October 14, 2020

Jeffrey F. London
Executive Director
Loan Guaranty Service
U.S. Department of Veterans Affairs
810 Vermont Avenue, NW
Washington, DC 20420

RE: Circular 26-20-33 Deferment as a COVID-19 Loss Mitigation Option for CARES Act Forbearance Cases

Dear Director London:

The Housing Policy Council[1] (HPC) and Mortgage Bankers Association[2] (MBA) are writing regarding the recently published Circular 26-20-33, "Deferment as a COVID-19 Loss Mitigation Option for CARES Act Cases." Our members appreciate that the Veterans Benefits Administration of the Department of Veterans Affairs (VA) is seeking to address the financial hardship faced by many veterans and their families due to the COVID-19 National Emergency. We believe that a deferral option could provide an opportunity for veterans no longer facing a hardship to successfully resume their regular mortgage payment. However, as highlighted in HPC's May recommendation (see Attachment A), HPC and MBA members believe that any deferral program must be accompanied by a reimbursement/partial claim process that ensures that servicers can responsibly offer this option to veterans.

[1] The Housing Policy Council is a trade association comprised of the leading national mortgage lenders and servicers, mortgage and title insurers, and technology and data companies. HPC advocates for the mortgage and housing marketplace interests of its members in legislative, regulatory, and judicial forums. Our interest is in the safety and soundness of the housing finance system, the equitable and consistent regulatory treatment of all market participants, and the promotion of lending practices that create sustainable homeownership opportunities in support of vibrant communities and long-term wealth-building for families. For more information, visit www.housingpolicycouncil.org

[2] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,300 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies, and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mba.org

Our members believe that Circular 26-20-33 suffers from two critical defects:

1. The absence of a reimbursement mechanism to allow servicers to recover advances made to cover the borrower's missed loan payments deters servicer adoption. In HPC's May recommendation, we suggested that servicer reimbursement could be achieved using the VA Refunds program authority to create a second lien held by the VA. In "buying" the outstanding amount of missed payment, the VA would pay off the deferred amount due ("partial claim" in FHA parlance) to the servicer who already advanced the amount to the Government National Mortgage Association (Ginnie Mae) to pay investors. This approach would not alter or reduce the existing Loan Guarantee. The second lien would be payable to the VA, generating the full recovery for the VA upon payoff of the loan balance, through refinance or loan maturity, or sale of the property. Regardless, the omission of any form of payment recovery for the servicers altogether inhibits the ability for mortgage servicers to provide this option to veterans and maintain operational liquidity; and
2. The lack of guidance on how to implement the deferral program, forestalls responsible servicers from offering this option to veterans.

HPC and MBA respectfully ask that the VA withdraw Circular 26-20-33 in order to address these two critical deficiencies. We also want to emphasize the urgency of this request as the vast majority of veterans currently on a COVID-19 initial forbearance will be ready to transition to a permanent solution or extend their forbearance by the end of October 2020.[3]

I. <u>Partial Claims Serve Veterans</u>

The deferral option announced in Circular 26-20-33 will not be widely adopted by our members without the ability to recover funds advanced to investors in Ginnie Mae mortgage-securities through a partial claim prior to payoff, refinance, or maturity. The ability of a servicer to recover advanced funds is crucial to maintaining liquidity during an ongoing National Emergency. Our analysis of publicly available Ginnie Mae data shows just how massive a challenge an unreimbursed deferral program could be for servicers (see Attachment B). We estimate that if just 10% of all VA borrowers who are delinquent on their loans were to choose a deferral repayment option, servicers would not be able to recover over $154 million dollars advanced to Ginnie Mae investors until loan payoff.[4] If instead 40% of all delinquent VA borrowers chose the deferral repayment option (which the HPC and MBA believe is a reasonable estimate if offered to all veterans in forbearance), servicers would be unable to recover over $618 million dollars of advances until loan payoff. Even with the current historic levels of refinancing pushing the average duration of a VA loan to just 31 months, servicers would still generally have to wait more than 2.5 years to recover this massive $154-$618 million in advances. Quite simply, the servicing industry was not set up to account for advancing this amount of money and for this length of time without being reimbursed. This is not a sustainable or sound business practice for the majority of VA servicers.

