

INITIAL STATEMENT OF REASONS
FOR THE ADOPTION OF RULES UNDER THE
CALIFORNIA FORECLOSURE PREVENTION ACT

As required by Section 11346.2 of the Government Code, the Commissioner (Commissioner) of the Department of Real Estate (Department) sets forth below the reasons for the proposed adoption of Article 16.5, Subarticle 1, Sections 2850.1, 2850.2, 2850.3, 2850.4, 2850.5, and 2850.6; Subarticle 2, Sections 2850.7 and 2850.8; Subarticle 3, Section 2850.9; and Subarticle 4, Section 2850.10 in Chapter 6 of Title 10 of the California Code of Regulations (10 C.C.R. Sections 2850.1, 2850.2, 2850.3, 2850.4, 2850.5, 2850.6, 2850.7, 2850.8, 2850.9, and 2850.10).

I. BACKGROUND

In the fall of 2008, in response to the continuing foreclosure crisis in California, the Governor proposed to the Legislature a concept to reduce foreclosures by encouraging loan modifications in the marketplace. This plan was a follow-up to the Administration's previous actions to encourage loan modifications by servicers, including a November 2007 agreement with servicers intended to address resetting interest rates, and the signing of SB 1137 (Perata, Chapter 69, Statutes of 2008) in the summer of 2008, to require residential mortgage servicers to reach out to borrowers at least 30 days before a notice of default is filed in a foreclosure proceeding, to attempt to work out a solution.

The Governor's proposal involved encouraging residential mortgage loan servicers to streamline the process for modifying loans by changing the requirements for nonjudicial foreclosures for loans serviced by mortgage loan servicers that had not implemented a comprehensive loan modification program. The initial loan modification program model was based on the program that the Federal Deposit Insurance Corporation ("FDIC") announced for distressed loans of IndyMac Federal Bank, FSB. Through the legislative process, the Governor's proposal developed further and became the California Foreclosure Prevention Act. In February of 2009, during the second extraordinary session the Legislature sent to the Governor two bills enacting the California Foreclosure Prevention Act: ABX2 7 (Lieu – 2009) and SBX2 7 (Corbett – 2009). On February 20, 2009, the Governor signed these bills.

II. ADOPTION OF RULES

Among other things, the California Foreclosure Prevention Act ("CFPA") requires the Commissioners of Corporations, Financial Institutions and Real Estate (collectively, "Commissioners") to adopt emergency regulations to clarify the application of Civil Code Sections 2923.52 and 2923.53; two sections within the California Foreclosure Prevention Act. The Commissioners adopted the emergency regulations and on June 1, 2009, the regulations were filed with the Secretary of State and became effective immediately. In accordance with the law's provisions, 14 days after the effective date of the regulations, the CFPA became operative. These emergency regulations were readopted by the Commissioner on December 1, 2009.

1. Invitation for Comments

The Departments of Corporations, Financial Institutions, and Real Estate (collectively, "Departments") sought to incorporate the comments of interested parties into the rulemaking process before the public notice period for the emergency regulations.¹ On April 21, 2009, the Departments released draft rules to interested parties and the public with a request for comments by May 6, 2009.

The initial draft regulations that the Departments requested comments on were similar to the rules ultimately adopted, and included sections on the scope of the regulations, participant eligibility, availability of programs, program requirements, loan modification features, additional requirements, the application, the application form, and data collection. The initial draft regulations, dated April 21, 2009, are hereby incorporated by reference. In response to this invitation the Departments received 17 comment letters from interested parties.

The Departments considered the comments and amended the rules in appropriate circumstances. While most comments were directed at the substantive requirements of the rules, some comments were more broadly directed at the policy behind the CFPA. Several commentors requested clarification on the interplay between the rules and the U.S. Department of Treasury's Home Affordable Modification Program.² One commentor expressed concern with the impact of the legislation (and thus the rules) on small businesses that face losses from the repeated refinancings of borrowers, and requested that borrowers who received significant amounts of cash from the loan, or who were in default at the inception of the loan, be excluded from eligibility for a modification.³ One commentor objected to the legislation (and thus the rules) based on the concern that the CFPA would lengthen the real estate crisis.⁴ The California Financial Services Association inquired about the applicability of the data collection survey on federally-chartered institutions subject only to federal visitorial powers.⁵

The Departments received comments from other impacted industry groups, including representatives of a homeowner association ("HOA") and the United Trustees Association.⁶ The commentor representing HOAs suggested that modifying loans without taking into consideration HOA debt continues to leave a borrower vulnerable to foreclosure, and suggested areas of the rules where HOA debt should be incorporated.⁷

¹ See Government Code Section 11346.45 (although note that Gov't Code Section 11346.1(a)(1) provides that an emergency regulation is not subject to the provision).

