despite the lender's LM efforts, the lender may file a claim for the insurance benefits.

Mortgagee Monitoring by HUD. One comment recommended that in reimbursing mortgagees for foreclosure and acquisition costs, and in the payment of partial claims, HUD should closely monitor mortgagees to make sure they are making good faith efforts to bring accounts current before initiating foreclosure on mortgagors.

Response: HUD realizes that mortgagees will need to be monitored on their implementation of LM, and HUD has allocated staff and modified automated procedures to accomplish this. HUD is monitoring lenders' performance and will take necessary enforcement actions to assure compliance with servicing requirements.

Section 203.412 Payment for Foreclosure Alternative Actions

Lender Incentives. One comment stated payment of insurance benefits for loss mitigation activities, if adequate, will provide a near-term benefit that could balance the cost of employing loss mitigation techniques. If HUD wishes to avoid the costs associated with default and foreclosures, it must be willing to pay a reasonable amount to the lender and the borrower.

Response: HUD believes that lenders will have sufficient incentive to employ LM measures. While the reimbursements and incentives provided by HUD may not by themselves be decisive, lenders and servicers are in business to make money holding and servicing loans that perform. To the extent that LM actions result in mortgagors' retention of their homes, mortgagees retain their business. In addition, when a lender conveys a property to HUD, the lender, under the final rule, has to absorb one third or more of the foreclosure costs and forego substantial interest revenue. Thus, if the lender refuses to consider loss mitigation, the lender will certainly lose. Mortgage insurance continues after the LM is undertaken, whether successfully or not. The authorizing statute is explicit in directing HUD to give the mortgagees latitude to exercise their discretion in deciding upon using Loss Mitigation measures. The rule requires mortgagees to review each case monthly and determine which LM tool to utilize.

Fees (including attorney fees) Incurred in LM Actions. One comment suggested that in addition to reimbursement for any title examination

and/or title insurance policy endorsement, mortgagees should be reimbursed for their legal costs incurred in connection with a mortgage modification or recasting.

Response: The claims instructions issued in Mortgagee Letter 96–61 provide for payments to partially offset ''administrative fees'' (Item 129 on the claim) for special forbearance, loan modification, deed in lieu and partial claim to offset the lender's costs and thereby provide an incentive to undertake LM measures. The Department considers these fees adequate. In addition, HUD provides a payment for consideration to mortgagors in pre-foreclosure sale and deed-in-lieu cases.

Section 203.414 Amount of Payment—Partial Claims

Arrearage. Two comments recommended the rule should clarify that arrearage includes principal, interest, late charges, taxes, and other fees (inspection fees, attorney's fees, bankruptcy and foreclosure fees, insufficient check fees, late charges) necessary to bring the loan current.

Response: Mortgagee Letter 96–61 clarified ''mortgage payment'' to consist of PITI. The arrearage includes only PITI; no other costs are eligible for reimbursement under a partial claim, although the lender will also receive a flat administrative fee and will be reimbursed recordation costs.

Section 203.471 Special Forbearance

Circumstances Beyond the Mortgagor's Control. One comment observed HUD has not defined, here and in § 203.342, ''circumstances beyond the control.'' This leaves servicers open to being second-guessed.

Response: HUD does not intend to second-guess lenders who reasonably provide for the use of LM tools. HUD defined ''circumstances'' in an objective manner in Mortgagee Letter 96–61 to address a broad audience of homeowners. The Letter indicates that ''Homeowners may be considered for special forbearance provided they have recently experienced (1) an involuntary reduction in income or an increase in living expenses and (2) the lender determines the borrower has a reasonable ability to pay under the terms of the forbearance plan to eliminate the arrearage.''

Non-hardship Forbearance. One comment claimed the concept of penalizing the lender by not reimbursing those forbearance delinquencies which are not caused by hardship will stifle the incentive of the lenders to forbear.

Response: HUD's loss mitigation program does not have a ''hardship'' test. As noted immediately above, FHA has broadened the basis for when special forbearance and mortgage modification may be considered as available loss mitigation tools. The lender must now confirm that the homeowner has experienced a loss of income or an increase of expenses to qualify for special forbearance.

Section 203.552 Fees and Charges after Endorsement

Elimination of Regulatory Control of Post-endorsement Fees and Charges. One comment stated HUD needs to be moving towards eliminating regulatory control over post endorsement fees and charges.

Response: The setting of post endorsement fees and charges by the Department provides consistency where needed and allows regional differences where HUD deems appropriate. Releasing or withdrawing any oversight in setting those fees would lead to far more disparate treatment of mortgagors than is done currently.

