Congressional Research Service
Informing the legislative debate since 1914

Mortgage Servicing and Selected Policy Issues

September 18, 2025

Congressional Research Service
https://crsreports.congress.gov
R48713

Congressional Research Service
Informing the legislative debate since 1914

SUMMARY

Mortgage Servicing and Selected Policy Issues

R48713

September 18, 2025

Darryl E. Getter
Specialist in Financial Economics

A mortgage *servicer* is an institution that works on behalf of either a lienholder (i.e., an entity that owns the future streams of principal and interest repayments of the loan and absorbs the financial loss if a mortgage defaults) or guarantor (i.e., an entity that agrees to absorb the financial loss if a mortgage defaults). Servicers perform a variety of administrative tasks, such as providing borrowers with periodic billing statements and collecting their mortgage payments. A servicer distributes principal and interest payment portions to the lienholder, the guarantee fee to the guarantor of mortgage default risk, the property tax payments to the local tax authorities where the property is located, and homeowners' insurance payments to the borrower's insurance company.

In addition, if a borrower is delinquent or defaults on a mortgage, the servicer attempts to make contact and—from a set of *loss mitigation* (i.e., workout) options—chooses a solution that minimizes losses for the lienholder and possibly helps a borrower resume regular payment. If a borrower is unlikely to resume making mortgage payments, then foreclosure—the process of taking possession of the collateral (i.e., property) used to secure the loan—may become a more feasible option. Servicers generally perform the legal and operational tasks associated with administering a foreclosure. After the foreclosure is completed, the property is sold and the proceeds are used to reimburse the servicer and lienholder (or guarantor) for losses linked to the default.

Mortgage servicers consists of specialized firms and other financial entities such as banks, credit unions, and nonbank loan originators that purchase from lienholders the right to receive future cash flows for performing the administrative tasks; these rights are referred to as *mortgage servicing assets (MSAs)*. When servicers collect borrowers' payments, they also collect their servicing fees. Under ordinary situations in absence of any delinquencies or defaults, a servicer's monthly fee is computed as a percentage of the outstanding mortgage balance. Servicers' profits, known as *excess servicing fees*, are computed as the difference between the fees collected from borrowers' outstanding mortgage balances minus the costs to purchase MSAs and other operating costs (typically incurred when dealing with troubled mortgages where lienholders may not fully reimburse some of the additional expenses).

Greater focus on issues related to servicing followed two nationwide events marked by numerous distressed mortgages. The first event, the 2008 financial crisis, saw widespread house price declines, rising unemployment risk, and an increase in foreclosures. Rising foreclosures led to concerns about whether servicers' procedures and practices protected borrowers and mitigated foreclosure risks. Consequently, Congress instructed the Consumer Financial Protection Bureau (CFPB) to promulgate rules, which became the minimum baseline servicing requirements for all covered U.S. mortgages. The CFPB rules do not preempt any servicing rules that provide even greater borrower protections and mitigate foreclosure outcomes.

The second event, the COVID-19pandemic, led to an increase in liquidity risk for mortgage servicers. Because the CARES Act (P.L. 116-136) allowed borrowers to request up to 360 days of forbearance relief, they no longer had to send mortgage payments to servicers and technically were not delinquent or in default. Servicers, however, were still required to send principal and interest payments to those investors that owned mortgage-backed securities issued by Fannie Mae, Freddie Mac, and Ginnie Mae. (Investors are entities that own the future streams of principal and interest repayments from numerous mortgages used to create mortgage-based securities.) Nonbank servicers that lacked access to federally insured deposits or to the Federal Reserve System faced greater liquidity risk. Nevertheless, rising liquidity risk among numerous financial institutions can be systemically important. Consequently, some stakeholders have suggested that servicers should set aside a portion of their excess servicing fees to accumulate cash buffers to offset sudden liquidity downturns.

Mitigating mortgage servicing risks (e.g., foreclosure risk, liquidity risk) generally involves imposing regulations and other costs on the industry to reduce negative outcomes but may simultaneously increase homeownership costs. For example, if rules designed to discourage or delay foreclosure increase the costs to service trouble loans, then servicers may be reluctant to purchase MSAs linked to borrowers with greater income variability or impaired credit. If cash reserve requirements are established as liquidity backstops, then the additional funds must be collected from borrowers, lienholders (or investors in mortgage-backed securities), servicers, or some combination. In short, mitigation of mortgage servicing risks likely increases homeownership financing costs.

Contents

Appendixes

Contacts

Introduction

Suppose a loan originator, which can be a financial institution or a mortgage broker, approves and issues mortgages to homebuyers. The originator may choose to retain the mortgages in its loan portfolio or sell them, often to securitizers that create securities linked to the underlying pools of mortgages for purchase by private investors.[1] Regardless whether the mortgage owner—typically referred to as a lender or lienholder—is an originating financial institution or a set of investors that jointly own mortgage-backed securities (MBSs), mortgages are generally *serviced* by agents acting on their behalf. These agents, known as *servicers*, perform various administrative tasks that include collecting from borrowers their payments comprised of principal and interest, property taxes, and homeowners' insurance premiums. The servicers then distribute the principal and interest payments to mortgage owners, the property tax payments to local tax authorities, and insurance premium payments to insurance companies.[2] Mortgage servicers also process the loan titles after mortgages are paid in full, and they administer loss mitigation (e.g., forbearance plans) or foreclosure resolution on behalf of the lender if full payment is not received. Servicers receive compensation for these administrative tasks after purchasing the *mortgage servicing assets* (MSAs), also referred to as mortgage servicing rights, from mortgage owners. MSAs generate fees reportedly averaging 25 basis points (0.25%, or $250 per $100,000) of an outstanding mortgage balance per year.[3]

Although the generic term *lender* is commonly used, a mortgage servicer enters into a contractual arrangement specifically with the entity that owns a mortgage's *default risk*, the risk that a borrower repays the mortgage obligation late or fails to repay it in full. Because a mortgage's default risk can be separated from its expected principal and interest repayments, the following definitional distinctions used in this report are relevant.[4] *Owners*, *lienholders*, or *creditors* own (1) the future streams of principal and interest repayments as well as (2) financial losses associated with mortgage default risk. *Guarantors* or *assignees* agree to absorb financial losses associated with mortgage default risk. *Investors* in securities linked to mortgages guaranteed by federal agencies or federally related entities own the future streams of principal and interest repayments linked to numerous mortgages but not the default risk.

This report discusses policy issues pertaining to mortgage servicing. It begins with an overview of mortgage servicing and loss mitigation options generally available for troubled mortgage borrowers, which can help them become and stay current on their mortgage payments. Next, the report focuses on policy issues pertaining to (1) consumer protection and (2) financial stability.

From the consumer protection perspective, the Consumer Financial Protection Bureau (CFPB) promulgated mortgage servicing rules that went into effect in 2014 in response to the 2008 financial crisis. The CFPB's servicing rules were designed to address improper servicing practices and to mitigate *foreclosure risk*, the risk that the ownership of a property used as

[1] For information about securitizers and how they attract funds to finance mortgage pools, see CRS Report R46746, *Fannie Mae and Freddie Mac: Recent Administrative Developments*, by Darryl E. Getter.

[2] For securitized mortgages, the servicer collects borrowers' mortgage payments, forwards the principal and interest portions to the securitization trust, and, in some cases, forwards specific tranches depending upon how the trust is structured. If a separate guarantor agrees to bear the financial losses associated with a mortgage delinquency or default, the servicer forwards to that entity the guarantee fee.

[3] A single basis point is equal to 1/100 percent, meaning that 100 basis points equals 1%. For more information on the pricing of residential mortgages, see CRS Report R46980, *Single-Family Mortgage Pricing and Primary Market Policy Issues*, by Darryl E. Getter.

[4] For more information about how to separate and price the risk components of mortgages, see CRS Report R46980, *Single-Family Mortgage Pricing and Primary Market Policy Issues*, by Darryl E. Getter.

collateral for a mortgage is transferred to the holder of the default risk after a borrower defaults. During COVID-19, some rules were temporarily modified to become better aligned with the loss mitigation options approved for distressed mortgages guaranteed by the Federal Housing Administration (FHA) or the *government-sponsored enterprises* (i.e., Fannie Mae and Freddie Mac, also called *the Enterprises*). The CFPB has since proposed to permanently adopt some of the revisions after observing their effectiveness. Servicing outcomes, however, depend upon the disruption and restitution of cash flows for both borrowers and servicers, which appear largely correlated with contemporaneous housing market and macroeconomic conditions. Therefore, if servicing rules keenly focused on mitigating foreclosure risk add costs—particularly at times when financial and economic conditions cause foreclosures to be unavoidable—the rules may inadvertently impede the expansion of homeownership opportunities for some households.