[3] Page 18, MBA Forbearance and Call Volume Survey Results 09.28.2020 edition

[4] The assumptions we used to derive this arithmetic were the following: A) We looked at all VA loans in Ginnie securities. B) Then looked for all loans that were current as of February and went 60 days delinquent any time after March. Assumed all of the loans meeting these criteria were COVID-19 forbearance loans and that deferment eligibility is only for those loan current as of 3/1 – this resulted in a total of 156,889 delinquent veterans. C) Assumed monthly tax & insurance at 35.4% of the P&I payment, which is the average size for one HPC member. D) Assumed that the forbearance would average six months of missed payments.

HPC and MBA are also concerned that unequal utilization of the program will cause confusion and will put some veterans at a disadvantage, based solely on the particular business model of their servicer. Veterans who have their loans serviced by banks that have balance sheet capacity to tolerate the long-term expense of this program could be offered the deferral option, but most VA customers in forbearance will not have access to the program.[5] The disparity in application will likely cause confusion and could damage the relationship between veterans and their servicers, as many veterans will likely be frustrated and skeptical that their servicer cannot provide the deferral option.

The primary alternative to a deferral is to offer loan modifications to repay the payments missed during the CARES Act forbearance. These modification options, however, require the loan to be repurchased from the Ginnie pool to complete the modification and repay/recover advance amounts. Additional flexibility is needed if the interest rate environment makes buyout/resecuritization prohibitively expensive when these long-term CARES Act forbearance periods end. Therefore, our members would prefer to have a deferral option, but one with a reimbursement mechanism that will make the program economically viable for servicers. As noted in HPC's May recommendation, the deferral would offer an alternative to loan modifications that may unnecessarily extend the term of their loans, costs the VA money, and negatively affects Ginnie Mae securities, even in cases where a borrower would have been able to successfully make their original mortgage payment.

In previous discussion with VA officials, HPC and MBA, and our members have come to believe that challenges in developing a partial claim process may be the limitations of the existing regulatory authority and the impact on the veteran's entitlement.

a) Regulatory Authority

Existing regulatory authority has previously been identified as a barrier for VA to establish a partial claim process for veterans and servicers. There are two specific regulatory authority challenges that have been cited most frequently. First, that the regulation at 38 CFR § 36.4324 could be read to mean that a VA Guaranty claim can only be paid after a liquidation event. Second, that the VA Refund Program would need to be modified to allow for purchase of a portion of the outstanding loan balance. HPC and MBA have previously acknowledged that although the VA Refund Program appears to be a viable pathway to paying partial claims, it likely would require utilizing regulatory flexibilities.[6]

Although our members are disappointed with Circular 26-20-33, we are encouraged to see the VA's willingness to waive existing regulations during the COVID-19 National Emergency, and the acknowledgment that VA has the clear authority to do so.[7] We are simply requesting that the VA follow the Circular 26-20-33 precedent to waive existing regulations, and in this case, to either wave 38 CFR § 36.4324 to allow for a claim to be paid prior to a liquidation event, and/or to use waiver authority to make changes to the VA Refund Program.

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[5] A similar disparity has occurred with the VA extend modification program, where there has been an unequal utilization of the program between banks and non-banks. HPC is concerned that the deferral program has the potential to further amplify the disparity between the loss mitigation solutions available to veterans based on the business model of their servicer.

[6] As highlighted in Attachment A, HPC prefers to use the VA Refund Program to allow the VA to purchase the forbearance balance and hold it until loan maturity. Our preference would be to have the forbearance balance treated as a recoverable advance (not requiring a second lien), though the second lien approach used by HUD is also viable. Utilizing either option would create a valid collectable balance for VA.

[7] 85 FR 31353 and 38 CFR § 36.4338(a)

b) Veteran Entitlement

Additionally, the VA has expressed concern that the payment of a partial claim prior to a liquidation event could adversely affect a veteran's entitlement and their ability to meet qualifying criteria for a future purchase/refinance. Although this is an important concern, as established in Circular 26-20-33, the VA has the authority to create an exception to the regulations for the specific purpose of providing relief to veterans under the CARES Act. The VA should use this authority to create an exception to controlling regulations to protect against any impact to a veteran's entitlement.

