

**DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT****24 CFR Parts 30 and 203**

[Docket No. FR-4553-P-02]

RIN 2501-AC66

**Treble Damages for Failure To Engage in Loss Mitigation**

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

**ACTION:** Proposed rule.

**SUMMARY:** This proposed rule amends HUD's civil money penalty regulations to reflect HUD's authorization to impose treble damages on a mortgagee for any mortgage for which the mortgagee had a duty but failed to engage in appropriate loss mitigation actions. The proposed rule follows publication of an advanced notice of proposed rulemaking (ANPR) and takes into consideration public comments received on the ANPR.

**ADDRESSES:** Interested persons are invited to submit comments regarding this rule to the Rules Docket Clerk, Regulations Division, Office of General Counsel, Room 10276, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410-0500. Communications should refer to the above docket number and title. Facsimile (FAX) comments are not acceptable. A copy of each communication submitted will be available for public inspection and copying between 8 a.m. and 5 p.m. weekdays at the above address.

**DATES:** *Comment Due Date:* June 14, 2004.

**FOR FURTHER INFORMATION CONTACT:** Michael Reyes, Office of the Deputy Assistant Secretary for Single Family Housing, Office of Housing, Department of Housing and Urban Development, 301 NW Sixth Street, Oklahoma City, OK 73102-2807, telephone (405) 609-8475 (this is not a toll-free number). Hearing-or speech-impaired individuals may access this number through TTY by calling the toll-free Federal Information Relay Service at 1-800-877-8339.

**SUPPLEMENTARY INFORMATION:****I. Background**

Sections 601(f), (g), and (h) of the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1999 (Pub. L. 105-276, approved October 21, 1998) amended sections 230, 536(a), and 536(b)(1) of the National Housing Act (NHA) (12 U.S.C. 1715u, 12 U.S.C. 1735f-14(a)(2), and 12

U.S.C. 1735f-14(b)(1), respectively) to add a triple penalty to the existing civil money penalty system for failure to engage in appropriate loss mitigation. Section 230(a) of Title II of the NHA, as amended, makes it mandatory for the mortgagee, upon the default of a single family mortgage, to engage in loss mitigation actions (including, but not limited to, special forbearance, loan modification, and deeds in lieu of foreclosure) for the purpose of providing alternatives to foreclosure. Section 601(h) amends section 536(b) of the NHA to authorize but not require HUD to impose a civil money penalty on mortgagees that fail to engage in loss mitigation activities, as required in section 230(a) of the NHA. Section 601(g) amends section 536(a) of the NHA to provide that the penalty shall be equal to three times the amount of any insurance benefits claimed by a mortgagee with respect to any mortgage for which the mortgagee had a duty to engage in loss mitigation and failed to do so.

On December 6, 2000 (65 FR 76520), HUD published in the **Federal Register** an advance notice of proposed rulemaking (ANPR) that advised the public of HUD's plan to issue a proposed rule to amend HUD's civil money penalties regulations to assess treble damages for a mortgagee that had a duty to engage in loss mitigation and failed to do so. HUD's ANPR also solicited comments on the use of a tier ranking system (TRS) that analyzes a mortgagee's loss mitigation efforts on a portfolio-wide basis, and ranks the mortgagee on performance ratios of loss mitigation actions to real estate owned (REO). The TRS, proposed through this rule, is based on a system that HUD implemented through notice as a pilot.

HUD's TRS consists of four tiers (Tiers 1, 2, 3 and 4) and is designed to measure a mortgagee's loss mitigation performance. While any mortgagee that has duty to engage in loss mitigation and fails to do so is subject to treble damages, this rule provides appropriate notification that HUD will focus on Tier 4 mortgagees. Information available to HUD indicates that Tier 4 mortgagees engage in little or no loss mitigation. The public will be apprised of any change to HUD's focus through **Federal Register** notice. In addition, for any mortgagee, regardless of ranking or absence of ranking, HUD is not prevented from pursuing HUD penalties or sanctions.

Failure to engage in loss mitigation is defined as a servicing lender's failure to evaluate a loan for loss mitigation before four full monthly mortgage installments are due and unpaid to determine which,

if any, loss mitigation techniques are appropriate (see 24 CFR 203.605), or subsequent failure to take appropriate loss mitigation action(s). Offering plausible loss mitigation options (as defined in 24 CFR 203.501) to qualified borrowers is engaging in loss mitigation. Mortgagees must be able to provide documentation of their loss mitigation evaluations and actions. Should a claim for mortgage insurance benefits later be filed, this documentation must be maintained in the claim review file in accordance with 24 CFR 203.365(c). Failure to successfully engage in loss mitigation with a borrower that is uncooperative or otherwise ineligible is not considered "failure to engage" in loss mitigation for that mortgage.

**II. This Proposed Rule***A. Proposed Amendments*

Consistent with HUD's proposal as expressed in the ANPR, this proposed rule would add a triple penalty to the existing penalty system for failure to engage in loss mitigation. The proposed rule would also describe the process for assessing the treble damages when a mortgagee fails to engage in loss mitigation activities with cooperative and qualified mortgagors. The proposed rule would amend 24 CFR parts 30 and 203 to set out the maximum penalty amounts for those servicing mortgagees who fail to engage in loss mitigation. Mortgagees who fail to engage in loss mitigation may be subject to penalties of three times the amount of any mortgage insurance benefits claimed by the mortgagee.