From the financial stability perspective, the MSAs face heightened liquidity pressures when the costs of servicing distressed mortgages can exceed the fees servicers earn during periods of mortgage market distress. Although maintaining cash reserves could mitigate liquidity risks for servicers, the funds would likely come from one or more of the following stakeholders—mortgage borrowers, servicers, securitizers, MBS investors, or taxpayers. Stakeholders' contributions to maintain an ample liquidity backstop would have implications likely to increase the cost of mortgages, inadvertently affecting the policy goal to expand homeownership opportunities.

Overview of Servicing and Loss Mitigation Options

Owners of mortgage default risk and servicers enter into *servicing contracts*, which contain provisions guiding the behavior of servicers when borrowers are past due on their mortgage payments. A mortgage loan is generally considered delinquent when payment is late by 30-90 days and seriously delinquent or in default when payments are 90 or more days overdue, but specific definitions can vary.[5] When a delinquency or default occurs, servicer-contract provisions (along with applicable federal and state regulations) determine (1) whether the servicer can offer *loss mitigation workouts* (discussed in the paragraph below) and, if so, which type and with what limitations; (2) when the servicer can initiate foreclosure; (3) if the servicer may act as an agent at the foreclosure auction; and (4) any bidding rules the servicer must follow. For example, if a servicer can initiate foreclosure, the rules are likely to state how much can be bid (e.g., up to a certain percentage of a borrower's unpaid balance) at a foreclosure auction. Because servicers are hired by and work on behalf of lienholders, servicing rules are typically designed to minimize their expenses and not necessarily those incurred by borrowers (although federal regulations require servicers to follow procedures to protect borrowers, discussed in the next section).[6]

Loss mitigation workouts refer to options, such as rescheduling payments or loan modification arrangements, that may help distressed borrowers become and stay current in their payments.

---

[5] Fannie Mae and Freddie Mac, which are government-sponsored enterprises that purchase newly originated mortgage loans, define *default* as 120 days late. The FHA, which is a federal mortgage insurance company, defines *default* as 30 days late. See FHA, "FHA Single Family Housing Policy Handbook: Glossary," https://www.hud.gov/sites/documents/40001gahsgh.pdf.

[6] For examples of contractual guidelines that servicers must follow, see 24 C.F.R. Part 203, Subpart C, https://www.ecfr.gov/current/title-24/subtitle-B/chapter-II/subchapter-B/part-203/subpart-C (for loans insured by the Department of Housing and Urban Development and FHA); Department of Veterans Affairs, "VA Home Loans: Servicers of VA Loans," https://www.benefits.va.gov/homeloans/servicers.asp; U.S. Department of Agriculture, Rural Development, "Loan Servicing," https://www.rd.usda.gov/resources/usda-linc-training-resource-library/loan-servicing; Fannie Mae, "Servicing Guide," https://servicing-guide.fanniemae.com/; and Freddie Mac, "Freddie Mac's Selling and Servicing Requirements," https://guide.freddiemac.com/.

Prior to offering a workout, a servicer may wait for some delinquencies to *self-cure* or become current on their own.[7] Some borrowers may resume payments after having received reminders or borrower counseling or if the circumstances that led to delinquency were temporary. When loans do not self-cure, the servicer has permission to offer various loss mitigation workouts. Distressed borrowers may still be able to avoid foreclosure if alternative workout options are mutually beneficial to lienholders. Servicing agreements typically allow servicers to offer at least one, some, or all of the following workout options depending upon borrower circumstances:

- A *repayment plan* is an option that allows a defaulted borrower to repay the amount in arrears and become current in mortgage payments. For example, a past due amount divided over a 12-month time period could be added to the regular payment amount, resulting in an increased total monthly payment over the next year.
- *Forbearance* allows a borrower to reduce or suspend payments for a short period of time after experiencing a sudden or temporary hardship. Forbearance may give borrowers a window of opportunity to resolve the temporary hardship before they must repay the amounts owed, including accumulated interest. A new mortgage contract does not need to be renegotiated to implement a repayment plan. The mortgage payments borrowers miss due to forbearance eventually need to be repaid, and repayment options can vary depending on the mortgage type and borrower circumstances.
- *Refinancing* out of a distressed mortgage into a new mortgage may also be an option that does not involve renegotiation of the original mortgage contract. Instead, the original mortgage contract is retired and a new one is issued. Distressed borrowers may be able to pull equity out of their homes to repay arrears and any accumulated penalties or add these expenses into the new loan balances. The availability of the refinance option, however, depends upon the market value of the home at the time of borrower default. The market value of the home, which would be used as collateral, must be high enough to cover the outstanding balance of the new loan. The new mortgage may also have an interest rate that is higher than the initial mortgage rate or current market rates (or both) to better reflect the greater credit risk of the recently defaulted borrower.[8]
- *Renegotiations* or *modifications* of mortgage contracts often involve concessions to borrowers in the form of interest rate reductions, term to maturity extensions, principal balance deductions, or some combination of such options. Servicers are not likely to offer mortgage contract renegotiations until after distressed borrowers have demonstrated the inability to become current using their own resources and resume making their original monthly payments going forward.[9] Modifications may still be beneficial to the lienholder when the costs to modify and retain the loan are lower than the costs to foreclose.

[7] *Cure period* refers to the time, typically prior to the 90 or 120 days before the loan is officially in default, in which borrowers have to become current on their mortgages.

[8] If interest rates have risen since the borrower originally obtained the mortgage, the refinancing option may not be available. Lienholders may also be reluctant to offer the refinancing option if borrowers are unable to satisfy the minimum requirements of the qualified mortgage rule. See CRS InFocus CRS In Focus IF11761, *The Qualified Mortgage (QM) Rule and Recent Revisions*, by Darryl E. Getter.

[9] See Manuel Adelino et al., "Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitization," Federal Reserve Bank of Boston, 2009.

If borrower circumstances make any of the abovementioned workout options infeasible, the troubled mortgage may need to be liquidated. Liquidating the mortgage involves selling the underlying asset (or home) that served as collateral for the loan and then using the proceeds to reduce the debt obligation.

- Liquidations such as *pre-foreclosure* or *short sales* and *deeds-in-lieu of foreclosure* are considered voluntary because they happen with the consent of both the lienholder and the distressed borrower. Specifically, a pre-foreclosure or short sale occurs when the borrower is allowed to sell the home and use the proceeds from the sale to satisfy the mortgage debt even if the proceeds are less than the amount owed. If the house does not sell, then the borrower may transfer title of the property over to the lienholder via signing a deed-in-lieu of foreclosure to settle the mortgage debt obligation. Deeds-in-lieu of foreclosure allow the property title to transfer without the lienholder having to repossess the property via legal proceedings, which is the definition of *foreclosure*.
- *Foreclosure*, which may also be considered a form of loss mitigation (for the lienholder), is the process of liquidating the distressed mortgage to recover losses by repossessing and selling the property.[10] Foreclosure may begin after a mortgage loan default. Specifically, foreclosure may occur when a borrower in default fails to respond to any efforts made by the servicer to communicate, is unemployed or lacks an income such that even a modified mortgage payment would be unaffordable, is *underwater* or *upside-down*—both terms referring to a home value decline below the amount of the outstanding mortgage balance—or is unable to obtain a workout option that is beneficial for the lienholder.

Servicing troubled mortgages typically entails incurring additional costs. For example, contacting and interacting with distressed borrowers may be more labor intensive, which arguably runs counter to financial industry trends to automate mortgage servicing functions to streamline costs.[11] If a delinquency or default occurs on a securitized mortgage, which is held in a trust with other mortgages and funded with MBS issuances, a servicer is still contractually required to forward timely payments to MBS investors until the troubled mortgage has been repurchased out of the trust. Servicers, therefore, have a greater financial incentive to purchase MSAs linked to mortgages originated for borrowers of pristine credit quality to lower the risk of incurring material costs to service non-performing loans.

Loan servicers generally weigh the costs and benefits of the various loss mitigation options and offer borrowers the one that is least costly. Loan forbearance can be the least costly option when the duration of consumer hardship is temporary and short such that the lienholder can be repaid quickly. Loan modifications may also be beneficial to the lienholder when the costs to modify and retain the loan are less than the costs of foreclosure.

When other workout options are infeasible, foreclosure may become the least costly way to resolve the default. Foreclosure, however, may still be costly for both parties. Borrowers lose what typically may be the largest assets in their portfolios. A lienholder may not be able to recoup the total outstanding loan amount, legal fees, lost revenue, and maintenance costs even after selling the distressed property.