II. Qualifying Criteria for the COVID-19 Deferment Option[8]

To ensure timely, efficient, and cost-effective implementation of the VA's deferral option, we recommend that VA replicate the FHA COVID-19 Standalone Partial Claim process as released in Mortgagee Letter 2020-06. Fortunately, we believe the VA Loan Electronic Reporting Interface (VALERI) already possesses the functionality for servicers to file partial claims in the Bulk Upload template. Currently, Circular 26-20-33 appears to describe a deferral program that seems to be similar in nature to the GSE deferral programs. However, the VA Circular provides insufficient detail for servicers to understand if the requirements of the VA program will be similar to either FHA or the GSE programs, including the criteria that servicers should apply to approve a veteran for the deferment option. Aside from greater clarity on how to report the deferral in VALERI, we ask that VA provide clarifying guidance on the following issue so that operational processes can be built:

a) Delinquency

Is there a minimum delinquency requirement for a veteran to qualify for a deferral? Both FHA and the GSEs require consumers to be current or, in the case of FHA less than 30 days past due as of March 1, 2020 in order to qualify for their COVID-19 partial claim. If there is no delinquency requirement, the less likely the deferment option will be adopted due to the higher volume of advances servicers will have to absorb, even if a veteran is able to resume their regular mortgage payment. It is not unreasonable to assume VA's intent is to qualify only veterans current or less than 30 days past due as of March 1, 2020, since the CARES Act was signed on March 27, 2020. Regardless, the VA should clearly articulate which veteran borrowers qualify for a deferral.

b) Number of Missed Payments Eligible for Deferral

How many payments can be deferred? The GSEs and FHA both allow up to 12 months of past due principal and interest, but Circular 26-20-33 was silent on this.

c) Amount of Missed Tax and Insurance / Property Advances Eligible for Deferral

What property expenses (that are otherwise covered by the escrow account, but now are advanced by the servicer), can be included in the deferral? FHA's second lien/partial claim program permits inclusion of both the expenses covered by servicer corporate advances and the escrow shortages, to ensure that the borrower can resume payments that are generally similar to their previous mortgage payments. That said, how does the VA want servicers to treat escrow shortages? FHA and the GSEs have different approaches to how to treat escrow eligibility for deferral. Our members can operationalize either approach, but it is important to know if the VA has a rule or will be permissive to either option.

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[8] If the VA adopts our recommendation to establish a second lien/partial claim process, we request that the VA work with HPC and other industry stakeholders to ensure that there are clear operational standards for how the process will work.

d) *Treatment of Deferred Amounts in a Redefault*
What happens to the deferred amount if a borrower later re-defaults on the loan? Similarly, how does a deferred amount work in a subsequent loan modification? Is this outstanding deferred total capitalized back into the loan balance?

e) *Deferred Amounts and IRRL Eligibility*
How does participation in the deferral program affect IRRRL eligibility? Would the deferred amount be capitalized into the IRRRL transaction? If yes, would there be any restrictions on the total amount acceptable?

f) Reporting Payment Deferrals
How should servicers report payment deferrals to VA?

g) Allowing borrowers to Make Periodic Payments on Partial Claim
Circular 26-20-33 if applied to partial claim could be read to potentially allow borrowers to periodically make payments on the deferred amount. This is not something allowed by the FHA partial claim or GSE payment deferral programs and introduces a host of operational challenges. We would like to confirm repayment of the partial claim could only occur at maturity, payoff, refinance, or property sale. Alternatively, we would like VA to lay out the operational guidance for how allowing borrowers to make periodic payments on partial claims would work.

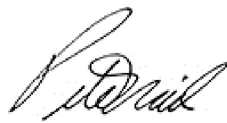
h) Treatment of Deferred Balance
Does VA have any restrictions on where the deferred balance should be housed on the servicing system (the deferred principal balance field vs a corporate advance field) or how the deferred balance should be displayed to the customer on billing, year-end or payoff statements?

