Lessons Learned from the Great Recession:

Regulatory Impact on the COVID-19 Pandemic

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EXECUTIVE SUMMARY

The COVID-19 pandemic of 2020 caused the first recession since the Great Recession of 2008-2009. Millions of homeowners are struggling to make their mortgage payments and unemployment rates have increased considerably. Following the 2008-2009 recession, regulators developed new guidelines for the mortgage market intended to strengthen lending standards and increase consumer protections. In addition to the regulatory changes, the market itself changed. Banks, stung by the financial losses and poor media coverage stemming from the Great Recession, reduced their role in the mortgage market. Non-banks and fintech firms gained a majority market share. The 2020 recession marked the first test of these regulatory changes. This study will show that the regulatory changes since the Great Recession improved the overall response to the 2020 mortgage crisis.

This paper will analyze the key changes in the mortgage market since 2008-2009, evaluate the regulatory response to the COVID-19 pandemic and discuss several ways the response can improve during the next recession. Regulators can use conclusions from this research to tailor their response to future recessions. Bankers may use the research to improve their customer assistance programs, or even whether to continue servicing mortgages.

With the rapid onset of the COVID-19 pandemic, the government quickly recognized the need to assist homeowners. Congress passed the CARES Act just 14 days after the national emergency declaration. The CARES Act contains several benefits for homeowners. Mortgage borrowers can request payment forbearance for up to 12 months, with no documentation necessary. Mortgage servicers must continue to report borrowers in forbearance at their previous payment status to the credit bureaus, meaning there will be no impact to their credit scores for requesting forbearance. Servicers must also waive all late fees associated with the

forbearance plans. Lastly, the CARES Act suspended foreclosures on all federally backed mortgages and prevented eviction of tenants in rental properties with federally backed mortgages.

Congress has also passed two rounds of fiscal stimulus payments to Americans. Congress intended these payments to stimulate consumer spending, but with many retail, dining and travel locations closed due to the pandemic, some Americans have used these funds to pay off debt or make their monthly mortgage payments.

We reviewed various data sources to support our hypothesis. The primary source for mortgage market data was Black Knight, a leading mortgage industry vendor, whose Mortgage Service Platform (MSP) contains data on more than 36 million loans. We also reviewed various economic indicators published by the Federal Reserve to analyze how the economy has shifted from the previous recession to current. Lastly, we reviewed several regulatory changes since the Great Recession, including the Dodd-Frank Act and the Basel III capital rules.

Our research indicates the regulatory response to the Great Recession improved the response to the COVID-19 pandemic. Banks were financially strong entering 2020. Capital ratios were at all-time highs. Regulators increased capital requirements, particularly on mortgage servicing assets held by banks following the Great Recession. The Consumer Financial Protection Bureau implemented strict new mortgage servicing standards, with a focus on consumer-friendly loss mitigation practices. The economy and consumers were also in strong positions. The national unemployment rate was 3.5 percent in February 2020, amongst the lowest rates on record. Debt payments by American consumers were historically low compared to their incomes. Homeowners benefitted from strong housing price gains over the last 10 years as well. Each of these regulatory changes and economic indicators mitigated the impact of the COVID-19 pandemic on the mortgage market.

At the onset of the pandemic, regulators pushed mortgage forbearance plans as the primary tool to deal with the pandemic impact on the housing market. Borrowers would be able to skip their mortgage payments, with no credit or financial impacts, up to 12 months. Consumers have several options to address the forbearance payments when they can resume making payments. Most borrowers will elect to defer the missed payments until the end of the mortgage, or when the house is sold. The deferral program allows consumers to retain their equity in the home and does not require a lump-sum repayment of the skipped payments. The mortgage forbearance program coupled with the foreclosure moratorium prevented millions of borrowers from losing their homes. The pandemic has not materially impacted delinquency rates, by allowing borrowers flexible repayment terms.

Although the regulatory response to the pandemic has been successful, regulators and banks should take away several lessons from their response. Regulators were indecisive when providing guidance to banks, servicers and customers. It took regulators more than 45 days from announcing the mortgage forbearance program to provide details on the deferral program. Mortgage regulators could allow for more streamlined refinance opportunities for government backed mortgages; many consumers are unable to take advantage of record low interest rates due to an active forbearance plan. The government programs created in response to the pandemic, including forbearance and deferral plans, foreclosure and eviction moratoria, consumer and business fiscal stimulus packages should be used as templates for future economic crises. Regulators and banks could improve upon several areas of operation related to the pandemic. Nobody was able to predict the immediate onset of the pandemic, followed by millions of employees working from home. This led to significant operational issues for banks and servicers; regulators should review banks abilities to shift to a work from home environment for all tasks in the future. Lastly, many customer service functions struggled to adapt to a work from home environment. Regulators should require all servicers to provide basic loss mitigation enrollment online, requiring minimal interaction with customer service to enroll.

STATEMENT OF PROBLEM

The 2008-2009 recession exposed flaws in banks ability to respond to financial crises impacting millions of customers. Congress and the regulatory agencies created new rules and oversight of financial firms to improve response to future crises. This paper will discuss the actions taken by regulatory agencies from 2008-2020 and their effectiveness at reducing risks to the financial system and improving assistance to consumers during the COVID-19 pandemic, with a focus on the mortgage and consumer credit markets.

This topic warrants research because the COVID-19 pandemic is the first test of regulatory changes put into place since the Great Recession. Financial institutions have had more than a decade to improve risk management and prepare for another financial crisis. The mortgage industry has shifted from a sector dominated by banks to a diverse mix of banks, fintech's, and private equity companies. Did the regulations put in place after the last crisis reduce risk to the financial system and reduce impact to consumers during the COVID-19 pandemic?

It is our belief that lessons learned from the Great Recession and the subsequent regulations have lessened the COVID-19 pandemic's impact on homeowners and strengthened the ability of the overall financial system to withstand another recession.

This study will research actions taken by the various regulatory agencies to improve risk management and respond to lessons learned from the Great Recession. We will compare various economic and financial metrics, such as unemployment, mortgage and consumer credit delinquencies, debt service trends and forbearance rates, amongst others, from the Great Recession and the COVID-19 pandemic to determine if regulatory changes have strengthened banks and lessened the pandemic's impact on consumers.

Results of this research have several potential uses. Policy makers can utilize this research to support the benefits regulatory changes have had on the financial industry. It can allow a more targeted review of which regulatory changes had the most benefit to banks, and consumers as well. On the other hand, the research may show that regulatory changes had little benefit in reducing the pandemic costs to the banking industry or improving bank response to impacted customers.