---

[10] Because the foreclosure process is governed by state law, when servicers can initiate foreclosure varies by state.

[11] The costs to service non-performing mortgages have increased such that the industry is showing less willingness to assume this risk. See Laurie Goodman, "Servicing Costs and the Rise of the Squeaky-Clean Loan," *Mortgage Banking*, February 2016, https://www.urban.org/sites/default/files/publication/77626/2000607-Servicing-Costs-and-the-Rise-of-the-Squeaky-Clean-Loan.pdf.

Foreclosure Risk Mitigation and Policy Issues

A servicing crisis tends to occur when above-normal numbers of mortgages experience distress.[12] Servicers saw significant increases in the number of distressed mortgages in the years surrounding the 2008 financial crisis as well as during the COVID-19 pandemic. This section discusses the influence these events have had on the development of mortgage servicing rules.

The 2008 Financial Crisis and CFPB Mortgage Servicing Rules

During the 2008 financial crisis, which saw widespread house price declines and rising unemployment, borrowers who stopped paying their mortgages faced foreclosure risk. As foreclosures increased, concerns grew about mortgage servicers' procedures and practices.[13] Federal regulators identified a variety of issues related to mortgage servicing including, among other things, documentation issues.[14] For example, information about troubled borrowers' circumstances was frequently lost during transfers to *specialty servicers*, which specialize in servicing delinquent and defaulted loans. Consequently, loss mitigation applications and resolutions were delayed, and state foreclosure processes were disrupted across the nation.

As mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203), the CFPB issued—under the Real Estate Settlement Procedures Act (P.L. 93-533, implemented by Regulation X)—a mortgage servicing rule that became effective in 2014.[15] This rule became the minimum baseline servicing requirements for all covered U.S. mortgages. However, the CFPB servicing rule does not preempt servicing rules promulgated by states if they provide more protections for consumers.[16] Likewise, if a federal agency or an Enterprise guarantees the mortgage default risk, then its servicing rules become effective even though the CFPB servicing rules are still the minimum baseline.[17]

[12] The CFPB is also likely to see an increase in mortgage servicing complaints under these circumstances. See, for example, Lorelei Salas, "Seven Examples of Unfair Practices and Other Violations by Mortgage Servicers: CFPB Supervision Activities Uncover Red Flags," CFPB, December 9, 2021, https://www.consumerfinance.gov/about-us/blog/seven-examples-unfair-practices-and-other-violations-mortgage-servicers-cfpb-supervision-activities-uncover-red-flags/.

[13] For example, see U.S. Congress, House Committee on Financial Services, Subcommittee on Housing and Community Opportunity, *Robo-Signing, Chain of Title, Loss Mitigation, and Other Issues in Mortgage Servicing*, 111th Cong., 2nd sess., November 18, 2010, Serial No. 111-166 (GPO, 2011), https://www.govinfo.gov/content/pkg/CHRG-111hhrg63124/pdf/CHRG-111hhrg63124.pdf; U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Problems in Mortgage Servicing from Modification to Foreclosure*, 111th Cong., 2nd sess., November 16 and December 1, 2010, S. HRG. 111-987 (GPO, 2011), https://www.govinfo.gov/content/pkg/CHRG-111shrg65258/pdf/CHRG-111shrg65258.pdf; and Federal Reserve System, Office of the Comptroller of the Currency (OCC), and Office of Thrift Supervision, *Interagency Review of Foreclosure Policies and Practices*, April 2011, https://www.occ.gov/news-issuances/news-releases/2011/nr-occ-2011-47a.pdf.

[14] U.S. Government Accountability Office, *Mortgage Foreclosures: Documentation Problems Reveal Need for Ongoing Regulatory Oversight*, GAO-11-433, May 2011, https://www.gao.gov/assets/320/317923.pdf.

[15] See CFPB, "Mortgage Servicing Rules Under the Real Estate Settlement Procedure Act (Regulation X)," https://www.consumerfinance.gov/rules-policy/final-rules/2013-real-estate-settlement-procedures-act-regulation-x-and-truth-lending-act-regulation-z-mortgage-servicing-final-rules/.

[16] See CFPB, "CFPB Finalizes April Clarifications to Mortgages," July 10, 2013, https://www.consumerfinance.gov/about-us/newsroom/cfpb-finalizes-april-clarifications-to-mortgage-rules/; and CFPB, "Amendments to the 2013 Mortgage Rules Under the Real Estate Settlement Procedures Act (Regulation X) and the Truth in Lending Act (Regulation Z)," 78 *Federal Register* 44686-44728, July 24, 2013.

[17] For example, the FHA states: "Mortgagees must comply with all laws, rules, and requirements applicable to mortgage servicing, including full compliance with the applicable requirements under the purview of the Consumer (continued...)

The servicing rules were generally designed to address challenges that were discovered when the industry attempted to process the surging volume of mortgage delinquencies during the 2008 financial crisis. Specifically, the CFPB 2014 servicing rule and subsequent amendments focused on consumer protection issues as well as to mitigate foreclosure outcomes.[18] The rule covers the following nine topics related to mortgage servicing[19]:

1. **Periodic billing statements.** Owners of mortgage default risk (e.g., creditors, assignees) and servicers must provide periodic statements for each billing cycle that contain information about previous and currently due payments, fees, and servicer contact information.
2. **Interest-rate adjustment notices for ARMs.** A consumer whose mortgage has an adjustable interest rate must receive a notice between 210 and 240 days prior to the first payment due that would incorporate the first rate adjustment.
3. **Prompt payment credit and payoff statements.** Servicers must promptly credit periodic payments from borrowers as of the day of receipt.
4. **Force-placed insurance.**[20] A servicer may not charge for force-placed insurance coverage unless the servicer has reasonable basis to believe that the borrower has failed to maintain hazard insurance and the required notices (45 days, 30 days, and 15 days prior to charging for force-placed insurance coverage) have been provided.
5. **Error resolution and information requests.** Servicers must establish certain procedural requirements for responding to written information requests or complaints by borrowers. Servicers must acknowledge borrowers' requests within five days and investigate any errors within 30-45 days.
6. **General servicing policies, procedures, and requirements.** Servicers must establish consistent policies and procedures to contact delinquent borrowers, provide information about mortgage loss mitigation options, and evaluate borrower applications for loss mitigation in a timely manner.
7. **Early intervention with delinquent borrowers.** A servicer must establish or make good-faith efforts to establish live contact with the borrower by the 36th day of delinquency. Live contact includes telephoning or conducting an in-person meeting with the borrower but does not include leaving a recorded message. The

Financial Protection Bureau (CFPB), including the Real Estate Settlement Procedure Act (RESPA) and the Truth in Lending Act (TILA), and, if applicable, Ginnie Mae's mortgage-backed securities requirements. FHA requirements that are more stringent or restrictive than those provided for in applicable law are set forth in this Handbook 4000.1 and the Mortgagee must comply with these requirements." See HUD, "Handbook 4000.1, FHA Single Family Housing Policy Handbook, Title 1 Content," May, 20, 2024, p. 1162, https://www.hud.gov/sites/dfiles/OCHCO/documents/40001-hsgh-update15-052024.pdf.

[18] For more information, see CFPB, "Mortgage Servicing Rules Under the Real Estate Settlement Procedures Act (Regulation X) and the Truth in Lending Act (Regulation Z)," https://www.consumerfinance.gov/rules-policy/final-rules/mortgage-servicing-rules-under-real-estate-settlement-procedures-act-and-truth-lending-act/; and CFPB, "Mortgage Servicing Proposed and Final Rules," https://files.consumerfinance.gov/f/documents/cfpb_mortgage-servicing-rule_table.pdf.

[19] For more information, see CFPB, "Table Listing the Bureau's Mortgage Servicing Proposed and Final Rules," https://www.consumerfinance.gov/rules-policy/final-rules/mortgage-servicing-rules-under-real-estate-settlement-procedures-act-and-truth-lending-act/table-listing-bureau-mortgage-servicing-proposed-and-final-rules/; CFPB, Summary of the Final Mortgage Servicing Rules," January 17, 2013, https://files.consumerfinance.gov/f/documents/201301_cfpb_servicing-rules_summary.pdf; and CFPB, "Mortgage Servicing Rules Under the Real Estate Settlement Procedures Act (Regulation X)," 78 *Federal Register* 10695-10899, February 14, 2013.