In part 30, HUD proposes to revise § 30.35 to set out the maximum penalty amounts for failing to engage in loss mitigation. Additionally, HUD proposes to amend the existing language and add paragraph (l) of § 30.80 to establish that, with regard to treble damages, the factors listed in paragraphs (a) through (k) may only be considered in assessing the appropriateness of the sanction, because the statute provides no flexibility with regard to the amount of the penalty. Attention will be given to whether circumstances beyond the control of the mortgagee made loss mitigation impossible (e.g., natural disaster) or whether the mortgagee took affirmative steps prior to the Department's awareness of the violation to make HUD and the mortgagor whole for losses sustained due to the mortgagee's failure to engage in loss mitigation.

In 24 CFR part 203, HUD proposes to revise and reorganize § 203.605, currently captioned "Loss Mitigation Evaluation." The first sentence of

§ 203.605 that begins, “No later than when three full monthly mortgage payments due on the mortgage are unpaid” is revised for clarity to read “Before four full monthly installments due on the mortgage are unpaid \* \* \*”. Section 203.605 is then reorganized into three paragraphs. The existing and sole paragraph in § 203.605, which sets out a lender’s duty to mitigate, becomes paragraph (a), “Duty to mitigate.” New paragraph (b) describes how HUD will measure a mortgagee’s loss mitigation performance and analyze its loss mitigation efforts portfolio-wide by using the current tier ranking system. New paragraph (c) provides the consequences for mortgagees that fail to perform the loss mitigation techniques as provided in paragraph (a) of this section and in § 203.501.

#### B. The Tier Ranking System

HUD’s TRS is designed to measure loss mitigation performance by each mortgagee. Tier 1 reflects the highest or best ranking mortgagees and Tier 4 reflects the lowest or least satisfactory ranking mortgagees. HUD considers a Tier 4 ranking evidence that a mortgagee has failed to engage in loss mitigation to such an extent that it is highly probable that the mortgagee has systematically denied loss mitigation to cooperative and qualified borrowers. Therefore, as noted earlier in this preamble, while any mortgagee that fails to engage in loss mitigation may be subject to treble damages, HUD’s present intent is to focus on Tier 4 mortgagees.

The current formula for determining TRS ranking is: (Forbearances + Loss Mitigation Retention Claims + Pre Foreclosure Sale claims + Deed in Lieu Claims) / (Forbearances + Loss Mitigation Retention Claims + Pre Foreclosure Sale Claims + Deed in Lieu Claims + Foreclosure Claims).

Loss mitigation retention claims are special forbearance claims, loan modification claims, and partial claims. An account is counted only once for purposes of calculating the number of loss mitigation actions the mortgagee performed. Therefore, if within the same evaluation period, a mortgagee provides the mortgagor a forbearance agreement and also a loan modification, the loan would be counted as having received only one loss mitigation action. However, if the loan is terminated due to foreclosure during the same ranking period, the loan would be counted twice in the denominator—once for having received a loss mitigation claim, and once for the foreclosure.

The current stratification for the tiers is as follows:

Tier 1 is greater than or equal to 80 percent;  
Tier 2 is equal to or greater than 55 percent and less than 80 percent;  
Tier 3 is equal to or greater than 15 percent and less than 55 percent; and  
Tier 4 is less than 15 percent.

Neither the current TRS nor the current stratification will be codified in regulation. The TRS formula and stratification will be issued through **Federal Register** notice. Changes to the TRS formula and stratification will be announced through **Federal Register** notice and provide the opportunity for public comment before taking effect.

HUD sets the cut-off between tiers based on break points identified by application of the formula to the mortgagees. The Tier 4 cut-off is currently at 15 percent. HUD’s information indicates that mortgagees below 15 percent are performing little or no loss mitigation. Three mortgagees scored in Tier 4 for the most recent round of scoring, with scores issued on April 28, 2003.

Under the TRS, a mortgagee will have notice of its tier ranking through (1) HUD’s quarterly “Tier Ranking Letters” and (2) the mortgagee’s ability to calculate its own score at any interval desired for self-monitoring. The documents will advise the mortgagee that it has the opportunity to appeal its ranking. The scoring methodology is such that mortgagees can calculate their own score at any interval desired for self-monitoring. The quarterly Tier Ranking Letters cover a rolling 12-month period, so the ranking assigned to a mortgagee always covers 12 months of performance with a one-quarter lag from the ending calculation date.

A mortgagee that disagrees with its Tier 4 ranking may appeal to the Deputy Assistant Secretary for Single Family or the Deputy Assistant Secretary’s designee and request an informal conference on the ranking. The only basis, however, for appeal of a Tier 4 ranking is the mortgagee’s belief that the ranking was based on incorrect or incomplete data. For example, the tiering formula relies in part on the lender’s accurate reporting of informal forbearance (where no loss mitigation claim has been filed). This is accomplished by the mortgagee’s reporting of servicing actions to HUD’s Single Family Default Monitoring System (SFDMS), which also requires the mortgagee to report other loss mitigation actions (including loan modification) whether or not a claim for a loss mitigation incentive may also be submitted. If the lender produces appropriate documentation of informal forbearance agreements, delinquent

refinances, or other valid loss mitigation actions, which were not reported to HUD or were not included in the tier ranking calculation, HUD will revise that servicer’s tier ranking score.

In order for treble damages to be imposed relative to an individual loan, HUD will first look to see if the servicing mortgagee took any loss mitigation action. As stated in Mortgagee Letter 00-05, “HUD believes that the mortgagee is in the best position to determine which, if any, loss mitigation strategies are appropriate in a given circumstance.” Without HUD approval, mortgagees may, in their sole discretion, utilize any of the loss mitigation options within the guidelines provided in Mortgagee Letter 00-05 and any subsequent mortgagee letter regarding loss mitigation.

