Steering Loan Modifications Post-Pandemic

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I

INTRODUCTION

For a brief moment in early 2020, as policymakers and the public became more aware of the severity of the COVID-19 pandemic, it seemed like Congress might provide Americans with true relief during an unprecedented time. Although Congress passed three relief bills during the pandemic, the majority of relief delivered to households came in the form of debt forbearance. The Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"), which took effect at the end of March 2020,[1] included three key moratoria—a foreclosure moratorium for homeowners, an eviction moratorium for renters, and a student loan payment moratorium—all of which were continued through mid to late 2021.[2]

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1. CARES Act is short for the Coronavirus Aid, Relief, and Economic Security Act. Congress passed and the President signed the CARES Act into law on March 27, 2020. CARES Act, Pub. L. No. 116–36, § 2102(a)(3) (2020), https://www.congress.gov/116/bills/hr748/BILLS-116hr748enr.pdf [https://perma.cc/R39P-9M23].

2. Michelle Singletary, *The Federal Foreclosure Moratorium Has Ended. Struggling Homeowners May Still Be Able to Keep Their Homes*, WASH. POST (Aug. 3, 2021), https://www.washingtonpost.com/business/2021/08/03/faq-foreclosure-moratorium-ending/ [https://perma.cc/N5B3-7ZMH]; Adam Liptak & Glenn Thrush, *Supreme Court Ends Biden's Eviction Moratorium*, N.Y. TIMES (Aug. 26, 2021), https://www.nytimes.com/2021/08/26/us/eviction-moratorium-ends.html [https://perma.cc/3ZTZ-LYVX]; Michelle Singletary, *Student Loan Relief is Extended Until Jan. 31, 2022. Here's What You Need to Know.*, WASH. POST (Aug. 6, 2021), https://www.washingtonpost.com/business/2021/08/06/student-loan-payment-pause/ [https://perma.cc/39HC-5LLY]. Before it ended, the Consumer Financial Protection Bureau proposed rules that would ban mortgage servicers from foreclosing until 2022. *CFPB Proposes Mortgage Servicing Changes to Prevent Wave of COVID-19 Foreclosures*, CONSUMER FIN. PROT. BUREAU (Apr. 5, 2021), https://www.consumerfinance.gov/about-us/newsroom/cfpb-proposes-mortgage-servicing-changes-to-prevent-wave-of-covid-19-foreclosures/ [https://perma.cc/W5HL-8UD9]. After the decision to extend the eviction moratorium, some states, such as New York, extended their own state-wide eviction bans. Nell Clark, *New York Extends Its Eviction Moratorium Through End Of 2021*, NPR (Sept. 2, 2021), https://www.npr.org/2021/09/02/1033634413/new-york-extends-its-eviction-moratorium-through-end-of-2021 [https://perma.cc/5DKK-JWCP].

Soon after the CARES Act was passed, we published a series of papers critiquing the relief provided to American households.[3] As we detailed in *The Folly of Credit As Pandemic Relief*, these three moratoria amounted to extensions of credit.[4] People were temporarily relieved of their obligations to pay their mortgages and student loans, and their landlords could not evict them if they did not pay their rent. But eventually, extensions of credit still require payment. Although they gave people breathing room, upon the moratoria's expirations, people will again face these debt obligations. Indeed, when the foreclosure moratorium ended in July 2021, foreclosure activity increased.[5]

This Article focuses on the likely fallout for American households as a result of expiring moratoria and provides a regulatory path for steering creditors to offer borrowers workable loan modifications or else to bring people to the point of reckoning with their debts in bankruptcy. For each forborne debt, borrowers will have to make up the missed payments in some way. Depending on the deals that borrowers entered with their creditors during the moratorium period, assuming they entered into a deal at all, loan terms may extend by the number of missed payments or regular payments may increase to spread the missed payments over the remaining life of the loan. Regardless of the details of each deal, in the near future, people will have to face the large debt obligations that come with mortgages, auto loans, and credit cards. Similarly, people who did not need forbearance of certain debts during the pandemic may find themselves unable to keep up with their debts and in danger of defaulting.

With individuals and families now facing the pandemic's economic repercussions, many are likely to be in worse financial shape than they were in pre-pandemic. Although unemployment declined in 2021,[6] racial and ethnic minorities' unemployment rates remained high.[7] In the third quarter of 2021,

3. Pamela Foohey, Dalié Jiménez, & Christopher K. Odinet, *The Debt Collection Pandemic*, 11 CALIF. L. REV. ONLINE 222 (2020) [hereinafter *The Debt Collection Pandemic*], http://www.californialawreview.org/wp-content/uploads/2020/05/JimenezFooheyOdinet_DebtCollectionPandemic_CalLRev-2.pdf [https://perma.cc/PUS3-A24W]; Pamela Foohey, Dalié Jiménez, & Christopher K. Odinet, *The Folly of Credit As Pandemic Relief*, 68 UCLA L. REV. DISC. 126, 129 (2020) [hereinafter *The Folly of Credit As Pandemic Relief*], https://www.uclalawreview.org/the-folly-of-credit-as-pandemic-relief/ [https://perma.cc/HD6W-RGB7]; Pamela Foohey, Dalié Jiménez, & Christopher K. Odinet, *CARES Act Gimmicks: How Not To Give People Money During A Pandemic And What To Do Instead*, 2020 U. ILL. L. REV. ONLINE 81 (2020) [hereinafter *Cares Act Gimmicks*], https://www.illinoislaw review.org/online/cares-act-gimmicks/ [https://perma.cc/LTR8-TGUS].

4. *See generally The Folly of Credit As Pandemic Relief*, *supra* note 3, (arguing that "Congress got the balance between providing true money versus what amount to credit products to people fundamentally backwards[,]" resulting in "a serious error that will have enduring negative consequences").

5. *August 2021 U.S. Foreclosure Activity Rises Following the End of the Foreclosure Moratorium*, ATTOM (Sept. 9, 2021), https://www.attomdata.com/news/market-trends/foreclosures/attom-august-2021-u-s-foreclosure-market-report/ [https://perma.cc/4RXV-KEKR].

6. Christopher Rugaber, *US Jobless Rate Sinks to 4.2% as Many More People Find Jobs*, AP NEWS (Dec. 3, 2021), https://apnews.com/article/coronavirus-pandemic-health-business-unemployment-economy-e62c5ed35f69bc763a6d297858ceb084 [https://perma.cc/Z7B3-SB2Q].

7. *State Unemployment by Race and Ethnicity*, ECON. POL'Y INST. (Nov. 2021),

Black workers and Latine workers were sixty-five and fifty-two percent more likely than white workers to be unemployed, respectively.[8] Women also dealt with greater and more persistent rates of unemployment during 2021, although they too experienced recovery toward the end of the year.[9]

Between the CARES Act, the Consolidated Appropriations Act, 2021,[10] and the American Rescue Plan Act of 2021 ("ARP"),[11] American households received some, but almost certainly not enough, direct money relief to deal with the pandemic's financial fallout. Across the three relief packages, eligible individuals and families received direct payments ranging from $3,200 to $6,400, plus a total of up to $2,500 for each qualifying dependent.[12] Each of the relief packages also included enhanced unemployment benefits,[13] and the ARP increased the child tax credit.[14] The relief provided to American households, particularly in the ARP, is a momentous achievement. Relief payments, unemployment benefits, and the child tax credit delivered much needed cash to

https://www.epi.org/indicators/state-unemployment-race-ethnicity/ [https://perma.cc/V76J-4AXK].

8. *Id.*

9. *See* Nelson D. Schwartz & Talmon Joseph Smith, *Job Gains Offer a Brighter Picture of the U.S. Economy*, NY TIMES (Nov. 5, 2021), https://www.nytimes.com/2021/11/05/business/economy/october-2021-jobs-report.html [https://perma.cc/4PZ6-5CBD] (depicting improvement in unemployment numbers for women at the end of 2021); Kweilen Ellingrud & Liz Hilton Segal, *COVID-19 Has Driven Millions of Women Out of the Workforce. Here's How To Help Them Come Back*, FORTUNE (Feb. 13, 2021), https://fortune.com/2021/02/13/covid-19-women-workforce-unemployment-gender-gap-recovery/ [https://perma.cc/PP6B-VXJZ] (illustrating the unemployment disparities that existed throughout much of 2021).

10. Congress passed the Consolidated Appropriations Act, 2021 on December 21, 2020, and the President signed the Act into law on December 27, 2020. *See President Signs the Consolidated Appropriations Act, 2021*, SOC. SEC. ADMIN. (Dec. 28, 2020), https://www.ssa.gov/legislation/legis_bulletin_122720.html [https://perma.cc/D4N9-SA4M]. The bill is available at https://www.govinfo.gov/content/pkg/BILLS-116hr133enr/pdf/BILLS-116hr133enr.pdf [https://perma.cc/2M2J-3Y57].

