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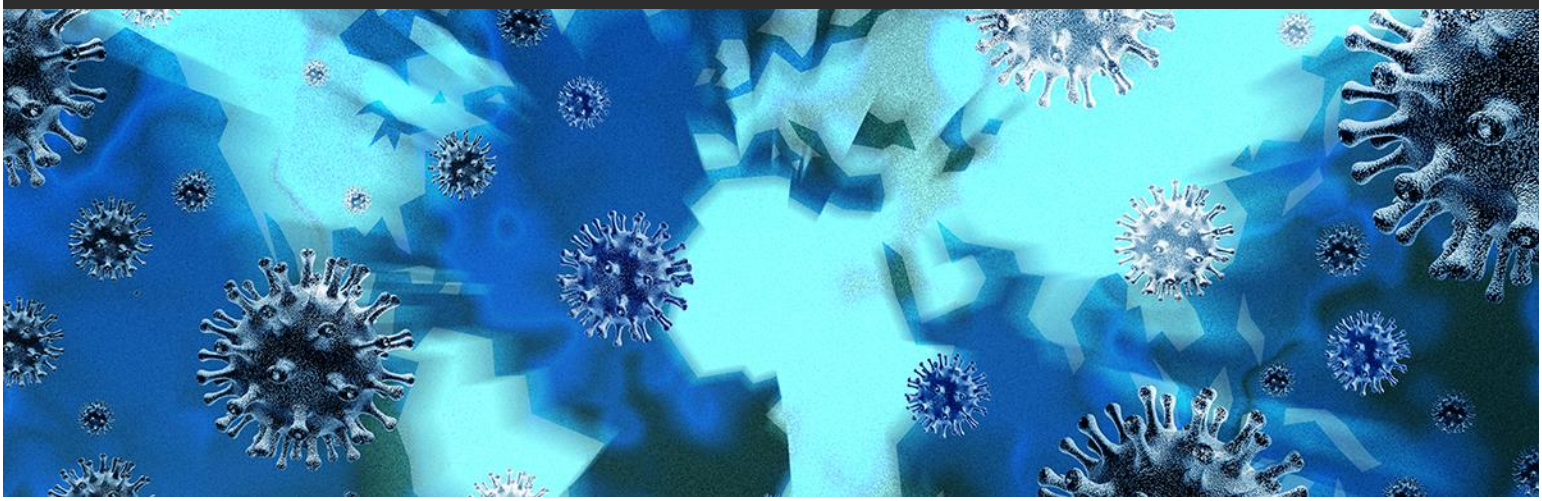
Alert | Health Emergency Preparedness Task Force: Coronavirus Disease 2019/COVID-19 Economic Stimulus



April 9, 2020

The CARES Act, Consumer Bankruptcy, and Mortgage Servicing: What to Know and Potential Pitfalls

Enacted March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) places short-term obligations and restrictions on lenders and servicers of federally backed loans. As part of these limitations due to Coronavirus Disease 2019 (COVID-19), lenders and servicers are temporarily subject to moratoriums on foreclosures, mandatory forbearance obligations, and revised credit reporting obligations. For borrowers currently in bankruptcy or who received a discharge but retained real property and continued making payments thereon, lenders and servicers should proceed with caution to minimize their risk of violating the Bankruptcy Code. This GT Alert outlines the obligations created by the CARES Act, identifies some potential litigation concerns, and discusses certain considerations for minimizing risk of exposure.

Key Provisions of the CARES Act

While the CARES Act provides relief to a wide swath of industries, companies, and individuals, there are two overarching considerations relevant to borrowers and the Bankruptcy Code.[1] First, the CARES Act makes three significant revisions to the Bankruptcy Code:

[1] All three of these revisions are temporary and will expire on March 27, 2021.

- Increasing the cap for small business debtors seeking relief pursuant to the Small Business Reorganization Act under Subchapter 5 of the Bankruptcy Code from approximately $2.7 million to $7.5 million.
- Removing COVID-19-related relief payments from calculations of (a) a debtor's income for determining eligibility for Chapter 7 and Chapter 13 relief and (b) a debtor's disposable income for a Chapter 13 Plan.
- Permitting a Chapter 13 debtor with a confirmed Plan to modify the Plan based on "material financial hardship" resulting "directly or indirectly" from the COVID-19 pandemic, including extending payments under the Plan up to seven years after the debtor's initial Plan payment was due.