Generally, a mortgagee would be considered in compliance and not subject to treble damages for a particular loan if (1) a proper evaluation indicated that the mortgagor was not eligible for any loss mitigation tools or (2) despite documented attempts to evaluate or provide loss mitigation, implementation could not occur due to the borrower’s refusal or failure to cooperate with the mortgagee.

A mortgagee is subject to treble damages when the mortgagee has failed to properly evaluate whether a mortgagor was eligible for any loss mitigation tool and, if the mortgagor was eligible and cooperative, the mortgagee has failed to undertake loss mitigation for the eligible mortgagor. However, in determining whether to proceed with a violation, HUD will consider whether the mortgagee’s failure to engage in loss mitigation is excused by circumstances beyond the mortgagee’s control (e.g. natural disasters), or whether the mortgagee has taken affirmative steps, prior to HUD’s awareness of the violation, to make HUD and the mortgagor whole for losses sustained as a result of the mortgagee’s failure to engage in loss mitigation. If HUD determines to proceed on a violation, the due process procedures provided in 24 CFR part 30 apply.

#### III. Discussion of Public Comments on ANPR

The public comment period for the ANPR closed on February 5, 2001. HUD received seven comments in response to the ANPR. The following discussion provides a summary of the issues and comments raised by the commenters and HUD’s responses to these comments. Specifically, HUD sought comments on the proposed tier system and any other factor that commenters believe should be included. HUD has

taken these comments into consideration in developing the proposed rule.

*Comment:* Two commenters wrote that four components of treble damages should be: (1) Definition of “failure to engage in loss mitigation”, (2) assessment of penalty, (3) standards for compliance, and (4) standards to measure performance.

*HUD Response:* HUD agrees, and all four components are part of the regulation in this proposed rule.

*Comment:* Two commenters wrote that good overall performers, such as those in Tiers 1 through 3 should be excluded from treble damages even if a small number of loans are found to be in noncompliance. The commenters suggested that this exemption is fair, because HUD has the ability to impose other sanctions, including ordinary civil money penalties.

*HUD Response:* As discussed in Section II of this preamble, while no mortgagee that fails to engage in loss mitigation is exempt from possible imposition of treble damages, the proposed rule provides notification that HUD’s focus is Tier 4 mortgagees. As also discussed earlier in this preamble, HUD retains the authority to impose other sanctions, including civil money penalties, on all mortgagees.

*Comment:* Two commenters wrote that, rather than subjecting a Tier 4 servicer to treble damages automatically, HUD should develop a process that provides (1) a standard for liability, (2) an opportunity to mitigate or bring up compensating factors, (3) sufficient warning before penalties are assessed, and (4) an appeals process.

*HUD Response:* The proposed rule provides for the components suggested by the commenter, as noted earlier in this preamble. A Tier 4 servicing mortgagee is not automatically subject to treble damages. The rule provides a standard for liability, and the Tier 4 servicing mortgagee has sufficient warning of its ranking and the opportunity to appeal the ranking based on a mortgagee’s disagreement with the data used in the calculation. As also noted earlier in this preamble, mortgagees are able to calculate their TRS score at any time on their own, and therefore have sufficient advance notice of where they will fall in the ranking process.

*Comment:* Two commenters requested that “failure to engage in loss mitigation” be defined to identify the types of violations that would give rise to treble penalties on a loan-level basis, and that minor violations should clearly not give rise to treble damages. The commenter describes minor violations

as (1) failure to document when letters were mailed or that the monthly evaluation took place, or (2) repayment plans that are subjectively judged “unrealistic” by auditors.

*HUD Response:* Earlier in this preamble, HUD described how failure to engage in loss mitigation would be defined. Additionally, the preamble noted that a servicing mortgagee would be considered in compliance and not subject to treble damages if (1) a proper evaluation indicated that the borrower was not eligible for any loss mitigation tools and (2) despite documented attempts to evaluate or provide loss mitigation, implementation could not occur due to the borrower’s refusal or failure to cooperate with the mortgagee’s mitigation activities.

*Comment:* Two commenters wrote that HUD should exclude a loan from the treble penalty if certain “compensating factors” were present. The commenters suggested that these factors would include that the violation did not result in financial damage to HUD; the borrower was not eligible for loss mitigation in any case; the reason for the failure of loss mitigation was the borrower’s failure to cooperate; the borrower was in bankruptcy; the borrower was incarcerated or otherwise unable to manage his or her affairs; the property was abandoned or the property was seized by the government; loss mitigation was attempted but there was partial non-compliance; the infraction was isolated and the mortgagee took steps to ensure that the situation would not continue; the borrower was offered a remedy despite technical noncompliance; HUD had internal delays, such as delays in the payment of claims; and loss mitigation alternatives would create a loss to the servicer, i.e., modification.

*HUD Response:* The response to the preceding comment addresses generally when a servicing lender would be considered in compliance and not subject to treble damages. Additionally, HUD may exclude a loan from treble damages if factors beyond the mortgagee’s control made loss mitigation impossible (e.g., natural disasters) or the mortgagee took affirmative steps prior to the Department’s awareness of the violation to make HUD and the mortgagor whole for the mortgagee’s failure to engage in loss mitigation.