III. Conclusion

In sum, HPC and MBA urge the VA to withdraw Circular 26-20-33, which announced a payment deferral option, because it lacks the necessary reimbursement and business rules for servicers to be able to offer it to veterans. However, we believe it is not too late to still help most veterans if the VA acts quickly to build out a partial claim process and provide the necessary operational clarity on how the deferral option works and collaborate with Ginnie Mae on reporting and remitting requirements of such a product. Until both of these deficiencies are resolved, please withdraw Circular 26-20-33.

Thank you for considering these recommendations. We look forward to continuing to work with your team on these issues and others to deliver the help our veterans deserve. If you have any questions or would like to discuss these comments, please contact Matt Douglas, ABA Vice President for Mortgage Policy, at 202-589-1924 or Sara Singhas, MBA Director of Loan Servicing, at 202-557-2826.

Yours Truly,



Meg Burns
Executive Vice President
Housing Policy Council

Pete Mills
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Mortgage Bankers Association

Attachment A

HPC Memo to VA RE Forbearance
Sent on May 4, 2020

HPC
HOUSING POLICY COUNCIL

Veterans Deserve a VA Guaranty Option Similar to FHA Borrowers

Background – CARES Act Forbearance Mandate: The unprecedented economic impact of COVID-19 has triggered an enormous response from almost all sectors of the Federal government. Policy makers recognized, early on, the potentially devastating consequences for homeowners, and the CARES Act included critical provisions to provide relief to those affected. The key provision of the Act allows borrowers to suspend up to 12 mortgage payments (forbearance) on all loans guaranteed or owned by Fannie Mae, Freddie Mac, HUD/FHA, VA, and USDA.

While forbearance satisfies the immediate short term need to delay payments during a time of financial stress, its' value is limited if not paired with an affordable long term solution. The law made the availability of extended forbearance readily available but appropriately deferred to the government entities the details for what would occur following the end of the forbearance period. The law implied, however, that the Federal government would be responsible for the enormous cost and economic burden associated with this level of forbearance. Existing programs, even those implemented during the housing crisis of the Great Recession, do not contemplate the impact of having a large percentage of US homeowners seeking a 6 to 12 month suspension of mortgage payments.

VA Program Limitations: Most Federal departments and government agencies have responded with programs that provide an option for borrowers to postpone any repayment of the forborne balance, interest free, for the life of the mortgage. Further, each of these programs has substantially all of the costs and economic burden of this Federally-mandated forbearance absorbed by the Federal department or agency that insures or owns the mortgage loan.

Specifically,

- FHA offers a plan whereby the forbearance balance can be converted into a subordinate lien payable to HUD which does not require the original loan to be purchased out of the existing GNMA pool. HUD pays a partial claim to the servicer and collects against this amount, via the second lien, at loan payoff. The HUD subordinate loan accrues no interest, requires no payments, and is only payable upon sale or maturity of the first lien. USDA has a similar program.
- The FHFA has directed the GSEs to develop a proposed approach applicable to FannieMae and FreddieMac which will also allow borrowers to fully defer the forborne balance until maturity.

Impact on Veterans: Without modifications to the law and/or VA policies, the provision of loan forbearance consistent with the requirements of the CARES Act will impose significant burdens on both Veterans and mortgage loan servicers. Veterans will face the burden in repaying the accrued forbearance balance, and servicers will face a burden related to advancing cash for payments to bondholders, taxing authorities, and insurance companies until the forbearance amount is repaid or recovered.

VA has flexibility to amend requirements for loan modifications, which the agency has effectively used in previous disasters (see VA Circular 26.17.39). However, these options, at best, will allow borrowers to add the forborne payments to the existing loan balance resulting in payment increases and interest charges on the forborne balance (see example below for illustrative cost comparison). Further, as loans would need to be purchased from GNMA pools in order to be modified, Veterans could face potentially higher interest rates on the entire balance.

It seems inconsistent with the objectives of the VA home loan insurance benefit for Veterans to have the most expensive and least attractive alternative, post-forbearance, of any government owned or insured mortgage program.

Further, any approach that places the economic costs and liquidity burden of forbearance on the mortgage servicer jeopardizes future VA borrowers, by discouraging lender program participation. This unexpected costs and risks associated with the cost of such forbearance could reduce the number of lenders interested in servicing VA loans and ultimately increase borrower costs.

