Veterans Benefits Administration
Department of Veterans Affairs
Washington, D.C. 20420

Circular 26-11-22
December 23, 2011

FINAL LOAN MODIFICATION REGULATION REVISION

1. Purpose. The purpose of this circular is to announce a final change to the regulation for modifying Department of Veterans Affairs (VA) guaranteed home loans that was previously published as an interim final rule.

2. Background. In February 2008, VA revised its regulation to provide loan servicers more authority to modify loans without VA prior approval. Subsequent to that change, VA noted that some portions of the 2008 rule created burdens or obstacles to modifying VA loans. On February 7, 2011, VA published an interim final rule to address those obstacles in the Federal Register (76 FR 6555). The public submitted comments on the interim final rule and in response VA slightly revised the final rule as published in the Federal Register (76 FR 78827) on December 20, 2011, effective January 19, 2012.

3. Changes Based on Public Comment. Several public comments suggested that VA change the establishment of the maximum interest rate from the date the modification is executed to the date the modification is approved. VA agreed with this comment and revised 38 CFR 36.4315(a)(8)(i) by replacing the word “executed” with the word “approved”. Other comments suggested that VA set a limit of $1,000 on the amount of legal fees that may be capitalized when a loan is modified. In recognition that fees vary from state to state based on legal procedures, VA amended 38 CFR 36.4315(a)(10) to limit the amount of legal fees and costs for a cancelled foreclosure that may be included in the modified indebtedness to the maximum amounts prescribed in 38 CFR 36.4314.

4. Public Comments Not Resulting in Revisions. Other public comments suggested that VA always require that the interest rate and the payment on a modified loan be lower than the interest rate on the existing loan. VA did not concur because this was considered to be a disincentive for loan servicers to complete modifications. Another comment suggesting mandatory loss mitigation was not acted upon because existing VA regulations both require and encourage loss mitigation efforts.

5. Prior Approvals. Paragraph (a) of 38 CFR 36.4315 contains the conditions that must be satisfied for a servicer to modify a loan without first obtaining VA's prior approval. Paragraph (b) of that section provides that a servicer must seek VA's prior approval if the proposed modification does not meet one or more of those conditions. An example might be where the modified loan term will have a maturity date more than 10 years after the original maturity of a 30-year loan. VA has the authority to approve a modification exceeding the term limit stated in paragraph (a). Paragraph (b) of the regulation states that VA will approve the modification request if it is determined to be in the best interests of the Veteran and the Government after balancing the risks of non-approval versus the risks of approval, despite the absence of one or more of the conditions identified in paragraph (a).

6. Procedure for Prior Approval. The VA Loan Electronic Reporting Interface (VALERI) application contains a menu item for a Pre-Approval Process in the Servicer Web Portal. If a loan is less than 61 days delinquent, the servicer must first submit an Electronic Default Notification with "imminent default" selected as the reason for default, in order to have the case assigned to a VA Loan Technician for review. When selecting the Pre-Approval Process the servicer must enter the type of approval requested, and provide a justification for the request. After the servicer uploads documentation to support the request, VALERI will initiate a process for the assigned Loan Technician to review the request, update the status in VALERI, and notify the servicer.

7. Trial Modifications. VA is aware that some servicers may find it desirable to establish a trial modification before actually changing the formal loan terms. This may be appropriate if the modification analysis indicates some uncertainty as to the ability of the Veteran borrower to maintain revised payments, and completion of a trial period can serve as additional justification for determining that the Veteran is a satisfactory credit risk. In addition, Ginnie Mae guidelines for buying loans out of a guaranteed pool may require that a period of default on the loan terms continue for a specific period, and borrowers making less than the full scheduled payment during the trial period may satisfy this requirement. Because the borrower is making payments under what is essentially a special forbearance agreement, VA encourages servicers to suspend derogatory credit reporting.

8. Interest Rate Consideration. When a servicer approves any modification, including a modification subject to the satisfactory completion of a trial period, it must be reported in VALERI as an approved modification. This will ensure that the date of approval is used to verify that the interest rate on the subsequently completed modification does not exceed the maximum interest rate allowed by VA regulation as of the date of approval.

9. VA Reviews. The effective date of the new rule is January 19, 2012. However, because the change has already been announced, in its modification reviews VA will not consider a servicer in violation of the regulation if the modified interest rate complies with the maximum rate allowable as of the date of approval.

10. Rescission: This circular is rescinded April 1, 2014.

By Direction of the Under Secretary for Benefits

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