11. Congress passed the ARP on March 10, 2021 and the President signed the Act into law on March 11, 2021. *See* Grace Seggers, *Biden Signs $1.9 Trillion American Rescue Plan Into Law*, CBS NEWS (March 11, 2021), https://www.cbsnews.com/news/biden-signs-covid-relief-bill-american-rescue-plan-into-law/ [https://perma.cc/S3LE-86QD]. The bill is available at https://www.congress.gov/bill/117th-congress/house-bill/1319/text [https://perma.cc/2F4G-NTYB].

12. *See CARES Act Gimmicks*, *supra* note 3, at 83–84 (identifying amounts of first direct payment); *President Signs the Consolidated Appropriations Act, 2021*, *supra* note 10 (identifying amounts of second direct payment); *American Rescue Plan Act of 2021*, NAT. CONF. STATE LEGISLATURES (Mar. 9, 2021), https://www.ncsl.org/ncsl-in-dc/publications-and-resources/american-rescue-plan-act-of-2021.aspx [https://perma.cc/EZ34-AS49] (identifying amounts of third direct payment).

13. *See CARES Act Gimmicks*, *supra* note 3, at 137–40 (describing unemployment benefits); Jillian de Chavez-Lau & Jenna D. Russell, *The 2021 Consolidated Appropriations Act Extends Pandemic Unemployment Benefits*, NAT. L. REV. (Jan. 25, 2021), https://www.natlawreview.com/article/2021-consolidated-appropriations-act-extends-pandemic-unemployment-benefits [https://perma.cc/B6ZE-UYYX] (detailing the Consolidated Appropriations Act); Seggers, *supra* note 11 (discussing the ARP).

14. *Fact Sheet: The American Rescue Plan Will Deliver Immediate Economic Relief to Families*, TREASURY DEP'T (Mar. 18, 2021), https://home.treasury.gov/news/featured-stories/fact-sheet-the-american-rescue-plan-will-deliver-immediate-economic-relief-to-families [https://perma.cc/A6WW-WP34]; Carmen Reinicke, *New $3,000 Child Tax Credit Might Not Come With Monthly Payments, IRS Says*, CNBC (Mar. 19, 2021), https://www.cnbc.com/2021/03/19/the-3000-child-tax-credit-might-not-be-sent-via-monthly-payments.html [https://perma.cc/DS84-SHXD].

people as they struggled amidst layoffs and reduced work hours, closure of schools and daycares, and shutdowns and stay-at-home mandates.

Nonetheless, even with the labor market recovery, the length of the pandemic has left millions of households in a deep financial hole, one that relief payments and other enacted measures will not fully fill. It will likely take years for many people to recover financially. National and state-level moratoria on eviction, foreclosure, and student loan payments all will have expired by early 2022.[15] If other creditors, such as auto and credit card servicers, have agreed to pause or alter people's debt payments, those deals also will expire. People will have to budget for increased debt payments. Many people may not have the liquidity to meet all their ongoing expenses. Added to this will be renewed housing payments, student loan payments, and other previously paused or reduced debt payments. Something will have to give. People may fall behind on their obligations, leading them to ask their lenders or servicers for help or to default, which could spark a wave of debt collection lawsuits, repossessions, and foreclosures, as we previously predicted in *The Debt Collection Pandemic*.[16]

Part II of this Article picks up at the point of people's impending defaults on various forms of consumer credit.[17] To avoid losing their homes, cars, and seeing their credit scores destroyed, people may seek help from their creditors. As such, this Article focuses specifically on auto loans, credit cards, unsecured personal loans, and other installment or revolving loans.

As detailed in Part III, consumer borrowers will find that their lenders' obligations to work with them vary significantly, which will complicate navigating possible loan modifications. Servicers (whether they hold the loan or not) lack incentives to alter the status quo to streamline their current loan modification procedures before they experience an uptick in modification requests. Once requests start to pile up, some lenders may use people's desperation and lack of specific knowledge to place borrowers in unaffordable loan modifications geared less toward helping the individual get back on track and more toward keeping them in the "sweat box" of credit.[18] Other lenders may hastily offer a modification that does not consider the borrower's ability to successfully repay the modified loan. Under either scenario, *modification failures* may abound, similar to what

15. *See* Liptak & Thrush, *supra* note 2 (stating the end dates of each moratoria).

16. *See generally The Debt Collection Pandemic*, *supra* note 3, at 240 ("The inevitable result, though, was to put millions of Americans at risk for debt collection.").

17. This Article does not focus on student loans, which largely are under the purview of the Department of Education (DOE), and which the DOE, amendments to bankruptcy law, and Congress are better able to address. *See* Dalié Jiménez & Jonathan D. Glater, *Student Debt is a Civil Rights Issue: The Case for Debt Relief and Higher Education Reform*, 55 HARV. C.R.-C.L. L. REV. 131, 165–97 (2020) (arguing for broad-based cancelation and reform of higher education funding based on the effect of using student debt as the primary means of funding higher education).

18. *See* Ronald J. Mann, *Bankruptcy Reform and the "Sweat Box" of Credit Card Debt*, 2007 U. ILL. L. REV. 375, 391–92 (showing examples of modifications that keep borrowers in the "sweat box"); *see also* Pamela Foohey, Robert M. Lawless, Katherine Porter, & Deborah Thorne, *Life in the Sweatbox*, 94 NOTRE DAME L. REV. 219–26 (2018) (describing the "sweatbox" and showing its prevalence through data).

happened in the mortgage market after the 2008 financial crisis. Debt settlement mills and other companies selling scams are almost certain to emerge, as they did during the Great Recession's foreclosure crisis.[19] Overall, the current lack of structure for loan modifications across consumer credit products has the strong potential to result in lenders offering people modifications that will fail or push people toward less than reputable debt consolidation companies that likewise will result in people defaulting on their modified loans.[20]

In light of this trajectory, Part IV introduces and advocates for regulatory intervention, via the Consumer Financial Protection Bureau ("CFPB")'s statutory powers, to incentivize and steer consumer credit lenders to offer sustainable loan modifications. Specifically, the CFPB should issue a compliance bulletin which directs loan servicers to make a reasonable determination whether a borrower has the ability to make all required, scheduled payments in connection with any loan modification. Given the CFPB's scope, this intervention can target direct auto lenders, credit card issuers, and other lenders that offer people revolving credit or installment loans. This Part also discusses oversight of these modifications, with an eye toward ensuring that those people disproportionately sold subprime, expensive loans, particularly communities of color, will have access to beneficial modification deals.[21]

Part V of this Article concludes by considering the effects of requiring lenders to provide people with workable loan modifications. This Article advocates for an "ability to repay" structure for two key reasons. First, it will result in lenders placing people into modifications that they are likely to be able to meet over the long term. Second, it will result in lenders telling some people that they do not qualify for loan modifications based on their financial situation. For these borrowers, filing bankruptcy may be their best option, even considering its expense and negative consequences.[22] Yet research shows that people typically will seriously struggle to pay their debts for years before resorting to bankruptcy, sacrificing their well-being and approaching their lenders for help while they

19. *See Federal and State Agencies Target Mortgage Relief*, FED. TRADE COMM'N (Nov. 24, 2009), https://www.ftc.gov/news-events/press-releases/2009/11/federal-state-agencies-target-mortgage-relief-scams [https://perma.cc/6C4W-AWYL] (detailing a federal operation to combat scams in the wake of the 2008 financial crisis).

20. At present, because the United States is still dealing with the pandemic, there is no robust evidence that we know of regarding loan modification of these consumer credit products. This Article's insights extrapolate from prior crises, particularly the Great Recession. *See infra* Part III.

21. Manisha Padi, *Contractual Inequality*, MICH. L. REV. (forthcoming 2022) (manuscript at 42), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3915707 [https://perma.cc/6JES-ZJUG] (finding "disparate treatment of neighborhoods with different racial characteristics"). *See also* Abbye Atkinson, *Borrowing Equality*, 120 COLUM. L. REV. 1403, 1457 (2022) (arguing that "If Congress is serious about subsidizing borrowing as a means of equality and mobility, then it has to align both the front and back-end aspects—the economic and noneconomic aspects of credit and debt.").

22. *See* Pamela Foohey, Robert M. Lawless, & Deborah Thorne, *Portraits of Bankruptcy Filers*, 56 GA. L. REV. (forthcoming 2022) (manuscript at 47–54), https://ssrn.com/abstract=3807592 [https://perma.cc/W7JQ-83ZG] (identifying the potential benefits and difficulties from bankruptcy, including what it can and cannot resolve).

struggle.[23] Because people shy away from filing bankruptcy and, instead, ask their lenders for help, interventions at the pre-bankruptcy modification request stage are crucial to helping borrowers realize that bankruptcy may be the better option.[24] Incentivizing lenders to only offer loan modifications that borrowers can afford going forward, as this Article suggests, should shepherd people toward bankruptcy when modification, particularly of unsecured loans, will be comparably disadvantageous and costly over the long term.

II

THE COMING LOAN MODIFICATION CRASH

Relief efforts stemming from the pandemic have resulted in forbearances across various credit products. Understanding the state and nature of these consumer credit markets is fundamental to properly anticipating and affecting loan modification behavior. This Part reviews data about the state of major consumer credit markets (mortgages, student loans, auto loans, and credit cards) to predict the need for loan modifications.

