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Payment Processing: Part 2

Article by
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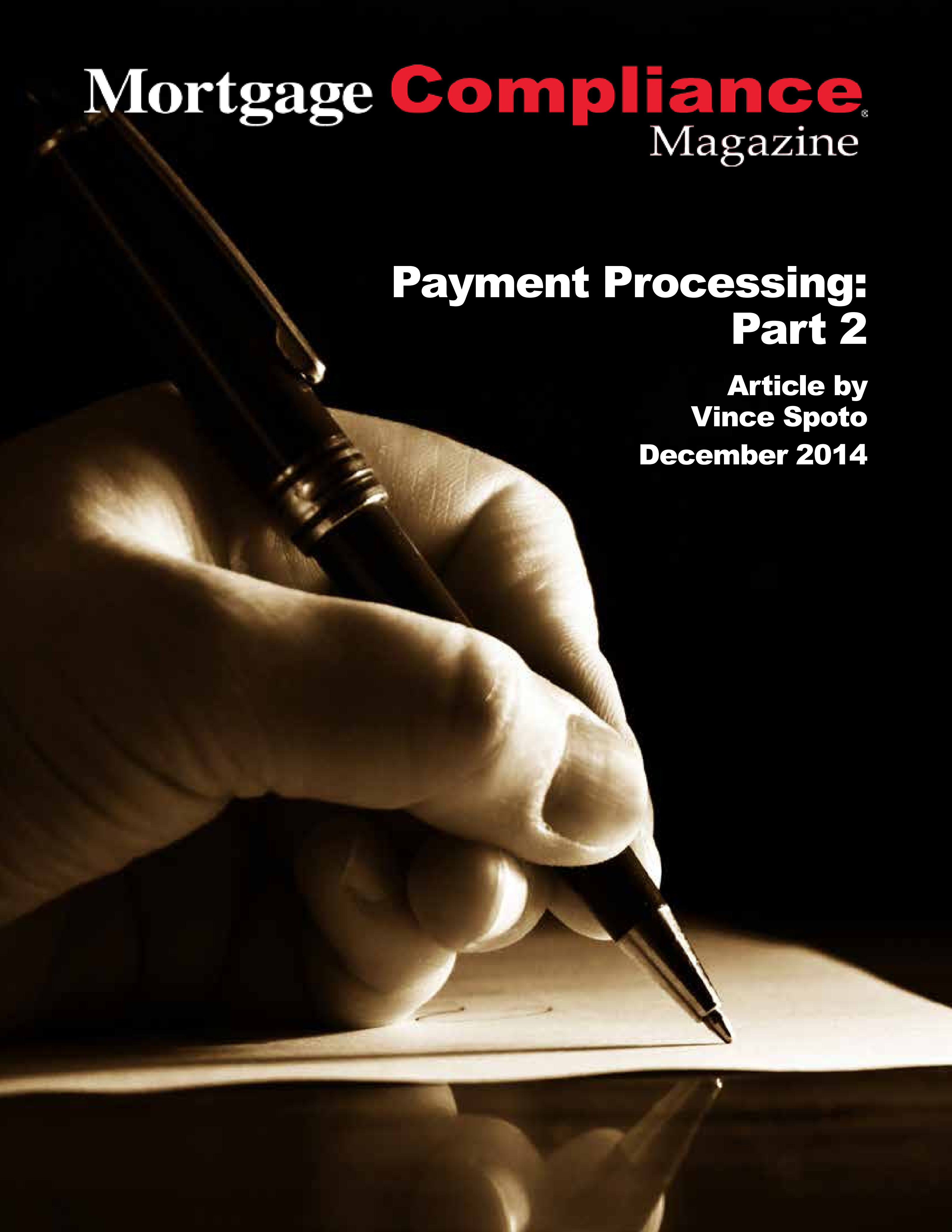