² See e-mail dated 5/6/09 from Joe Loots, Cenlar FSB; e-mail dated 5/7/09 from Alicia Clarke, Residential Credit Solutions; and e-mail dated 5/6/09 from Daryl Mcleod, SVP Loss Prevention, Nationstar Mortgage.

³ See e-mail dated 5/6/09 from Jeff T.F. Rose, President, Rose Financial.

⁴ See e-mail dated 5/6/09 from David Huey, CEO, River Forest Financial, LLC.

⁵ See letter dated 5/6/09 from David C. Knight, Executive Director, California Financial Services Association.

⁶ See e-mails dated 5/5/09 and 5/11/09 from Andrew Schlegel, CCAM, EVP Finance, Merit Property Management, regarding HOAs, and Phillip M. Adleson, Adleson, Hess & Kelly, on behalf of the United Trustees Association.

⁷ The definition of "housing-related debt" in Civil Code Section 2923.53(k)(2) includes homeowner

The United Trustees Association indentified the impact of the rules on trustees who may be brought into disputes between servicers and borrowers, identified ambiguities in the rules, and requested a number of clarifications in the rules.⁸ These suggestions were considered, and where appropriate changes were made.

The California Credit Union League expressed support for the streamlined process to obtain an exemption for financial institutions that have adopted a comprehensive loan modification program in conformance with the federal Home Affordable Modification Program Guidelines. The league reiterated its support for a blanket waiver, rather than individual waivers, for modifications made as part of a comprehensive loan modification program, in conformance with the rules.⁹

First Federal Bank of California weighed in with comments on a number of key issues in the rules.¹⁰ Among other things, First Federal requested clarification that a lack of eligibility for a loan modification under, for example, the eligibility provisions of the rules, does not subsequently result in the borrower being eligible for 90 additional days in the foreclosure process. The Departments considered whether clarification was necessary, but determined that the statutory language of the CFPA was clear that a single order of exemption from a Commissioner exempted a servicer from the additional 90 days in the foreclosure process, regardless of whether any particular borrower is eligible for a modification under that servicer's program.¹¹

An additional issue raised by First Federal was whether the Departments' draft rules had accurately interpreted Civil Code Section 2923.53(a)(2), providing that a loan modification program targets a ratio of borrower's housing-related debt to the borrower's gross income of 38% or less, on an aggregate basis. The Departments' draft rules required a servicer to explain the reasons why a higher ratio was accepted on loans. First Federal and others raised concern that the Departments' approach was not consistent with the statute, since the statute did not require that every loan meet a 38% debt-to-income ratio, but instead provided that a comprehensive program should target a 38% debt-to-income ration on an aggregate basis.¹² In contrast, the standard

association fees.

⁸ In addition to Phillip M. Adleson, Adleson, Hess & Kelly, on behalf of the United Trustees Association, requesting the need for additional definitions, by e-mail dated 5/6/09, Matthew S. Reynolds, Kroloff, Belcher, Smart, Perry & Christopherson, attorneys for Rabo Agrifinance, Inc., also identified the need to further define terms.

⁹ Letter dated 5/6/09 from Bill Cheney, President/CEO, California and Nevada Credit Union Leagues. An exemption or waiver for credit unions had been advocated in other forums, such as the March 18, 2009 Senate Banking, Finance & Insurance hearing entitled, "Making State and Federal Mortgage Foreclosure Rescue Plans Work: Can At-Risk Homeowners Be Saved?"

¹⁰ Letter from David W. Anderson, EVP/Chief Credit Officer, First Federal Bank of California.

¹¹ Civil Code Section 2923.52 provides a servicer that has obtained an order from one of the Departments with an exemption from the additional 90-day requirement for all of the loans serviced by the servicer, provided that the servicer has an approved comprehensive loan modification program. Nevertheless, the minimum standards for a comprehensive loan modification program in the rules do not require a program to modify loans for loans or borrowers not meeting the eligibility requirements of the rules, for a servicer to have all of its loans exempted from the additional 90 days in the foreclosure process. By letter dated 5/6/09, the California Bankers Association also requested that this point be made clear in the rules.