HUD would not exclude the imposition of treble damages because the failure to engage in loss mitigation was isolated and the lender had taken steps to ensure that the situation would not continue. Additionally, the borrower’s being in bankruptcy by itself

does not always prohibit the “Partial Claim” or “Pre-Foreclosure Sale” options.

*Comment:* One commenter, a state housing agency, stated that, because of the unique characteristics of its borrowers, opportunities for loss mitigation were limited and that this should be taken into account when assessing treble penalties. The commenter stated that these included the fact that a large percentage of the borrowers were rural, first time homebuyers with low interest loans. In order to be fairly evaluated, this commenter suggested that lower tier ratios or other compensating factors needed to be implemented. Additionally, a mortgage company commenter wrote that its low average rate of interest limited its loss mitigation options. Furthermore, this commenter wrote that it uses the “informal equivalent” of recognized loss mitigation options, but a formal claims procedure was not worthwhile because of the low incentive payment.

*HUD Response:* HUD has evaluated the special circumstances surrounding the unique characteristics of state housing agencies. During 2001, HUD had several discussions with representatives of state housing agencies and the National Council of State Housing Agencies (NCSHA). The NCSHA provided HUD with the results of its survey of members’ loss mitigation actions. The survey cited reasons that some members could not utilize loan modifications, and these reasons included limitations due to bond financing requirements.

HUD does not find a need to establish any special requirements for state housing agencies. As HUD’s records indicate from the October 17, 2001, TRS test scoring (Round 5), the only state housing agency to receive a Tier 4 ranking was so rated due to its failure to report accurately to the “Single Family Default Monitoring System” (SFDMS). The ranking had nothing to do with its status as a quasi-government entity. Further, of the four state housing agencies ranked in Tier 1, none utilized “Mortgage Modification,” three did not utilize “Partial Claims,” and one agency only used “Special and Formal Forbearances.” The result is that no impact to state housing agencies was found, other than failure to report accurately to HUD’s SFDMS. As of Round 11, no state housing agencies were ranked in Tier 4. State housing agencies may appeal their Tier 4 ranking or penalty assessment or both in the same manner as other mortgagees.

A mortgagee has the right to utilize the “informal equivalent” of special

forbearance, since the mortgagee could receive credit for forbearances reported to HUD's default system. The mortgagee also has the right not to file incentive claims in the belief that to do so is not worthwhile. However, HUD will not alter the TRS formula to accommodate mortgagees who, while eligible, choose not to file loss mitigation incentive claims.

**Comment:** Three commenters wrote that mortgage servicers should have an opportunity to appeal their rankings to HUD staff knowledgeable about loss mitigation policies. Two of the commenters specifically objected to the fact that currently servicers are required to refute findings with the auditors.

**HUD Response:** Mortgagees may contact the Deputy Assistant Secretary or the Deputy Assistant Secretary's designee if they wish to appeal their Tier 4 rankings based on the TRS formula. Mortgagees may only appeal their Tier 4 ranking on grounds that the data on which the ranking was based are incomplete or incorrect.

**Comment:** Six commenters objected to aspects of the tiered scoring system outlined in the ANPR, based on their understanding of the tiered scoring system. The commenters stated that the scoring system would involve a ratio (Special Forbearances + Modifications + Partial Claims + Deeds in Lieu + Pre-Foreclosure Sales)/(Foreclosures + Deeds in Lieu + Pre-Foreclosure Sales) of loss mitigation claims that did not result in foreclosure divided by the number of non-retention loss mitigation claims and foreclosures, such that servicers would be graded on their loss mitigation success rate.

**HUD Response:** The commenters are referring to the ranking system that was being tested when the ANPR was published. However, subsequent to that time and effective with the Round 6 and Round 7 TRS calculations released August 20, 2002, as part of HUD's testing of this system, HUD modified the scoring system to calculate loss mitigation over loss mitigation plus foreclosures (see Section II.B. of this preamble for a more precise formula). The benchmarks assign to Tier 1 (the most favorable tier) a ratio greater than or equal to 80 percent; to Tier 2, a ratio from 55 percent to less than 80 percent; to Tier 3, a ratio from 15 percent to less than 55 percent; and to Tier 4, a ratio of less than 15 percent. However, HUD reserves the right to change the benchmarks in the future by **Federal Register** notice that provides the opportunity for comment before the change takes effect.

**Comment:** Four commenters wrote that the proposed TRS and benchmarks

would result in the vast majority of mortgagees (as many as 84 percent based on calendar year 1999 figures) being in Tier 3 or Tier 4. The commenters noted further that this result does not make logical sense. Additionally, one commenter wrote that some servicers that would be ranked in Tiers 3 and 4 (as it understands HUD's proposal) would be ranked in the top tier in Freddie Mac's default performance measurement tool.

**HUD Response:** For the calendar year 1999 calculation, 46 percent of the mortgagees were ranked Tier 3, and 38 percent of mortgagees were ranked in Tier 4, for a total of 84 percent. For the eleventh round of TRS scores, released April 28, 2003, 14.23 percent of mortgagees were ranked in Tier 3, and 1.26 percent of mortgagees were ranked in Tier 4, for a total of 15.49 percent. What is significant is that only three mortgagees (1.26 percent of Tiered mortgagees) achieved a ratio of less than 15 percent, thus, receiving a Tier 4 ranking. A comparison to Freddie Mac's default measurement tool would not be an appropriate comparison due to the different methods of program delivery.