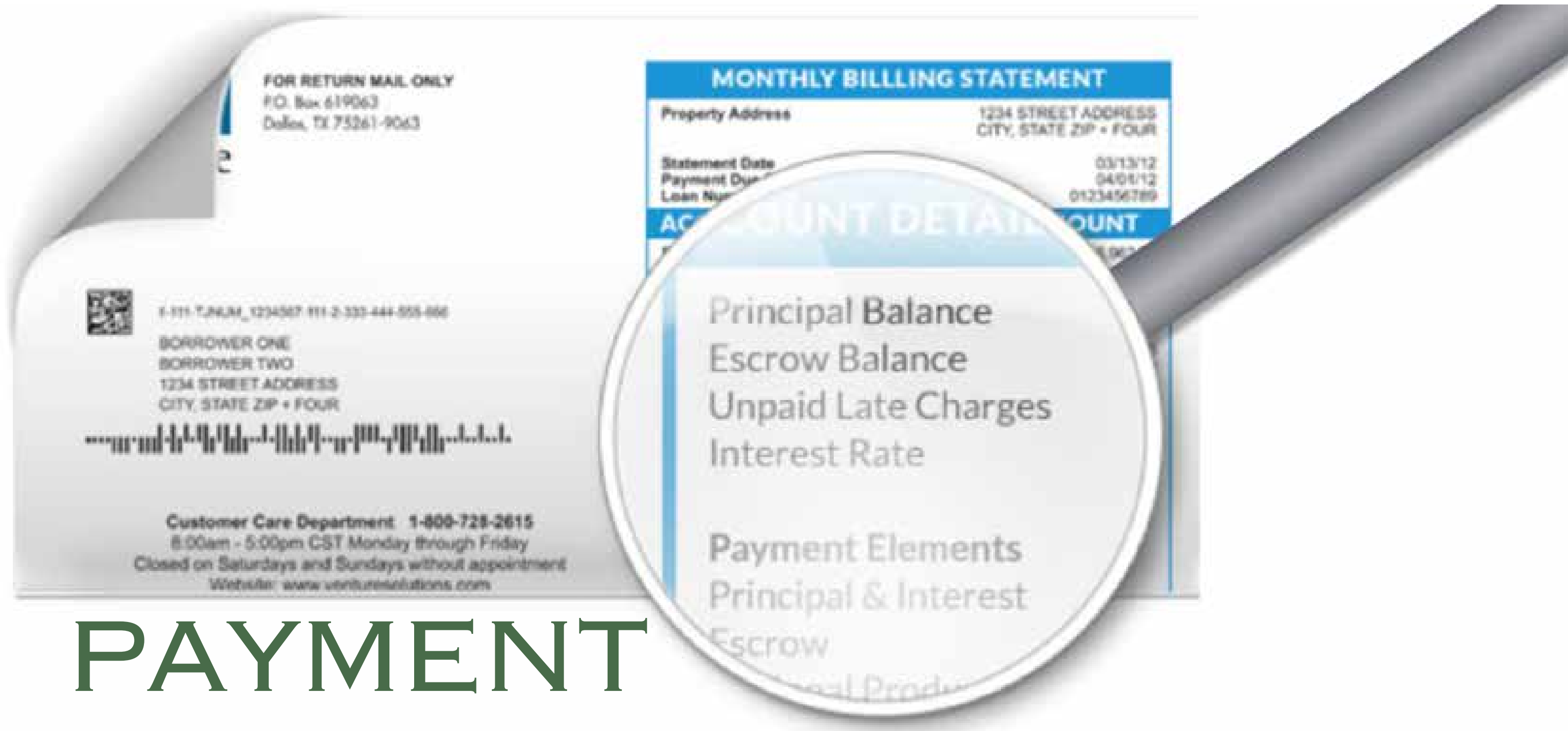

PAYMENT PROCESSING: PART 2

BY VINCE SPOTO


Vince Spoto

Regulatory guidelines and standards are designed to provide borrowers with better disclosures about their mortgage obligations and provide servicers with protocols and options.

This is the second part of a two-part series.