A. Troubled Credit Markets

Largely because the mortgage loan market is heavily intertwined with federal agency support and monitoring,[25] there exists rich data about mortgage loans. In January 2021, the total number of mortgage loans in forbearance was 5.2%, with variances from that percentage depending on the specific government mortgage program. *Figure 1* draws on data compiled by the data analytics firm Black Knight to show the forbearance differences between loan types.[26]

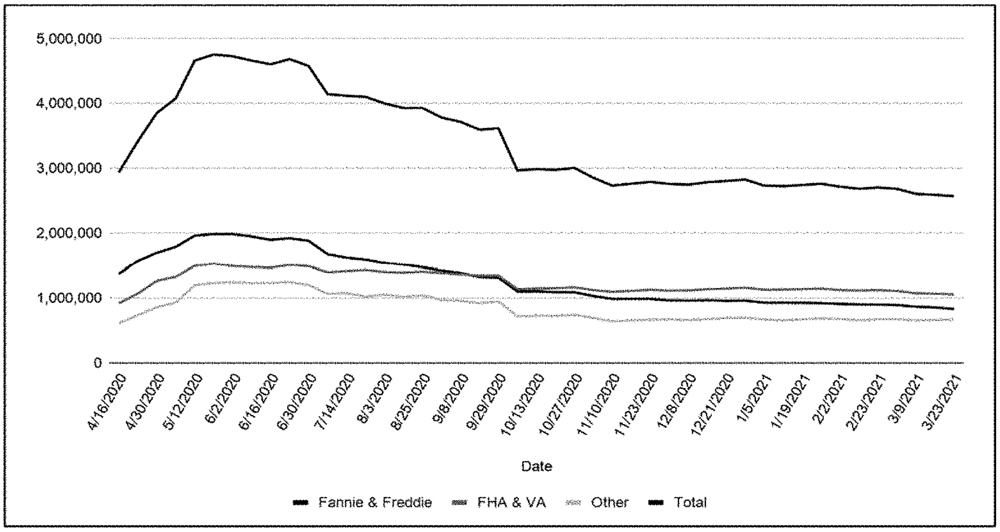
23. Foohey et al., *supra* note 18.

24. This Article's recommendations can be coupled with changes to bankruptcy laws to account for the fuller range of modifications. In some instances, modification outside bankruptcy will be more effective for borrowers. *See* Alan M. White & Carolina Reed, *Saving Homes? Bankruptcy and Loan Modifications in the Foreclosure Crisis*, 65 FLA. L. REV. 1713, 1723 (2013) (finding that modifications to loans may be more effective at preventing foreclosure). In other instances, bankruptcy can better help borrowers. *See infra* note 104.

25. Christopher K. Odinet, *Modernizing Mortgage Law*, 100 N.C. L. REV. 89, 93 (2021).

26. BLACK KNIGHT, MORTGAGE MONITOR 7 (Jan. 2021), https://cdn.blackknightinc.com/wp-content/uploads/2021/03/BKI_MM_Jan2021_Report.pdf [https://perma.cc/6NDP-CGTX].

Figure 1
Mortgage Loans under Active Forbearance Plans
by Loan Project Type
(May 2020 through March 2021)



Borrowers who opted for a mortgage loan forbearance have two notable common traits. First, these individuals have lower credit scores than those homeowners who did not opt for a forbearance—a difference of about forty-six points.[27] Second, those who received a forbearance carried a mortgage loan balance about thirty percent greater than that of people who did not.[28] These data points suggest that more financially troubled homeowners have obtained mortgage relief—people on the lower end of the credit spectrum and people less likely to have built up significant equity in their homes.

As to student loans, the credit reporting agency Experian reported that as of the third quarter of 2020, seventy-two percent of all student loans were in forbearance or deferral.[29] A considerable proportion of these are likely part of

27. Andrew Haughwout, Donghoon Lee, Joelle Scally, & Wilbert van der Klaaw, *Following Borrowers through Forbearance*, FED. RSRV. BANK OF N.Y.: LIBERTY ST. ECON. (Nov. 17, 2020), https://libertystreeteconomics.newyorkfed.org/2020/11/following-borrowers-through-forbearance.html [https://perma.cc/53JE-LRU7].

28. *Id.*

29. Stefan Lembo Stolba, *Student Loan Debt Reaches Record High as Most Repayment Is Paused*, EXPERIAN (Feb. 24, 2021), https://www.experian.com/blogs/ask-experian/state-of-student-loan-debt/ [https://perma.cc/K8UX-KELA]. Both forbearance and deferral pause student loan debt payments for a period of time, but in forbearance interest continues to accrue, while in deferment interest does not. *See generally What Is the Difference Between a Deferment and a Forbearance?*, FED. STUDENT AID, https://studentaid.gov/help-center/answers/article/difference-between-deferment-and-forbearance [https://perma.cc/9C6P-YLV2].

the U.S. Department of Education's automatic pause on payments and reduction of interest rates for many loans to zero percent. And yet despite this effort, the growth of student debt more than doubled from 2019 to 2020.[30]

The auto loan market merits separate attention because of the pre-pandemic boom in subprime auto lending[31] and because of cars' heightened importance during the pandemic in light of curtailed public transit options.[32] Despite cars' importance, none of the federal relief packages provided for auto debt relief. Instead, people were required to consult lenders or loan servicers if they encountered problems paying auto loans.

Although systemic data about auto loans is not available, other indicators suggest that people struggled with auto debt during the pandemic. For example, between March and July 2020, the CFPB reported a sharp uptick in submitted complaints, with one in five dealing with auto loans or leases.[33] Consumer borrowers noted trouble obtaining relief, problems with changing loan terms and incorrect billing, and dealing with aggressive auto debt collectors.[34] Data from the New York Federal Reserve Bank and Equifax show that auto loan forbearances rose from less than $1 million in March 2020 to a height of $8 million in June 2020. They then tapered off to around $5 million in September 2020 and declined slowly through the spring of 2021.[35] Additionally, as with mortgage loans, borrowers who obtained auto loan relief in 2020 had similar traits: they had lower credit scores (about forty points lower) and higher outstanding loan balances (about thirty percent higher) than those who did not enter a forbearance.[36] This information, as with mortgage loans, indicates the relative financial fragility of those people in auto loan forbearance.

Lastly, during the pandemic, people sought credit card forbearances. As with auto loans, federal relief did not address credit card or similar unsecured

30. Stolba, *supra* note 29. The student debt market, at present, stands apart from all other consumer credit markets because its primary creditor is the United States Department of Education. *See* Jiménez & Glater, *supra* note 17, at 153 (noting that "[s]tudent loan servicers are firms hired by the Department to provide loan servicing and collection on its $1.5 trillion portfolio of student loans").

31. *See generally* Pamela Foohey, *Bursting the Auto Loan Bubble in the Wake of COVID-19*, 106 IOWA L. REV. 2215 (2021).

32. Jack Stewart, *Pandemic Shifts People's Feelings about Owning a Car*, MARKETPLACE (July 20, 2020), https://www.marketplace.org/2020/07/20/pandemic-shifts-peoples-feelings-about-owning-a-car/ [https://perma.cc/FNG5-ZT5E].

33. U.S. PIRG EDUC. FUND, AUTO LOAN COMPLAINTS RISE 2 (Oct. 2020), https://uspirgedfund.org/sites/pirg/files/reports/AutoLoanComplaintsRise/WEB_USP_CFPB-Auto-Loan_Report_1020_v1.pdf [https://perma.cc/K6ZV-CZTY].

34. *Id.* at 11–23.

35. Haughwout et al., *supra* note 27; Tanya Bakshi & Jonathan Rose, *What Happened to Subprime Auto Loans During the Covid-19 Pandemic?*, CHI. FED INSIGHTS (June 30, 2021), https://www.chicagofed.org/publications/blogs/chicago-fed-insights/2021/what-happened-subprime-auto-loans [https://perma.cc/JA69-5MNX]; *see also* José J. Canals-Cerdá & Brian Jonghwan Lee, *COVID-19 and Auto Loan Origination Trends* (Fed. Res. Bank of Phila., Working Paper No. 21-28, 2021), https://www.philadelphiafed.org/-/media/frbp/assets/working-papers/2021/wp21-28.pdf [https://perma.cc/VG3X-5GP3] (noting a drop in auto loan originations in March and April, but a near rebound in May and June).

36. Haughwout et al., *supra* note 27.

consumer debt.[37] People had to make specific deals with their credit card lenders or other creditors to obtain forbearances. Reports indicate some forbearances were granted. In the third quarter of 2020, only 1.53 percent of bank issued credit card accounts were thirty days or more past due.[38] However, data from the American Bankers Association indicate that many households used their stimulus checks to pay off existing credit card debt, suggesting that the percentage of accounts in forbearance is quite low.[39] The types of forbearances entered vary.[40] Some agreements deferred or lowered the monthly payment, while other agreements waived late fees or reduced interest rates.[41]

As vaccination rates increased and the country began reopening, some consumer credit markets seemed more troubled than others. Chief among the markets to watch is the mortgage market because it accounts for nearly seventy percent of all household debt and it drives so many spending decisions.[42] How households handle their auto debt, student loan debt, and credit card debt also will be important in the period after relief programs expire. Collectively, these three credit products constitute twenty-five percent of household debt.[43] Each of these products plays an important role in how households manage liquidity mismatches, get to work, obtain employment, and cover unexpected expenses. Concern over the people currently in forbearance across these products is warranted given that data show that their profile generally correlates with people who chronically struggle financially.