Regulators can utilize the data to determine whether post-crisis regulations and guidance have positively impacted banking industry results during the current pandemic. Regulators may also be able to determine if regulations and guidance issued during the current pandemic provided enough flexibility to banks in both assisting consumers and protecting their financial position. The COVID-19 pandemic and its financial impact is still evolving, so it may be premature to conclude on this aspect, but we have more than six months of economic and financial data since the pandemic began to analyze. Banks can use the research to identify regulations that may be burdensome to comply with that provide little benefit to consumers.

In the future, regulators may be able to improve upon regulatory guidance during crises by applying this research. Bankers may use the research to determine the best course of action when assisting mortgage customers facing hardships. Banks may be able to use this research as a business case to pursue or divest mortgage servicing or mortgage divisions. Many banks faced similar decisions following the Great Recession.

The 2008-2009 financial crisis accelerated a fundamental shift in mortgage lending and servicing from banks to the non-bank sector. The shift in mortgage servicing from banks to non-bank entities is attributable to three key factors, discussed below:

- **Litigation and reputation risk faced by banks after the Great Recession**
    - According to the Wall Street Journal, the U.S. government has fined the six biggest U.S. banks $110 billion for mortgage origination and servicing issues. The billions in fines and legal expenses associated with the handling of non-performing loans during and after the Great Recession impacted profitability of mortgage servicing lines of business and deterred future growth in those areas.
- **Changes to capital regulations of mortgage servicing rights applicable to banks**
    - In 2013, banking regulators issued revised capital regulations which decreased the amount of mortgage servicing assets includable in regulatory capital and increased the risk-weighting of those servicing assets included in capital. Banks, particularly large banks, have an economic incentive to limit holdings of servicing rights based on these capital regulations. Non-banks are not federally regulated for safety and soundness and are instead subject to a patchwork of federal, state and local rules.
- **Aggressive expansion and technological innovation by non-banks**
    - Non-banks often operate as single-line business models, only offering mortgage origination and/or servicing. They can develop technological systems that are efficient and unencumbered by the requirements to integrate with other bank IT systems. This has allowed non-banks to be technological leaders in the mortgage market.

The two primary bank regulatory changes since the Great Recession were the Dodd-Frank Act and implementation of the Basel III international capital standards. Federal Reserve governor Lael Brainard believes Dodd-Frank and Basel strengthened the banking sector, stating “Those reforms were vital in positioning banks to respond to COVID, and they were able as a result, unlike the last financial crisis, to continue lending to households and businesses, to work with their customers who need assistance, and to intermediate financial transactions."[1]

Dodd-Frank

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 was the most pervasive financial reform law since the Great Depression. The Dodd-Frank Act increased bank capital requirements, expanded stress testing, gives the Federal Reserve more authority to examine non-bank firms and prohibited banks from trading for their own account. Additionally, it created a new financial regulatory agency, the Consumer Financial Protection Bureau (CFPB). The CFPB has broad regulatory powers over medium and large-sized banks and financial companies.

Basel III Capital Rules

Basel III is an internationally agreed upon set of measures developed in response to the 2008-2009 financial crisis. The Basel agreement altered bank capital requirements in a way to discourage bank's from owning mortgage servicing rights (MSRs). The Basel agreement limited MSRs included in bank capital to 15 percent of total capital.

COVID-19 Pandemic

The regulatory and industry changes since 2008-2009 have shaped the response to the COVID-19 pandemic in 2020. China identified the first case of the COVID-19 virus in December 2019. The disease spread rapidly through China and the first confirmed case in the United States was on January 20, 2020. The federal government declared a public health emergency on January

[1] Haggerty, N. (2020, June 30). Dodd-Frank has softened blow of pandemic, its authors say. *American Banker*.

31, 2020. The first known death from COVID-19 in the United States was on February 6, 2020. The government declared the COVID-19 pandemic a national emergency on March 13, 2020.

As the pandemic was evolving, federal banking regulators were busy revising existing pandemic guidelines and issuing new guidance to bankers to guide them through this unprecedented crisis. The Federal Financial Institutions Examination Council (FFIEC) issued the first pandemic related guidance on March 6, 2020, with guidelines for banks to follow to minimize the potential impact of the virus.

CARES Act

Congress passed the Coronavirus Aid, Relief, and Economic Security (CARES) Act on March 27, 2020. This piece of legislation provided the most wide-reaching consumer protection laws since the Great Recession. The CARES Act had various provisions to provide economic support to impacted businesses and individuals, including mortgage relief. The mortgage related provisions of the CARES Act include:

- **Mortgage Forbearance:** Borrowers with federally backed mortgages may request up to two 180-day payment forbearance periods, regardless of delinquency status. Customers must attest they have been impacted by the pandemic, without providing any documentation.
- **Credit Bureau Reporting**: Servicers must continue to report a borrower in the forbearance program to credit bureaus at their previous payment status.
- **Fees:** For borrowers in forbearance, servicers may not charge any additional fees or interest, as if the borrower made all contractual payments on time.
- **Foreclosure and Eviction Moratorium:** Servicers may not initiate foreclosure on a federally backed mortgage until August 31, 2020. Landlords may not evict tenants from

rental properties with federally backed mortgages until July 24, 2020. Individual states extended the foreclosure moratorium beyond the August 31st date.

FHFA Guidance

Congress created the Federal Housing Finance Agency (FHFA) in 2008 to regulate the government sponsored enterprises (GSE's) Fannie Mae and Freddie Mac. FHFA took several actions in response to the COVID-19 pandemic. Fannie Mae and Freddie Mac are responsible for implementing FHFA's guidance. Primary amongst these issuances include:

- March 19, 2020 – FHFA Suspends Foreclosures and Evictions for Enterprises during National Emergency
- April 22, 2020 – FHFA Announces that Enterprises will Purchase Qualified Loans in Forbearance to Keep Lending Flowing
- May 13, 2020 – Enterprises to Offer Payment Deferral as a New Repayment Option for Homeowners in COVID-19 Forbearance Plans

FHFA has extended the CARES Act consumer protections related to foreclosures and evictions several times as the pandemic continues.

The initial rapid response by regulators is important to note. Fannie Mae and Freddie Mac introduced the COVID-19 forbearance plan option on March 18th, just 5 days after the national emergency declaration. FHFA suspended foreclosure and eviction activity just 6 days after the emergency declaration. Regulators learned from the Great Recession that slow and timid actions will cause additional borrower harm, and that making programs overly specific would only target certain segments of the population. Despite the initial quick response, it took more than two months for the government to create the payment deferral program at the end of the forbearance period. This delay led to borrower confusion and uncertainty in the forbearance process, as well as uncertainty for banks and servicers processing the forbearance plans.