Section 203.605 Loss Mitigation Evaluation

When the Mortgagor Does Not Qualify or is Uncooperative. One comment recommended no further evaluations should be necessary once a determination is made that the mortgagor does not qualify or is uncooperative. Another comment requested that to help assure that lenders are not at risk for allegations of fair lending violations, HUD should establish specific standards for actions that mortgagees should take to determine a defaulted borrower's eligibility for loss mitigation measures. Such standards would address the issue of borrowers whose circumstances would qualify them for loss mitigation, but who do not seek out the mortgagee for such assistance.

Response: Mortgagee Letter 96–61 and the checklists in Attachment A to the Letter describe the qualifications for LM and also state that LM should be used where ''appropriate.'' After review and consideration of all LM tools and all the facts of the case, the lender can decide to decline to grant LM to an uncooperative mortgagor in accordance with this general principle of appropriateness.

Under the pre-foreclosure sale (PFS) procedure, the mortgagor's good-faith efforts are required and monitored. Besides PFS, the cooperativeness of the mortgagor would be relevant to special forbearance, partial claim and loan modification. Mortgagee Letter 96–61 requires that, in these cases, the mortgagor should have ''a commitment to remain in'' the home (see checklists in Attachment A). The cooperative participation of the borrower is implicit in this criterion.

Loss mitigation does not add new requirements related to Fair Housing. HUD expects lenders will comply fully with existing fair lending laws and will continue to ensure compliance with those laws. The object of LM is to avoid foreclosure, and lenders must justify use or non-use of all LM tools and reevaluate monthly. In this respect, lenders are directed to HUD's Mortgagee Letter 96–61, page 3, and § 203.605 of this final rule.

Section 203.606 Pre-Foreclosure Review

Notice to the Mortgagor of the Consequences of Default. One comment stated that although the rule states the required notification to the mortgagor of default and the mortgagee's intent to foreclose will be in ''a format prescribed by the Secretary,'' the industry would welcome the opportunity to comment on the content of the notice. The notice should be firm in explaining the consequences of inaction, while also being informative and consumer-friendly to encourage communication with the mortgagee.

Response: HUD will seek comments relative to possible modifications of mortgagor notification required by § 203.606.

Use of HUD-approved Housing Counseling Agencies. One comment suggested that the use of Housing Counseling Agencies should be a part of all mortgagee letters to mortgagors when requesting payments and/or information. Another comment stated that HUD should strongly recommend that mortgagees provide donations to counseling agencies in their communities.

Response: Regarding the use of housing counseling agencies, HUD's current practice, in accordance with the requirements of § 203.602, is that the lender must send the mortgagor a delinquency notice (currently in the form of the ''Avoiding foreclosure'' pamphlet) during the second month of delinquency (see Handbook 4330.1 REV–5, Par. 7–7G and Appendix 19). This notice includes a recommendation to contact a HUD-approved housing counseling agency.

Some lenders already sponsor or form partnerships with counseling agencies. However, it would be inappropriate for HUD to recommend that mortgagees make donations to counseling agencies.

Section 203.616 Recasting of Mortgage

Time for lenders to implement the recasting requirement. One comment noted that mortgagees generally do not have established procedures and documents for modifications and recasting of insured loans. Mortgagees will have to establish such procedures after reviewing detailed underwriting standards yet to be set by HUD. March 1, 1997, is too soon to implement the recasting requirement.

Response: HUD believes that with the issuance of Mortgagee Letter 96–61, November 12, 1996, and Mortgagee Letter 97–17, May 1, 1997, the lenders have sufficient time to gear up for this procedure.

Scope of recasting. One comment noted the regulation is currently written as if recasting the unpaid amount due over the remaining term of the mortgage is the only option available. Language should be added to allow specifically for modification such as an interest rate reduction, or conversion from an ARM to a fixed rate mortgage. In addition, the comment recommended the heading for this section should read: *Modifying/Recasting of mortgage.*

Response: HUD acknowledges the potential ambiguity of the rule language pointed out by this comment and has clarified the rule to indicate that adjustments to both term and interest rate are permitted. There is no prohibition of reduction of interest rate or conversion from ARM to fixed. In addition, HUD is changing the titles of §§ 203.342 and 203.616 to ''Mortgage Modifications.''

Recasting Current Loans and Fair-lending Complaints. HUD should reconsider whether to provide for recasting of a current loan, because of the small population of loans that would be served by this provision, which may, nonetheless, give rise to complaints based on fair housing or other grounds.

