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Due to the significant volume of questions we have been receiving recently regarding borrower requests for loan modifications to take advantage of historically low mortgage interest rates, we have put together the following resource we hope will be helpful.

However, we do so with the following caveats:

- Most importantly, official guidance has not yet been released by the regulatory agencies specifically on-point. Therefore, this is our collective interpretation of existing regulatory provisions and corresponding guidance.

- This guidance is meant to be inclusive of the major regulatory considerations but, may not exhaustive. You may find you have additional, more specific questions. Please direct these questions to our AnswerPerson service at: answerperson@mandm.consulting.

- Unfortunately, as it is outside the realm of our consumer compliance expertise, we are not able to review and provide opinions regarding either drafted templates for modification agreements/promissory notes or the rights and liabilities within existing promissory notes/agreements. These are contracts subject to state contract law and, as a result, are best reviewed by the Bank/Credit Union's legal counsel.

TRID (Reg Z & Reg X) Considerations

Loan Modification vs. Refinance

Unfortunately, up to this point, loan modifications have only been specifically addressed within Reg X (RESPA) as they relate to loss mitigation measures for non-performing loans. However, as Banks/Credit Unions seek to remain competitive and convenient for their customers/members, loan modifications have taken on a life of their own making them ripe for Regulator feedback.

Many questions surround whether TRID disclosures are required for loan modifications. To determine TRID applicability, you need to clarify whether the transaction in-question rises to the level of "refinance" for the purposes of disclosure requirements regarding post-consummation events as outlined within § 1026.20(a) of Reg Z:

> ***(a) Refinancings.*** *A refinancing occurs when an existing obligation that was subject to this subpart is satisfied and replaced by a new obligation undertaken by the same consumer. A refinancing is a new transaction requiring new disclosures to the consumer. The new finance charge shall include any unearned portion of the old finance charge that is not credited to the existing obligation. The following shall not be treated as a refinancing:*
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> > ***(1)*** *A renewal of a single payment obligation with no change in the original terms.*
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> > ***(2)*** *A reduction in the annual percentage rate with a corresponding change in the payment schedule.*
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> > ***(3)*** *An agreement involving a court proceeding.*
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> > ***(4)*** *A change in the payment schedule or a change in collateral requirements as a result of the consumer's default or delinquency, unless the rate is increased, or the new amount financed exceeds the unpaid balance plus earned finance charge and premiums for continuation of insurance of the types described in § 1026.4(d).*
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> > ***(5)*** *The renewal of optional insurance purchased by the consumer and added to an existing transaction, if disclosures relating to the initial purchase were provided as required by this subpart.*

Comment 20(a)-1 of the Official Interpretation goes on to clarify:

> *1.* ***Definition.*** *A refinancing is a new transaction requiring a complete new set of disclosures. Whether a refinancing has occurred is determined by reference to whether the original obligation has been satisfied or extinguished and replaced by a new obligation, based on the parties' contract and applicable law. The refinancing may involve the consolidation of several existing obligations, disbursement of new money to the consumer or on the consumer's behalf, or the rescheduling of payments under an existing obligation. In any form, the new obligation must completely replace the prior one.*
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>> *i. Changes in the terms of an existing obligation, such as the deferral of individual installments, will not constitute a refinancing unless accomplished by the cancellation of that obligation and the substitution of a new obligation.*
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>> *ii. A substitution of agreements that meets the refinancing definition will require new disclosures, even if the substitution does not substantially alter the prior credit terms.*
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> *2.* ***Exceptions.*** *A transaction is subject to § 1026.20(a) only if it meets the general definition of a refinancing. Section 1026.20(a)(1) through (5) lists 5 events that are not treated as refinancing, even if they are accomplished by cancellation of the old obligation and substitution of a new one.*
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> *3.* ***Variable-rate.*** *i. If a variable-rate feature was properly disclosed under the regulation, a rate change in accord with those disclosures is not a refinancing. For example, no new disclosures are required when the variable-rate feature is invoked on a renewable balloon-payment mortgage that was previously disclosed as a variable-rate transaction.*
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>> *ii. Even if it is not accomplished by the cancellation of the old obligation and substitution of a new one, a new transaction subject to new disclosures results if the creditor either:*
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>>> *A. Increases the rate based on a variable-rate feature that was not previously disclosed; or*
>>>
>>> *B. Adds a variable-rate feature to the obligation. A creditor does not add a variable-rate feature by changing the index of a variable-rate transaction to a comparable index, whether the change replaces the existing index or substitutes an index for one that no longer exists.*
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>> *iii. If either of the events in paragraph 20(a)-3.ii.A or ii.B occurs in a transaction secured by a principal dwelling with a term longer than one year, the disclosures required under § 1026.19(b) also must be given at that time.*
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> *4.* ***Unearned finance charge.*** *In a transaction involving precomputed finance charges, the creditor must include in the finance charge on the refinanced obligation any unearned portion of the original finance charge that is not rebated to the consumer or credited against the underlying obligation. For example, in a transaction with an add-on finance charge, a creditor advances new money to a consumer in a fashion that extinguishes the original obligation and replaces it with a new one. The creditor neither refunds the unearned finance charge on the original obligation to the consumer nor credits it to the remaining balance on the old obligation. Under these circumstances, the unearned finance charge must be included in the finance charge on the new obligation and reflected in the annual percentage rate disclosed on refinancing. Accrued but unpaid finance charges are included in the amount financed in the new obligation.*
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> *5.* ***Coverage.*** *Section 1026.20(a) applies only to refinancing undertaken by the original creditor or a holder or servicer of the original obligation. A "refinancing" by any other person is a new transaction under the regulation, not a refinancing under this section.*