**Comment:** Some of the commenters proposed lowering all the tier rankings. One commenter wrote that the tier rankings should include mortgagees with ratios as follows: Tier 1, greater than 50 percent; Tier 2, 26–50 percent; Tier 3, 6–25 percent, and Tier 4, less than 5 percent. Additionally, commenters wrote that these ratios would be comparable to Freddie Mac's scoring system. Another commenter wrote that HUD's benchmarks should always be below the conventional loan workout efficiency ratio, citing as support the fact that 85 percent of the servicers on the initial Tier Ranking Report fell into a Tier 3 or lower ranking.

**HUD Response:** HUD has carefully examined the issue of tier ranking benchmarks. In the eleventh round of TRS scores, released April 28, 2003, there were 113 Tier 1 mortgagees (47.28 percent of tiered mortgagees), 89 Tier 2 mortgagees (37.24 percent of tiered mortgagees), and 34 Tier 3 mortgagees (14.23 percent of tiered mortgagees). Only three mortgagees (1.26 percent of tiered mortgagees) achieved a ratio of less than 15 percent, therefore, receiving a Tier 4 ranking and possible imposition of treble damages. There were a total of 37 mortgagees (15.49 percent of tiered mortgagees) in the 11th round that received a Tier 3 or lower ranking.

Effective with the Round 6 scores, released concurrently with the Round 7 scores, HUD began using the TRS ratio. HUD may choose to adjust the

benchmarks in consideration of prevailing economic conditions during a ranking period. It is necessary for HUD to have the flexibility to balance the goals of advancing loss mitigation efforts with the mortgagee's need to exercise sound business judgments. HUD will issue changes through a **Federal Register** notice with the opportunity to comment before the changes take effect.

**Comment:** Three commenters wrote that the scoring system should take account of situations where servicers have purchased a large number of already-delinquent loans, for which some loss mitigation options may be too late and which thus have a negative impact on the servicer's score. Two of the commenters noted that such accounts, by their nature, represent a higher degree of risk and that the proposed tier scoring formula does not take this risk into account. Additionally, the commenters noted that the loss mitigation options that are available (pre-foreclosure sales and deeds in lieu) carry less weight in the formula, adversely affecting servicers who purchase such loans.

**HUD Response:** There are FHA mortgagees who routinely acquire delinquent loans yet are ranked in Tier 1. Therefore, HUD believes the issue of acquisition of delinquent loans affecting the tier ranking of mortgagees should be addressed through the purchasing lender's due diligence efforts.

**Comment:** Two commenters wrote that HUD should provide a single, aggregate score for mortgagees with multiple HUD identification numbers. The commenters noted further that such mortgagees have received excessively low scores on one mortgage number and overly high scores on another.

**HUD Response:** HUD provides a single, aggregate score only for those mortgagees with multiple HUD identification numbers who have legally become a single entity, and who have provided this notification to and met other requirements of HUD's Lender Approval and Recertification Division.

**Comment:** Two commenters requested that HUD take steps to eliminate backlogs in payment of loss mitigation claims, on which the ratio is based, to keep the scoring current. The commenter noted further that if claims data is used as a basis for scoring, backlogs must not occur. Another commenter wrote that HUD should delay implementation of the treble damages rule pending development of systems that will eliminate backlogs.

**HUD Response:** Effective with Mortgagee Letter 2001–02, dated January 16, 2001, mortgagees may file

loss mitigation retention claims through the FHA Connection instead of on paper. Since making the FHA Connection available for the filing of loss mitigation retention claims, there has been no backlog of unpaid claims. Should a backlog occur due to unforeseen circumstances, HUD will provide notification to industry of the backlog. HUD would then take the individual impact of the backlog into consideration before providing the next round of tiering.

**Comment:** Two commenters wrote that the drawback of HUD's proposal is that the rule does not take into account assumptions, refinances of delinquent loans or forbearance plans that do not meet the technical requirements of HUD rules. The commenter noted further that this could be accomplished by giving servicers credit for these actions directly or by lowering all the benchmarks to reflect the "incomplete" nature of the data.

**HUD Response:** HUD has begun to give mortgagees credit for formal and informal forbearance agreements, provided the mortgagee has reported these agreements in accordance with reporting requirements of the SFDMS. Where a mortgagee has been identified as having a tier four ranking and wishes to appeal the ranking, the Department will accept appropriate documentation of informal forbearance agreements, delinquent refinances, and other valid loss mitigation actions that were not reported to HUD or were not included in the tier ranking calculation. Where adequate documentation is provided, HUD will revise that tier ranking score.

**Comment:** Several commenters wrote that the incentive payment system should be revised. Commenters stated that loss mitigation costs exceed incentive payments. Another commenter wrote that relying on incentive claims is flawed because it overlooks what a mortgagee may have done prior to getting to that stage. Other commenters wrote that incentives should compensate mortgage servicers for their expenses in promoting and implementing loss mitigation programs.

**HUD Response:** Although HUD understands that mortgagees and servicers would prefer not to pay any loss mitigation expenses, payment of all such expenses by HUD would prove financially burdensome to HUD. Since successful loss mitigation benefits both HUD and mortgagees, certain costs of doing business should be borne by mortgagees and servicers themselves. The revised TRS formula does give mortgagees credit for formal and informal forbearance actions as well as loss mitigation actions.

**Comment:** One commenter proposed incentives in the range of \$100 (for Tier 4) to \$300 (for Tier 1) for special forbearances, \$500 to \$750 for loan modification, \$250 to \$500 for partial claims, \$1,000 to \$1,500 for foreclosure sales, and \$250 to \$375 for deeds in lieu of foreclosure.

