



FEDERAL RESERVE BANK *of* KANSAS CITY

July 26, 2012

**Guidance on Decisions to Abandon Foreclosure Proceedings**

**Attention:** Chief Executive Officer of each Tenth District State Member Bank, Bank Holding Company, and Savings and Loan Holding Company

**Subject:** On July 11, 2012, the Board of Governors of the Federal Reserve System issued guidance to organizations with residential mortgage servicing operations regarding decisions to abandon foreclosure proceedings. Specifically, SR 12-11/CA 12-10 instructs organizations to appropriately notify stakeholders of decisions to abandon foreclosures and maintain prudent foreclosure abandonment risk management practices. Finally, the guidance discusses how organizations' foreclosure abandonment decision-making will be supervised.

**Highlights:** The guidance directs organizations to notify borrowers of foreclosure abandonment decisions using the same methods to collect payments and inform borrowers of any: (1) rights to occupy the property; (2) financial obligations for the mortgage, taxes, and insurance; and (3) maintenance obligations. The guidance states safety-and-soundness examiners will oversee organizational efforts to regularly monitor collateral property values while consumer compliance examiners will ensure an organization's foreclosure abandonment decisions reflect prudent business practices. Consumer compliance examiners will also evaluate the organization's efforts to control risks in this area, including its policies and procedures, staff training, and oversight of third party foreclosure service providers.

**Attachment:** A copy of SR 12-11/CA 12-10 and the Examination Procedures for Reviewing a Banking Organization's Abandoned Foreclosure Process are attached.

**Contact:** Questions regarding SR 12-11/CA 12-10, related to consumer compliance may be directed to your organization's CA contact or Jeff Legette at (800) 333-1010, ext. 16712. Questions related to safety and soundness may be directed to your organization's central point of contact or Ryan Harwell at (800) 333-1010, ext. 12043.

**Internet:** A copy of SR 12-11/CA 12-10 and the Examination procedures are available on the Board's web site at:  
<http://www.federalreserve.gov/bankinfo/reg/srletters/SR1211.htm>



**BOARD OF GOVERNORS**  
OF THE  
**FEDERAL RESERVE SYSTEM**

WASHINGTON, D.C. 20551

DIVISION OF BANKING  
SUPERVISION AND REGULATION

DIVISION OF CONSUMER AND  
COMMUNITY AFFAIRS

**SR 12-11**

**CA 12-10**

**July 11, 2012**

**TO THE OFFICER IN CHARGE OF SUPERVISION  
AT EACH FEDERAL RESERVE BANK**

**SUBJECT: Guidance on a Lender's Decision to Discontinue Foreclosure Proceedings**

**Applicability to Community Banking Organizations:** This guidance applies to state member banks, bank holding companies, and savings and loan holding companies with residential mortgage servicing operations, including those with \$10 billion or less in consolidated assets.

The Federal Reserve is issuing this guidance to emphasize the importance of appropriate risk management practices and controls in connection with a decision not to complete foreclosure proceedings after they have been initiated (a situation referred to in this guidance as an abandoned foreclosure). This guidance applies to state member banks, bank holding companies and savings and loan holding companies (collectively, banking organizations) with residential mortgage servicing operations. Information obtained on mortgage industry practices has revealed that lenders and servicers sometimes discontinue a foreclosure process without notification to borrowers or local authorities, which can raise a number of issues.<sup>1</sup> Banking organizations with residential mortgage servicing operations should ensure that the following key concepts are addressed in their policies and practices governing abandoned foreclosures:

- *Notification to Borrowers.* Supervised banking organizations should notify the borrower(s) when a decision is made not to pursue a foreclosure action, and should inform the applicable borrower(s) of their (1) rights to occupy their property until a sale or other title transfer action occurs, (2) financial obligations regarding the outstanding loan balance and the payment of applicable taxes and insurance premiums, and (3) property maintenance responsibilities.