Interagency Guidance

Similar to the FHFA, the federal financial regulators (Consumer Financial Protection Bureau, Federal Reserve, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of Comptroller of the Currency, Conference of State Bank Supervisors) have issued multiple pieces of guidance to guide banks and protect consumers through the pandemic. Several of the key pieces of guidance include:

- April 3, 2020 - Joint Statement on Supervisory and Enforcement Practices Regarding the Mortgage Servicing Rules in Response to the COVID-19 Emergency and the CARES Act
- June 2020 – Interagency Examiner Guidance for Assessing Safety and Soundness Considering the Effect of the COVID-19 Pandemic on Institutions
- August 3, 2020 – Joint Statement on Additional Loan Accommodations Related to COVID-19

The CFPB has separately issued FAQ guidance to guide mortgage servicers offering loss mitigation options to consumers during the pandemic.

Fiscal Stimulus

The CARES Act created several government programs to support consumers and small businesses during the pandemic, including direct payments to consumers, enhanced unemployment benefits and forgivable loans to small business that retain workers. These programs were designed to mitigate the pandemic's impact on the American financial system. Consumers with incomes less than $75,000 ($150,000 for married couples) were eligible to receive direct payments of $1,200 each, with an additional $500 per child. Reduced benefits were available for incomes up to $99,000 ($198,000 married couples). Similarly, the enhanced unemployment benefits added $600 per week to existing state unemployment benefits through December 2020. Both the direct payments to consumers and enhanced unemployment benefits mitigated the impact of the pandemic on the American economy and the mortgage market. Similarly, the Paycheck Protection Program offered loans to small businesses at a 1 percent interest rate. Loans are forgiven for those businesses that keep all current employees on the payroll through December 31, 2020. This program supported small businesses that might have otherwise closed due to the pandemic, and kept more consumers employed and able to pay their mortgages.

RESEARCH METHODOLOGY

We will review financial and economic data to assess whether these financial reforms and lessons learned since the Great Recession benefitted consumers and banks during the 2020 pandemic. There is a considerable amount of economic and financial data available on consumer finances and industry data on the financial condition of banks. We will primarily utilize trending and comparison data from four main sources, each discussed below.

Our primary source for consumer economic data is the Federal Reserve Economic Data (FRED) site, published by the Federal Reserve Bank of St. Louis. The FRED database tracks over 750,000 data series published by government agencies and financial firms, including several applicable to our analysis of consumers heading into the 2020 pandemic. Data series reviewed in our analysis include the unemployment rate, home price index, and mortgage and household debt service ratios as a percentage of income.

Monthly unemployment rates, as measured by the U.S. Bureau of Labor Statistics, represents the number of unemployed Americans as a percentage of the overall labor force. We will analyze unemployment trends during each recession and the resulting impact on consumers ability to repay mortgage debt. Borrowers who are unemployed are less likely to be able to make mortgage payments or withstand the financial pressures of a recession. The Case-Shiller National Home Price Index data provided by S&P Dow Jones will provide a comparison of homeowner equity during the Great Recession to the pandemic. The amount of equity a homeowner has is a key factor in their determination to keep a home or cease mortgage payments. Mortgage and household debt service ratios indicate the percentage of household income devoted to repayment of mortgage and all household debt, respectively. The Federal Reserve Board publishes this data, which will allow trend and comparison analysis of consumers overall ability to repay the debt they have undertaken. Mortgage borrowers who have high leverage may be unable to withstand a financial crisis, including potential unemployment, furlough or reduction of hours due to a pandemic. Additionally, borrowers may be forced to take time off due to sickness of themselves or a family member, or time off to accommodate e-learning by children, as many schools remained closed.

We will utilize two primary sources for COVID-19 forbearance data, Black Knight and the Mortgage Bankers Association (MBA). Black Knight is a leading service provider to the mortgage industry. 72 percent of the top 25 mortgage servicers utilize the Black Knight Mortgage Servicing Platform (MSP) software and includes more than 36 million loans, with a total principal balance exceeding $5 trillion. This volume of data allows Black Knight to publish monthly Mortgage Monitor reports, utilizing aggregate data from the MSP system. Key data points that we will use in our analysis include mortgage delinquency data, and pandemic related forbearance plan activity. Similarly, the Mortgage Bankers Association started a weekly Forbearance and Call Volume Survey at the beginning of the pandemic. The MBA survey includes more than 38 million loans and 77 percent of the mortgage servicing market. MBA data will further support data points provided by the Black Knight Mortgage Monitor reports.

The last data source is the FDIC. We will review bank capital ratios, provided by the FDIC, which indicate the amount of leverage and risk a bank has on its balance sheet. A comparison and trend analysis of capital ratios from the Great Recession up to the COVID-19 pandemic will help determine the ability of banks to withstand losses during a downturn.

Lastly, we have reviewed news articles and academic papers published on the economic recovery since the Great Recession, the government's pandemic response and the resulting impact on consumer finances. News sources include Inside Mortgage Finance, the Wall Street

Journal, and American Banker, and we reviewed academic papers published by sources such as the Mortgage Bankers Association and Federal Reserve economists. We have also reviewed the various regulatory guidance outlined earlier in this paper. We also conducted an interview with Joseph Smith, Mortgage Banking Technical Expert, in OCC's Retail Credit Policy division, who offered his opinions on this topic. The news articles, academic research and expert interviews provide additional support for my hypothesis and insight into the regulatory response to the pandemic.

There are few limitations in this research. There is a wealth of data available for trend and comparison analysis on all economic and financial metrics utilized in this report. Data provided by industry sources, such as Black Knight and MBA, is subject to the accuracy and honesty of survey participants. Errors in this data could lead to inaccurate findings. Neither vendor discloses whether the data is subject to a data integrity review. We plan to review and discuss data trends from both sources; any variance in results could be the result of inaccurate or dishonest data. Lastly, we must point out that the long-term impacts from COVID-19 will be unknown for some time. Despite government intervention, consumers may still struggle and eventually lose their home.

FINDINGS AND CONCLUSIONS

Banks entered 2020 better prepared to deal with a potential crisis than anytime in recent history. Regulators had increased capital requirements and refined loss mitigation options to strengthen oversight of the mortgage market. The CFPB's 2014 and 2016 servicing rules provide significant consumer protections from foreclosure. Delinquency rates were near record lows, home prices were soaring, and bank capital ratios were increasing.