Proposal: HPC strongly encourage the Veterans Administration to develop a similar approach for VA insured loans based on the same basic premises of the FHA, FannieMae, and FreddieMac program:

- Permit the “missed payments” balance accumulated during the extended forbearance period to be repayable upon maturity and without any additional fees or interest charges to the Veteran
- Accept the economic costs and liquidity demands of this Federal mandate to be covered by VA, similar to the other Federal entities that own or insure these mortgage loans.

Impact – Illustrative Cost Comparison Example*:

The 1st column 'Deferred Option' shows a loan with the HUD or GSE deferred payment option (forborne balance paid at maturity with no additional interest and no change in the Veterans payment or remaining principal balance).

The 2nd column '6 Months Forbearance' shows the exact same loan using the modification option available on VA loans, where the borrower has 180 days of forbearance and the loan is modified with a term of 30 years. In this scenario, the Veteran's monthly payment drops by $42.46 but the interest paid by the Veteran over the life of the loan increases by $29,084.53.

The 3rd column shows the exact same loan with 360 days of forbearance and the loan modified with new 30 year term. In this scenario, the Veteran's monthly payment drops by $3.81 but the interest paid by the Veteran over the life of the loan increases by $59,635.58.

Deferred Option (paid at end of loan) Forbearance

Original Loan Amount Remaining:	
Remaining Loan amount	$232,543.27
Annual interest rate	4.00%
Loan period in months	315

Assumes monthly escrows of $583.33

Loan originated 7/1/2016

Scheduled P&I	$1,193.54
Total interest	$179,673.77
Total Payments	$429,673.77
Deferred Amount 6 Months (no change)	**$8,146.64**
Deferred Amount 12 Months (no extra interest)	**$16,242.54**

Increase in monthly payment	*0*
Increase in Interest	*0*

Modification Options for 6 months and 12 month COVID

6 Months Forbearance - Mod	
Loan amount	$241,106.91
Annual interest rate	4.00%
Loan period in month	360
Scheduled payment	$1,151.08
Total interest	$208,758.30
Total Payments	$466,904.94
Increase in monthly payment	***$(42.46)***
Increase in Interest	***$29,084.53***

12 Months Forbearance - Mod	
Loan amount	$249,202.81
Annual interest rate	4.00%
Loan period in months	360
Scheduled payment	$1,189.73
Total interest	$239,309.34
Total Payments	$496,335.32
Increase in monthly payment	***$(3.81)***
Increase in Interest	***$59,635.58***

** For the purpose of this example, we have used a loan with an original term of 30 years, originated in July of 2016 and with an original balance of $250,000. According to the most recent Annual Benefits Report of the Veterans Administration, the average balance of a VA guaranteed loan is $264,197.*

DISCUSSION DOCUMENT – CARES ACT FORBEARANCE & VA LOANS

Without modifications to the law and VA policies, the provision of loan forbearance consistent with the requirements of the CARES Act will impose significant burdens on both Veterans and mortgage loan servicers. Veterans will face the burden in repaying the accrued forbearance balance, and servicers will face a burden related to advancing cash for payments to bondholders, taxing authorities, and insurance companies until the forbearance amount is repaid or recovered.

VA has substantial flexibility to amend requirements for Loan Modifications, which the agency has effectively used in previous disasters (see VA Circular 26.17.39). We encourage VA to treat Covid-19/CARES Act forbearance similar to other disasters and make access to programs similar to Disaster Modifications and Extended Disaster Modifications available to borrowers who required CARES Act forbearance.

These modification options, however, require the loan to be repurchased from the GNMA pool to complete the modification and repay/recover advance amounts. Additional flexibility is needed in the event that the interest rate environment makes buyout/resecuritization prohibitively expensive when these long term CARES Act forbearance periods end.

We are proposing changes to the law and regulations that would permit accumulated CARES Act forbearance balances to be separately funded by VA, independent of the insured existing first lien balance.

Separate Funding of an accumulated CARES Act forbearance balance (change in law and regulations)

FHA developed a plan whereby the forbearance balance can be converted into a subordinate lien payable to HUD which does not require the original loan to be purchased out of the existing GNMA pool. HUD pays a partial claim to the servicer and collects against this amount, via the second lien, at loan payoff. The HUD subordinate loan accrues no interest, requires no payments, and is only payable upon sale or maturity of the first lien.