<sup>1</sup> The Government Accountability Office (GAO) released a study that discusses the scope of the issues that abandoned foreclosures pose for borrowers, communities, local governments, lenders, and servicers. This report, GAO-11-93, *Mortgage Foreclosures: Additional Mortgage Servicer Actions Could Help Reduce the Frequency and Impact of Abandoned Foreclosures*, is available on the GAO public website at <http://www.gao.gov/new.items/d1193.pdf>.

- *Communications.* Supervised banking organizations should use all means possible to provide the notification described above to affected borrowers, particularly those who prematurely vacated their homes based on the servicers' initial communications regarding foreclosure actions. In particular, when attempting to provide the notification, supervised organizations should employ the same extensive methods they use to contact borrowers in connection with payment collection activities.
- *Notification to Local Authorities.* Supervised banking organizations should ensure that their procedures include reasonable efforts to notify appropriate state or local government authorities of the organization's decision to not pursue a foreclosure, including complying with applicable state or local government notification requirements. These local entities may include tax authorities, courts, or code enforcement departments.
- *Obtaining and Monitoring Collateral Values.* Supervised banking organizations should have a process for obtaining the best practicable information on the collateral value of a residential property that may be subject to foreclosure, updating this information on a regular basis and using current information in their assessment as to whether to initiate, continue, or abandon a foreclosure proceeding.<sup>2</sup>

## Supervisory Process

The objective of the supervisory process related to abandoned foreclosures is to confirm that a banking organization manages its decisions to initiate and/or discontinue foreclosure proceedings in a prudent manner. When determining the scope of a residential real estate examination, the attached examination procedures for the review of an organization's abandoned foreclosure practices should be considered by safety-and-soundness and consumer compliance examiners. In particular, safety-and-soundness examiners will determine if an organization's policies and procedures include regular monitoring of property values. This review may be done as part of the regular assessments of banking organizations' appraisal and evaluation programs.

Consumer compliance examiners will determine if the organization took appropriate steps to notify property owners and local authorities of a decision to discontinue a foreclosure proceeding, provided appropriate training to its staff, and conducted appropriate oversight of third party foreclosure service providers to ensure compliance with these guidance requirements. In addition, consumer compliance examiners will determine if the organization's decision-making process for initiating and discontinuing a foreclosure proceeding reflects responsible, prudent business practices that consider the current collateral property value and effect of foreclosure abandonment on property owners, local authorities, and other interested parties, and minimizes any potential adverse effects.

Federal Reserve Banks are asked to distribute this letter to state member banks, bank holding companies and savings and loan holding companies in their districts as well as to their supervisory and examination staff, as appropriate. For questions concerning consumer compliance issues, please contact Mayank Patel, Senior Supervisory Consumer Financial Services Analyst, Division of Consumer and Community Affairs, at (202) 452-2316. Questions

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<sup>2</sup> Refer to SR letter 10-16, "Interagency Appraisal and Evaluation Guidelines," for supervisory expectations for a regulated banking organization's policies and procedures on collateral monitoring in support of its loan modification or workout activity.

concerning appraisals and collateral valuation issues should be directed to Carmen Holly, Supervisory Financial Analyst, Credit, Market and Liquidity Risk Policy, Division of Banking Supervision and Regulation, at (202) 912-4611.

In addition, questions may be sent via the Board's public website.<sup>3</sup>

Michael S. Gibson  
Director  
Division of Banking Supervision  
and Regulation

Sandra F. Braunstein  
Director  
Division of Consumer  
and Community Affairs

Attachment:

- *Examination Procedures for Reviewing a Banking Organization's Abandoned Foreclosures Process*

Cross References to:

- SR letter 10-16, "Interagency Appraisal and Evaluation Guidelines"

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<sup>3</sup> <http://www.federalreserve.gov/apps/contactus/feedback.aspx>.