¹² By letter dated 5/6/09, the California Bankers Association also expressed concern with the manner the rules were interpreting the provision.

waterfall process under the Home Affordable Modification Program requires servicers to target a 31% debt-to-income ratio on a per-loan basis. Accordingly, the Departments amended the rules to more closely follow the statute.

First Federal and other commentors raised a concern with including junior liens in the calculation of housing-related debt to gross income, noting that the calculation was inconsistent with industry practice and federal modification programs, and suggesting that this formula may result in fewer loans qualifying for a modification under the net present value comparison of foreclosure to loan modification.¹³ This provision was changed to more closely follow the federal program. First Federal also questioned whether the modification data requested in the loan application was necessary, suggesting that the purpose for requesting modification data with the application was unknown, and indicating that compliance was difficult and burdensome in a short time period.¹⁴ The Departments considered the comments but determined that for servicers who have the data available, the data permits the Departments to more fully evaluate the servicers' loan modification program.

A consortium of consumer and public interest groups collectively weighed in on the rules.¹⁵ They commented on several areas where the rules could better promote the accessibility of the loan modification programs to borrowers, such as placing the burden on servicers to consider loan modifications for all eligible borrowers, not permitting second liens to affect eligibility for a modification, permitting greater flexibility in underwriting criteria, expanding eligibility to borrowers in bankruptcy, including the telephone number for HUD approved housing counseling agencies on all correspondence, and expanding the net present value test to include principal reduction.¹⁶ The consortium further commented on the greater need for transparency and suggested that all applications be placed on the Internet, that all data be made

¹³ See also letter dated 5/5/09 from Private National Mortgage Acceptance Company, LLC ("PennyMac"), and letter dated 5/6/09, from the California Bankers Association. The California Bankers Association noted that this proposed rule marked a significant departure from the Home Affordable Modification Program Guidelines.

¹⁴ The California Mortgage Association also expressed concern with the availability of the data (letter dated 5/6/09 by Phillip M. Adleson, Adleson, Hess & Kelly, on behalf of the California Mortgage Association). The California Bankers Association expressed concern with the workload and potential preemption concerns.

¹⁵ Letter dated 5/6/09 from Affordable Housing Services, California Reinvestment Coalition, California Rural Legal Assistance, Consumer Action, Consumers Union, East LA Community Corporation, Fair Housing Council of San Diego, Fair Housing Counsel of the San Fernando Valley, Fair Housing Law Project, Fair Housing of Marin, Housing and Economic Rights Advocates, Housing Opportunities Collaborative, Korean Churches for community Development (KCCD Housing Counseling Agency), Law Foundation of Silicon Valley, Legal Aid Foundation of Los Angeles, Unity Council, and Visionary Home Builders. These organizations represent nonprofit housing counseling agencies and collaboratives, legal service offices, affordable housing developers, fair housing councils, and advocacy and policy groups.

¹⁶ By letter dated 5/5/09, PennyMac recommended the removal of a provision requiring a servicer to make a reasonable attempt to obtain the consent of a subordinate lien holder, suggesting that loans may be modified without this consent and the requirement added undue delay. By letter dated May 13, 2009, Select Portfolio Servicing, Inc. suggested that that in most instances consent of the second lien holder is not necessary. However, by letter dated 5/6/09, the California Bankers Association supported the provision in the draft rules, indicating that in some instances a second lienholder has rights that may prevent the first lienholder from modifying its loan.

publicly available, that data collection include information about race and ethnicity, and that data reporting link modification terms to redefault rates. Additionally, the consortium commented that establishing the sustainability of loans be narrowed, that servicers disclose the identify of investors and demonstrate efforts to secure investor approval of modifications, that servicer establish compliance with SB 1137 in the Notice of Sale, and that servicer meet HOPE NOW timelines. In addition to other comments, the consortium recommended that the rules clarify the circumstances for the revocation of an exemption. The Departments considered the comments, and where appropriate, amended the rules to incorporate suggestions. When considering heightened reporting requirements and making servicer information public, the Departments were cognizant of the goal of the CFPB to encourage servicers to commit to loan modification programs rather than acquiescing to a longer foreclosure process.