**HUD Response:** HUD is reviewing incentive levels as part of its ongoing analysis of the effectiveness of its loss mitigation program. Any changes to loss mitigation program provisions or incentives will be announced in future notices or rules, as appropriate, with opportunity for comment as applicable.

**Comment:** Three commenters wrote that HUD should give greater incentives as rewards to Tier 1 and Tier 2 servicers. According to two of these commenters, Tier 1 servicers should receive a 50 percent increase in incentive payment as well as a two-month extension of pre-foreclosure sale time frames and automatic reimbursement of 75 percent of foreclosure costs on Part B claims.

**HUD Response:** While there has been some industry discussion of replacing the existing annual Mortgagee Performance Scores with the proposed TRS as the basis for increased incentives to the best scoring lenders, HUD has determined that the Mortgagee Performance Scores should continue to be applied. However, HUD continues to evaluate the TRS as a potential replacement of the existing scoring system as the basis for loss mitigation incentives.

**Comment:** One commenter stated that the tier calculation should be based on recent data. Another commenter sought a more detailed explanation of the calculation, including "timeframes" of the data HUD uses. This commenter asked whether the relevant time is when the servicer files Part A or Part B claims, when HUD approved the claim for payment, or the date that HUD processes the first claim check or the second claim check. This commenter also wanted to know how the formula is affected by claims that HUD suspends.

**HUD Response:** Most Tier Ranking letters have been issued with a one-quarter lag from the ending calculation date. For example, the Tiering Ranking letter issued during the third quarter of FY 2003 (April 28, 2003) covered the second quarter of FY 2002 through the first quarter of FY 2003, allowing the second quarter of FY 2003 to be used to ensure that all claims have been processed for the period under review. The tiering calculation always covers a 12-month period. The formula counts paid loss mitigation retention claims as of the date the claim was paid. It counts

Pre-Foreclosure, Deed-In-lieu of Foreclosures and Foreclosures as of the insurance termination date, which is the date the deed was filed, as reported by the lender on the Pre-Foreclosure, Deed-In-Lieu of Foreclosure, or Foreclosure insurance claim form HUD 27011.

**Comment:** One commenter stated that HUD's formula for measuring loss mitigation is misleading because it relies on the number of incentive claims a mortgagee files and does not consider other factors, such as loss mitigation efforts undertaken without filing claims.

**HUD Response:** With the inclusion of formal and informal forbearances into the TRS calculation, HUD is able to give mortgagee credit for payment plans that do not result in a loss mitigation claim filing. HUD will consider whether other factors should be calculated, and welcomes additional comment on this issue.

**Comment:** One commenter stated that the tier ranking system should treat smaller servicers differently because the rankings could be extremely volatile using the same scoring system as for larger servicers. This commenter recommended HUD adopt a system similar to Freddie Mac's, which assigns servicers with fewer than 25 loans that are 90 days or more delinquent a ranking that generally allows these servicers to service all types of loans, unless Freddie Mac becomes dissatisfied with the servicer's delinquency ratio. In this case, the servicer may become ineligible for certain high-risk loans.

The commenter noted further that servicers with fewer than 10 conveyance claims in the prior 12-month period should be unranked. Those with 10–40 conveyance claims should be designated "small servicers." Under the commenter's proposal, the unranked servicers would be excluded from the tiered ranking system and from treble damages. Small servicers who rank in Tiers 2 through 4 would all be considered Tier 2 servicers. This is equitable, the commenter suggested, because (1) HUD's ranking system is not precise as the system fails to recognize certain loss mitigation techniques; (2) the severity of the penalty in relation to a small servicer's net worth is excessive; (3) HUD does not have significant risk exposure because these are small portfolios; and (4) borrowers with FHA-insured financing generally have higher loan to value ratios and less disposable income than conventional borrowers, so fewer of them qualify for loss mitigation options.

**HUD Response:** All mortgagees have an obligation to ensure that all borrowers are afforded the opportunity

for loss mitigation where loss mitigation is appropriate, and HUD has an obligation to enforce the loss mitigation requirements, regardless of the servicing lender's portfolio size. HUD recognizes, however, that the rankings for smaller servicers can be extremely volatile using the same scoring system applied to larger servicers. That is why HUD has provided consideration for smaller servicers in its calculation. Servicers with fewer than 11 foreclosure claims in the 12-month evaluation period are unranked, unless the tier calculation would place them in Tier 1 or Tier 2.

**Comment:** Two commenters wrote that there should be a periodic review of the tier benchmarks to ensure that they reflect economic and market conditions. Another commenter wrote that changing market conditions could cause a lender's ranking to vary widely. For example, in a market where loan originations decline, the ratio of mitigation plans generated to foreclosures completed would drop considerably. Because the majority of loss mitigation plans are generated early in the default stage, fewer new loans would produce fewer defaults (hence fewer opportunities for mitigation plans), while prior foreclosures would continue to move forward. The ratio of plans to foreclosures would appear to decline, giving the false impression that servicers are doing a poor job of loss mitigation.

**HUD Response:** HUD is cognizant of the fact that changing market conditions can substantially impact, positively and negatively, the successful implementation of loss mitigation techniques. Periodic reviews of market conditions will be conducted and if an adjustment to the scoring system is determined appropriate, HUD will provide advance notice of the scoring changes through **Federal Register** notice as discussed in this preamble.