Existing law does not appear to provide for such an alternative on VA loans. The existing VA approach with some similarities is the VA Refund program, which allows VA to buy a delinquent loan when all other Loss Mitigation options fail.

It is believed that modifications to the language in the law and regulations related to the VA Refund program would permit a program with benefits similar to the FHA approach for both Veterans and servicers of VA loans.

Section 3732(a)(2) of Title 38 authorizes the VA Refund program. Proposed changes to 3732 (a)(2)(A) would allow the VA to purchase the forbearance balance and hold it until loan maturity. If utilized in the same way the VA Refund is used today, this option could be made available where Loan Modification or other Loss Mitigation tools will not work. Our

preference would be to have the forbearance balance treated as recoverable advance (not requiring a second lien), though the second lien approach used by HUD is also viable. In either way, this would be a valid collectable balance for VA.

Section 3732(a)(2) of Title 38:

(2)(A) Before suit or foreclosure the holder of the obligation shall notify the Secretary of the default, and within thirty days thereafter the Secretary may, at the Secretary's option,

> *(i) pay the holder of the obligation the unpaid balance of the obligation plus accrued interest and receive an assignment of the loan and security. Nothing in this section shall preclude any forebearance for the benefit of the veteran as may be agreed upon by the parties to the loan and approved by the Secretary, or*
>
> *(ii) should the obligation include a balance accrued under a forbearance program provided in accordance with the CARES Act, purchase from the holder of the obligation a note and second lien representing the accrued forbearance balance. The obligation shall remain insured for the full amount permitted under this section without regard to such forbearance balance.*

Corresponding changes would need to be made to the Regulations for the Refund program (38 CFR 36.4320 Refunding of Loans in Default).

An alternative to this (2)(A)(ii) language envisions no requirement for a second lien and treats the CARES Act forbearance balance as a recoverable advance. This is proposed due to the industry's experience with the HUD program. As the second lien, which requires no monthly payment, is between the borrower and HUD (not the servicer), borrowers are sometimes surprised to learn this additional amount is due, years later, at payoff. By using a recoverable advance approach, this amount would be listed on statements and payoff letters from the servicer and would be collected by the servicer on behalf of VA.

> *(ii) should the obligation include a balance accrued under a forbearance program provided in accordance with the CARES Act, pay the holder of the obligation the accrued forbearance balance. If the Secretary makes such a payment, Secretary shall be subrogated to the rights of the holder of the obligation to the extent of the amount paid. The obligation shall remain insured for the full amount permitted under this section without regard to such forbearance balance.*

Attachment B

HPC's Analysis of the VA Deferral Program

% Deferment	Loans	Monthly PITI	6 Months Total PITI
10%	15,689	$25,758,151	$154,548,906
20%	31,378	$51,516,302	$309,097,813
30%	47,067	$77,274,453	$463,646,719
40%	62,756	$103,032,604	$618,195,625
50%	78,445	$128,790,755	$772,744,532
60%	94,133	$154,548,906	$927,293,438
70%	109,822	$180,307,057	$1,081,842,344
80%	125,511	$206,065,208	$1,236,391,251
90%	141,200	$231,823,359	$1,390,940,157
100%	156,889	$257,581,511	$1,545,489,063

Maximum Delq Since March'20		Feb Non Delq	
	Total	**3,123,410**	
	1. Non Dlq	2,817,631	
	2. 30	84,354	
	3. 60	**37,297**	
	4. 90	**55,319**	
	5. 120	**27,917**	
	6. 150	**31,147**	
	7. 180+	**5,209**	
	9. Unk	64,536	
	Total 60+	**156,889**	A
	Average PITI	$1,642	B
	Average PI	$1,213	C
	Average TI	$429	D
	PITI		
	50% Deferral	78,445	E = A * 50%
	Monthly PITI	$128,790,755	F = E * B
	Total PITI 6 Months	$772,744,532	G = F * 6
	Avg PITI 6 Months	$9,851	H = G / E

Assumptions

PI Calculated Based on Orig Balance / Term / Rate

TI based on 35.4% of PI

6 Month FB Term