Forbearance Plans

The primary tool to address the COVID-19 pandemic has been the forbearance plan. The CARES Act permits customers to skip mortgage payments for up to 12 months. When the forbearance period expires, borrowers have two options: Repay the missed payments or defer the missed payments to the end of the loan. We reviewed mortgage forbearance data provided by Black Knight and the Mortgage Bankers Association to determine the impact of the pandemic on mortgage borrowers. Black Knight data as of September 30, 2020 indicates the number of borrowers who were 30- or 60-days delinquent set record highs in 2020, but levels quickly recovered to well below the Great Recession peak due to rapid government intervention in the mortgage market.[2] The 90-day delinquent population is high at more than 2.3 million borrowers at September 30th but remains 20 percent below the peak of the Great Recession in 2008-2009. The chart in Figure 18 displays the Black Knight data from September 2020 compared to the Great Recession. The chart indicates that nearly all loan performance measurements are well below the Great Recession, despite vastly higher unemployment rates. State and Federal foreclosure moratoriums have kept borrowers who might otherwise face foreclosure due to COVID-19 in the 90-day delinquency population. Loans in active foreclosure

[2] Black Knight. (2020, September). *Mortgage Monitor.*

at September 30th were 90 percent below the peak volume during the Great Recession. In total, more than 6.3 million borrowers have entered a COVID-19 related forbearance plan since March. Most plans were setup on initial 3- or 6-month terms. As of October 20, there were approximately 3 million active forbearance plans remaining. Forbearance numbers decreased by 18 percent at the beginning of October when the first wave of forbearance plans reached their six-month term, indicating many borrowers were either re-employed, or confident in their ability to resume making monthly mortgage payments.

Mortgage Bankers Association data similarly indicated loans in forbearance at the end of September totaled 6.8 percent of loans, or approximately 3.2 million homeowners.[3]

The 2020 forbearance plans are straightforward compared to the loan modification programs of the Great Recession, which required submission of many forms and required frequent communication between the servicer and borrower. Many banks have designed the forbearance and deferral processes to minimize the needed borrower communication and simply rely on website forms and phone calls. Borrowers only need to attest they've been impacted by COVID-19, without any supporting documentation. Similarly, consumers only need to attest their ability to resume payments to complete the payment deferral, without submission of any employment or financial records to support that assertion. The Great Recession proved that making the loss mitigation process complicated only extends the process and harms consumers and banks. Forbearance plans are simple to setup and do not require extensive paperwork. Deferrals at the end of the forbearance period are similarly processed with minimal paperwork.

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[3] Mortgage Bankers Association. (2020, September 28). *Share of Mortgage Loans in Forbearance Declines to 6.87%*. Retrieved from https://www.mba.org/2020-press-releases/september/share-of-mortgage-loans-in-forbearance-declines-to-687

Comparison to other Natural Disasters

With the COVID-19 pandemic causing short-term unemployment and cash flow problems for consumers, many in the mortgage industry are comparing the pandemic to the issues faced by borrowers after a natural disaster. In fact, the forbearance plans used by Fannie Mae and Freddie Mac during the pandemic are modeled after those offered to consumers in areas hit by a natural disaster. Black Knight compared delinquency patterns from several recent hurricanes to the COVID-19 pandemic and found that delinquency rates typically peak 3-4 months after a hurricane, while they appear to have peaked 5 months after the onset of COVID-19.The rate of improvement however, is slower than that of a hurricane, and at the current pace, Black Knight estimates delinquency rates will be elevated through the 1st quarter 2022. [4]

Unemployment Rate

The COVID-19 pandemic and resulting economic downturn had a devastating impact on Americans jobs. As displayed in the chart on page 28, the unemployment rate was 3.5 percent in February 2020, amongst the lowest rates on record. The unemployment rate skyrocketed as COVID-19 spread, reaching 14.7 percent in April 2020. As the economy slowly reopened, employment figures improved, but still stood at 6.9 percent in October 2020. Unemployment during the Great Recession reached a peak of 10.0 percent in October 2009, considerably lower than the COVID-19 peak. Without various telework and work-from-home programs, unemployment may have exceeded the 25 percent unemployment rates from the Great Depression in the 1930's.

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[4] Black Knight. (2020, September). *Mortgage Monitor.*

The CFPB analyzed the impact of COVID-19 on consumer credit. They concluded that new delinquencies on mortgage, auto, student loan and credit card accounts fell between March 2020 and June 2020, after gradually increasing for the previous year. The CFPB also noted that credit card balances decreased by 10 percent during the same period, consistent with a decrease in consumer spending due to the pandemic and overlapping with the substantial government assistance provided through the CARES Act and other assistance programs.[5] Government intervention, via the stimulus payments, extra unemployment assistance and the Paycheck Protection Program, offset the economic impact of the COVID-19 pandemic for many consumers. Other consumers may have taken mortgage forbearance despite being able to continue paying the debt, instead using those savings to paydown consumer debt.

Mortgage and Consumer Debt Service Ratios

Low interest rates and a strong economy positioned American mortgage borrowers well for the 2020 pandemic. Monthly mortgage payments represented more than 7 percent of the average American's disposable monthly income at the onset of the 2008 recession.[6] Despite rising home prices and higher mortgage amounts, this ratio had decreased to 4.0 percent in the 1st quarter 2020 when the pandemic began. Since then, Federal Reserve actions have pushed mortgage interest rates to unprecedented lows, allowing the ratio to decrease to 3.7 percent by the 2nd quarter 2020. Although borrowers are facing financial stress from the pandemic, their mortgage is more affordable today than it was in 2008. The charts on pages 35-36 display the relative

[5] CFPB Office of Research. (n.d.). The Early Effects of the COVID-19 Pandemic on Consumer Credit. *CFPB Office of Research Special Issue Brief*.

[6] Federal Reserve Bank of St. Louis. (n.d.). *Mortgage Debt Service Payments as a Percent of Disposable Personal Income*. Retrieved from Federal Reserve Bank of St. Louis Economic Research: https://fred.stlouisfed.org/series/MDSP

affordability of mortgage and consumer debt payments today when compared to the Great Recession.

Similar to the pattern in mortgage debt service ratios, Americans were less burdened by consumer loan debt during the pandemic than the 2008 Great Recession, when consumers spent 6 percent of disposable income on consumer debt payments. This ratio steadily fell after the Great Recession, until 2013 when it began increasing again, reaching 5.5 percent of disposable personal income by the start of the COVID-19 pandemic.[7] The ratio fell below 5 percent in the 2nd quarter 2020, supported by falling interest rates and consumer deleveraging. Credit card delinquency rates followed a similar pattern. Credit card delinquencies peaked at 7 percent of credit card loans in the 2nd quarter 2009. Delinquency rates steadily declined over the previous decade, totaling 2.7 percent of loans in the first quarter 2020. Interestingly, credit card delinquencies declined in the 2nd quarter of 2020, during the pandemic. Consumers utilized savings and stimulus funds during the quarantine to repay debt and were spending less as they were quarantined in their homes.