B. Need For Debt Relief

Forbearance does not mean forgiveness. At the end of the forbearance period, missed payments must be accounted for, which can mean a significant

37. For a discussion of the rise in online unsecured installment loans, see Christopher K. Odinet, *Consumer Bitcredit and Fintech Lending*, 69 ALA. L. REV. 781, 800 (2018) (citing a number of factors that have contributed to the rise of fintech lending); Christopher K. Odinet, *Securitizing Digital Debts*, 52 ARIZ. ST. L.J. 477, 483 (2020) (discussing the shift in credit markets with the rise of fintech platforms); Christopher K. Odinet, *Predatory Fintech and the Politics of Banking*, 106 IOWA L. REV. 101, 108 (2021) (stating that "[t]he combination of a dearth in the availability of consumer credit in the wake of the financial crisis on the one hand and rapid innovations in technology on the other have created the perfect conditions for Silicon Valley tech firms to enter the consumer finance space.").

38. *ABA Report: Delinquencies Improved in Second and Third Quarters of 2020*, AM. BANKERS ASS'N (Jan. 22, 2021), https://www.aba.com/about-us/press-room/press-releases/aba-report-delinquencies-improved-in—second-and-third-quarters-of-2020 [https://perma.cc/NVY5-RRGS].

39. *Id.*

40. *See* Ben Luthi, *Credit Card Forbearance Programs Help With Piling Bills—But Should You Use Them?*, FOX BUS. (Apr. 22, 2021), https://www.foxbusiness.com/money/credit-card-forbearance-programs-bills [https://perma.cc/7JVK-7YQ8] (noting that forbearance plans and terms vary across credit card companies).

41. *Credit Card Debt During Coronavirus: Relief Options and Tips*, CONSUMER FIN. PROT. BUREAU (May 19, 2020), https://www.consumerfinance.gov/about-us/blog/credit-card-debt-during-coronavirus-relief-options-tips/ [https://perma.cc/3HVN-LADN].

42. *See The State of Household Debt in America*, VISUAL CAPITALIST (May 16, 2021), https://www.visualcapitalist.com/the-state-of-household-debt-in-america/ [https://perma.cc/RW3M-DVR7] (showing that mortgage debt has grown from $5.1 trillion since 2003 and now stands at $10.04 trillion).

43. *Id.*

increase in financial obligations during a time when, at best, individuals are just getting back on their feet. Some borrowers still may be struggling financially when paused debt obligations resume. And some borrowers who did not request or did not receive modifications during the pandemic may find themselves unable to keep up with all their debt payments as they continue to deal with the accumulated financial fallout of the pandemic.

For those who entered forbearance, the accounting for missed payments often came in the form of a modification of the loan contract—that is, a change in terms of the original deal.[44] Some modifications give the borrower more time to pay, with missed payments spread over an additional period. Other modifications may require the borrower to make up the missed payments via an increased monthly amount for the remainder of the original term. Still other modifications may require the borrower to pay all the missed payments at once—termed a balloon or bullet payment—and then resume regular payments as provided by the original deal.

Borrowers who agreed to increased payments or balloon payments as part of their post-forbearance modification deal may be especially vulnerable to difficulties keeping up with the modified obligation in the coming months and years. Likewise, other borrowers may have trouble meeting various debt obligations for a variety of reasons that have festered during the pandemic. Even though the job market improved in 2021, months of unemployment can take a financial (and health) toll. Being employed does not mean that someone's current job is as stable as it was pre-pandemic, as exemplified by Black and Latine workers' employment numbers that continue to lag behind white workers.[45] Those hit the hardest by the pandemic were "essential workers," minorities, and women, particularly those individuals not protected by unions or collective bargaining agreements.[46] Pre-pandemic, female-led and minority households, on average, had less money saved to weather financial hardships. Thus, these households may have the most difficulties recovering, particularly as they are required to restart paying paused debts.[47]

44. Sometimes the accounting for the missed payments takes the form of a refinancing of the credit—the taking out of another loan to pay off the existing one. The availability of this option on affordable terms depends upon the debtor's creditworthiness.

45. *See supra* notes 7–9 and accompanying text.

46. *See generally* A. Mechele Dickerson, *Default Protections for Pandemic Essential Workers*, 85 LAW & CONTEMP. PROBS., no. 2, 2022, at 177.

47. *See* Emily Moss, Kriston McIntosh, Wendy Edelberg, & Kristen Broady, *The Black-White Wealth Gap Left Black Households More Vulnerable*, BROOKINGS (Dec. 8, 2020), https://www.brookings.edu/blog/up-front/2020/12/08/the-black-white-wealth-gap-left-black-households-more-vulnerable/ [https://perma.cc/8G73-AFDU] (identifying wealth as a "critical safety net to households during economic downturns"); Neil Bhutta, Andrew C. Chang, Lisa J. Dettling, & Joanne W. Hsu, *Disparities in Wealth by Race and Ethnicity in the 2019 Survey of Consumer Finances*, FEDS NOTES (Sept. 28, 2020), https://www.federalreserve.gov/econres/notes/feds-notes/disparities-in-wealth-by-race-and-ethnicity-in-the-2019-survey-of-consumer-finances-20200928.htm [https://perma.cc/JL6C-GN9S] (finding that wealth disparities between families of different racial and ethnic groups have only marginally changed since last surveyed in 2016); *The Basic Facts About Women in Poverty*, CTR. FOR AM. PROGRESS (Aug. 3, 2020), https://www.americanprogress.org/article/basic-facts-women-poverty/

Regardless of the reasons for struggling with debt payments, people will eventually approach their lenders for help.[48] In most circumstances, the loan servicer is the party that handles the modification and makes the decisions about modification terms. Government agencies can promulgate guidance or regulations regarding modifications, as is the case currently with most mortgage loans, but not other consumer credit, such as auto loans and credit cards, as detailed in the next two Parts.

III
PLANNING FOR LOAN MODIFICATIONS

With any loan modification, the goal for both the lender and the consumer should be to achieve not only a modification but a successful one—that is, a modification with terms that the consumer can afford. Important lessons can be learned from the federal government's previous attempts to encourage loan modifications. This Part analyzes prior government interventions in the home mortgage market and how they failed to achieve meaningful modifications.

A. Past Modification Failures

After the 2008 financial crisis, the federal government created two major programs to entice mortgage loan servicers to make loan modifications so people could remain in their homes. The Home Affordable Modification Program ("HAMP") primarily offered modifications of existing loan terms, usually by lowering the interest rate or lengthening the repayment term.[49] The Home Affordable Refinance Program ("HARP") primarily refinanced existing loans into loans with lower market interest rates.[50]

These two programs largely failed, both because of poor program design. Rather than giving homeowners money to pay their mortgage loans, HAMP gave money to mortgage servicers in exchange for modifying loan terms. Servicers, who are paid by taking a percentage of the unpaid outstanding principal balance due on the loan and who are entitled to a portion of the late fees and expenses of a foreclosure, had no reason to participate in this government program.[51] By September 2015, only $10.2 billion of the $75 billion set aside for HAMP had

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[https://perma.cc/3VGR-QL2E] (noting that women have higher rates of poverty than men across the vast majority of races and ethnicities).

48. *See* Foohey et al., *supra* note 18, at 241 (noting that people who file bankruptcy report that they approached their lenders for help with debt payments prior to filing).

49. *See Making Home Affordable Updated Detailed Program Description*, U.S. DEP'T OF TREASURY (Mar. 4, 2009), https://docplayer.net/14931738-Making-home-affordable-updated-detailed-program-description.html [https://perma.cc/T8L4-LAG2] ("The Home Affordable Modification program has a simple goal: reduce the amount homeowners owe per month to sustainable levels.").

50. *See generally Home Affordable Refinance Program (HARP)*, FED. HOUS. FIN. AGENCY, https://www.fhfa.gov/PolicyProgramsResearch/Programs/Pages/HARP.aspx [https://perma.cc/2ALS-HQXS].