**Comment:** One commenter urged HUD and Congress to work to rescind the treble damages law. The commenter stated that the penalty was unnecessary because of increased loss mitigation workouts in recent years; assuming a "5 percent error rate, or a 95 percent compliance rate," the provision could erase the majority of profits of the mortgage servicing industry, with a potential \$1 billion annual cost to the industry; the value of servicing rights would be negatively impacted; and the penalty was not related to HUD's actual damages or loss. As a consequence, this commenter wrote, mortgagees could decide to stop originating and servicing FHA-insured loans.

**HUD Response:** HUD supports this legislation passed by Congress as an

additional means to protect the FHA Insurance Fund from abuse and to promote homeownership retention.

**Comment:** Three commenters wrote that the rule should only have prospective effect. One commenter stated that any application of the treble damages penalty should relate only to loans originated after the publication date of the final rule. Two commenters asked that HUD give mortgagees a one year transition period under the TRS before applying any treble damages.

**HUD Response:** Section 230(a) of the National Housing Act states that a mortgagee shall engage in loss mitigation actions "upon default of any mortgage insured under [Title II] \* \* \* as provided in regulations by the Secretary." HUD believes there is no reason to delay application of TRS beyond issuance of the final rule. All tier rankings are based on one year's data, so mortgagees have sufficient information and notice of their performance to gauge their compliance. As part of the pilot testing of TRS, 11 rounds of TRS scores have been issued since December 2000, when HUD initiated the TRS pilot.

**Comment:** One commenter wrote in support of the \$1,100,000 per year cap on civil money penalties per mortgagee, which is statutorily required. Another commenter wrote that HUD should "confirm that treble damages assessed to a servicer fall within this \$1,100,000 limit."

**HUD Response:** HUD cannot exceed the statutory limitation per mortgagee on civil money penalties. The civil money penalty amounts that may be imposed were raised by statute and implemented in a HUD final rule published on March 17, 2003 (68 FR 12785), and which became effective April 16, 2003.

**Comment:** One commenter wrote that HUD should "communicate its FHA guidelines" to the offending company and conduct any needed investigation.

**HUD Response:** Through this rulemaking and future notices or mortgagee letters, HUD will continue to communicate the guidelines of the loss mitigation program. Instances of a lender's failure to engage in loss mitigation are and will continue to be investigated by HUD's Quality Assurance Division and HUD's National Servicing Center (NSC). Mortgagees, regardless of tier ranking, that do not comply with HUD's loss mitigation requirements will be required to affect corrective action in all instances and will be afforded the opportunity for additional training by NSC.

## Findings and Certifications

### Public Reporting Burden

The information collection requirements contained in this rule have been approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. Chapter 35) and assigned OMB control number 2502-0523. 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.

### Regulatory Flexibility Act

The Secretary, in accordance with the Regulatory Flexibility Act (5 U.S.C. 605(b)), reviewed this rule before publication and by approving it certifies that this rule would not have a significant economic impact on a substantial number of small entities. All entities, small or large, will be subject to the same penalties for failure to engage in loss mitigation as established by statute and proposed to be implemented by this rule. The statute does not provide an exemption for small entities. Nevertheless, the Department is sensitive to the fact that the uniform application of requirements on entities of differing sizes often places a disproportionate burden on non-profits/small entities businesses. That is why HUD has built a factor for smaller servicers into its scoring calculation. As noted in this preamble, HUD provides that servicers with fewer than 11 foreclosure claims in the 12-month evaluation period remain unranked, unless the tier calculation would place them in Tier 1 or Tier 2. Although HUD has determined that this proposed rule would not have a significant economic impact on a substantial number of small entities, HUD welcomes comments regarding any less burdensome alternatives to this rule that will meet HUD's objectives as described in this preamble.

### Environmental Impact

In accordance with 24 CFR 50.19(c)(6) of HUD's regulations, this rule involves establishment of treble damages for lender's who fail to perform the loss mitigation evaluation and actions under 24 CFR 203.605. In accordance with 24 CFR 50.19(c)(1) of HUD's regulations, this proposed rule does not direct, provide for assistance or loan and mortgage insurance for, or otherwise govern or regulate, real property acquisition, disposition, leasing, rehabilitation, alteration, demolition, or new construction, or establish, revise, or provide for standards for construction or

construction materials, manufactured housing, or occupancy. Therefore, this proposed rule is categorically excluded from the requirements of the National Environmental Policy Act (42 U.S.C. 4321 *et seq.*).

#### Executive Order 13132, Federalism

Executive Order 13132 (entitled “Federalism”) prohibits, to the extent practicable and permitted by law, an agency from promulgating a regulation that has federalism implications and either imposes substantial direct compliance costs on state and local governments and is not required by statute, or preempts state law, unless the relevant requirements of section 6 of the Executive Order are met. This rule affects only mortgagees and does not have federalism implications and does not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

#### Regulatory Planning and Review

The Office of Management and Budget (OMB) reviewed this rule under Executive Order 12866, *Regulatory Planning and Review*. OMB determined that this rule is a “significant regulatory action” as defined in section 3(f) of the Order (although not an economically significant regulatory action under the Order). Any changes made to this rule as a result of that review are identified in the docket file, which is available for public inspection in the office of the Regulations Division, Office of General Counsel, Room 10276, 451 Seventh Street, SW., Washington, DC 20410-0500.

#### Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 (Pub. L. 104-4; approved March 22, 1995) (UMRA) establishes requirements for federal agencies to assess the effects of their regulatory actions on state, local, and tribal governments, and on the private sector. This proposed rule does not impose any federal mandate on any state, local, or tribal government, or on the private sector, within the meaning of UMRA.

#### Catalog of Federal Domestic Assistance

The Catalog of Federal Domestic Assistance number applicable to the program affected by this rule is 14.117.