[20] *Force-placed insurance* refers to a situation when a servicer obtains fire, flood, or other type of insurance to protect a property that is used as collateral for a mortgage loan because the borrower failed to maintain an updated policy.

servicer must also inform a delinquent borrower of available loss mitigation options, if available, by the 45th day of delinquency.

8. **Continuity of contact with delinquent borrowers.** Servicers must establish reasonable policies and procedures that would allow delinquent borrowers the ability to access personnel who can assist with loss mitigation options.
9. **Loss mitigation procedures.** Among other things, servicers must exercise reasonable diligence in obtaining documents and information to complete applications for loss mitigation options. Servicers must provide borrowers with written explanations for reasons for denying any loss mitigation options. Servicers are also not allowed to initiate the foreclosure process until mortgages are more than 120 days delinquent. In addition, foreclosure processes cannot be initiated until borrowers are informed that they are not eligible for certain loss mitigation options (and any appeal has been exhausted); borrowers have rejected all loss mitigation offers; or borrowers fail to comply with the terms of loss mitigation options during trial periods.

The servicing rules apply to federally related (i.e., those directly guaranteed by the federal government or by the Enterprises) closed-end mortgage loans. The servicing rules do not cover loans on property of 25 acres or more, business-purpose loans, temporary financing (e.g., bridge loans, construction to permanent loans), loans secured by vacant land, open-end lines of credit (e.g., home equity loans), reverse mortgage transactions, or mortgage loans for which the servicers are also qualified lenders under the Farm Credit Act of 1971.[21]

Various exemptions from some of the servicing rules exist for small servicers, defined as those entities that service 5,000 or fewer mortgage loans for all of which the servicer is the creditor or assignee.[22] For example, small servicers are exempt from having to provide periodic billing statements for each billing cycle. Servicers are prohibited from purchasing force-placed insurance if the cost is less than the cost of advancing funds to escrow for hazard insurance. However, small servicers are exempt from this provision. Small servicers are also exempt from the early intervention provision. Lastly, although small servicers are exempt from most of the loss mitigation provisions, they still cannot initiate foreclosure until mortgages are more than 120 days delinquent. A small servicer also cannot complete foreclosure or conduct a foreclosure sale if the borrower is in compliance with the terms of a loss mitigation agreement.

Although the CFPB mortgage servicing standards establish baseline procedural requirements, they do not dictate the specific loss mitigation options that must be offered to borrowers. Instead, the available loss mitigation options depend upon the entity (e.g., owner, investor, guarantor) that retains the default risk. For example, if any of the federal guaranty agencies—the FHA, the Department of Veterans Affairs (VA), the U.S. Department of Agriculture (USDA)—or the federally related Enterprises held the default risk, then servicers must offer loss mitigation options that follow their respective eligibility requirements. (Ginnie Mae is a federal agency that does not guarantee mortgage default risk but, instead, facilitates the creation of MBS linked to mortgages

[21] P.L. 92-181.

[22] For summaries of servicing rules for smaller servicers, see National Credit Union Administration (NCUA), "Mortgage Servicing Requirements from the Consumer Financial Protection Bureau (CFPB) Under the Real Estate Settlement Procedures Act (RESPA)," January 2014, https://www.ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/mortgage-servicing-requirements-consumer-financial-protection-bureau-cfpb-under-real; Federal Deposit Insurance Corporation (FDIC), "Servicing Rule Provisions That Apply to Small Servicers," https://www.fdic.gov/regulations/resources/director/technical/servicing/servicing-3.pdf; and Independent Community Bankers of America, "Summary of Mortgage Servicing Rules," October 2016, https://www.icba.org/docs/default-source/icba/advocacy-documents/icbasummarymortgageservicing.pdf.

insured by FHA, VA, and USDA.) Notably, a federally insured bank or credit union holds MSAs, then federal banking regulators (i.e., the Federal Reserve, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation or the federal credit union regulator—National Credit Union Administration—can monitor servicing *best practices*. Private sector owners or investors establish their own respective sets of loss mitigation eligibility and procedural requirements for servicers to follow.

CFPB's Temporary Measures in Response to COVID-19

In response to the COVID-19 pandemic, Congress, the federal agencies, and the Enterprises required mortgage servicers to implement certain temporary policies to assist eligible borrowers affected by COVID-19. Notably, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act, P.L. 116-136) was enacted on March 27, 2020. Section 4022 required that servicers of federally backed mortgages grant forbearance for up to 360 days upon request of the borrowers.[23] Section 4022 and other CARES Act provisions led to temporary revisions of the CFPB's existing mortgage servicing standards to apply more broadly. In June 2021, for example, the CFPB promulgated a final rule temporarily amending certain mortgage servicing procedures under Regulation X in response to the pandemic and the concern that a large number of borrowers might exit forbearance around the same time without receiving a meaningful opportunity to be reviewed for loss mitigation.[24] Among other things, the final rule, which became effective on August 31, 2021, allowed a servicer to offer certain types of loan modifications to a borrower with pandemic-related hardships even if the servicer had not received a completed loss mitigation application from the borrower. In addition, until January 1, 2022, the rule required servicers to ensure that at least one of several procedural safeguards (described in the final rule) were met before initiating foreclosure on mortgages that were at least 120 days past due.

Movement Towards Greater Standardization of Servicing Rules

In addition to more formal servicing procedures, consideration has been given to greater harmonization, particularly of federal servicing guidelines and solutions, to reduce confusion among servicers and possibly enhance outcomes for distressed borrowers. Specifically, the CFPB noted its participation with other federal agencies in informal discussions since 2011 about national mortgage servicing standards through interagency regulations and guidance, particularly about the possible benefits from greater uniformity.[25] The Federal Housing Finance Agency (FHFA) also announced the Servicing Alignment Initiative in 2011, requiring Fannie Mae and Freddie Mac to align their loss mitigation programs.[26] Having greater uniformity was intended to

---

[23] For more information, see CRS Insight IN11334, *Mortgage Provisions in the Coronavirus Aid, Relief, and Economic Security (CARES) Act*, by Katie Jones and Andrew P. Scott.

[24] CFPB, "Protections for Borrowers Affected by the COVID-19 Emergency Under the Real Estate Settlement Procedures Act (RESPA), Regulation X," 86 *Federal Register* 34848-34903, June 30, 2021, https://www.federalregister.gov/documents/2021/06/30/2021-13964/protections-for-borrowers-affected-by-the-covid-19-emergency-under-the-real-estate-settlement. For an executive summary of the rule, see CFPB, Executive Summary of the 2021 Mortgage Servicing COVID-19 Rule, June 28, 2021, https://files.consumerfinance.gov/f/documents/cfpb_covid-mortgage-servicing-rule_executive-summary_2021-06.pdf.

[25] See CFPB, "Mortgage Servicing Rules Under the Real Estate Settlement Procedures Act (Regulation X)," 78 *Federal Register* 10696-10899, February 14, 2013.

[26] See FHFA, "Fannie Mae and Freddie Mac to Align Guidelines for Servicing Delinquent Mortgages," April 28, 2011, https://www.fhfa.gov/Media/PublicAffairs/Pages/Fannie-Mae-and-Freddie-Mac-to-Align-Guidelines-for-Servicing-Delinquent-Mortgages.aspx; FHFA, "Loss Mitigation," https://www.fhfa.gov/PolicyProgramsResearch/Programs/Pages/Loss-Mitigation.aspx; and FHFA, "Mortgage Servicing," https://www.fhfa.gov/PolicyProgramsResearch/Policy/
(continued...)

increase servicer efficiencies in resolving delinquencies.[27] Moreover, various stakeholders, including mortgage servicers, collaborated on efforts to substantially increase the amount of data collected to better understand the servicing process.[28] Given previously discussed concerns regarding the lost information about troubled borrowers' circumstances during data transfers to specialty servicers, a data collection initiative may promote more data compatibility in the industry, possibly increasing both the accuracy and timeliness of data transfers.

A 2016 report issued by the Department of the Treasury, the Department of Housing and Urban Development (HUD), and FHFA discusses how two government-sponsored programs—Making Home Affordable and the Home Affordable Modification Program—provided a standardized approach for mortgage modifications to assist financially distressed borrowers stemming from the 2008 housing market and macroeconomic conditions.[29] Also, the **Appendix** below summarizes a 2021 audit report conducted by the HUD Office of the Inspector General of servicing activities stemming from the COVID-19 period in which the findings arguably demonstrate advantages that may accrue when servicing rules can be harmonized.