51. CHRISTOPHER K. ODINET, FORECLOSED: MORTGAGE SERVICING AND THE HIDDEN ARCHITECTURE OF HOMEOWNERSHIP IN AMERICA 51 (2019).

been spent[52] and twenty-eight percent of modified loans had defaulted.[53] HARP provided meager incentives to banks to refinance underwater mortgage loans, leading most lenders to continue to view refinancing these loans as risky.[54]

Spurred in part by the failures with HAMP and HARP, debt settlement companies played a significant role in modifications after the 2008 financial crisis. These companies, which remain part of the consumer finance market, promise to provide an easy solution to dealing with creditors when a borrower is in default or experiencing related financial trouble. The company negotiates with creditors on the borrower's behalf and works out a deal for the borrower to pay less than the full amount that is owed.[55] Typically the negotiated deal requires that the borrower open a special account to set aside a certain amount of savings each month. That money is used to pay the settlement amount.[56] The debt settlement company collects a fee in exchange for the service.[57]

During the 2008 financial crisis, people's use of debt settlement sometimes yielded harmful results.[58] Debt settlement companies do not guarantee that they will succeed in making a deal with their clients' creditors.[59] Yet they typically encourage clients to stop making payments directly to creditors so that the company can become the single point of contact. This can result in late fees, negative credit reporting, and the seizure of property.[60] Apart from the inherent riskiness of this business model, during the 2008 financial crisis, the industry became known for its high rate of fraud.[61] Some debt settlement companies collected fees on the front end without ever achieving a settlement, and some

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52. David Dayen, *Obama Program That Hurt Homeowners and Helped Big Banks Is Ending*, THE INTERCEPT (Dec. 28, 2015), https://theintercept.com/2015/12/28/obama-program-hurt-homeowners-and-helped-big-banks-now-its-dead/ [https://perma.cc/Z8TL-8T3G]; Andy Kroll, *Worst $75 Billion Investment Ever?*, MOTHER JONES (Dec. 8, 2009), https://www.motherjones.com/politics/2009/12/hamp-foreclosure-program-failure/ [https://perma.cc/7YXR-EKE5].

53. David Dayen, *The Government Program That Failed Homeowners*, THE GUARDIAN (Mar. 30, 2014), https://www.theguardian.com/money/2014/mar/30/government-program-save-homes-mortgages-failure-banks [https://perma.cc/AQ9K-PU3G].

54. Cora Currier, *Lack of Competition Stifles Refinance Program for Underwater Homeowners*, PROPUBLICA (Apr. 5, 2012), https://www.propublica.org/article/lack-of-competition-stifles-refinance-program-for-underwater-homeowners [https://perma.cc/XJ4T-ZV7C]. Also, large mortgage lenders preferred to refinance only their existing underwater customers rather than to assist others. *Id.*

55. *What are Debt Settlement/Debt Relief Services and Should I Use Them?*, CONSUMER FIN. PROT. BUREAU (Feb. 15, 2017), https://www.consumerfinance.gov/ask-cfpb/what-are-debt-settlementdebt-relief-services-and-should-i-use-them-en-1457/ [https://perma.cc/3THP-4UV8].

56. *Settling Credit Card Debt*, FED. TRADE COMM'N (Nov. 2012), https://www.consumer.ftc.gov/articles/0145-settling-credit-card-debt [https://perma.cc/8WV6-C478].

57. *What are Debt Settlement/Debt Relief Services and Should I Use Them?*, *supra* note 55.

58. *See Debt Relief and Credit Repair Scams*, FED. TRADE COMM'N, https://www.ftc.gov/news-events/media-resources/consumer-finance/debt-relief-credit-repair-scams [https://perma.cc/N56Y-5W96] (noting, for example, how many scams "charge[d] cash-strapped consumers a large up-front fee, but then fail[ed] to help them settle or lower their debts.").

59. *Settling Credit Card Debt*, *supra* note 56.

60. *Id.*

61. *See generally How Not to Spell Relief: Debt Relief Scams*, DEP'T OF JUST. (Aug. 16, 2012), https://www.justice.gov/archives/opa/blog/how-not-spell-relief-debt-relief-scams [https://perma.cc/L454-4X4V].

posed as government relief programs to entice participation.[62] For instance, a debt settlement business that operated under many names and across multiple states collected fees between $2,500 and $4,300 by promising distressed homeowners that they were already approved for a loan modification, when, in actuality, the company had never been in touch with the relevant mortgage servicers.[63]

Past attempts by the federal government to encourage mortgage modifications in the wake of a financial crisis did not succeed.[64] These programs' failure during a period of intense need for modifications helped grow an industry that preyed on desperate borrowers. The debt settlement industry also benefited during the 2008 financial crisis from the federal government's lack of any program at all to deal with non–mortgage consumer debt. As the United States emerges from the pandemic, the government can learn from its mistakes, both in the home mortgage market and in leaving people on their own to determine how to manage other debts.

B. Learning From Past Mistakes: Modifications And Credit Market Heterogeneity

In the coming months, people may find that they need to seek loan modifications. When they do, people will find that the type of modifications their creditors offer will depend on the specific credit product. This will make navigating potential loan modifications with a host of different creditors and on different timelines complicated. Although federal agencies thus far have stepped up in the context of home mortgage loans, other consumer credit markets have thus far escaped scrutiny. This presents an opportunity for federal agencies to plan, in particular, for all the other potential modifications to provide people with a workable framework before they turn to their creditors for help. The steps that federal agencies have taken to address home mortgage loan issues emerging post-pandemic can inform potential solutions that agencies may implement in regard to other parts of the consumer loan market.

1. Home Mortgages

In contrast to the feeble programs instituted for mortgage loans during the 2008 financial crisis, as the United States emerged from the pandemic, federal

62. *Settling Credit Card Debt*, *supra* note 56.

63. *California Ringleader Sentenced in Connecticut to 112 Months for Mortgage Fraud Scheme*, U.S. IMMIGR. & CUSTOMS ENF'T (July 18, 2016), https://www.ice.gov/news/releases/california-ringleader-sentenced-connecticut-112-months-mortgage-fraud-scheme [https://perma.cc/Z84A-2AVX].

64. For a review of voluntary mortgage modification as the United States was emerging from the Great Recession, *see generally* Alan M. White, *Deleveraging the American Homeowner: The Failure of 2008 Voluntary Mortgage Contract Modifications*, 41 CONN. L. REV. 1007 (2009); Alan M. White, *Rewriting Contracts, Wholesale: Data on Voluntary Mortgage Modifications from 2007 and 2008 Remittance Reports*, 36 FORDHAM URB. L.J. 509 (2009). *See also* Jonathan C. Lipson, *Securitization and Social Distance*, 37 REV. BANKING & FIN. L. 827 (2018) (linking why real-property mortgage-backed securities performed worse than other securitized assets during the Great Recession with incentivizes to enter into mortgage modifications).

agencies seemed to be planning for a wave of mortgage loan modifications. Between the CARES Act, individual government agency policies[65] and the CFPB's recent rule to amend the Real Estate Settlement Procedures Act of 1974 ("RESPA"),[66] no residential mortgage foreclosure will occur until 2022. This elongated respite provided government mortgage agencies time through 2021 to provide their servicers with forbearance instructions and preset modification packages for dealing with distressed homeowners.

In spring 2021, Fannie Mae and Freddie Mac instructed their servicers, at the end of the forbearance, to determine whether borrowers should make up the payments either in a lump sum or in accordance with a payment plan under modified loan terms.[67] Because they largely operate through market power rather than through any kind of regulatory control, Fannie and Freddie can make changes to their servicing guidelines without the need for formal comment and rulemaking.[68] This provides Fannie and Freddie with nimble control over their servicers, allowing them to respond rather quickly to changing needs of borrowers.

For those borrowers seeking loan modifications, post-forbearance or otherwise, Fannie and Freddie publicly released two options. Under the COVID-19 Deferral option, if the borrower is financially able to resume the contractual monthly payment, then up to one year's worth of forborne payments will be added as a zero interest balloon payment due at the time the loan is to be paid off.[69] The Flex Modification option is available for borrowers who cannot resume

65. *See, e.g.*, *Fannie Mae Lender Letter 2020-02*, FANNIE MAE (Dec. 9, 2020) [hereinafter *Lender Letter 2020-02*], https://singlefamily.fanniemae.com/media/22261/display [https://perma.cc/9UVY-FC68]; *Bulletin 2021-8: Temporary Servicing Guidance Related to COVID-19*, FREDDIE MAC (Feb. 25, 2021) [hereinafter *Bulletin 2021-8*], https://guide.freddiemac.com/app/guide/bulletin/2021-8 [https://perma.cc/747S-8J5E].

66. *See* Protections for Borrowers Affected by the COVID-19 Emergency Under the Real Estate Settlement Procedures Act (RESPA), Regulation X, 86 Fed. Reg. 18840 (Apr. 9, 2021) (amending 12 C.F.R. § 1024.41(f)).

67. *COVID-19 Script for Servicer Use with Homeowners*, FREDDIE MAC (Jan. 20, 2022), https://sf.freddiemac.com/content/_assets/resources/pdf/covid-19_forbearance-servicer-script.pdf [https://perma.cc/RLL5-BAM9]. The FHFA director later stated that lump sum payments will not be required. *"No Lump Sum Required at the End of Forbearance" says FHFA's Calabria*, FED. HOUS. ADMIN. (Apr. 27, 2020), https://www.fhfa.gov/Media/PublicAffairs/Pages/No-Lump-Sum-Required-at-the-End-of-Forbearance-says-FHFAs-Calabria.aspx [https://perma.cc/NWC4-TUX8]. *See also* OVERSIGHT BY FANNIE MAE AND FREDDIE MAC OF COMPLIANCE WITH FORBEARANCE REQUIREMENTS UNDER THE CARES ACT AND IMPLEMENTING GUIDANCE BY MORTGAGE SERVICERS, OFF. OF THE INSPECTOR GEN., FED. HOUS. FIN. AGENCY 12 (2020), https://www.fhfaoig.gov/sites/default/files/OIG-2020-004.pdf [https://perma.cc/ZE3V-GNHD] (assessing Freddie Mac and Fannie Mae's oversight of their respective mortgage servicers' compliance with the CARES Act).