Response: The LM tools represent a spectrum of foreclosure-avoidance techniques, not all of which can be applied to particular buyers, but which as a whole represent substantial opportunities for FHA borrowers to maintain home ownership. As stated in the response under § 203.605, above, loss mitigation does not add new requirements related to Fair Housing; HUD expects lenders will comply fully with existing fair lending laws and will continue to ensure compliance with those laws.

V. Findings and Certifications

Environmental Impact

At the time of publication of the interim rule, a Finding of No Significant Impact with respect to the environment was made in accordance with HUD regulations in 24 CFR part 50 that implement section 102(2)(C) of the National Environmental Policy Act of 1969 (42 U.S.C. 4332). The interim rule is adopted by this final rule without significant change. Accordingly, the initial Finding of No Significant Impact remains applicable, and is available for public inspection between 7:30 a.m. and 5:30 p.m. weekdays in the office of the Rules Docket Clerk at the above address.

Congressional Review of Major Final Rules

This rule is a ''major rule'' as defined in the Administrative Procedure Act (5 U.S.C. 804(2)), and will be submitted to the Congress for review in accordance with the statutory procedure.

Regulatory Flexibility Act

The Secretary, in accordance with provisions of the Regulatory Flexibility Act (5 U.S.C. 605(b)), has reviewed this rule before publication and by approving it certifies that it will not have a significant economic impact on a substantial number of small entities. Most of the economic impact of the rule will affect the Department, which stands to benefit from the successful implementation of the loss mitigation techniques addressed by the rule.

Executive Order 12612, Federalism

HUD has determined, in accordance with Executive Order 12612, *Federalism*, that this rule will not have a substantial, direct effect on the States or on the relationship between the Federal government and the States, or on the distribution of power or responsibilities among the various levels of government, since the rule involves primarily relationships between the Department and private entities.

Executive Order 13045, Protection of Children from Environmental Health Risks and Safety Risks

This rule will not pose an environmental health risk or safety risk on children.

The Catalog of Federal Domestic Assistance Number for Single Family HOME Insurance is 14.117.

List of Subjects

24 CFR Part 203

Hawaiian Natives, Home improvement, Indians—lands, Loan programs—housing and community development, Mortgage insurance, Reporting and recordkeeping requirements, Solar energy.

24 CFR Part 206

Aged, Condominiums, Loan programs—housing and community development, Mortgage insurance, Reporting and recordkeeping requirements.

Accordingly, for the reasons stated in the preamble, parts 203 and 206 of title 24 of the Code of Federal Regulations are amended by adopting the interim rule published in the **Federal Register** on July 3, 1996 (61 FR 35014) as final with the following changes:

PART 203—SINGLE FAMILY MORTGAGE INSURANCE

1. The authority citation for part 203 continues to read as follows:

Authority: 12 U.S.C. 1709, 1710, 1715b, and 1715u; 42 U.S.C. 3535(d).

2. A new § 203.341 is added to read as follows:

§ 203.341 Partial claim.

If the conditions of § 203.371 are met and a partial claim is paid pursuant to that section, the contract of insurance shall continue in force, except as otherwise provided in this subpart.

3. Section 203.342 is revised to read as follows:

§ 203.342 Mortgage modification.

If a mortgage is recast pursuant to § 203.616, the principal amount of the mortgage, as modified, shall be considered to be the ''original principal balance of the mortgage'' as that term is used in § 203.401.

4. In § 203.355, paragraphs (a), (c), (g) introductory text, and (h) are revised and a new paragraph (i) is added to read as follows:

§ 203.355 Acquisition of property.

(a) *In general.* Upon default of a mortgage, except as provided in paragraphs (b) through (i) of this section, the mortgagee shall take one of the following actions within nine months from the date of default, or within any additional time approved by the Secretary or authorized by §§ 203.345 or 203.346. For mortgages where the date of default is on or after February 1, 1998, the mortgagee shall take one or a combination of the following actions within six months of the date of default or within such additional time approved by HUD or authorized by §§ 203.345 or 203.346:

(1) Obtain a deed-in-lieu of foreclosure (see §§ 203.357, 203.389 and

203.402(f) of this part) with title being taken in the name of the mortgagee or the Secretary;

(2) Commence foreclosure;

(3) Enter into a special forbearance agreement under § 203.614;

(4) Complete a modification of the mortgage under § 203.616;

(5) Complete a refinance of the mortgage under § 203.43(c);

(6) Complete an assumption under § 203.512;

(7) File a partial claim under § 203.371; or

(8) Initiate a pre-foreclosure sale under § 203.370.