Fair Credit Reporting Act (Reg V) Considerations

If, in evaluating these requests for loan modifications, your Bank/Credit Union is requiring a fresh credit pull, you will want to ensure that you consider FCRA's "permissible purpose" requirement and notice formalities. Relevant sections of 15 U.S.C. §1681b(a) of FCRA set forth the following guidelines for what constitutes a "permissible purpose" such that a financial institution is justified in obtaining and evaluating a consumer's credit report in a loan transaction:

> *…any consumer reporting agency may furnish a consumer report under the following circumstances and no other:*
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> *(1) In response to the order of a court having jurisdiction to issue such an order, or a subpoena issued in connection with proceedings before a Federal grand jury.*
>
> *(2) In accordance with the written instructions of the consumer to whom it relates.*
>
> *(3) To a person which it has reason to believe—*
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> > *(A)intends to use the information in connection with a credit transaction involving the consumer on whom the information is to be furnished and involving the extension of credit to, or review or collection of an account of, the consumer…*

While FCRA's "permissible purpose" standard is commonly considered fairly flexible, from an auditability standpoint, it is important that a loan file be strengthened with supporting documentation that confirms the Bank/Credit Union had an adequate foundation upon which to order and analyze a new consumer report. What this means in terms of practical application to the more informal loan modification process is: the Bank/Credit Union should ensure that it obtains written confirmation of the borrower's request to seek the modification and archive that documentation to the loan file.

Additionally, relevant excerpts of § 1002.9(a) of the codified Reg V outlines the instances in which notification to a borrower is required as follows:

> *(a) Notification of action taken, ECOA notice, and statement of specific reasons —*
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> > *(1) When notification is required. A creditor shall notify an applicant of action taken within:*
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> > > *(i) 30 days after receiving a completed application concerning the creditor's approval of, counteroffer to, or adverse action on the application;*
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> > > *(ii) 30 days after taking adverse action on an incomplete application, unless notice is provided in accordance with paragraph (c) of this section;*
> > >
> > > *(iii) 30 days after taking adverse action on an existing account; or*
> > >
> > > *(iv) 90 days after notifying the applicant of a counteroffer if the applicant does not expressly accept or use the credit offered.*
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> > *(2) Content of notification when adverse action is taken. A notification given to an applicant when adverse action is taken shall be in writing and shall contain a statement of the action taken; the name and address of the creditor; a statement of the provisions of section 701(a) of the Act; the name and address of the Federal agency that administers compliance with respect to the creditor; and either:*
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> > > *(i) A statement of specific reasons for the action taken; or*
> > >
> > > *(ii) A disclosure of the applicant's right to a statement of specific reasons within 30 days, if the statement is requested within 60 days of the creditor's notification. The disclosure shall include the name, address, and telephone number of the person or office from which the statement of reasons can be obtained. If the creditor chooses to provide the reasons*

orally, the creditor shall also disclose the applicant's right to have them confirmed in writing within 30 days of receiving the applicant's written request for confirmation.

Home Mortgage Disclosure Act (Reg C) Considerations

To answer the question whether loan modifications are HMDA-reportable, the Preamble of the 2015 Final Rule states the following:

> *While there is a need for publicly available data about loan modifications, the Final Rule does not require reporting of loan modifications. Covering all loan modifications would be a complex undertaking and would constitute a major revision of Regulation C.*

Flood Considerations

What's most important to consider with regards to Flood is whether a transaction triggers the requirement to obtain a flood determination and, if a determination on a subject property has previously been obtained, whether it can still be relied on. Interagency Flood Regulation specifies that the following transactions trigger the need for obtaining a flood determination:

> *An institution shall not make, increase, extend, or renew any designated loan unless the building or mobile home and any personal property securing the loan is covered by flood insurance for the term of the loan.*

Thus far, regulatory guidance has confirmed that loan modifications are to be considered triggering events commensurate with these provisions.