68. *See* Cnty. of Sonoma v. Fed. Hous. Fin. Agency, 710 F.3d 987, 990 (9th Cir. 2013) (noting that, under HERA, if the directive challenged is a lawful exercise of FHFA's power as conservator of the Enterprises, the court system's ability to review such action is significantly limited).

69. *Payment Deferrals Matrix*, FANNIE MAE (Dec. 14, 2021), https://singlefamily.fanniemae.com/media/22936/display [https://perma.cc/6S83-RYSB]; *Bulletin 2020-15: Freddie Mac COVID-19 Payment Deferral*, FREDDIE MAC (May 13, 2020) [hereinafter *Bulletin 2020-15*], https://guide.freddiemac.com/app/guide/bulletin/2020-15 [https://perma.cc/C7TR-XUHY].

contractual payments, decline to resume payments, or are ineligible for the deferral option.[70] Under *Flex Modification*, the borrower enters a three-month trial period plan with revised mortgage terms, such as capitalizing the missed interest and escrow payments into the principal amount, changing the interest rate, expanding the loan term, or lowering the portion of the principal that bears interest.[71] Determining which or how many of these revisions to implement involves a complicated analysis furnished by Fannie and Freddie in their servicing guidelines.[72] The Federal Housing Administration ("FHA") likewise published four options for COVID-related loan modifications for borrowers if they want to remain in their homes, and borrowers may request one of these options even if they did not participate in a forbearance program.[73]

Freddie, Fannie, and the FHA control the majority of mortgages in America.[74] The forethought involved in implementing standardized modification packages for their servicers is a notable departure from how modifications were handled in the post-2008 financial crisis period, during which significant discretion was left to the servicers. Nonetheless, foreseeable problems may emerge in the coming months and years. Private servicers will be the entities carrying out these modifications. This is potentially problematic because the mortgage servicing industry is currently dominated by nonbank financial firms.[75] Nonbanks are much more thinly capitalized and less regulated compared to bank servicers.[76] They lack resources to quickly hire and train staff, as well as to invest in the tech infrastructure, both of which may be necessary to assist financially struggling borrowers as forbearances end.[77]

Also, though well-intentioned, the modification guidance issued by Freddie, Fannie, and the FHA is complicated. The steps that the servicer must walk through to determine eligibility and to properly modify the loan requires a high level of skill.[78] Servicing staff will need to be trained for the task.

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70. *Fannie Mae Lender Letter 2020-07*, FANNIE MAE (Nov. 18, 2020), https://singlefamily.fanniemae.com/media/22916/display [https://perma.cc/4JK5-9SVQ]; *Bulletin 2020-15*, *supra* note 69.

71. *Servicing Guide*, FANNIE MAE (Mar. 10, 2021), https://singlefamily.fanniemae.com/media/25291/display [https://perma.cc/8G5W-W9R3]; *Seller/Servicer Guide*, FREDDIE MAC (Feb. 2, 2022), https://guide.freddiemac.com/ci/okcsFattach/get/1002095_2 [https://perma.cc/Y8QM-GE23].

72. For example, the Freddie Mac Seller/Servicer Guide includes over 2000 pages of servicer guidelines. *See id.*

73. *Mortgagee Letter 2021-05*, U.S. DEP'T HOUS. & URB. DEV. (Feb. 16, 2021), https://www.hud.gov/sites/dfiles/OCHCO/documents/2021-05hsgml.pdf [https://perma.cc/36CV-G724].

74. *See* MORTG. BANKERS ASS'N, REFORM: CREATING A SUSTAINABLE, MORE VIBRANT SECONDARY MORTGAGE MARKET 39 (2017), https://ypfsresourcelibrary.blob.core.windows.net/fcic/YPFS/17305_MBA_GSE_Reform_Paper%20(2).pdf [https://perma.cc/5B8D-4QUW].

75. *See* ODINET, *supra* note 51, at 124–25 (noting that nonbanks have quickly expanded due to their lack of overhead and avoidance of the "legacy technology costs" that plague established banking institutions).

76. *Id.* at 125–26.

77. *Id.* at 124.

78. *See, e.g.*, *Flex Modification Reference Guide*, FREDDIE MAC (Jan. 2022), https://sf.freddiemac.com/content/_assets/resources/pdf/other/flex_mod_ref_guide.pdf [https://perma.cc/A9YX-4SKN]. *See*

2. Other Consumer Credit Products

The government's involvement in the housing debt market has allowed for the creation of coordinated and streamlined mortgage modification programs. The same can be said for the student loan market where the federal government similarly dominates the landscape. In contrast, the government's lack of involvement in other consumer credit markets makes similar centralized loan modification programs impossible. Central to this Article, these markets include auto loans, credit cards, and other revolving credit and installment loans. Instead, at present, each creditor has nearly complete discretion in if and how to modify non-mortgage debt contract obligations. This presents a potential problem for the people who will seek loan modifications post-pandemic in the coming months and years, and an opportunity to intervene in these markets before people start seeking modifications in bulk.

Because of a lack of uniformity among credit products and creditors, under the status quo, modification failures may abound, similar to what happened in the mortgage market after the 2008 financial crisis. Two types of modification failures are reasonable to predict. First, a creditor may engage in abusive behavior by placing a borrower into an unaffordable loan modification that is geared less toward helping the individual get back on track and more toward exploitation for additional profit. Second, a creditor may hastily agree to a modification with a borrower that does not carefully consider the borrower's ability to successfully repay the modified loan.

In either scenario, many borrowers may be likely to agree to modifications that are not in their financial interests or that they may not be able to successfully pay in full. In the case of auto loans, borrowers worry about losing cars that are essential to their livelihoods and to taking care of their families.[79] They will agree to the deal put before them by their lenders. In addition, in the case of the range of consumer credit loans, because most borrowers are biased towards optimism, they will overestimate their ability to pay the modified loan, and agree to the deal put before them.[80] Likewise, in the case of all loans, because borrowers generally try to live up to their obligations and feel shame when unable to pay, they will be likely to agree to the deal put before them.[81]

Knowing that borrowers are often held captive by lenders' suggested modification deals for these primary reasons, lenders and servicers naturally may

also supra note 72.

79. *See generally* Pamela Foohey, *Consumers' Declining Power in the Fintech Auto Loan Market*, 15 BROOK. J. CORP. FIN. & COM. L. 5 (2020) (detailing people's dependency on cars); Pamela Foohey, Robert M. Lawless, & Deborah Thorne, *Driven to Bankruptcy*, 55 WAKE FOREST L. REV. 287 (2020) (detailing people who file bankruptcy with the primary goal of keeping their cars).

80. *See* Lauren E. Willis, *Against Financial Literacy*, 94 IOWA L. REV. 197, 235 (2008) (finding that "[p]eople maintain overoptimism about their own susceptibility to risks through overconfidence or illusions" and that "[o]veroptimism and overconfidence in personal-finance decisionmaking is widespread.").

81. *See* Foohey et al., *supra* note 18, at 249 (noting that about two-thirds of bankruptcy filers report that they felt shame upon filing).

not always negotiate with borrower's best interests in mind, particularly if they are pressed for time or resources, such as when they are dealing with a flood of modification requests. Post-pandemic, such a flood is likely to occur. For unsecured loans, like credit cards, lenders also know that their recovery likely will come solely from payments made by borrowers. Most people own little property that the lender can attach via judicial process upon default.[82] Although carefully considering borrowers' ability to repay may benefit lenders over the longer term, lenders are just as likely to focus on short-term profits and attempt to ensure that they recover now from borrowers. This focus would push lenders to offer modifications that may be exploitative or, more simply, hastily put together.

In either scenario, the probability of an eventual default—a modification failure—increases as compared to a well-considered and pre-structured modification. In addition, market heterogeneity likely will lead to irregularity and uncertainty in communications between creditors and borrowers. If creditors are not clear or responsive, frustrated borrowers may again turn to debt settlement companies for help. However, individual lenders do not have an incentive to reform or streamline their modification procedures, especially before they begin experiencing an uptick in modification requests. But once borrowers come knocking on lenders' doors, it likely will be too late for them to timely change their modification processes.

Being able to predict modification failures, however, allows for the government to get ahead of the likely wave of non-mortgage loan modification requests, as it has done in the context of the home mortgage market. That is, a regulatory intervention in consumer credit markets is necessary to help consumers given the predictable status quo. The next Part sketches how federal financial regulators can achieve those interventions. As detailed, these interventions also may help mitigate lingering issues with the streamlined programs for mortgage modifications.