#### List of Subjects

#### 24 CFR Part 30

Administrative practice and procedure, Grant programs—housing and community development, Loan

programs—housing and community development, Mortgages, Penalties.

#### 24 CFR Part 203

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

For the reasons stated in the preamble, HUD proposes to amend 24 CFR parts 30 and 203 as follows:

#### PART 30—CIVIL MONEY PENALTIES: CERTAIN PROHIBITED CONDUCT

1. The authority citation for 24 CFR part 30 continues to read as follows:

**Authority:** 12 U.S.C. 1701q-1, 1703, 1723i, 1735f-14, 1735f-15; 15 U.S.C. 1717a; 28 U.S.C. 2641 note; 42 U.S.C. 3535(d).

#### Subpart B—Violations

2. In § 30.35, add a new paragraph (a)(15) and revise paragraph (c) to read as follows:

##### § 30.35 Mortgagees and lenders.

\* \* \* \* \*

(a)(15) Fails to engage in loss mitigation as provided in § 203.605 of this title.

\* \* \*

(c) *Amount of penalty.* (1) *Maximum penalty.* Except as provided in paragraph (c)(2) of this section, the maximum penalty is \$6,500 for each violation, up to a limit of \$1,250,000 for all violations committed during any one-year period. Each violation shall constitute a separate violation as to each mortgage or loan application.

(2) *Maximum penalty for failing to engage in loss mitigation.* The penalty for a violation of paragraph (a)(15) of this section shall be three times the amount of the total mortgage insurance benefits claimed by the mortgagee with respect to any mortgage for which the mortgagee failed to engage in such loss mitigation actions.

#### Subpart C—Procedures

3. In § 30.80 add a new paragraph (l) to read as follows:

##### § 30.80 Factors in determining the appropriateness and amount of civil money penalty.

\* \* \* \* \*

(l) HUD may consider factors listed in paragraphs (a) through (k) of this section to determine the appropriateness of a penalty under § 30.35(c)(2); however, HUD cannot change the amount of the penalty under § 30.35(c)(2).

#### PART 203—SINGLE FAMILY MORTGAGE INSURANCE

4. The authority citation for 24 CFR part 203 continues to read as follows:

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

#### Subpart C—Servicing Responsibilities

5. Revise § 203.500 to read as follows:

##### § 203.500 Mortgage servicing generally.

This subpart identifies servicing practices of lending institutions that HUD considers acceptable for mortgages insured by HUD. Failure to comply with this subpart shall not be a basis for denial of insurance benefits, but failure to comply will be cause for imposition of a civil money penalty, including a penalty under § 30.35(c)(2), or withdrawal of HUD’s approval of a mortgagee. It is the intent of the Department that no mortgagee shall commence foreclosure or acquire title to a property until the requirements of this subpart have been followed.

6. Section 203.605, including its heading, is revised to read as follows:

##### § 203.605 Loss mitigation performance.

(a) *Duty to mitigate.* Before four full monthly installments due on the mortgage have become unpaid, the mortgagee shall evaluate on a monthly basis all of the loss mitigation techniques provided at § 203.501 to determine which is appropriate. Based upon such evaluations, the mortgagee shall take the appropriate loss mitigation action. Documentation must be maintained for the initial and all subsequent evaluations and resulting loss mitigation actions. Should a claim for mortgage insurance benefits later be filed, the mortgagee shall maintain this documentation in the claim review file under the requirements of § 203.365(c).

(b) *Assessment of mortgagee’s loss mitigation performance.* (1) HUD will measure and advise mortgagees of their loss mitigation performance through the Tier Ranking System (TRS). Under the TRS, HUD will analyze each mortgagee’s loss mitigation efforts portfolio-wide on a quarterly basis, based on 12 months of performance, by computing ratios involving loss mitigation attempts, defaults, and claims. Based on the ratios, HUD will group mortgagees in four tiers (Tiers 1, 2, 3 and 4), with Tier 1 representing the highest or best ranking mortgagees and Tier 4 representing the lowest or least satisfactory ranking mortgagees. The precise methodology for calculating the TRS ratios and for determining the tier stratification (or cutoff points) will be provided through **Federal Register**

notice. Notice of future TRS methodology or stratification changes will be published in the **Federal Register** and will provide a 30-day public comment period.

(2) Before HUD issues each quarterly TRS notice, HUD will review the number of claims paid to the mortgagee. If HUD determines that the lender's low TRS score is the result of a small number of defaults or a small number of foreclosure claims, or both, as defined by notice, HUD may determine not to designate the mortgagee as Tier 3 or Tier

4, and the mortgagee will remain unranked.

(3) Within 30 calendar days after the date of the TRS notice, a mortgagee that scored in Tier 4 may appeal its ranking to the Deputy Assistant Secretary for Single Family or the Deputy Assistant's designee and request an informal HUD conference. The only basis for appeal by the Tier 4 mortgagee is disagreement with the data used by HUD to calculate the mortgagee's ranking. If HUD determines that the mortgagee's Tier 4 ranking was based on incorrect or incomplete data, the mortgagee's

performance will be recalculated and the mortgagee will receive a corrected tier ranking score.

(c) *Assessment of civil money penalty.* A mortgagee that is found to have failed to engage in loss mitigation as required under paragraph (a) of this section shall be liable for a civil money penalty as provided in § 30.35(c) of this title.

Dated: March 22, 2004.

**Sean Cassidy,**

*General Deputy, Assistant Secretary for Housing.*

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