* * * * *

(c) *Prohibition of foreclosure within time limits.* If the laws of the State in which the mortgaged property is located, or Federal bankruptcy law:

(1) Do not permit the commencement of foreclosure within the time limits described in paragraphs (a), (b), (g), (h) and (i) of this section, the mortgagee must commence foreclosure within 90 days after the expiration of the time during which foreclosure is prohibited; or

(2) Require the prosecution of a foreclosure to be discontinued, the mortgagee must recommence the foreclosure within 90 days after the expiration of the time during which foreclosure is prohibited.

* * * * *

(g) *Pre-foreclosure sale procedure.* Within 90 days of the end of a mortgagor's participation in the pre-foreclosure sale procedure, *or* within the time limit described in paragraph (a) of this section, whichever is later, if no closing of an approved pre-foreclosure sale has occurred, the mortgagee must obtain a deed in lieu of foreclosure, with title being taken in the name of the mortgagee or the Secretary, or undertake one of the actions listed at § 203.355(a). The end-of-participation date is defined as:

* * * * *

(h) *Special forbearance.* If the mortgagor fails to meet the requirements of a special forbearance under § 203.614 and the failure continues for 60 days, the mortgagee must undertake one of the actions listed at § 203.355(a) within the time limit described in paragraph (a) of this section or 90 days after the mortgagor's failure to meet the special forbearance requirements, whichever is later.

(i) *Modification under § 203.616, refinance under § 203.43(c), or assumption under § 203.512.* Provided that the mortgagee has established the mortgagor's eligibility within the time frame provided in § 203.355(a), if a mortgagee enters into a loss mitigation relief measure (*i.e.*, modification under § 203.616, refinance under § 203.43(c), or assumption under § 203.512) and it fails, the six-month period provided in § 203.355(a) is extended by an additional 90 days to allow the mortgagee to try another loss mitigation tool or go to foreclosure.

5. In § 203.371, paragraphs (b)(1) and (b)(5) are revised to read as follows:

§ 203.371 Partial claim.

* * * * *

(b) * * *

(1) The mortgagor has been delinquent for at least 4 months or such other time prescribed by HUD;

* * * * *

(5) The mortgagor is not financially qualified to support monthly mortgage payments on a modified mortgage or on a refinanced mortgage in which the total arrearage is included.

* * * * *

6. In § 203.402, paragraph (f) is revised to read as follows:

§ 203.402 Items included in payment—conveyed and non-conveyed properties.

* * * * *

(f) Foreclosure costs or costs of acquiring the property otherwise (including costs of acquiring the property by the mortgagee and of conveying and evidencing title to the property to HUD, but not including any costs borne by the mortgagee to correct title defects) actually paid by the mortgagee and approved by HUD, in an amount not in excess of two-thirds of such costs or $75, whichever is the greater. For mortgages insured on or after February 1, 1998, the Secretary will reimburse a percentage of foreclosure costs or costs of acquiring the property, which percentage shall be determined in accordance with such conditions as the Secretary shall prescribe. Where the foreclosure involves a mortgage sold by the Secretary on or after August 1, 1969, or a mortgage executed in connection with the sale of property by the Secretary on or after such date, the mortgagee shall be reimbursed (in addition to the amount determined under the foregoing) for any extra costs incurred in the foreclosure as a result of a defect in the mortgage instrument, or a defect in the mortgage transaction or a defect in title which existed at or prior to the time the mortgage (or its assignment by the Secretary) was filed for record, if the mortgagee establishes to the satisfaction of the Commissioner that such extra costs are over and above those customarily incurred in the area.

* * * * *

7. In § 203.414, paragraph (a) is revised to read as follows:

§ 203.414 Amount of payment—partial claims.

(a) *Claim Amount.* Where a claim for partial insurance benefits is filed in accordance with § 203.371, the amount of the insurance benefits shall consist of the arrearage not to exceed an amount equivalent to 12 monthly mortgage payments, and any costs prescribed by HUD related to the default.

* * * * *

8. In § 203.552, paragraph (a) introductory text is revised to read as follows:

§ 203.552 Fees and charges after endorsement.

(a) The mortgagee may collect reasonable and customary fees and charges from the mortgagor after insurance endorsement only as provided below. The mortgagee may collect these fees or charges from the mortgagor only to the extent that the mortgagee is not reimbursed for such fees by HUD.

* * * * *

9. Section 203.616 is revised to read as follows:

§ 203.616 Mortgage modification.

The mortgagee may modify a mortgage for the purpose of changing the amortization provisions by recasting the total unpaid amount due for a term not exceeding 360 months. The mortgagee must notify HUD of such modification in a format prescribed by HUD within 30 days of the execution of the modification agreement.

Dated: September 16, 1997.

Stephanie A. Smith,

General Deputy Assistant Secretary for Housing, Federal Housing Commissioner.

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