Mortgage delinquency ratios

The 2008 recession uniquely impacted homeowners. Millions of homeowners were unable or unwilling to pay their mortgage. Delinquency rates peaked in the first quarter 2010 at more than 11 percent of all mortgages delinquent. Thanks to forbearance programs and the various fiscal stimulus programs, 2020 delinquency rates are below 3 percent, despite the pandemic.[8]

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[7] Federal Reserve Bank of St. Louis. (n.d.). *Consumer Debt Service Payments as a Percent of Disposable Personal Income*. Retrieved from Federal Reserve Bank of St. Louis: https://fred.stlouisfed.org/series/CDSP

[8] Federal Reserve Bank of St. Louis. (n.d.). *Mortgage Delinquency Rates*. Retrieved from Federal Reserve Bank of St. Louis Economic Research: https://fred.stlouisfed.org/series/Q09084USQ507NNBR

The mortgage market has shifted since the last recession; most mortgages are not owned by banks. The business model has shifted to one led by non-bank lenders and servicers. In fact, banks represent just 3 of the top 10 and 9 of the top 25 servicers in the country as of September 30, 2020.[9] The chart on page 34 displays the dramatic shift in business models between banks and non-banks. This shift is attributable to the regulatory changes made since the Great Recession and the reputation risk banks face as an active participant in the mortgage market. Many lenders were driven out of the business as capital requirements increased, servicing laws changed to benefit consumers in loss mitigation, and mortgage bankers paid billions in fines stemming from misdeeds in the last recession.

House Price Index

During the Great Recession, mortgage borrowers faced two key problems: loss of income and lack of equity. Not only were consumers unable to make their mortgage payment, but in many cases their homes were worth less than the mortgage balance. The mortgage assistance programs rolled out to assist consumers during the Great Recession focused on reducing consumers mortgage payments to keep them in their homes. Since the Great Recession, housing prices have increased significantly. The S&P Case Schiller U.S. National Home Price Index experienced a 26 percent drop between December 2007 and June 2009, with many metropolitan areas declining even further.[10] OCC Mortgage Banking Technical Expert Joe Smith noted the regional variances in house price declines during the Great Recession, while the COVID-19 pandemic uniformly impacts the entire country. Since June 2009, the index has increased 73

[9] Top 50 Mortgage Servicing Participants. (2020, November 6). *Inside Mortgage Finance*.

[10] Federal Reserve Bank of St. Louis. (n.d.). *S&P/Case-Shiller U.S. National Home Price Index*. Retrieved from Federal Reserve Bank of St. Louis Economic Research: https://fred.stlouisfed.org/series/CSUSHPISA

percent, with house prices reaching record highs in 2020. A study by Freddie Mac indicates that only 0.3 percent of customers in forbearance have negative equity in their homes.[11] Since consumers have sufficient equity (supported by rising home prices), the COVID-19 pandemic mortgage programs only have to address the unemployment situation. As the unemployment data shows, although unemployment rates remain well above historical averages, many employees have returned to work already. The CARES Act forbearance program assists these consumers with the short-term (up to 12 months) liquidity issues faced with job loss or reduction in income. Economic stimulus payments and the Paycheck Protection Program also quickly put liquidity in the hands of consumers who may need assistance. The forbearance programs provide immediate payment relief to consumers, allowing consumers to receive forbearance with only a statement they were impacted by the pandemic, rather than submit complex paperwork, which was required of the mortgage assistance programs during the Great Recession. This intervention by the regulators made servicers better equipped to deal with the volume of loans in forbearance.

Bank Capital Ratios

Despite increased regulation, in the years following the Great Recession banks enjoyed strong profitability and growth. The Basel capital rules prompted careful management of bank capital position, particularly regarding mortgages. Banks are incentivized to play a smaller role in the mortgage servicing market by holding fewer mortgage servicing rights. Non-banks have increased their share of the mortgage servicing market from 30 percent during the last recession

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[11] Freddie Mac Economic & Housing Research Group. (2020). Mortgage Forbearance Rates during the COVID-19 Crisis. *Freddie Mac Insight Report*.

to more than 50 percent of loans in 2020. The 12 years of profits increased bank's capital cushion for the inevitable recession that arrived with the COVID-19 pandemic in March 2020. Tier 1 Leverage Capital for the United States banking industry totaled 7.95 percent of average total assets immediately prior to the Great Recession. Capital ratios had increased to 9.66 percent of average assets by December 31, 2019. The COVID-19 pandemic first hit bank balance sheets in the 1st quarter 2020, as Tier 1 capital ratios decreased to 9.41 percent. By June 30, 2020, Tier 1 capital ratios declined to 8.77 percent.[12] The total amount of bank capital has actually increased during the pandemic, with higher asset levels on the denominator decreasing capital ratios. The growth in assets is attributable to several factors, including bank funding of government guaranteed loans during the pandemic, customers drawing down bank credit lines in case of emergency, and a general flight to safety, with investors pulling back from the stock market and storing funds in banks. Higher capital requirements leading up to the COVID-19 pandemic played a critical role at ensuring no financial institutions would be in danger of failing due to another mortgage crisis.

Limitations of Regulatory Response

COVID-19 has had limited impact on bank's and mortgage borrowers due to lessons learned from the Great Recession. The Great Recession saw millions of homeowners in foreclosure; the government stepped in swiftly during the pandemic with foreclosure moratoriums. The Great Recession saw homeowners struggle to obtain loan modifications and loss mitigation; regulators made forbearance plans and deferrals the primary loss mitigation option during the pandemic.

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[12] Federal Deposit Insurance Corporation. (n.d.). *FDIC Statistics on Depository Institutions*. Retrieved from https://www7.fdic.gov/sdi/index.asp

The strong economy and financial condition of banks at the onset of the pandemic also benefitted the overall response. In fact, in a Federal Reserve survey, 77 percent of adults reported doing "at least okay" financially in July 2020, up from 72 percent in April and 75 percent in October 2019.[13] Aside from unemployment rates, all financial indicators support the argument that government programs and regulation have improved the response to the COVID-19 crisis and made consumers more confident about their financial condition.