Second, lenders and servicers dealing with consumer borrowers subject to the Bankruptcy Code, in addition to the automatic stay applicable under section 362 of the Bankruptcy Code during pending bankruptcy proceedings, should be aware of the following provisions of the CARES Act: (i) the moratorium on foreclosures and foreclosure-related evictions for federally-backed mortgages; (ii) the mandate for short-term forbearance accommodations for federally-backed mortgages; (iii) the suspension of GAAP requirements to permit loan modifications without designating a loan as a "troubled debt restructuring"; and (iv) revisions to Fair Credit Reporting Act (FCRA) obligations. For more in-depth discussions of these provisions under the CARES Act, please see our April 2 GT Alert on the Mortgage Foreclosure Moratorium and our April 9 GT Alert on CARES Act and the FCRA. In addition, lenders and servicers should keep abreast of additional state-issued COVID-19 mandates, prohibitions, regulations, and guidelines for any state in which they service debts.

Potential Bankruptcy Issues

Because the CARES Act does not explicitly address the interplay between its statutory provisions and the Bankruptcy Code, lenders and servicers may wish to evaluate the status of borrowers and loans subject to the Bankruptcy Code. There are three general categories of debtors that warrant consideration given the requirements of the CARES Act:

- Debtors that recently filed bankruptcy and request an accommodation when no Plan has been proposed or confirmed;
- Debtors that are operating under a confirmed Chapter 11 or Chapter 13 Plan, and either become delinquent under the Plan or request an accommodation; and
- Debtors who have received a discharge of their personal liability for a mortgage debt but elected to retain the subject property[2] and continue making monthly payments, and have either become delinquent or request an accommodation.

For borrowers that recently filed for bankruptcy, the CARES Act does not prohibit a post-petition request for an accommodation. Thus, lenders and servicers should be aware of any contact from debtors or their counsel seeking an accommodation pursuant to the CARES Act. At the same time, lenders and servicers should remain cognizant that any accommodations under the CARES Act are temporary in nature. Thus, negotiations of any Plan treatment or other post-petition payment terms that will extend beyond the expiration of the applicable stimulus provisions of the CARES Act should address how the terms will change after the temporary statutory benefits expire.

[2] Under the CARES Act, the foreclosure moratorium does not apply to abandoned or vacant property.

For borrowers operating under a confirmed Plan, lenders and servicers should be aware that debtors are entitled to request accommodations under the CARES Act and that Chapter 13 debtors are additionally able to seek modifications to their Plan extending payments up to seven years after the first payment was due under the Plan. This right to modification is provided to the debtor and does not require consent of the creditor, though requested modification must still comply with the requirements of sections 1322(a), 1322(b), and 1323(c) of the Bankruptcy Code.

For borrowers that have already received a discharge of their personal liability but retained real property subject to a security interest, lenders and servicers should recognize that the CARES Act extends to payment obligations generally, not just those that constitute personal liabilities. Post-discharge borrowers may, therefore, still request an accommodation, and lenders and servicers should follow the same protocol in granting accommodations and forbearances, as they would for borrowers still obligated under a promissory note.

Finally, as to borrowers in the second and third categories, lenders and servicers should be careful before filing any pleadings suggesting a default under a confirmed Plan or sending any pre-foreclosure notices until the expiration of the current foreclosure moratorium. Making any such filings or sending any such notices during the pendency of the moratorium period could be construed by a Bankruptcy Court as "initiating a foreclosure process," which, in turn, could subject the lender or servicer to the risk of potential sanctions to the extent the Bankruptcy Court retains jurisdiction over any dispute. Further, for any property believed to be abandoned or vacant, lenders and servicers should confirm that status before proceeding with any foreclosure activity.

For more information and updates on the developing situation, visit GT's Health Emergency Preparedness Task Force: Coronavirus Disease 2019 or GT's COVID-19 Economic Stimulus Team.

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