NID Housing Counseling Agency expressed concern that the draft regulations did not sufficiently capture the intent of the CFPB, and recommended that servicers be required to reach out to borrowers with high debt-to-income ratios, borrowers in imminent danger of default, and senior citizens who received loans since 2003.¹⁷ The agency further recommended that servicers have a specific, affirmative outreach strategy in place to reach underserved borrowers, ethnic/racial minorities, and the elderly in high foreclosure zip codes; that servicers report on race/ethnicity and zip code information; and that servicers report the rationale for declining loan modifications. Finally, NID Housing Counseling Agency explained the pitfalls of permitting a temporary exemption before a servicer has established a comprehensive loan modification program, recommending that servicers demonstrate borrower safeguards to ensure that all requests are reviewed and responded to within 30 days, servicers have a transparent rationale for decisions, and servicers have an appeals process and timeline. The Departments considered the comments, and where appropriate, amended the rules.

Private National Mortgage Acceptance Company, LLC ("PennyMac") recommended that the rules not permit the exclusion of borrowers who have contracted with third parties to advise the borrowers on extending the foreclosure process or avoiding their contractual obligations. PennyMac also recommended that the regulations not require a web address describing the loan modification program. PennyMac indicated that it does not disclose the contents or methodology for its proprietary loan modification programs for competitive reasons, and indicated that it uses its programs in the acquisition and disposition of assets. The Departments consider the comments and amended the rules, as appropriate.

The California Mortgage Association ("CMA") indicated that its members make or arrange loans held by multiple lenders or mortgage pools, and the servicing relationships are governed by loan servicing agreements or by pool management agreements requiring the consent of the investors or the consent of a majority of the investors regarding post-default decisions, including modifications.¹⁸ The CMA

¹⁷ Letter dated 5/5/09 from Jacqueline Carlisle, Executive Director, NID Housing Counseling Agency.

¹⁸ Letter dated 5/6/09 from Phillip M. Adleson, Adleson, Hess & Kelly, on behalf of the California Mortgage Association.

identified the lack of incentive for these servicers to obtain an exemption under the CFPA, given their inability to participate in the Home Affordable Modification Program, which provides financial incentives to institutional lenders to make loan modifications. The CMA further described the burdens and costs of the rules, and suggested the rules expressly permit servicers to charge borrowers for modifications.

The CMA suggested that the CFPA and rules should not permit investors who opt out of modifying loans to have the benefit of the exemption, and identified the need to clarify the meaning of several terms and phrases in the rules. The CMA further suggested that the requirement that the program target a debt-to-income ratio of 38% on an aggregate basis may provide a perverse incentive for servicers to exclude borrowers who would not be able to meet this criteria from the program. The CMA recommended that the types of modifications be expanded to include forgiveness or deferral of unpaid principal, late charges and other arrearages, and further recommended clarifications on the timing of modifications, the modification of a modified loan, and the application declaration. Additionally, the CMA recommended clarifying the Notice of Sale exhibit in the application, clarifying whether multiple exemptions were needed for multiple licenses, and defining several terms in the data collection form. The Departments considered the comments and amended the rules, where appropriate.

The California Bankers Association ("CBA") commented on the importance of the state law and rules not conflicting with comparable federal programs, and not requiring concurrent compliance. The CBA suggested the rules clarify that a servicer is not required to comply with both the Home Affordable Modification Program Guidelines and the rules, and recommended various amendments on this point. The CBA commented that a provision requiring servicers to have criteria to ensure that the granting of modifications is applied fairly to applicants was burdensome given the unique characteristics of borrowers and loans, and suggested that laws already exist to prevent the discriminatory treatment of consumers. The CBA suggested clarification regarding certain terms and phrases, and suggested that the rules clarify that banking institutions may seek exemptions through the Department of Financial Institutions. The CBA made a number of comments similar to those of other commentors. Finally, the CBA identified areas in the application requiring further clarification, questioned the need for a notarized application signed under penalty of perjury, and questioned the value of monthly reporting. CBA offered to work with the Departments to develop reporting procedures. The Departments considered the comments and amended the rules, where appropriate.

Select Portfolio Servicing, Inc. ("SPS") and other commentors commented on the use of the term "customary underwriting and analysis," and suggested that by the time a servicer is involved with the distressed mortgage loans, the time for "customary underwriting" has passed and will not be effective in deciding whether a modification is warranted.¹⁹ SPS suggested deferring to the Home Affordable Modification Program Guidelines, to address the significant issues servicers encounter in determining who is

¹⁹ Letter dated 5/13/2009 by Jeff Graham, Senior Vice President & Chief Compliance Officer, Select Portfolio Servicing, Inc.

eligible for relief under a modification. Along with other commentors, SPS expressed concern with obtaining the consent of second lien holders, and, along with other commentors, commented on the difficulty of creating parameters for the flow of the modification process to ensure neither servicers nor borrowers are harmed by the other party's delays.