Despite the improvements to loss mitigation programs, banks and servicers were not prepared for the rapid onset of the pandemic. Regardless of minimal requirements to enroll in forbearance programs, many homeowners found themselves on hold with mortgage servicers for hours, trying to enroll. Servicers themselves are struggling with work from home policies for call center employees. The rapid rollout of the forbearance and deferral programs also caused confusion for servicers and borrowers. A study of the top 30 servicer websites by the Department of Housing and Urban Development found that ten servicers did not have information about forbearances available on the website and only four servicers listed an available forbearance period of 12 months.[14] Websites and call center agents also struggled to disclose customers options at the end of the forbearance period. Customers were often told that all missed payments would be due in a lump sum, despite numerous statements to the contrary by the government sponsored enterprises.

[13] Board of Governors of the Federal Reserve System. (2020, September). *Update on the Economic Well-Being of U.S. Households: July 2020 Results*. Retrieved from https://www.federalreserve.gov/publications/files/2019-report-economic-well-being-us-households-update-202009.pdf

[14] Department of Housing and Urban Development. (n.d.). *Some Mortgage Loan Servicers' Websites offer Information about CARES Act Loan Forbearance That is Incomplete, Inconsistent, Dated and Unclear.* Department of Housing and Urban Development.

Despite a pullback from the mortgage market, banks remain exposed to reputational risk and litigation risk from forbearance plans. News reports in July 2020 indicated Wells Fargo had enrolled many borrowers in unrequested forbearance plans. The bank faced lawsuits in 14 states tied to the alleged practice.[15] Wells Fargo will likely not be the only big bank to face litigation risk from the pandemic; with more than 6.3 million borrowers enrolled in forbearance plans at some point during 2020, it is possible that some percentage of customers were harmed or erroneously enrolled in the forbearance plans. As of July 2020, the CFPB reported receiving more than 8,000 complaints related to COVID-19, with 19 percent of those related to mortgages.[16] As regulators begin to examine the servicing of loans in the forbearance process, it is possible additional concerns will arise, potentially leading to regulatory action for banks.

The CARES Act forbearance programs may not be enough to prevent foreclosures for all homeowners. Even with 12 months of forbearance, customers will have to resume mortgage payments in 2021, absent additional government intervention. Regulators streamlined loan modification programs since the Great Recession, but still require borrowers to have an income to repay the mortgage. If unemployment rates remain high into 2021, seriously delinquent mortgage rates may begin to increase. Many states have extended foreclosure moratoriums to December 31, 2020; as these moratoriums expire, foreclosure rates may increase.

[15] NBC News. (2020, July 22). More Wells Fargo customers say the bank decided to pause their mortgage payments without asking.

[16] CFPB (2020, July 16). *CFPB Releases Updated COVID-19 Consumer Complaint Data*. Retrieved from https://www.consumerfinance.gov/about-us/newsroom/cfpb-releases-updated-covid-19-consumer-complaint-data

Positive/Negative consequences on an organization

The successes (and failures) of the COVID-19 response have important lessons for regulators and the banking industry going forward. Regulators learned from the prior recession that swift and decisive action was necessary to strengthen the economy. Although regulators were quick to issue guidance and assistance to the industry, they were slow to roll out the deferral program upon forbearance expiration. That led to borrower confusion and millions of phone calls to servicers to find out their options. Regulators should have issued guidance on what would happen at the end of the forbearance period up front. Banks and servicers were unprepared for the rapid rise in loss mitigation assistance needed. Compared with the Great Recession, which stretched out over two years, the COVID-19 pandemic struck within a matter of weeks. This happened at the same time offices were closed and employees transitioned to work from home. Business continuity plans were not prepared for the combination of call centers operating from personal residences and the onslaught of loss mitigation requests. The combination of these factors led to extended call hold times for all banks and mortgage servicers. Banks and mortgage servicers should adjust their technology and continuity plans to allow for greater flexibility when working from home.

RECOMMENDATIONS

Although the COVID-19 pandemic continues to evolve, some initial successes and failures can be identified. The mortgage payment forbearance has become the preferred loss mitigation method for borrowers experiencing a short-term inability to make payments. The program is relatively simple for both servicers and borrowers to understand and implement. On the other hand, regulators should be more decisive in providing guidance to the mortgage industry. It took regulators more than 45 days from the announcement of the forbearance program to provide guidance on the deferral process at the end of the forbearance period. This delay caused unneeded stress to borrowers who may have been incorrectly told they would have to repay all missed payments in a lump sum, and it also caused high volumes of calls to servicers.

Government leaders have created new programs that could be a template for future recessions. The fiscal stimulus programs, including the direct consumer payments, enhanced unemployment benefits and the Paycheck Protection Program loans, provided immediate assistance to American consumers who may have otherwise missed mortgage or other debt payments. Not only did these programs support consumers, but they also contributed to lower delinquency and charge-off rates at banks. The government mandated foreclosure and eviction moratoria provided reassurance to borrowers that they would not lose their homes despite struggling to make payments.

Government regulators could improve more consumers financial positions by allowing more streamlined refinances. Despite record low interest rates, many consumers have not refinanced either because they are ineligible due to the COVID-19 forbearance or don’t feel the savings is worth the refinance process. Allowing a straightforward interest rate decrease on loans owned by Fannie Mae and Freddie Mac would allow more borrowers to take advantage of the record-low interest rates.

Banks and servicers should prepare all functions for a work from home environment. Although disaster recovery plans have always been prepared for key functions operating remotely, the scale and length of the pandemic are unprecedented. Back office functions that were only tested to be performed remotely for hours or days have now been remote for nearly a year. Banks and servicers were unprepared for the volume of assistance requests combined with a remote workforce. They discovered that there weren't enough laptops for all employees, or that not every employee had internet access at home. Banks and servicers should implement these lessons into their business continuity and disaster recovery plans going forward. Regulators should review and discuss the ability for all functions to be performed remotely in a stressed environment. Additionally, many servicers were slow to roll-out online forbearance enrollment, requiring consumers to call the servicer to enroll. Servicers should develop templates allowing a quick roll-out of online loss mitigation enrollment.

EPILOGUE

With no end in sight for the pandemic, Congress passed additional support for consumers in December 2020. This aid package included $600 payments to individuals, additional $300 enhanced unemployment benefits, another round of Paycheck Protection Program loans and an extension of the federal eviction moratorium. The Federal Housing Finance Agency has extended the foreclosure moratorium until June 30, 2021, and borrowers with federally backed loans are now eligible for 6 additional months of payment forbearance. Mortgage delinquencies fell for the sixth consecutive month in November 2020 and remains nearly 2 percent below the peak delinquency rate from May 2020. Forbearance plans have mitigated the early stage delinquencies, but seriously past due loans over 90 days delinquent are 1.8 million over pre-pandemic levels. The national unemployment rate remained high at year-end 2020, at 6.7 percent, or nearly twice the figure at the beginning of the year.