PAYMENT APPLICATION

Servicers must promptly credit payments received from borrowers as of the day of receipt, except when a delay in crediting does not result in a late fee being charged to the borrower or in the reporting of negative information to a credit bureau(s). Payments must be posted to borrower accounts on the same day that they are received. Guidelines and standards of federal regulators and government sponsored entities (i.e. Federal National Mortgage Association (FNMA or Fannie Mae), Federal Home Loan Mortgage Corp (FHLMC or Freddie Mac), etc.) stipulate the payment application hierarchy to be: (i) principal, (ii) interest, (iii) escrow (i.e. taxes, and insurance), and (iv) late fees (if applicable).

Valid reasons for a servicer's failure to credit borrower payments on the day of receipt may include instances such as payments that are received after normal servicer business hours, payments received after reasonable cut-off times specified by the servicer, payments received that do not reference the appropriate loan account/borrower information, systems outages, etc. Payments received by servicers on weekends or holidays must be credited to the borrower's account on the next business day. In the absence of specified requirements, payments may be made at any location where the servicer conducts business at any time during normal business hours. Payments can be made by cash, money order, draft, check or via other similar negotiable instruments, or by electronic funds transfers if both the servicer and the borrower have so agreed. Payments can also be sent to an established lock-box.

PARTIAL PAYMENTS

Payment amounts insufficient to cover principal, interest and escrow (if applicable) are defined as 'periodic payments.' In cases where servicers specify in writing to the borrower specific requirements for making payments and a partial payment is accepted ▷

that does not conform to the stated requirements, the servicer has up to five days after the receipt of funds to credit the payment to the borrower's account. Partial payments held in a suspense account are not considered to have been 'accepted,' so they are not required to be applied by the servicer within five days.

For payments received by the servicer and credited to the borrower's account (or in cases in which a partial payment is received and applied to a suspense account) that are returned by the corresponding financial institution for non-sufficient funds (NSF), such payment credits will be reversed by the servicer immediately with borrowers notified promptly of the NSF action. (In accordance with normal and usual practices adhered to by other servicers across the industry, borrowers are generally notified within 48 hours by the servicer after it becomes aware of an NSF payment). NSF payments will be adjusted by the servicer (with payments that have been already credited reversed from the borrower's account), and the borrower advised that a payment made by check has been returned by the bank or applicable financial institution for insufficient funds. This will result in borrowers being reported as delinquent unless a payment in good form is made within the corresponding billing period.

If a servicer receives a payment that is less than the amount due (i.e. a partial payment), the payment may be held in a suspense account. When the amount in the suspense account covers the full amount of the monthly scheduled principal and interest (P&I) payment, the servicer must apply the funds to the borrower's account. Servicers also have the option of returning to the borrower partial payments that are made. In cases where partial payments are returned to the borrower, such payments do not need to be included as a line item in the transaction activity section of the monthly billing statement, as this activity would neither credit nor debit the outstanding account balance. In accordance with normal and usual operating practices followed by other servicers, partial payment amounts that are not returned to borrowers, but are instead held in a suspense account, are monitored monthly to ensure proper payment application is done in accordance with full P&I payment thresholds. This process is generally automated to ensure borrower accounts are credited at the time the suspense account balance reaches the full monthly scheduled P&I payment for the applicable loan. In summary, the handling of partial payments from borrowers can be processed by servicers in one of the following manners:

- Non-acceptance and return of partial payments received from borrowers;
- Crediting to the borrower's account of partial payments received; or
- Application of partial payments received from borrowers to a suspense or unapplied funds account.

LOANS IN FORECLOSURE OR BANKRUPTCY

The acceptance of partial payments from borrowers with Federal Housing Administration (FHA) loans that are in foreclosure may result in a 're-start' of the foreclosure process. While there may be legitimate reasons for borrowers making partial payments that relate to their ability and willingness to pay, caution should be exercised here as some borrowers (i.e. 'strategic defaulters') use this tactic as a means of 'gaming the system' to delay foreclosure and eviction, thereby prolonging their stay in the residence. The head of collections at a medium-sized, East Coast-based servicer points out that "strategic defaulters have increased in recent years as homeowners have become more savvy by having gone through hard economic times. I constantly remind my collectors to be on the look-out for these types, and maintain proper balance between helping [to] keep the homeowner in the home and being conned and taken advantage of. Borrowers must demonstrate they have overcome the cause of the default and can resume making regular monthly mortgage payments and/or comply with any re-payment plan that may have been agreed to."