**Examination Procedures  
For Reviewing a Banking Organization's Abandoned Foreclosures Process<sup>1</sup>**

**July 11, 2012**

**General**

Has the supervised organization decided not to complete any foreclosures after the foreclosure process was initiated? If yes, continue with examination procedures.

**Safety and Soundness**

1. Review a banking organization's policies and procedures for regular monitoring of property values to support the analysis to continue or abandon the foreclosure. Collateral valuation information should be sufficient to support a decision to initiate, continue, or abandon a foreclosure proceeding. Refer to the *Interagency Appraisal and Evaluation Guidelines* (SR letter 10-16).
2. Discuss findings with the organization's management and obtain any necessary commitment for corrective action. Assess whether these actions will address the noted deficiencies and weaknesses and, if not, determine whether supervisory action is necessary.

**Consumer Compliance**

1. Review written internal policies and procedures relating to the banking organization's decision-making process for discontinuing foreclosures. The policies and procedures should address:
  - a. A comparison of the option of continuing the foreclosure or abandoning the foreclosure, considering the cost and potential recovery in a net present value analysis.
  - b. Current information on the property's value to support the analysis.
  - c. Appropriate management review and oversight of the decision to abandon the foreclosure.
  - d. Management reporting of loans and properties for which the organization has abandoned its right to foreclose.
  - e. Internal controls to demonstrate compliance with policies and procedures, including governance over policy exceptions.
  - f. Responsibilities of internal audit and compliance functions to confirm the organization's compliance with laws, regulations, and internal policies related to abandoned foreclosures.
2. Determine whether the organization is adhering to its policies and procedures governing its decision to discontinue a foreclosure by reviewing a reasonable sample of the organization's loan files and other internal documents.

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<sup>1</sup> Before incorporating a review of abandoned foreclosure practices in either a consumer compliance or safety-and-soundness examination, the reviewing examiner should discuss the scope of the review with an examiner from the other supervisory area to avoid duplication of effort.

3. Determine whether the organization's consumer inquiry and complaint process adequately addresses inquiries on the abandonment of a foreclosure by reviewing a reasonable sample of the organization's inquiries and complaints from property owners and the files evidencing the organization's investigation and response to borrower correspondence, loan files, and inquiries and complaints from property owners.
4. Assess the adequacy of the organization's policies and procedures regarding the methods used to notify property owners of its decision to discontinue a foreclosure proceeding, including methods used to locate property owners that are no longer living in the dwelling.
5. Assess the adequacy of the organization's policies and procedures regarding the methods used to notify local authorities and other relevant parties of its decision to discontinue a foreclosure proceeding. Include an assessment of the adequacy of the organization's methods to ensure that the organization complies with any requirement, as well as state and local laws, to report its decision to discontinue a foreclosure proceeding to any local centralized registry system or has made reasonable attempts to notify the appropriate governing entity if no property registry system exists in the local jurisdiction.
6. Determine whether the organization's decision-making process for initiating and discontinuing a foreclosure proceeding reflects responsible, prudent business practices that consider current collateral value information on the property and the effect of foreclosure abandonment on property owners, local authorities, and other interested parties, and minimizes any potential adverse effects (e.g., fair lending concerns) to these parties and the communities where the properties are located.
7. Determine whether the organization has incorporated its compliance responsibilities under the abandoned foreclosure guidance into its operations, particularly with respect to its foreclosure notice procedures, and with respect to requiring third-party foreclosure service providers to incorporate these compliance activities as well.
8. Determine whether the organization has conducted training for appropriate personnel on the abandoned foreclosure guidance, with particular emphasis on the adverse effects (e.g., fair lending concerns) of abandoned foreclosures on property owners, local authorities, and neighborhoods.
9. Determine whether the organization has incorporated routine reviews for compliance with the organization's policies and procedures for abandoned foreclosures into its compliance monitoring program.
10. Discuss findings with organization management and obtain any necessary commitment for corrective action. Assess whether these actions will address the noted deficiencies and weaknesses and, if not, determine whether supervisory action is necessary.