In March 2023, HUD published a final rule allowing for 40-year loan term modifications of FHA-insured mortgages under certain circumstances.[30] The earlier proposed rule noted that Fannie Mae, Freddie Mac, the NCUA, and USDA all allowed 40-year loan modifications under some circumstances and, by making this change, "HUD would align with the Enterprises, NCUA, and USDA and ensure that FHA borrowers receive comparable opportunities for home retention."[31] Thus, the federal regulators observed that harmonization of some federal servicing guidelines—particularly during emergency periods—mitigated confusion among servicers, possibly resulting in faster remediation for distressed borrowers.

If, however, servicing eligibility and procedural requirements become more standardized, lienholders may still incur higher costs if more customized options are not chosen for anomalous circumstances. In other words, an automatic application of a standardized loss mitigation option may not provide some borrowers with sufficient time to self-cure, which can increase costs for

Pages/Mortgage-Servicing.aspx. FHFA has been standardizing many of the Enterprises' business operations since their conservatorship. For more information, see CRS Report R46746, *Fannie Mae and Freddie Mac: Recent Administrative Developments*, by Darryl E. Getter.

[27] For a summary of some of the changes made to servicing requirements, see FHFA, "Servicing Alignment Initiative Frequently Asked Questions," April 28, 2011, https://www.fhfa.gov/Media/PublicAffairs/Pages/Servicing-Alignment-Initiative-FAQs.aspx; and FHFA, Office of Inspector General, *FHFA's Oversight of the Servicing Alignment Initiative*, February 12, 2014, pp. 11-12, https://www.fhfaoig.gov/sites/default/files/EVL-2014-003_0.pdf.

[28] See Karan Kaul et al., "The Case for Uniform Mortgage Servicing Data Standards," Urban Institute, November 2018, https://www.urban.org/sites/default/files/publication/99317/uniform_mortgage_servicing_data_standards.pdf.

[29] U.S. Department of the Treasury, *Guiding Principles for the Future of Loss Mitigation: How the Lessons Learned from the Financial Crisis Can Influence the Path Forward*, July 25, 2016, https://home.treasury.gov/system/files/136/archive-documents/guiding-principles-future-of-loss-mitigation.pdf. See pages 7-9 for a discussion of how these programs may have contributed to greater standardization of loss mitigation processes. The report also outlined five guiding principles for loss mitigation going forward: accessibility, affordability, sustainability, transparency, and accountability (see page 10).

[30] HUD, "Increased Forty-Year Term for Loan Modifications," 88 *Federal Register* 14252-14259, March 8, 2023, https://www.federalregister.gov/documents/2023/03/08/2023-04284/increased-forty-year-term-for-loan-modifications. A 40-year modified loan term reduces borrowers' monthly mortgage payments by increasing the loan term, thus increasing the length of time to repay the mortgage. FHA's proposed rule had noted, "All else held equal, borrowers who choose a 40-year loan modification would be subject to slower equity accumulation and additional interest payments over the course of the modified mortgage relative to a 30-year loan modification. However, to the extent a 40-year modification helps borrowers avoid foreclosure, the slower equity accumulation and additional interest would be greatly outweighed by the benefits of being able to retain their homes." See HUD, "Increased Forty-Year Term for Loan Modifications," 87 *Federal Register* 19038, April 1, 2022.

[31] HUD, "Increased Forty-Year Term for Loan Modifications," 87 *Federal Register* 19038, April 1, 2022.

lienholders.[32] Consequently, increased harmonization while simultaneously allowing for some flexibility may suggest a trade-off for policymakers and stakeholders to consider.[33]

CFPB's 2024 Proposed Modifications to Servicing Requirements

On July 10, 2024, the CFPB announced a proposed rule amending the 2013 servicing rules to streamline requirements and adopt new procedural safeguards to mitigate foreclosure risk.[34] Under CFPB's 2013 rule, for example, mortgage servicers must obtain *complete* loss mitigation applications, which require borrowers to submit all necessary information before they could be evaluated for all available loss mitigation options. By contrast, the Enterprises introduced in 2013 a streamlined modification program—specifically low- or perhaps no-documentation loan modifications—that arguably increases borrowers' willingness to apply for loan modifications. Streamlined loss mitigation applications were also used in COVID-19, allowing borrowers to enter faster into loss mitigation programs. With this in mind, the CFPB proposes to remove the existing requirement for complete loss mitigation applications and adopt a new framework based on foreclosure procedural safeguards. Servicers would then be able to review borrowers' applications using any collected information even if the applications are incomplete.

The CFPB also proposes, under a new framework, that a *loss mitigation review cycle* begins after a borrower's request for assistance. It continues until the loan is brought current or one of the following procedural safeguards is met: (1) the borrower has been evaluated for all available loss mitigation options and no available loss mitigation options remain, or (2) the borrower has not communicated with the servicer for at least 90 days despite the servicer having regularly taken steps to communicate with the borrower. During the loss mitigation review cycle, the servicer may not begin or advance the foreclosure process, and a borrower would also be protected against the accrual of certain fees.

The CFPB's proposal addresses additional concerns.

- For early intervention notices, the CFPB proposes that the servicer include the name of the owner (or assignee) of a borrower's mortgage, a brief description of the owner's available loss mitigation options, and the owner's website with the same and more detailed information.
- The CFPB proposes that servicers provide more detailed information for *loss mitigation determination notices*, the written notices to borrowers that explain the outcomes following their loss mitigation requests. Specifically, these notices should explain the factors used for deciding outcomes approved or denied as well as any loss mitigation options that are still available to borrowers.
- The CFPB proposes Spanish-language translations of certain written communications to borrowers, and it is soliciting comments regarding the feasibility to accommodate other languages upon borrowers' requests.
- The CFPB is soliciting comments on how to address situations when a servicer—perhaps due to internal systems not being updated in a timely manner—may

[32] For example, if offering a borrower an automatic extended forbearance period were adopted as standard loan servicing procedure, the implementation costs to a lienholder may be greater than the cost of waiting for a self-cure.

[33] See Urban Institute, "What Is the Future of Loss Mitigation? Normalizing Forbearance," webinar, December 5, 2022, https://www.urban.org/events/what-future-loss-mitigation.

[34] See CFPB, "Streamlining Mortgage Servicing for Borrowers Experiencing Payment Difficulties (Regulation X)," July 10, 20204, https://www.consumerfinance.gov/rules-policy/notice-opportunities-comment/open-notices/streamlining-mortgage-servicing-for-borrowers-experiencing-payment-difficulties-regulation-x/.

furnish to a credit bureau negative information about a borrower who is performing according to the terms of a newly agreed-to loss mitigation option.[35]

Policy Discussion and Implications

Since the 2008 financial crisis, servicing rules ultimately focus on mitigating foreclosures. Prior to 2008, for example, private market pooling-and-servicing agreements typically provided guidance for routine servicing activities that occurred when financial markets and economic conditions were stable, leaving servicers with broad discretion to foreclose or offer alternative loss mitigation workouts.[36] As the number of foreclosures surpassed the number of alternative workouts (e.g., loan modifications) during the 2008 financial crisis, some analysts attributed this outcome to a *principal-agent* problem, which exists if agents (servicers)—while working on behalf of principals (investors)—pursue their own self-interests rather than those of the principals. In other words, servicers' compensation structures were said to provide them with greater incentives to foreclose rather than offer loan restructurings that could benefit mortgage investors.[37] Servicers could presumably be reimbursed for some administrative costs and fees charged to borrowers during foreclosures.[38] Meanwhile, mortgage owners may not fully recover lost principal and interest, especially if house prices are falling. For these reasons, the principal-agent problem, also referred to as an *incentive misalignment* problem between investors and servicers, became one of the motivations for focusing servicing rules on foreclosure mitigation.

The incentive misalignment assumption is debatable. First, a Federal Reserve report indicated that, at the time of the financial crisis, many servicers lacked the capacity and were unprepared to manage the sudden and significant rise in loan defaults.[39] The report identified several issues. For example, many servicers had not invested in the technology to evaluate loss mitigation options for large volumes of distressed mortgages, nor did they have adequate experienced staff with the specialized skills necessary to administer workouts for any peculiar situations. Investing in the capabilities necessary to react effectively to a large-scale foreclosure crisis would have been costly, particularly for those servicers with small servicing portfolios. In other words, the evidence that servicers were unprepared for widespread mortgage defaults may serve as an alternative explanation to the incentive misalignment hypothesis.

Second, the cash flow streams and liquidity positions for both mortgage servicers and owners are intertwined. When conducting foreclosures, for example, servicers immediately incur expenses

[35] For more information about disputed negative information on credit reports, see CRS Report R44125, *Consumer and Credit Reporting, Scoring, and Related Policy Issues*, by Darryl E. Getter.