Upon consideration of all of the comments, the rules were amended to incorporate many of the changes recommended by interested parties. However, not all of the recommendations were incorporated into the rules. In incorporating recommendations, the Departments attempted to balance the competing goals of encouraging as many servicers as possible to participate, while at the same time facilitating the delivery of meaningful loan modifications to borrowers facing hardships.

2. 5-Day Notice and Filing of Emergency Regulations

On May 14, 2009, the Departments released revised regulations on their websites, electronically and by mail to interested parties. The revised regulations are incorporated by reference. The Departments received additional comments from the California Bankers Association, the California Mortgage Association, and the United Trustees Association.²⁰ After reviewing and considering these comments, additional changes were made to the emergency regulations and on May 21, 2009, they were filed with the Office of Administrative Law. With minor changes, the Office of Administrative Law approved the regulations and filed them with the Secretary of State on June 1, 2009. The law became operative on June 15, 2009. The emergency regulations were readopted on December 1, 2009.

III. PROPOSED REGULATIONS

In this rulemaking action the Commissioner seeks to permanently adopt the emergency regulations filed with the Secretary of State on June 1, 2009, operative June 15, 2009, and readopted on December 1, 2009, clarifying the application of Civil Code Sections 2923.52 and 2923.53 of the California Foreclosure Prevention Act.

The Commissioner proposes to adopt Article 16.5 to Chapter 6 of Title 10 of the California Code of Regulations, entitled "California Foreclosure Prevention Act." In addition, the Commissioner proposes to adopt Subarticle 1 to that subchapter, entitled, "Requirements." Within Subarticle 1 the Commissioner proposes to adopt six sections.

1. Section 2850.1: Scope of Regulations

Section 2850.1, entitled, "Scope of Regulations," defines the scope of the regulations. The section provides that the subchapter clarifies the application of Civil Code Sections 2923.52 and 2923.53, and sets forth the minimum requirements for a mortgage loan servicer to obtain an order of exemption from Civil Code Section

²⁰ See letter dated 5/19/09 by Leland Chan, General Counsel, California Bankers Association, letter dated May 20, 2009, by Phillip M. Adleson, Adleson, Hess & Kelly, on behalf of the California Mortgage Association and the United Trustees Association.

2923.52. Civil Code Section 2923.52 provides that a trustee may not proceed with a foreclosure sale until the lapse of an additional 90 days after a notice of default is filed on a mortgage, in addition to the 3 months time required in existing law.²¹ However, Civil Code Section 2923.52 provides that a mortgage loan servicer may obtain an order exempting it from the 90-day time period, if the mortgage loan servicer has implemented a comprehensive loan modification program.

Section 2850.1 of the proposed rules further provides that the modification of loans in conformance with the Home Affordable Modification Program Guidelines issued by the U.S. Department of the Treasury on March 4, 2009, as amended, shall constitute the implementation of a comprehensive loan modification program and shall be deemed to meet all of the requirements in the article. This provision was added to the emergency regulations and is now proposed in the permanent rules to coordinate loan modification relief efforts with the federal government, to reduce regulatory burdens that may unnecessarily delay loan modification programs, and to encourage servicers to participate in the federal program.

The section also defines "residential mortgage loan" and "borrower." "Residential mortgage loan" is defined the same as the definition in the Secure and Fair Enforcement Mortgage Lending Act (Title V of P.L. 110-289, the Housing and Economic Recovery Act of 2008),²² and is limited to consumer loans secured by residential real estate. "Borrower" is defined as a person who was the original obligor on the note or who has formally assumed the loan with the consent of the mortgagee.²³ The definitions seek to include the persons and transactions that the legislation intended to help.

2. Section 2850.2: Eligibility

Section 2850.2, entitled "Eligibility," sets forth the minimum eligibility requirements for a borrower and residential mortgage loan under a comprehensive loan modification program, in order for the program to obtain an order of exemption from the Commissioner. A mortgage loan servicer's comprehensive loan modification may be more inclusive than the minimum requirements set forth in this section, but may not be less inclusive, to obtain an order of exemption. Generally, modifications must be available for borrowers and loans meeting the following requirements:

1. The loan was made between January 1, 2003 and January 1, 2008,
2. The borrower lives in the property,
3. The loan is in default,
4. The loan is a first lien on property in California,

²¹ See Civil Code Section 2924.