With respect to loans in Chapter 7 bankruptcy, funds collected by the servicer will be applied to the loan's unpaid principal balance (UPB). For loans in Chapter 11 or Chapter 13 bankruptcy, funds collected by the servicer must pass through a court appointed receiver or trustee, who then ensures proper payment is made to the borrower's account with payments allocated in accordance with the re-payment plan on record. The receiver or trustee will then either re-forward the payment back to the servicer or provide proper authorization to apply the payment against the UPB. For loans in foreclosure, funds collected by the servicer should either be: (i) returned by the servicer to the borrower, or if accepted, (ii) placed by the servicer into a suspense account until the foreclosure action is completed and then subsequently be applied to the loan's UPB.

LATE FEES

In terms of assessing late charges, servicers must not engage in the practice of pyramiding of late fees. Late fees are not included in the Consumer Financial Protection Bureau's (CFPB) definition of a partial or periodic payment even if late fees remain outstanding. Current regulatory guidelines and standards do not exist to prevent servicers from charging and collecting late fees, nor do mandates or standards exist indicating that it is appropriate for servicers to make statements to borrowers regarding their obligation to pay late fees. CFPB's goal is to ensure that borrowers receive full benefit and credit for all payments made. While federal regulatory guidelines and standards concerning late fees prevail across the industry, individual state laws do not exist at the present time. One servicing executive at a Midwest based servicer said, "In a prior life, senior management prided itself on maximizing late fee income. Pyramiding of late fees was a common practice, and borrower rights were held in low regard. Needless to say, prior management is long gone and today the pyramiding of late fees is taboo. Borrower rights are always given priority. While maximizing fee income is important, doing so at the expense of borrowers is strictly forbidden."

SERVICEMEMBERS CIVIL RELIEF ACT

Under the Servicemembers Civil Relief Act (SMCRA), formerly known as the Soldiers' and Sailors' Civil Relief Act of 1940 (SSCRA), military members are afforded with some important privileges as they enter active duty. In limited situations, a soldier's dependents may also be eligible for certain benefits afforded by the SMCRA. Specifically, some key SMCRA advantages relate to debt collection and restrictions on eviction, civil judicial proceedings and income tax payments. However, interest rate reductions and postponement of monthly principal payments may begin immediately upon assignment to active military service. Service members also have the ability of having their mortgage interest rates significantly reduced under certain circumstances, in cases in which the mortgage was entered into prior to mortgagee becoming a member of the Armed Forces and serving on active duty. This interest rate reduction for mortgages generally terminates within 30-90 days after the date of discharge, but can extend for up to one year from the service member being released from active duty. As one professional at a large loan servicer points out, "Violating SMCRA is a sure fire way of bringing the regulatory police down on you."

California is the only state that currently permits military service members to seek treatment beyond the standards outlined in the SMCRA. Specifically, a servicemember, at any time during his or her most current period of military service or within six months thereafter, can petition a court for relief in respect of any obligation or liability incurred by prior to the effective date of the orders for the most current period of military service.

As consumers having past or present military sevice have recently been spotlighted and received more prominent attention, SMCRA has become very visible. Across the industry, a zero tolerance now exists with respect to SMCRA non-compliance by loan servicers. As such, servicers need to be aware of SMCRA compliance requirements and provide necessary personnel with training, and, as required, modify borrower disclosures, payment application processes and collection protocols accordingly.

SO, WHAT DOES IT ALL MEAN?

In a nutshell, servicers should beware that proper payment disclosures must be made to borrowers as a normal course of business, and that payments received be applied properly and timely.

To quote the chief operations officer (COO) of one prominent loan servicer, "The days of [manipulating] borrower payments and assessing late fee after late fee in order enhance revenues and bolster margins are gone. The CFPB has developed strict guidelines covering payment disclosures and application, and has made it clear that there is zero tolerance for [servicer] non-compliance. And when involving retired or active military personnel, non-compliance here makes for a very unpleasant and painful servicer experience." MCM

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