[36] For more information, see Margaret R. T. Dewar, "Regulation X: A New Direction for the Regulation of Mortgage Servicers," *Emory Law Journal*, vol. 63, no. 1 (2013), pp. 180-190, https://scholarlycommons.law.emory.edu/cgi/viewcontent.cgi?article=1224&context=elj.

[37] See Diane E. Thompson, "Foreclosing Modifications: How Servicer Incentives Discourage Loan Modifications," *Washington Law Review*, vol. 86 (December 1, 2011), footnote 24, p. 761, https://digitalcommons.law.uw.edu/cgi/viewcontent.cgi?article=4699&context=wlr. The discussion referred specifically to owners in the form of investors in MBSs.

[38] Allowable foreclosure fees include some or all attorney fees that include ordering and reviewing title reports, drafting papers to initiate foreclosure, preparing legal papers, court appearances, and conveying title. For a more detailed list, see Fannie Mae, "Allowable Foreclosure Fees," February 12, 2020, https://servicing-guide.fanniemae.com/svc/e-5-04/allowable-foreclosure-fees; and Freddie Mac, "Approved Attorney Fees and Title Expenses," June 11, 2025, https://guide.freddiemac.com/app/guide/exhibit/57a.

[39] See Larry Cordell et al., *The Incentives of Mortgage Servicers: Myth and Realities*, Board of Governors of the Federal Reserve System, September 8, 2008, https://www.federalreserve.gov/pubs/feds/2008/200846/200846pap.pdf.

and must wait to receive some or full reimbursements by owners.[40] Following extensive house price declines and the rise in unemployment rate over the 2007-2009 recession, neither mortgage investors nor servicers would expect borrowers that were underwater and unemployed to resume making payments.[41] For this reason, workouts designed to keep unemployed borrowers in their homes were less likely to have long-term success, thereby increasing cash outflows and financial losses for both servicers and mortgage owners. By contrast, during times such as COVID-19 when house prices are rising, borrowers' hardships (e.g., sickness, layoffs due to businesses closures) were arguably easier to verify, and loan restructurings became feasible options with the expectation that future cash inflows would resume. When mortgages *reperform*—that is, they resume generating interest income for owners—servicers also resume collecting servicing fees.

Effective loss mitigation workout options, therefore, appear highly dependent on contemporaneous housing market and macroeconomic conditions. As previously stated, more short sales, deeds in lieu, or foreclosures tend to be unavoidable at times when house prices are falling and unemployment rates are rising. When interest rates fall (and housing market and overall macroeconomic conditions are stable), refinancing trouble loans can reduce borrowers' payments and provide financial relief.[42] Conversely, refinancing distressed borrowers is unworkable when mortgage rates are higher than initial rates, and loan modifications (e.g., principal forgiveness) may increase in feasibility.[43] Insofar as the cash flow expectations of principals and agents are intertwined—and the feasibility of various workouts depends highly on existing financial market and macroeconomic conditions—then servicing rules may not necessarily influence the loss mitigation options pursued by servicers.

Regardless of whether workout options are influenced by incentive misalignment or existing financial and macroeconomic conditions, servicing rules designed to mitigate foreclosure risk are aimed to discourage an activity that imposes costs on society.[44] In this context, borrowers who

---

40 For more information, see FHFA, Office of Inspector General, *FHFA Oversight of Fannie Mae's Reimbursement Process for Pre-Foreclosure Property Inspections*, January 15, 2014, p. 5, https://www.fhfaoig.gov/Content/Files/AUD%202014-005.pdf.

41 The unemployment rate nearly doubled from 5.3% to 10.0% during the 2007-2009 recession. See Bureau of Labor Statistics, "Great Recession, Great Recover? Trends from the Current Population Survey," April 2018, https://www.bls.gov/opub/mlr/2018/article/great-recession-great-recovery.htm. A mortgage is underwater when the house value—the collateral used to secure the loan—declines below the amount of the outstanding loan balance. In other words, the house cannot be sold for a price that covers the current debt obligation. Some underwater borrowers may choose to default, and some may default following income or other cash flow disruptions. See Neil Bhutta et al., *The Depth of Negative Equity and Mortgage Default Decisions*, Board of Governors of the Federal Reserve System, May 2010, http://www.federalreserve.gov/pubs/feds/2010/201035/201035pap.pdf; Michael G. Bradley et al., "Strategic Mortgage Default: The Effect of Neighborhood Factors," *Real Estate Economics*, vol. 43 (January 2015), pp. 271-299; and Joseph S. Tracy, "Mortgage Design, Underwriting and Interventions: Promoting Sustainable Homeownership," Research Institute for Housing America, Mortgage Bankers Association, July 2024, https://www.mba.org/docs/default-source/research—riha-reports/26678-riha-sustainable-homeownership-paper.pdf.

42 Ted Tozer, "The Mortgage Interest Rate Increase Requires a Reevaluation of Loss Mitigation Techniques," Urban Institute, August 10, 2022, https://www.urban.org/urban-wire/mortgage-interest-rate-increase-requires-reevaluation-loss-mitigation-techniques.

43 Lienholders may still be reluctant to offer principal forgiveness because, in addition to incurring some principal and interest losses, other borrowers may be encouraged to pursue the equivalent of a mortgage refinance at below-market rates.

44 These rules are conceptually analogous to a tax, specifically a *Pigouvian tax*, which is designed to internalize an negative externality. For discussions regarding the strengths and weaknesses of a Pigouvian tax, see William J. Baumol, "On Taxation and the Control of Externalities," *American Economic Review*, vol. 62, no. 3 (June 1972), pp. 307-322; Earl A. Thompson and Ronald Batchelder, "On Taxation and the Control of Externalities: Comment," *American Economic Review*, vol. 64, no. 3 (June 1974), pp. 467-471; and Dennis W. Carlton and Glenn C. Loury, "The Limitations of Pigouvian Taxes as a Long-Run Remedy for Externalities," *Quarterly Journal of Economics*, vol. 95, no. 3 (November 1980), pp. 559-566.

were not involved with arrangements made between lienholders and servicers face foreclosure risk. Consumer protection rules may increase servicers' costs to initiate foreclosure without completely eliminating this option. Furthermore, servicing rules that require evaluation of non-foreclosure workout options may be less costly when house prices are not declining. Servicers do not require an added incentive to consider non-foreclosure workout options under circumstances when they are likely to be successful. By contrast, an added incentive to review non-foreclosure workout options at times when foreclosures are likely to be unavoidable may increase servicers' costs—but may safeguard against overlooking any alternative possibilities.

Servicing rules to mitigate foreclosure risk may pose a trade-off, namely to make the oft-stated policy goal to expand homeownership more difficult to achieve. Such policy discussions pertaining to homeownership expansion may focus on increasing credit access to borrowers with lower and more variable incomes as well as those with impaired or limited credit histories. If servicers choose to purchase fewer MSAs linked to higher-risk borrowers, who are less likely to make timely loan payments (particularly during distressed periods) and more costly to service, then lienholders may be less willing to provide loans for these groups.[45] In short, servicing rules may mitigate foreclosures, reduce lending to higher-risk borrowers, or some combination of both.

Systemic Risk Mitigation and Policy Issues

Servicers purchase MSAs for the right to receive future cash flows. In other words, just as a mortgage is an asset for a lienholder, the right to earn income for servicing a mortgage is an asset for a servicer. MSAs are traded (bought and sold) in a separate market from the original underlying mortgages. MSA values are based upon the discounted sum of expected future cash flows, which are calculated based upon the expected cash flows generated by the underlying mortgages themselves. Therefore, as previously discussed, the cash flows generated by a mortgage asset for an owner and a servicer's MSA are intertwined.

Prospective servicing firms typically place bids on MSAs at auctions. After settling on a price, a servicer may need to borrow funds to purchase the MSAs. One option may be to obtain a cash advance loan, which uses the MSAs' anticipated cash flows as collateral, and ultimately to repay the cash advance.[46] Servicers' potential profits, known as the *excess servicing fees (ESFs)*, are the fees charged to collect borrowers' scheduled mortgage payments (and to subsequently remit payments to lienholders, tax collectors, and insurance companies) minus the MSAs' purchasing costs and other operating costs incurred by servicers.

Like other marketable assets (e.g., bonds), MSA cash flows also have risks. For example, an MSA is conceptually similar to a financial derivative in that its value is linked to the performance of an underlying asset (i.e., the mortgage). An MSA's cash flows are linked to the cash flows of the underlying linked mortgage, which typically faces two key *timing risks*[47]:

- Mortgages have *prepayment risk*—the risk that a borrower repays the mortgage early or ahead of schedule, causing the asset to generate a lower yield (return) than initially expected. Declining interest rates increase a mortgage's prepayment

[45] See Goodman, "Servicing Costs and the Rise of the Squeaky-Clean Loan." A servicer must incur costs to provide a delinquent borrower with requisite notices and must continue forwarding timely principal and interest payments to investors even if the borrower's payment has not yet been collected and the matter has not been fully resolved.