²² This definition was recommended by Matthew S. Reynolds, Kroloff, Belcher, Smart, Perry & Christopherson, attorneys for Rabo Agrifinance, Inc., by e-mail dated 5/6/09, in response to the Departments' invitation for comments. The commentor recommended the S.A.F.E. Mortgage Act definition of "residential mortgage loan" to ensure the CFPA's coverage was limited to non-commercial loans.

²³ This definition was suggested in a letter dated 5/6/09 from Phillip M. Adleson, Adleson, Hess & Kelly, on behalf of the California Mortgage Association.

5. The borrower can document the ability to pay the modified loan,
6. The borrower has not surrendered the property, the borrower is not engaged in a bankruptcy proceeding, and the borrower has not contracted to delay the foreclosure process while intending to leave the property.

The minimum eligibility requirements are intended to ensure that loan modification programs include, at a minimum, loans made during the height of lending activity, and to apply to borrowers residing in their homes. The proposed rules are intended to assist borrowers facing financial hardship, as demonstrated by the minimum requirement that loans in default be included in the modification program. This provision and all of the minimum eligibility standards are not intended to limit the scope of the program, but instead to define the floor of borrowers that must be included in a program for the program to constitute a comprehensive loan modification program.

3. Section 2850.3: Availability

Section 2850.3, entitled, "Availability," requires the loan modification program to be made available to all persons and loans meeting the eligibility requirements who notify their servicer of a financial hardship or to request a loan modification. In addition, the section requires a servicer to reach out to borrowers in financial hardship by including information on the comprehensive loan modification program when contacting borrowers as required at least 30 days before the service of a Notice of Default under Civil Code section 2923.5 (see SB 1137 (Perata, Chap. 69, Stats. 2008)). The affirmative obligation to reach out to borrowers in default and notify them of the program, as well as the requirement that the program be made available to all eligible borrowers who contact the servicer, are intended to ensure that the program is made available to those borrowers most in need of the program.

4. Section 2850.4: Program Requirements

Sections 2850.4, 2850.5 and 2850.6 set forth the minimum requirements for a comprehensive loan modification program. Section 2850.4 provides that a comprehensive loan modification program must meet the requirements of both Sections 2850.5 and 2850.6.

5. Section 2850.5: Loan Modification Features

Section 2850.5, entitled, "Loan Modification Features," provides that loans refinanced in accordance with the Hope for Homeowners Program or the Home Affordable Refinance Program are deemed to meet the minimum requirements of a comprehensive loan modification program. While loan work outs under these federal programs constitute refinancings rather than modifications, the recognition of the federal programs in the Rules is intended to clarify that servicers may continue participating in those programs even for borrowers meeting the minimum eligibility requirements for modifications under these Rules.

The California Foreclosure Prevention Act provides that a servicer need only modify a loan where the anticipated recovery from a modification exceeds the

anticipated recovery from a foreclosure, on a net present value basis. Consequently, Section 2850.5 of the proposed rules provides clarification on determining the net present value. The rule provides that the net present value must be based on reasonable assumptions regarding discount rates, property values, costs of foreclosure, costs of modification, and the ability of the borrower to repay the loan. The proposed rule requires a servicer to have internal or external evidence to support the assumptions, and provides that the "Net Present Value Model Parameters" in the Home Affordable Modification Program Guidelines, meets the requirements of the section and does not require supporting evidence. The purpose of these provisions is to ensure that the net present value test to determine a borrower's eligibility for a loan modification is fair and reasonable.

The proposed rules further require servicers to explain deviations from the "Net Present Value Model Parameters" in the exemption application. This provision is intended to facilitate the ability of the Departments to evaluate deviations from the federal standard. The proposed rules require that a loan be modified where the net present value of modifying the loan exceeds the net present value of foreclosing on the loan, provided that the borrower can document income, and provided that after the loan is modified, the borrower can establish the ability to pay the modified loan. This provision is intended to ensure that loans are modified for eligible borrowers.

The California Foreclosure Prevention Act provides that a comprehensive loan modification program must target a ratio of a borrower's housing-related debt to a borrower's gross income of 38% or less, on an aggregate basis. Consequently, Section 2850.5 of the proposed rules provides that a servicer's loan modifications are to target a 38% housing-related debt to gross income ratio, on an aggregate basis. The rules clarify that a servicer is not required to meet this ratio for every loan modified under the program. The rules further provide that a servicer must identify the reasons in its application the reasons its program does not achieve a 38% housing-related debt to gross income ratio, on an aggregate basis, if such is the case. This explanation is necessary to allow the Departments to evaluate the derivations from 38% housing-related debt to gross income ratio.