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REFERENCE CHARTS

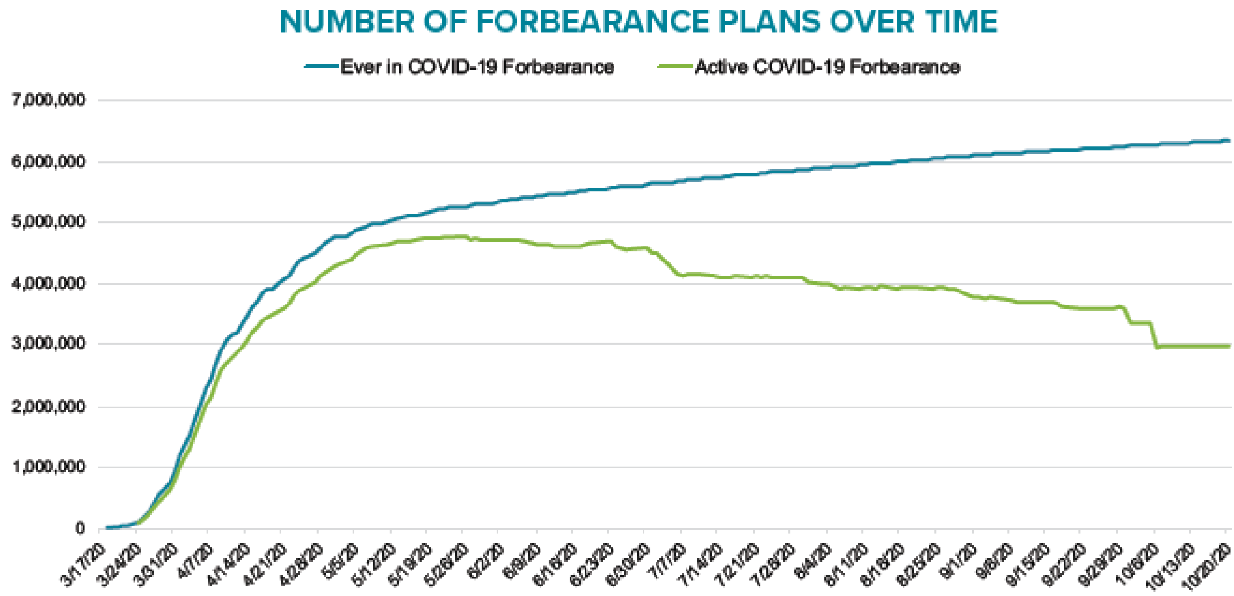
17

Black Knight Delinquency Comparison: Great Recession to COVID-19 Pandemic

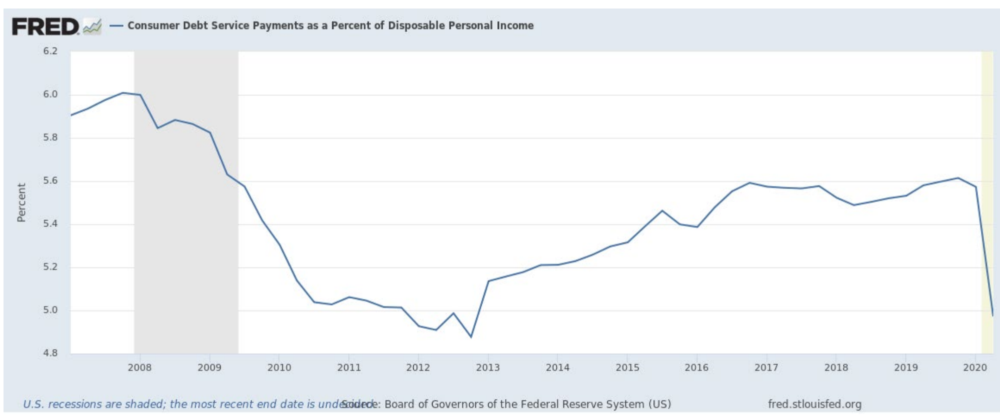
Metric	Current (Sept 2020)	COVID-19 Peak*	Great Recession Peak	COVID-19 Peak* vs. Great Recession Peak	
30 Days DQ	821,000	2,511,000	2,214,000	+297,000	+13%
60 Days DQ	397,000	1,734,000	957,000	+777,000	+81%
90+ Days DQ	2,323,000	2,366,000	2,973,000	-607,000	-20%
Active Foreclosure	181,000	220,000	2,296,000	-2,076,000	-90%
90+ Days or FC	2,504,000	2,553,000	5,042,000	-2,489,000	-49%
Total Delinquent	3,542,000	4,123,000	5,822,000	-1,699,000	-29%
Total Non-Current	3,722,000	4,324,000	7,891,000	-3,567,000	-45%
DQ%	6.7%	7.8%	10.6%	-2.8%	-27%
Foreclosure%	0.3%	0.4%	4.3%	-3.9%	-90%
Non Current%	7.0%	8.1%	14.3%	-6.2%	-43%