[46] For a typical collateralized loan, a borrower pledges an asset (e.g., real estate, bonds, equipment) that can be used as security for repayment. Loans secured by anticipated cash receivables, rather than physical assets, are considered riskier, particularly when the cash flows have embedded timing risks such as MSAs.

[47] See CRS Report R46980, *Single-Family Mortgage Pricing and Primary Market Policy Issues*, by Darryl E. Getter.

risk, causing the value of the linked MSA to decline in anticipation of terminated future cash payments.

- Mortgages have *credit (default) risk*—the risk that a borrower pays late or fails to repay the principal and interest obligations. Default risk reduces the cash flows for a mortgage and its linked MSA. Furthermore, the costs to service a defaulted mortgage rise substantially.

If the probability of timing risk rises, causing an MSA's market value to decline, then the servicer would likely receive a *margin call*, which requires either more collateral to be pledged or the cash advance to be repaid in full. Macroeconomic events (e.g., interest rate movements, rising unemployment) may trigger large amounts of unanticipated prepayments or defaults of mortgages, resulting in a decline in ESF payments (i.e., cash flow disruption) and possibly material financial losses for servicers obligated to repay any loans for MSA purchases.

The Prudential Regulatory Response to the 2008 Financial Crisis

When a delinquency or default occurs on a securitized mortgage (i.e., one held in a trust with other mortgages), a servicer must continue forwarding on-time payments to the MBS or Uniform MBS investors until the distressed mortgage has been repurchased out of the trust linked to either Ginnie Mae or one of the Enterprises, respectively (referred to collectively as the Agencies).[48] Investors in the Agencies' MBSs agree to assume only prepayment risk, and they do not expect to see any disruption in their cash flows that would occur for any other reason.[49] Therefore, servicers risk not having enough cash on hand to forward MBS payments during periods of rising defaults or when the completion of loss mitigation remediation strategies takes longer than anticipated even if they receive full or partial reimbursements after remediations have occurred.

Banks are required to maintain capital reserves and liquid assets to buffer against unanticipated reversals in cash flows, which occurs during *systemic risk* events.[50] While servicing large amounts of loans in 2007 and 2008, banks were unable to collect the necessary amount of mortgage repayments to meet their payment obligations to MBS investors and other parties. When financial institutions in general—and banks or credit unions in particular—cannot meet timely payment obligations or experience asset price declines (including MSA values), a panic among depositors and shareholders could emerge and possibly affect the confidence in the solvency of other financial institutions that may not even own any MSAs.[51]

In response to the 2008 recession, the federal prudential bank regulators took actions to mitigate systemic risk. Specifically, bank capital rules were revised such that MSAs exceeding 10% of a banks' minimum common equity Tier 1 capital ratio requirement must either be deducted or face significantly higher risk weights.[52] Consequently, banks sold significant shares of MSAs in bulk

[48] The Enterprises guarantee mortgage default risks and create MBSs—referred to as *Uniform MBSs* while under conservatorship—consisting of the underlying mortgages' prepayment risks.

[49] Servicers facilitate the purchases of defaulted mortgages from trusts and are reimbursed by the applicable Agency after resolution of matters associated with the defaults.

[50] Although economists have not arrived at a consensus definition, systemic risk may be viewed as an increase in correlation among individual default or wholesale funding risks largely due to a sudden loss of confidence (panic) of financial market participants following a liquidity disruption or decline in asset prices. For more information, see Lance Taylor and Stephen A. O'Connell, "A Minsky Crisis," *Quarterly Journal of Economics*, vol. 100 (1985), pp. 871-885.

[51] See David Greenlaw et al., "Leveraged Losses: Lessons from the Mortgage Market Meltdown," Proceedings of the U.S. Monetary Policy Forum, 2008, http://research.chicagobooth.edu/igm/docs/USMPF_FINAL_Print.pdf.

[52] For more information on bank capital ratios and risk weights, see Board of Governors of the Federal Reserve System, (continued...)

beginning in 2011 to nonbank mortgage servicers, discussed in greater detail in the section below titled "Policy Discussion and Implications."[53] By April 2020, the MSAs for approximately 50% of the federally insured mortgage market were held by nonbank servicers.[54] According to the Financial Stability Oversight Committee, the share of nonbank servicers has since increased to 66% as of January 2024.[55]

The COVID-19 Experience and Heightened Liquidity Risks

During COVID-19, the Federal Reserve responded by lowering interest rates, potentially triggering prepayments of existing mortgages. The rise in unemployment filings might have triggered mortgage default risks, but rising home values at the time may have had a dampening effect. Meanwhile, the CARES Act (P.L. 116-136) required a foreclosure moratorium for all federal and federally related insured loans. It also allowed borrowers with COVID-19-related hardships to request from their servicers 180 days' forbearance relief for no additional fees and, if necessary, an additional 180 days.

Consequently, both bank and nonbank servicers faced greater liquidity pressures due to (1) greater margin call risk following MSA value declines and (2) the requirement to continue forwarding payments to investors holding federally guaranteed MBSs with an abnormally large number of mortgages in forbearance. In light of these liquidity risk concerns, Ginnie Mae and FHFA—the primary regulator for the Enterprises and the Federal Home Loan Bank (FHLB) system—announced the expansion of various programs to support liquidity for mortgage servicers.[56] On April 7, 2020, Ginnie Mae announced a private market servicer liquidity facility for its servicers that borrow to finance Ginnie Mae MSAs. On April 21, 2020, FHFA announced that mortgage servicers for the Enterprises no longer had to advance scheduled payments to investors in the Enterprises' Uniform MBSs after having advanced four months of payments. In addition, FHFA allowed member institutions of the FHLB system to post residential mortgages in forbearance (i.e., the consumer defers payments) as collateral, which would allow them to continue receiving cash advances from their regional FHLBs. Some of the 11 FHLB institutions established additional collateral relief programs to allow member institutions to continue receiving wholesale funding.

Policy Discussion and Implications

As previously discussed, the federal banking agencies increased the capital requirements for banks holding MSAs above a designated threshold. In July 2019, however, the federal banking

FDIC, OCC, NCUA, *Report to the Congress on the Effect of Capital Rules on Mortgage Servicing Assets*, June 2016, https://www.federalreserve.gov/publications/other-reports/files/effect-capital-rules-mortgage-servicing-assets-201606.pdf.

[53] See Board of Governors of the Federal Reserve System, FDIC, OCC, NCUA, *Report to Congress on the Effect of Capital Rules on Mortgage Servicing Assets*.

[54] See John W. Ryan, president and CEO of the Conference of State Bank Supervisors, letter to the Hon. Maxine Waters, chairwoman of the House Financial Services Committee, the Hon. Mike Crapo, chairman of the Senate Banking Committee, the Hon. Patrick McHenry, ranking member of the House Financial Services Committee, and the Hon. Sherrod Brown, ranking member of the Senate Banking Committee, April 15, 2020, https://www.csbs.org/sites/default/files/2020-04/CSBS%20Letter%20COVID19%20Apr%2020f.pdf.

[55] See Financial Stability Oversight Council, *Report on Nonbank Mortgage Servicing*, 2024, https://home.treasury.gov/system/files/261/FSOC-2024-Nonbank-Mortgage-Servicing-Report.pdf.

[56] See CRS Report R46499, *The Federal Home Loan Bank (FHLB) System and Selected Policy Issues*, by Darryl E. Getter.

agencies reduced the costs to hold MSAs for *non-advanced-approaches banks*.[57] As this rulemaking was in process, banks (and credit unions, discussed in the textbox below), which typically enjoy greater access to liquidity (relative to nonbanks) and must also maintain loan loss reserve buffers, increased their MSA holdings.[58]

Credit Union Participation in MSA Markets

Partly in response to the savings and loan crisis of the 1980s, the National Credit Union Administration, the primary regulator for credit unions, limited credit unions' exposure to various mortgage risks and MSA market participation.[59] Specifically, a credit union could retain the MSAs for its own loan originations, but it could not directly purchase MSAs. Over time, credit unions have been allowed to increase their participation in the mortgage market and their use of financial derivatives to hedge exposures to mortgage-related risks.[60] On December 23, 2021, the NCUA also permitted federal credit unions that meet the requirements to be well-capitalized to purchase MSAs from other federal credit unions.[61] The ability to purchase MSAs will allow those credit unions choosing to specialize in this market to bypass membership restrictions and profit from scale (higher volume) advantages.