Section 2850.5 of the proposed rules provide that a comprehensive loan modification program must include at least two of the following features:

1. An interest rate reduction, as needed, for at least 5 years,
2. An extension of amortization period for the loan term to no more than 40 years from the original date of the loan,
3. Deferral of some portion of the principal until maturity,
4. A reduction in principal,
5. Compliance with a federally mandated loan modification program, or
6. Any other feature that Commissioner determines is appropriate, as described in the servicer's application.

The proposed rules clarify that a program must include at least two of the identified features, but a single loan modification need not include more than one feature. The rules further require that a servicer have criteria in place to define when

borrower qualifies for the potential concessions or modifications. The provisions are intended to clarify the minimum requirements of a program, and to ensure that a program has established criteria regarding potential concessions or modifications.

The California Foreclosure Prevention Act provides that when determining a loan modification solution for a borrower, a servicer must seek to achieve long-term sustainability. Consequently, Section 2850.5 sets forth characteristics that are presumed to constitute long-term sustainability, including:

1. The modification reduces a borrower's monthly payment for at least 5 years,
2. The modification results in a housing-related debt to income ratio of 38% or less,
3. After a modification, the borrower's back-end debt-to-income ratio is equal to or less than 55%,
4. The borrower is current under the terms of a modified loan at the end of a 3 month period, or
5. The modification is in accordance with a federal program.

These provisions are intended to provide guidance on achieving long-term sustainability by setting forth features or modification results that suggest a loan modification is sustainable.

6. Section 2850.6. Other Requirements for Comprehensive Loan Modification Programs

In addition to the foregoing, Section 2850.6 sets forth additional proposed requirements for a loan modification program. Subsection (a) sets forth conditions when a loan modification consists solely of a repayment plan. In particular, a servicer must be able to validate that the borrower has a housing-related debt to gross income ratio of 38% or less, and that the borrower can repay the loan. The subsection further defines a repayment plan as a plan or arrangement where amounts past due are added to the principal amount due on a loan and re-aged so that a loan is no longer delinquent, and no other loan concessions are provided to the borrower. This subsection is intended to ensure that a servicer's loan modification program does not consist solely of amortizing past due amounts into a borrower's outstanding loan balance, but instead provides loan concessions that offer borrowers facing financial hardships with assistance intended to help the borrowers stay in their homes.

Subsection (b) requires all eligible borrowers to be considered for modification under the plan unless an applicable pooling and servicing agreement prohibits the modification. This provision is intended to acknowledge that servicers may be unable to offer loan modifications to some borrowers, where pooling and servicing agreements prevent the modifications. Subsection (c) requires a servicer to use reasonable efforts to remove any prohibitions and obtain waivers or approvals from all necessary parties, including junior lien holders and investors. This provision is intended to require servicers to make a reasonable attempt to reach out to investors and junior lien holders, where necessary, prior to rejecting a loan modification request.

Subsection (d) requires a servicer to act on a loan modification request within a

reasonable time period, and requires a servicer to have procedures in place to ensure that delays in the process not caused by a borrower do not adversely impact a borrower in the loan modification or foreclosure process. Subsection (d) further requires a servicer to acknowledge the receipt of a loan modification request. These provisions are intended to protect a borrower from foreclosure while the borrower has a request for a loan modification pending with a servicer.

Subsection (e) permits a servicer to deny a loan modification request when a borrower abandons or unduly delays the process. Prior to denying the modification request, the servicer must notify the borrower in writing of the time period to respond and the consequence of failing to respond in a reasonable time. These provisions are intended to ensure that a borrower cannot delay the loan modification process from failing to respond to the servicer, while ensuring that the borrower has notice before the servicer declines a modification request as a result of delay. Subsection (f) provides that a comprehensive loan modification program may include foreclosure alternatives for borrowers who do not qualify for a loan modification program. This provision recognizes that not all situations will qualify for a loan modification. Subsection (g) provides that a servicer is not required to modify a loan more than once. This provision is intended to resolve the question of how many times a servicer is required to modify a loan.

7. Section 2850.7. Initial Application

Within Subarticle 2, the Commissioner proposes to adopt two sections. Section 2850.7, entitled "Initial Application," sets forth instructions on the filing of the application. This section provides that an applicant shall be temporarily exempt from Civil Code Section 2923.52(a) upon the filing of a substantially complete application. This provision is necessary to ensure that the exemption applications meet a minimum standard to qualify for the temporary exemption. The following items provide instructional information to servicers to facilitate the application process. Item 1 instructs applicants on where to file the application, and identifies how an applicant determines whether to file an application with the Department of Corporations, the Department of Financial Institutions, or the Department of Real Estate. Item 2 instructs applicants on when to file an application, and provides that an applicant will be temporarily exempt from Civil Code Section 2923.52(a) upon the appropriate department's receipt of the application.