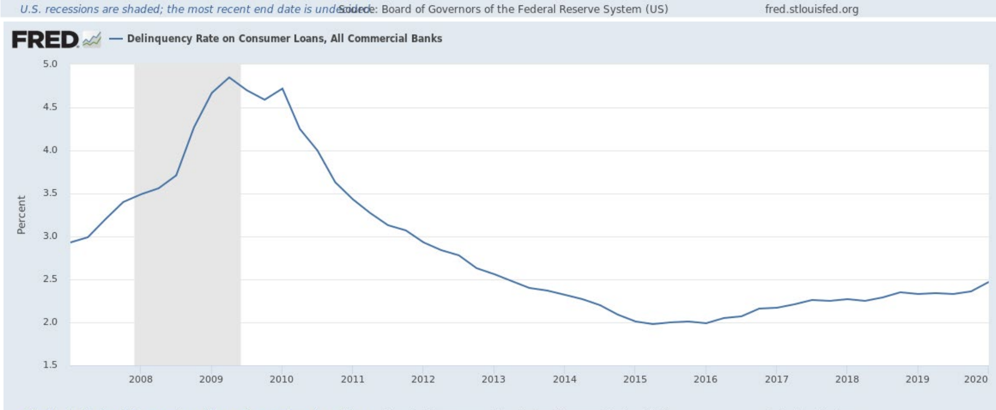
18

[17] Wall Street Journal
[18] Black Knight

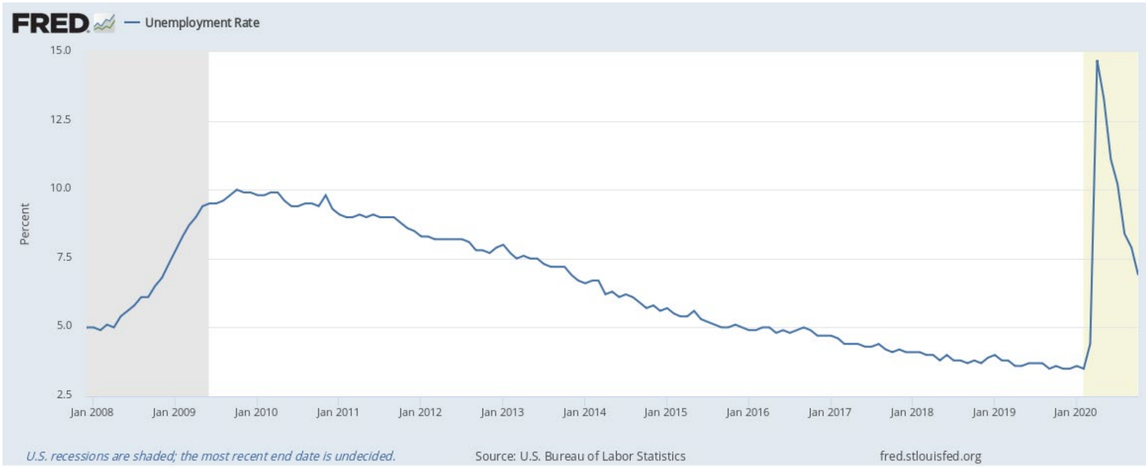


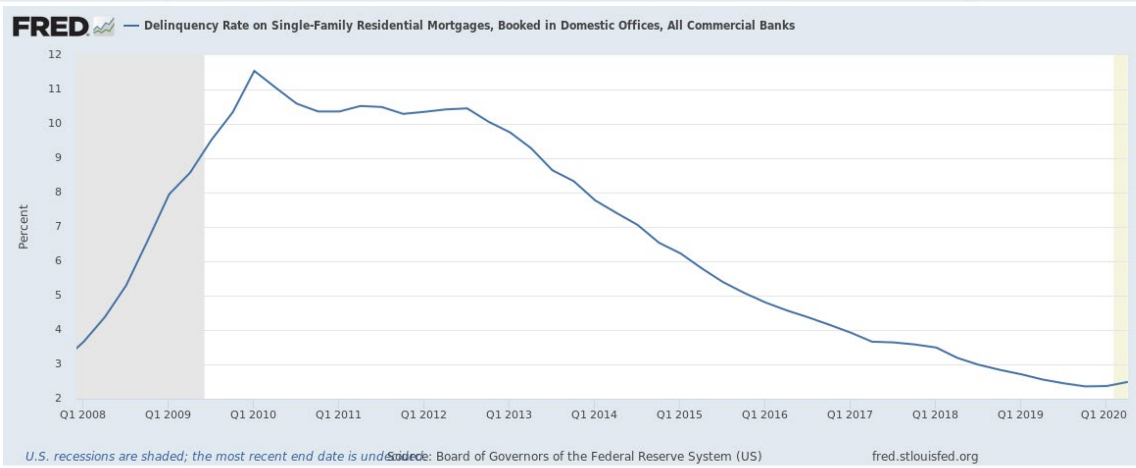
19

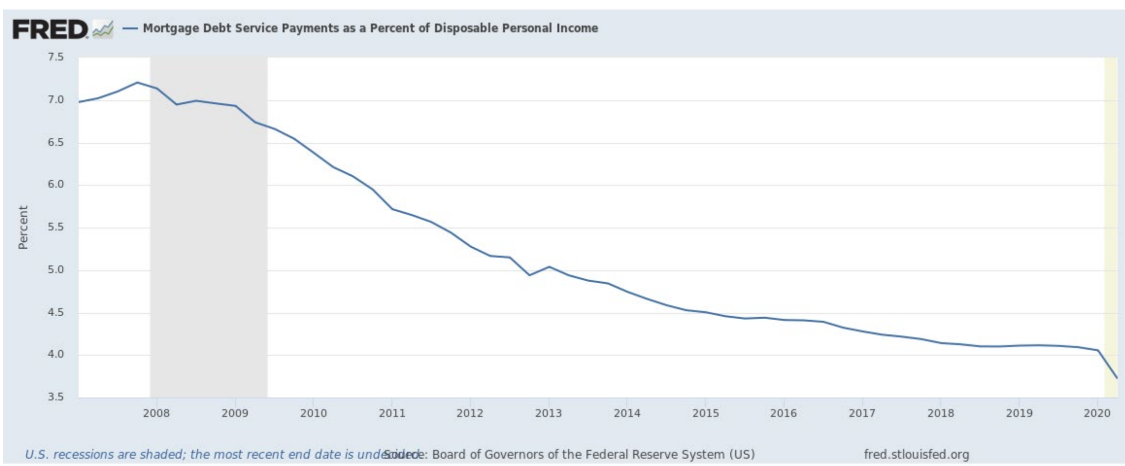




[19] Black Knight


FRED
Unemployment Rate
15.0
12.5
10.0
7.5
5.0
2.5
Percent
Jan 2008
Jan 2009
Jan 2010
Jan 2011
Jan 2012
Jan 2013
Jan 2014
Jan 2015
Jan 2016
Jan 2017
Jan 2018
Jan 2019
Jan 2020
U.S. recessions are shaded; the most recent end date is undecided.
Source: U.S. Bureau of Labor Statistics
fred.stlouisfed.org


FRED
Delinquency Rate on Single-Family Residential Mortgages, Booked in Domestic Offices, All Commercial Banks
12
11
10
9
8
7
6
5
4
3
2
Percent
Q1 2008
Q1 2009
Q1 2010
Q1 2011
Q1 2012
Q1 2013
Q1 2014
Q1 2015
Q1 2016
Q1 2017
Q1 2018
Q1 2019
Q1 2020
U.S. recessions are shaded; the most recent end date is unde
Source: Board of Governors of the Federal Reserve System (US)
fred.stlouisfed.org


FRED
Mortgage Debt Service Payments as a Percent of Disposable Personal Income
7.5
7.0
6.5
6.0
5.5
5.0
4.5
4.0
3.5
Percent
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
2020
U.S. recessions are shaded; the most recent end date is unde
Source: Board of Governors of the Federal Reserve System (US)
fred.stlouisfed.org