By contrast, *nonbank servicers*, which do not hold federally insured deposits, lack liquidity access comparable with banks and credit unions. Nonbank servicers are typically not required to set aside financial buffers for unanticipated financial crises that could cause MSA values to decline. Furthermore, nonbank mortgage servicers do not have access to federal backstops such as the Federal Reserve or the FHLB system.

In general, requirements to build cash reserves to buffer against timing risks (and related margin calls) makes them conceptually analogous to a tax applied to mitigate the negative effects of an adverse liquidity evaporation event. Because MBS investors would face the heightened risk of not receiving timely payments, liquidity buffer rules would arguably help maintain faith in the financial system and federally related mortgage entities. For this reason, adopting ESF set-aside requirements for nonbank servicers has been part of policy discussions given that they currently own the largest share of the Agencies' MSAs market.[62] However, just like some banks, nonbanks may reduce their participation in the MSA market if cash buffer requirements would reduce expected profitability.

If having an MSA liquidity backstop requirement for nonbanks is deemed necessary for financial stability, consideration of who bears most of the costs becomes a policy issue for debate.

---

[57] Non-advanced-approaches banks are those with less than $250 billion in total consolidated assets or less than $10 billion in foreign on-balance-sheet exposure. For these banks, their MSA holdings may exceed 25% of their common equity before having to reduce their capital reserves. However, the risk weight for MSAs below the threshold increased from 100% to 250%. For more information on the capital rule change, see OCC, the Federal Reserve System, and FDIC, "Regulatory Capital Rule: Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996," 84 *Federal Register* 35234-35280, July 22, 2019.

[58] For more information on the response by affected banks, see Adam Freedman et al., "The Impact of Recent Changes in Capital Requirements on Mortgage Servicing Assets," Bank Policy Institute, June 25, 2019, https://bpi.com/wp-content/uploads/2019/06/The-Impact-of-Recent-Changes-in-Capital-Requirements-on-Mortgage-Servicing-Assets.pdf.

[59] See NCUA, "Investment and Deposit Activities," 62 Federal Register 32989-33006, June 18, 1997; and CRS Report R46360, *The Credit Union System: Lending Activities and Selected Regulatory Developments*, by Darryl E. Getter.

[60] See NCUA, "Loans to Members and Lines of Credit to Members," 53 *Federal Register* 19748-19752, May 31, 1988. The final rule specifically discusses purchasing financial *put options*, which would allow a credit union to sell any MBS holdings to a counterparty at their initial prices prior to an interest rate increase.

[61] See NCUA, "Mortgage Servicing Assets," 86 *Federal Register* 72810-72818, December 23, 2021.

[62] See Financial Stability Oversight Council, *Report on Nonbank Mortgage Servicing*; and Donald H. Layton, "Nonbank Mortgage Servicers: Proposing a Better Path to Reduce Their Risk to Financial Stability," Furman Center, New York University, November 11, 2024, https://furmancenter.org/thestoop/entry/nonbank-mortgage-servicers-proposing-a-better-path-to-reduce-their-risk-to-financial-stability.

Suppose, for example, a liquidity backstop for MSAs is created and funded by collecting premiums, possibly by increasing mortgage prices in the form of basis points.[63] Stakeholders—mortgage borrowers, servicers, the Agencies, MBS investors—would bear a share of the costs to establish a liquidity backstop. As previously stated, prospective servicers may not bid on MSAs if they must bear most of these costs, thus resulting in a servicer shortage likely to translate into fewer mortgage originations. If borrowers bear most of these costs in the form of higher mortgage insurance premiums (also referred to as guarantee fees when linked to MBSs), then homeownership may become less affordable, particularly for low-income households. If some MBS investors can find equivalent substitute investment opportunities and avoid paying these costs, then their reduced participation in the MBS market could put upward pressures on mortgage rates. If, however, facilitating participation in both MBS and MSA markets as well as housing affordability are all deemed to be as important as a liquidity backstop for servicers, then the Agencies (and ultimately taxpayers) may bear more of the liability created by an adverse liquidity event.

[63] Banks and credit unions pay assessments to the Deposit Insurance Fund and the National Credit Union Share Insurance Fund, respectively. The proceeds maintained in the funds are used to protect depositors from losses following a bank or credit union failure. Similarly, liquidity funds (for each of the Agencies) could be established to maintain proceeds collected from all mortgage originators. Rather than pay capital charges, banks and credit unions could pay MSA surcharges forwarded to a liquidity fund if they hold MSAs.

Appendix. Summary of HUD Inspector General Servicing Report

To illustrate how multiple sets of servicing rules may create confusion for both servicers and borrowers, this Appendix summarizes some examples of servicing issues mentioned in a report conducted by the HUD Office of the Inspector General. The report audited servicers' implementation of COVID-19 forbearances for FHA-insured mortgages from March 1, 2020, through November 30, 2020, and identified several issues discussed in the bullets below.[64] FHA's servicing experiences over this period were not atypical compared to those of other servicers.[65] However, these examples are chosen because the information source is authoritative and well-documented.

- At least one-third of delinquent FHA borrowers over this period were either not informed or misinformed about the COVID-19 forbearance. Specifically, the audit states that FHA did not ensure that servicers adequately informed borrowers of the COVID forbearance option. Although FHA requires its servicers to provide borrowers with information about FHA's standard loss mitigation options, information about the CARES Act forbearance option—which should have been treated as a separate loss mitigation program to supersede the existing FHA loss mitigation options at the time—may not have been offered to borrowers. The audit did not say whether this understanding of CARES Act forbearances was understood by all FHA servicers, which could explain why some servicers continued to adhere to FHA servicing guidelines.
- The audit found that FHA servicers continued to require borrowers to fill out multiple pieces of documentation (e.g., a hardship letter, assistance application, income and expenses verification, and other supporting documents). The CARES Act, however, required servicers to provide forbearance with no additional documentation aside from a borrower's attestation to a financial hardship caused by the COVID-19 emergency. Consequently, the audit states that excessive documentation may have discouraged some borrowers from requesting forbearance.
- According to the audit, some servicers may have improperly denied forbearance for borrowers experiencing COVID-19 hardships, which would have been in conflict with the goals of the CARES Act. For example, the audit report states that some servicers may have denied forbearance to borrowers who were delinquent and in foreclosure proceedings before the pandemic; borrowers who did not lose their jobs due to the pandemic; and borrowers who experienced hardships such as supporting adult children who moved back home, having to purchase electrical equipment to work from home, or experiencing an increase in food and utility expenses. In absence of COVID-19, these life changes might not have been considered hardships under more common servicing agreements. Although the audit suggests that these hardships might have been acceptable under CARES Act forbearances, greater subjectivity about the eligible hardships may have caused some servicers to follow existing servicing agreements rather than risk noncompliance.

---

[64] See HUD, Office of Inspector General, *FHA Borrowers Did Not Always Properly Receive COVID-19 Forbearances from Their Loan Servicers*, December 15, 2021, https://www.hudoig.gov/reports-publications/report/fha-borrowers-did-not-always-properly-receive-covid-19-forbearances.

[65] For example, see FHFA, "Mortgage Servicing," https://www.fhfa.gov/PolicyProgramsResearch/Policy/Pages/Mortgage-Servicing.aspx.

- The audit found that servicers made frequent phone calls and sent frequent emails and letters, also considered inappropriate for administering CARES Act forbearances and possibly causing unnecessary frustration and confusion for borrowers. The excessive contact with borrowers suggests that servicers may have been following the servicing rules promulgated by the CFPB, which were designed to increase interactions between servicers and borrowers. However, the audit also points out that FHA services are required to contact borrowers before their forbearance periods ended and offer additional loss mitigation options, as required by FHA guidance. For this reason, knowing how much contact to make with borrowers and when to follow CARES Act forbearance rules and FHA servicing rules may have been confusing for some servicers.
- The CARES Act also prohibited servicers from charging late fees for CARES Act forbearances, and servicers were not supposed to report mortgage delinquencies or loan modifications to credit agencies. Absent the CARES Act, these prohibited actions would be standard procedure. (Official statistics pertaining to the frequency and amount of the various types of servicing errors caused by the confusion stemming from the existence of multiple sets of servicing rules were not provided.)

Author Information

Darryl E. Getter
Specialist in Financial Economics

Acknowledgments

Analyst in Housing Policy Katie M. Jones made substantive contributions to this report.

Disclaimer