Item 3 sets forth the manner for the Department to notify an applicant of the temporary order. Item 4 provides that the Department will notify the applicant of whether the applicant has a comprehensive loan modification program within 30 days of the receipt of an application, and notify the applicant of the issuance of a final order. Item 5 provides that upon the denial of an application, the Department will immediately notify the servicer, and the temporary order will remain in effect for 30 days following the denial. Item 6 provides that the Department will accept changes to an application while the application is under consideration.

8. Section 2850.8. Changes to Program After Final Order

Section 2850.8, entitled "Changes to Program After Final Order," sets forth procedures for the modification of a program after the receipt of a final order. Subdivision (a) prohibits a servicer from modifying a program after a final order is issued unless the servicer informs the Commissioner of the change. This provision is necessary to ensure that a servicer's loan modification program does not materially deviate from the program submitted to the Department, while at the same time allowing flexibility as experience develops regarding the efficacy of program provisions. Subsection (b) provides that a change to a federal program does not constitute a change to a comprehensive loan modification program and does not require notice to the Commissioner. This provision is intended to recognize the potential for changes to the federal programs, as federal law continues to develop in this area, and to relieve servicers of any regulatory burden under the CFPA that may result from such changes.

9. Section 2850.9. Application Form

Subarticle 3 consists of Section 2850.9, which incorporates the application form. The application requests identifying information from an applicant, requests information on whether an applicant is participating in a loan modification program administered by a federal agency, and requires an applicant to submit several exhibits. The information is necessary for the Departments to evaluate whether an applicant has a loan modification program that meets the requirements of the law and regulations. Exhibit 1 requires an applicant to describe its loan modification program, and to direct the Department to where within the submitted documentation the specified program requirements are located. Exhibit 2 requires an applicant to submit copy of the declaration to be included with the notice of sale, as required by Civil Code section 2923.54. Exhibit 3 requires an applicant to provide the notice to consumers required by Section 2850.3 of these rules. Exhibit 4 requires an applicant to submit 3 months of recent loss mitigation data.

Exhibit 5 requires an applicant to provide additional documentation for other items in the application, if applicable, including the differences between the net present value used by the applicant and the Department of the Treasury's Net Present Value Model Parameters, the reasons the servicer's program is unable to achieve an aggregate debt-to-income ratio of 38% or less, and a description of any additional features in the program to be considered by the Commissioner. The application provides that exhibits 1, 4 and 5 are confidential, and requires the application to be signed under penalty of perjury by a specified control person. The confidential treatment of exhibits is intended to recognize that some servicers consider their loan modification programs to be trade secrets, and to encourage servicers to apply for the exemption and commit to comprehensive loan modification programs.

10. Section 2850.10. Reports

Subarticle 4 consists of Section 2850.10, entitled "Reports." This section provides that upon request of the Commissioner, a servicer shall report loan modification data to the Commissioner on a quarterly basis. The section further incorporates a form for quarterly reporting. The section provides that a servicer may

request a hardship exemption from the Commissioner, and provides that the Commissioner may accept a report required by a federal loan modification program, in lieu of the report required in this section. This section is intended to provide a means for the Departments to measure the efficacy of the CFPA, while simultaneously not unduly burdening smaller servicers whose modification data is statistically insignificant. In accordance with Government Code Section 11346.3(c), the Commissioner hereby finds that a report on loan modifications achieved under the CFPA is necessary for the welfare of the people of the state.

ECONOMIC IMPACT (GOVERNMENT CODE SECTION 11346.2(b)(4))

The initial determination that the proposed regulatory action will not have a significant adverse economic impact on business is based on the content of the comment letters received from the public in response to the Department's invitation for comments on April 21, 2009.

TECHNICAL STUDIES RELIED UPON

The Department did not rely upon any technical, theoretical, or empirical study, report, or other similar document in proposing this regulatory action.

ALTERNATIVES CONSIDERED

The Department is not aware of any reasonable alternatives to this proposed rulemaking action for carrying out the purposes for which this action is proposed. The Department has determined that no alternatives would lessen the impact of this rulemaking action on small business.