IV

MITIGATING LOAN MODIFICATION FAILURES

Any government move to get ahead of this wave of loan modifications across consumer credit products, particularly auto loans and credit cards, must account for both differentiated credit and how a jumbled modification roll-out can welcome bad actor intermediaries. Federal financial regulators can play an important role in incentivizing sustainable loan modifications as the United States ends its COVID-related forbearance programs. This Part lays a legal framework for public intervention in debt contract modifications that is designed to steer people into affordable modification or, if there are no affordable options, implicitly guides people to the consumer bankruptcy system.

82. *See id.* at 226 n.35 (noting that over ninety percent of chapter 7 consumer bankruptcy cases are "no asset").

A. Unfair, Deceptive, or Abusive Acts or Practices as Contract Steering

The goal of federal intervention in the context of modifications of non-mortgage consumer loans should be to prevent modification failures, whereby a borrower's ability to repay is intentionally, negligently, or merely inattentively not considered during modification discussions and calculations. A blueprint for how to make such modification essentially illegal follows.

Under federal law, the CFPB has the authority to identify abusive acts or practices by certain covered financial institutions, including issuers of certain auto loans, credit cards, and other installment or revolving loans.[83] An act or practice is considered abusive if it does any one of the following:

- Materially interferes with a consumer's ability to understand terms or conditions of the product or service;
- Takes unreasonable advantage of a consumer's lack of understanding of the product or service's risks, costs, or conditions;
- Takes unreasonable advantage of the consumer's inability to protect his or her own interests when choosing or using a product or service; or
- Takes unreasonable advantage of the consumer's reliance on a covered person to act in the consumer's interests.[84]

Under this language, certain modification failures may be considered abusive, providing the CFPB with authority to enforce the structure of modifications offered by covered financial institutions. There are two main ways that the CFBP can accomplish this. It can promulgate rules or issue a compliance bulletin. The emergency situation created by the pandemic points toward using the faster method of issuing a compliance bulletin. Indeed, the CFPB has issued compliance bulletins in the past to highlight enforcement priorities.[85]

The compliance bulletin should direct loan servicers to make a reasonable determination that a borrower has the ability to make all required, scheduled payments in connection with any loan modification. This notice should include factors that servicers must consider in making this determination, such as accounting for the possibility of volatility in the individual's income and for the borrower's other, competing debt obligations. Although lenders could not and should not be deemed required to have predicted the COVID-19 pandemic and its effect on household finances, by the time borrowers come to lenders for help, most borrowers should have sufficient information about their financial futures and other debt obligations to allow lenders to make a good faith calculation about a borrower's ability to repay. In the past, this type of private ordering has proven

83. 12 U.S.C. § 5531.

84. *See* 12 U.S.C. § 5531(d).

85. *See, e.g.*, *CFPB Bulletin 2021-02: Supervision and Enforcement Priorities Regarding Housing Insecurity*, CONSUMER FIN. PROT. BUREAU (Apr. 1, 2021), https://files.consumerfinance.gov/f/documents/cfpb_bulletin-2021-02_supervision-and-enforcement-priorities-regarding-housing_WHcae8E.pdf [https://perma.cc/2V64-8M6P] (delineating the CFPB's enforcement priorities in the housing insecurity field).

productive for both contracting parties.[86] The notice can also indicate what the bureau would presumptively deem an abusive practice, such as intentionally lengthening the loan modification negotiation and decision timeline.[87] Importantly, the CFPB could consider the failure of a covered loan servicer to make a reasonable determination as prescribed by the bulletin an abusive act or practice.

Although the Dodd-Frank Act does not elaborate on what constitutes abuse beyond the four-part enumeration above, the use of this term in consumer financial regulation is not new and has been similarly used in the past in the context of consumer loan workouts. In 1994, Congress passed the Home Ownership and Equity Protection Act, which authorized the Federal Reserve Board to prohibit "abusive lending practices" in residential mortgage loans.[88] In passing that law, Congress was concerned with the refinancing of mortgage loans that were "not in the interest of the borrower."[89] Coming out of the 2008 financial crisis, the Federal Reserve Board exercised this statutory authority to issue an amendment to the regulation implementing the Truth in Lending Act. The amendment prohibited lenders from refinancing mortgage loans "without regard to the consumer's repayment ability," which included a mandate that lenders consider the "consumer's current and reasonably expected income, employment, assets other than the collateral, current obligations, and mortgage-related obligations."[90]

The same concerns about ability to repay should apply across consumer credit products, and the CFPB has the statutory authority to implement this standard across modifications offered regarding all covered consumer loans—mortgage, auto, credit card, and otherwise. Nothing in the Dodd-Frank Act's abusiveness provision limits its reach to mortgage credit or to merely refinancing transactions. Rather, as evident in the enumeration above, the coverage of statutory abusiveness is expansive and broad. It is, as Adam Levitin has observed, a codification of equitable concepts, such as good faith and fair dealing and unconscionability.[91] As such, it can and should be used by the CFPB to cover acts or practices relative to the modification of all covered existing consumer credit contracts—particularly auto loan and credit card contracts—which do not benefit from systemic government intervention already.[92]

86. *See* Jonathan C. Lipson & Norman M. Powell, *Contracting COVID: Private Order and Public Good (Standstills)*, 76 BUS. LAW 437, 465 (2021) (discussing the role standstill and forbearance agreements can play in subduing calamity costs).

87. *See* White, *Deleveraging the American Homeowner*, *supra* note 64, at 1113–24 (discussing problems with mortgage modifications after the Great Recession).

88. Home Ownership and Equity Protection Act § 152, 15 U.S.C. § 1639(p)(2)(b).

89. *Id.*

90. Truth in Lending, 73 Fed. Reg. 44521, 44603 (July 30, 2008) (codified at 12 C.F.R. pt. 226).

91. ADAM J. LEVITIN, CONSUMER FINANCE LAW: MARKETS AND REGULATION 205 (2018).

92. The CFPB can apply this standard to mortgage loans, buttressing existing oversight. This Article's suggested framework is meant to address the predicted swell of modification requests for auto loans, credit cards, and other revolving and installment loans as the United States emerges from the pandemic. These interventions are limited to the pandemic-recovery, which may be a few years. The

B. Modification Failure as Abusiveness

Once the CFPB issues a compliance bulletin, its next task will be to ensure that lenders know that it is ready to enforce the parameters. The credible threat of enforcement will incentivize lenders to offer loan modifications that meet the bulletin's parameters. Loan modification failures will fit multiple parts of the statutory abusiveness framework.

If the lender obscures or misrepresents the modification's terms, such as how the new periodic payments will be calculated or what amounts are being capitalized into the loan, this may constitute a material interference with the consumer's ability to understand the terms of the modified contract. Depending on the dynamic between the lender and the borrower, which almost always consists of the lender having comparatively superior knowledge about the product,[93] the lender may take advantage of the consumer's lack of understanding, triggering the second or third abusiveness criteria. And, concerning the fourth criteria, consumers most likely will express a desire for their lenders to advise them as to the most ideal type of modification. People are rarely if ever represented by counsel when working through loan modifications,[94] particularly those of auto, credit card, or unsecured debt, and people typically lack an individualized level of sophistication about financial terms.[95] The bulletin should note that if a lender fails to properly assess the borrower's ability to repay, but represents, directly or indirectly, that a modification is suitable for that borrower, the lender may have engaged in an abusive act or practice.[96]

Moving a step further, the CFPB has the power to engage in formal rulemaking, as it has done with other pandemic related issues.[97] In the past, the

ideas within may be useful to consider on a permanent basis in the future. If so, a similar regulatory framework may be used, although we suggest that the CFPB engage in rulemaking.

93. *See* Paige Marta Skiba & Will Dobbie, *Information Asymmetries in Consumer Credit Markets: Evidence from Payday Lending*, 5 AM. ECON. J. APPLIED ECON. 256 (2013) (discussing information asymmetries skewed toward lenders in payday lending).

94. *See Problems in Mortgage Servicing from Modification to Foreclosure: Hearing Before the S. Comm. on Banking, Hous., and Urb. Affs.*, 111th Cong. 48 (2010) (Statement of Sen. Richard C. Shelby, Member, S. Comm. on Banking, Hous., and Urb. Affs.), https://www.govinfo.gov/content/pkg/CHRG-111shrg65258/html/CHRG-111shrg65258.htm [https://perma.cc/4GBS-Y6PT].

95. *See* Lauren E. Willis, *The Financial Education Fallacy*, 101 AM. ECON. REV. 429 (2011) (discussing the inefficiency of current, ineffective financial education programs); *see also* Craig Hawley, *Most Americans Think They Know More about Money Than They Do*, KIPLINGER (Oct. 28, 2019), https://www.kiplinger.com/article/retirement/t047-c032-s014-most-think-they-know-more-about-money-than-they-do.html [https://perma.cc/6PX3-MQB6] (discussing the financial literacy gap).