With regards to relying on a prior determination, Interagency Flood Regulation specifies the following:

> *An institution may rely on a prior flood determination, whether or not the security property is located in an SFHA, and it is exempt from liability for errors in the previous determination if:*
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> - *The previous determination is not more than seven years old, and*
> - *The basis for the previous determination was recorded on the SFHDF.*
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> *There are, however, some circumstances in which an institution may not rely on a previous determination, such as:*
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> - *If FEMA's map revisions or updates show that the security property has been remapped into an SFHA, or*
> - *If the lender contacts FEMA and discovers that map revisions or updates affecting the security property have been made after the date of the previous determination.*
>
> *An institution may also rely on a previous determination, which is not more than seven years old and is set forth on an SFHDF, when it increases, extends, renews, or purchases a loan. The making of a loan is not listed as a permissible event that permits an institution to rely on a previous determination. However, when the loan involves a refinancing or assumption by the same lender who obtained the original flood determination on the same property, the institution may rely on the previous determination, but only if the original determination was made not more than seven years before the date of the transaction, the basis for the determination was set forth on the SFHDF, and there were no map revisions affecting the property since the original determination was made. The same is true for multiple loans made by the same lender to the same borrower secured by the same property. A new determination is required when a loan refinancing or assumption is made by a lender different from the one who obtained the original determination because this constitutes a new loan.*

Lastly, if it is required that a new determination be obtained and the property is now within a Flood zone, the Bank/Credit Union is still subject to Flood notice requirements and a notice would have to be provided the borrower when they apply for the modification or within a "reasonable" amount of time before the completion of the modification. "Reasonable" is not defined by a set number of days but rather a subjective good faith standard.

Fair Lending/UDAAP Considerations

From a Reg B (ECOA) perspective, it is important to consider whether declining a borrower's request to modify an existing loan constitutes an "adverse action" for the purposes of Reg B's notice requirements. Within both the CFPB's *ECOA Examination Procedures* and the FRB's *Consumer Affairs Letter 09-13* it is specified that a borrower's request for a loan modification should be considered an application and would be subject to formal notifications unless the request takes place while the borrower's loan is in default.

See *ECOA Examination Procedures*, Page 2:

> *Because the ECOA and Regulation B prohibit discrimination in any aspect of a credit transaction, a creditor violates the statute and regulation when discriminating against borrowers on a prohibited basis in approving or denying loan modifications. Moreover, as the definition of credit includes the right granted by a creditor to an applicant to defer payment of a debt, a loan modification is itself an extension of credit and subject to ECOA and Regulation B. Examples of loan modifications that are extensions of credit include, but are not limited to, the right to defer payment of a debt by capitalizing accrued interest and certain escrow advances, reducing the interest rate, extending the loan term, and/or providing for principal forbearance.*

See also *Consumer Affairs Letter 09-13*, Q&A #2 and #3:

> ***2. Is there an "application"?*** *If there is or may be an extension of credit, the next step is to determine whether there is an application. Whether a borrower's request for a mortgage loan modification is an "application" for an extension of credit depends on the creditor's application process. Under Regulation B, an "application" means "an oral or written request for an extension of credit that is made in accordance with procedures used by a creditor for the type of credit requested." The Official Staff Commentary clarifies that "[a] creditor has the latitude under the regulation to establish its own application process and to decide the type and amount of information it will require from credit applicants."*
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> *For example, we understand that Treasury's HAMP guidelines state that a mortgage loan has been evaluated for HAMP when, among other things, a borrower has submitted a written request for consideration for a HAMP modification that includes borrower income and a reason for default or hardship, or a borrower has verbally provided sufficient information to allow the servicer to complete a Net Present Value analysis. Thus, if a borrower has submitted sufficient information for the mortgage loan to be evaluated under HAMP guidelines, then the borrower has submitted an "application" for an extension of credit.*
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> ***3. Is there an "adverse action" on the application?*** *Under Regulation B, an "adverse action" includes "a refusal to grant credit in substantially the amount or on substantially the terms requested in an application." To determine when an inquiry becomes an "application" subject to the adverse action requirements, the Official Staff Commentary states that if the creditor "evaluates information about the consumer, decides to decline the request, and communicates this to the consumer, the creditor has treated the inquiry...as an application and must then comply with the [adverse action] notification requirements under section 202.9." For example, if a HAMP servicer evaluates a borrower's information according to HAMP guidelines, declines the request, and communicates the decision to the borrower, then the servicer has taken adverse action on an application and must comply with Regulation B's adverse action notice requirements.*

It is also important to note the overall Fair Lending and UDAAP scrutiny that loan modifications can face from Regulators. To this end, the Bank/Credit Union should ensure that it is offering modifications fairly – meaning, the opportunity to be considered for a loan modification should be available to all borrowers, the conditions set forth for

considering whether a modification will be approved should be adequately disclosed and applied fairly, and the modified terms being offered should be equally favorable to all borrowers.

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