96. The CFPB has done this before. *See Consumer Financial Protection Bureau Will Scrutinize Consumer Protection During Mortgage Servicing Transfers,* JONES DAY (Feb. 2013), https://www.jonesday.com/en/insights/2013/02/consumer-financial-protection-bureau-will-scrutinize-consumer-protection-during-mortgage-servicing-transfers [https://perma.cc/PBB2-SU5U] (noting the CFPB Bulletin "suggests that the failure to honor an agreed-upon trial or permanent loan modification, including properly applying payments or collecting debts under such a modification, may be considered a UDAAP violation").

97. *See CFPB Rule Clarifies Tenants Can Hold Debt Collectors Accountable for Illegal Evictions*, CONSUMER FIN. PROT. BUREAU (Apr. 19, 2021), https://www.consumerfinance.gov/about-us/newsroom/cfpb-rule-clarifies-tenants-can-hold-debt-collectors-accountable-for-illegal-evictions/

CFPB used this power to propose a rule regarding high-cost, short term loans: *Payday, Vehicle Title, and Certain High-Cost Installment Loans*.[98] The first version of the CFPB's proposed rule deemed it to be an abusive act or practice not to assess a borrower's ability to repay these high-cost, short term loans.[99]

But proceedings by rulemaking have drawbacks, least of which is that it can take significant time—time that many consumers may not have as their COVID-based forbearance periods come to staggered and unpredictable ends. The CFPB instead should act quickly through a compliance bulletin steering consumer financial service companies subject to its Unfair, Deceptive, or Abusive Acts or Practices ("UDAAP") enforcement authority towards offering workable and affordable loan modifications.[100] Doing so could lessen the racial and ethnic disparities that almost inevitably emerge in the context of consumer financial products.[101] Lenders (and servicers) may want to enter into modifications with borrowers, but history teaches that, unsupervised, they are likely to offer different deals across racial and ethnic groups.[102] Given the relative bargaining power, it is the lender or servicer who sets the terms of any deal made, if there is even one offered. Controls and monitoring of modification deal parameters promise to lessen the disparities in modifications across different communities. Given the pandemic's disproportionate effect on communities of color, reducing the potential disparities in loan modification deals offered to these communities is of paramount importance and will provide greater economic benefits for families and the economy. It also will lessen gender and class inequalities that likewise may emerge in modifications.

Requiring people to be offered affordable loan modifications necessarily will mean that some borrowers will not be able to get a modification. Some people simply will not have enough money or expected future income to sustain continued payments, even with a modification in loan terms. Without controls on the parameters of modifications, lenders likely would offer people deals that would end in default. These defaults would result in foreclosure of houses, repossessions of cars, and collection actions, including wage garnishment, for

[https://perma.cc/8K3S-4S3S] (discussing a CFPB interim final rule supporting the CDC's eviction moratorium).

98. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. 47863 (July 22, 2016), https://www.govinfo.gov/content/pkg/FR-2016-07-22/pdf/2016-13490.pdf [https://perma.cc/U5G8-76T2].

99. *See* Christopher K. Odinet, *Payday Lenders, Vehicle Title Loans, and Small-Value Financing: The CFPB's Proposal to Regulate the Fringe Economy*, 133 BANKING L. J. 263, 276–77 (2015) (discussing the initial version of the CFPB proposed rule and its required ability-to-pay requirements).

100. 12 U.S.C. §§ 5481(14), 5536(a)(1)(B) (including unfair, deceptive, and abusive acts and practices authority over covered persons under the definition of "federal consumer financial law."). This authority includes financial firms that service loans. 12 U.S.C. § 5564(a); 12 U.S.C. § 5481(6); 12 U.S.C. § 5481(15)(A)(1).

101. *See* Padi, *supra* note 21; Pamela Foohey & Nathalie Martin, *Fintech's Role in Exacerbating or Reducing the Wealth Gap*, 2021 U. ILL. L. REV. 459, 477 ("Through these examples, we detail how debt inequality compounds income inequality and exacerbates the racial and ethnic wealth gaps.").

102. J. Michael Collins, Maximilian D. Schmeiser, & Carly Urban, *Protecting Minority Homeowners: Race, Foreclosure Counseling and Mortgage Modifications*, 47 J. CONSUMER AFF. 289, 291 (2013).

unsecured debts, such as credit cards. This, in turn, would lead some people to file bankruptcy.[103]

Intercepting unsustainable loan modifications prior to their creation likely will result in some people considering filing bankruptcy earlier than if they had continued struggling with their debts for years. Although filing bankruptcy is expensive, so is paying on an unworkable loan modification for months prior to defaulting. A regulatory structure that pushes people toward bankruptcy has the potential to mitigate overall losses, while allowing those who can pay their modified debts to do so.

V

CONCLUSION

The COVID-19 pandemic brought a catastrophic financial shock that many American households were not prepared to bear. In recognition of these extraordinary circumstances, the federal government provided some monetary aid to households. In addition to some level of direct payments to households, the government extended people's credit obligations through foreclosure, eviction, and student loan payment moratoria. Some lenders followed suit by offering forbearance of other non–covered consumer credit products.

Forbearance does not equal forgiveness, and people will have to make up those missed payments in the future. As households emerge from the pandemic, some inevitably will find themselves unable to keep up with debt payments. Because of the pandemic's disproportionate impact on Black and Latine households, these borrowers are more likely to encounter difficulties paying all their debt obligations. These borrowers and lower-income individuals already disproportionately have sought help from their lenders during the forbearance period.

A significant number of borrowers may approach their lenders for modifications of debts, including mortgages, auto loans, and credit cards. Absent modifications, the likely outcomes are default, foreclosure, repossession, wage garnishment, and eventually, filing bankruptcy. Indeed, the consumer bankruptcy system is a kind of insurance. But not all people who cannot keep up with their debt obligations will turn to bankruptcy for help and, in some contexts, modifications of problematic loans may be preferable for borrowers and lenders. A desire to work with lenders to make good on their obligations, bankruptcy's stigma, lack of access to attorneys, and fears about bankruptcy's impact on credit scores may deter people from filing. For secured loans—mortgages and auto loans—coming to deals with lenders outside bankruptcy may save people time and money.[104]

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103. *See* Foohey et al., *supra* note 22, at 3 (noting many individuals file for bankruptcy after threatened or actual legal actions).

104. In December 2020, Senator Elizabeth Warren and Congressman Jerrold Nadler introduced the Consumer Bankruptcy Reform Act of 2020, which would modernize the consumer bankruptcy system

The 2008 financial crisis showed how ill-prepared lenders and the government have been in the past to ensure that borrowers would be offered modifications, particularly regarding mortgages, with terms that they could afford over the long term and via an understandable process. As a result, debt consolidation companies gained a stronghold. The pandemic's economic fallout places households in a similar position to where they found themselves following the 2008 financial crisis. A key difference is that home loans are not the only major debt contract that people may be worried about keeping up with in the coming months. Plus, the federal agencies that control the majority of mortgages in America have thought ahead to provide standardized modification packages that their servicers must use.

What the federal government has yet to address is all the other modifications that people will seek—notably auto loans, credit cards, and other installment credit. The crux of the problem across these credit products stems from the diversity of creditors and credit problems. This heterogeneity has a strong potential to result in lenders and their servicers offering people modifications that will end in default, a result which history teaches is even more likely for Black, Latine, and lower-income borrowers. And, similar to the 2008 financial crisis, debt consolidation companies again may capture the market for modifications, which could lead to economically destructive results. As with mortgages, streamlined regulations for the process and substance of modification are needed. Given its regulatory breadth and authority, the CFPB offers a natural place to situate these regulations via its UDAAP powers.

The benefits of the CFPB issuing the type of compliance bulletin we suggest will differ based on credit product. For secured debts, such as mortgages and auto loans, for which bankruptcy essentially offers modification deals that allow people to keep houses and cars, a streamlined modification process should save time and money for lenders and borrowers. In the context of mortgages, adding the CFPB's guidance will bolster what other federal agencies already have outlined, serving as a check on the potential for these programs' complexity to hinder the issuance of productive modifications.

For unsecured debts, such as credit cards, under the CFPB's guidance, lenders may not be able to offer people modifications that they have the ability to repay. In these instances, borrowers may recognize that filing bankruptcy to discharge these unsecured debts is the most financially productive option. In steering borrowers away from modifications, the requirements proposed in this Article should save people time and money, which will bring more economic benefits

and would provide debtors with the ability to modify individual debts, such as a mortgage or a car loan similar to what this proposal in the Article may incentivize outside of bankruptcy. *Warren and Nadler Introduce the Consumer Bankruptcy Reform Act of 2020*, SEN. ELIZABETH WARREN (Dec. 9, 2020), https://www.warren.senate.gov/newsroom/press-releases/warren-and-nadler-introduce-the-consumer-bankruptcy-reform-act-of-2020 [https://perma.cc/UW4L-SNUH]. Bankruptcy law currently has statutory barriers to modification of mortgages and auto loans and requires debtors to deal with all their debts simultaneously. *See* Foohey et al., *supra* note 22, at 51–54 (discussing ideas for tailoring bankruptcy to account for differences among the people who file bankruptcy).

overall. Now is the time for the federal government to consider how to incentivize modifications across the range of consumer loans that borrowers will struggle with during the coming months such that people will be offered workable deals or will be ushered toward a way to reset their financial lives.