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S. HRG. 111–902

TARP FORECLOSURE MITIGATION PROGRAMS

HEARING

BEFORE THE

CONGRESSIONAL OVERSIGHT PANEL

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

OCTOBER 27, 2010

Printed for the use of the Congressional Oversight Panel

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CONGRESSIONAL OVERSIGHT PANEL

PANEL MEMBERS

THE HONORABLE TED KAUFMAN, *Chair*

KENNETH TROSKE

J. MARK MCWATTERS

RICHARD H. NEIMAN

DAMON SILVERS

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HEARING ON TARP FORECLOSURE MITIGATION PROGRAMS

WEDNESDAY, OCTOBER 27, 2010.

U.S. CONGRESS,
CONGRESSIONAL OVERSIGHT PANEL,
Washington, DC.

The Panel met, pursuant to notice, at 10 a.m. in Room SD–138, Dirksen Senate Office Building, Washington, DC, Hon. Ted Kaufman, Chairman of the Panel, presiding.

Present: Hon. Ted Kaufman [presiding], Mr. Richard H. Neiman, Mr. Damon Silvers, Mr. J. Mark McWatters, and Dr. Kenneth R. Troske.

OPENING STATEMENT OF HON. TED KAUFMAN, CHAIRMAN, CONGRESSIONAL OVERSIGHT PANEL

The CHAIRMAN. Good morning. This hearing of the Congressional Oversight Panel will now come to order. My name is Ted Kaufman. I'm the Chairman of the Congressional Oversight Panel for the Troubled Asset Relief Program. We are here today to evaluate the progress of Treasury's foreclosure prevention programs and to examine the impact of recently reported irregularities in the foreclosure process.

I have always believed that sound oversight must start with an understanding of a program's goals. So let us begin by recalling the Administration's original goal for foreclosure prevention. In February 2009, the President announced an aim to help, and I quote, "as many as 3 to 4 million homeowners to modify the terms of their mortgage to avoid foreclosure."

At that time, our economy was on track to experience more than 8 million foreclosures, so the goal was always modest compared to the incredible scale of the problem. Certainly it was modest compared to the boldness shown in rescuing AIG, Fannie Mae, Freddie Mac, Bank of America, Citigroup, and the auto companies. Yet now, two years later, we can see that even this modest goal will not be met. To date, fewer than half a million homeowners have received permanent mortgage modifications through Treasury's programs. As many as half of these borrowers will ultimately redefault and lose their homes.

Recently, as the goal of preventing 3 to 4 million foreclosures has appeared increasingly distant, Treasury has redefined its aim. The goal now is to offer a temporary mortgage modification to 3 to 4 million homeowners. Let me repeat that. The goal, Treasury now says, is to offer—offer—a temporary mortgage modification to 3 to 4 million homeowners.

The distinction may sound subtle. I don't think it is. But the difference is vast. Borrowers who are offered temporary modifications may not accept. Those who accept may not complete the steps required to receive a permanent modification. Those who receive a permanent modification may redefault and lose their homes. At the rate that homeowners are falling through these cracks today, 3 million modification offers may translate in some cases to as few as 100,000 foreclosures prevented.

For all these reasons, a goal of offering 3 to 4 million modifications is hardly a goal at all. It divorces the program's measurement of success from its ultimate aim, as expressed by the President, to keep homeowners in their homes. In many ways it's like a major league batter pledging to swing at every pitch. What matters is not how often you swing. What matters is how often you get on base.

I hope the Treasury takes today's hearing as an opportunity to define in a detailed public way more concrete goals for success in foreclosure prevention. Most fundamentally, here are my main questions: How many foreclosures must be prevented? What redefault rate can we expect? How many temporary modifications will convert to permanent status? Clear answers are critical not only for our oversight work, but really, much more importantly, for Treasury's own ability to measure and improve its results.

I also hope to hear evidence that the foreclosure picture improved dramatically since the Panel last examined the issue. Yet all evidence seems to be to the contrary. Of particular concern are reports that banks and loan servicers may have rushed their foreclosure process by relying on affidavits, as they say, robo-signed by employees with no knowledge of the underlying facts. These reports are already undermining investor and homeowner confidence in the mortgage market and they threaten to undermine Americans' fundamental faith in due process.

If these reports reflect a disregard on the part of banks for legal requirements of foreclosure, that alone would be unconscionable. Yet it is conceivable that the banks' problem is even worse, that the banks have failed to follow the legal steps necessary to ensure clear title. If investors lose confidence in the ability of banks to document their ownership of mortgages, the financial industry could suffer staggering losses. The possibility is especially alarming coming so soon after taxpayers spent billions of dollars to bail out these very same institutions.

I do not want to prejudge what we will hear from today's witnesses, but I must say this. I am concerned. I am concerned in part because it is the Panel's mandate to oversee Treasury's foreclosure programs and the overall stability of the financial system. But much more critically, I am concerned because across America our mothers and fathers, sons and daughters, are losing their homes.

I do not pretend that every foreclosure in this country can or even should be eliminated. But even so, every foreclosure is clearly a tragedy. Every time a family is cast out of their home, their future is cast into doubt, their neighborhood's home prices plummet, and their town's stability diminishes. The American dream takes a step backward. Treasury cannot and should not prevent every foreclosure in this country for sure, but it can and must do far, far better.

Before we proceed, I would like to hear from my colleagues. Mr. McWatters.

[The prepared statement of Chairman Kaufman follows:]

SEN. TED KAUFMAN, CHAIRMAN
RICHARD H. NEIMAN
SHARON BRYANT
J. MARK McWATTERS
KENNETH R. ROSSE

732 North Capitol Street, NW
Room C-320
Washington, DC 20401

Congress of the United States

CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of Ted Kaufman

Congressional Oversight Panel Hearing on TARP Foreclosure Mitigation Programs

October 27, 2010

Good morning. My name is Ted Kaufman, and I am the chairman of the Congressional Oversight Panel for the Troubled Asset Relief Program (TARP). We are here today to evaluate the progress of Treasury's foreclosure prevention programs and to examine the impact of recently reported irregularities in the foreclosure process.

I have always believed that sound oversight must start with an understanding of a program's goals, so let us begin by recalling the administration's original goal for foreclosure prevention. In February 2009, the president announced an aim to help "as many as three to four million homeowners to modify the terms of their mortgages to avoid foreclosure."

At the time, our economy was on track to experience more than eight million foreclosures, so the goal was always modest compared to the scale of the problem. Certainly it was modest compared to the boldness shown in rescuing AIG, Fannie Mae, Freddie Mac, Bank of America, Citigroup, and the auto companies. Yet now, two years later, we can see that even this modest goal will not be met. To date fewer than half a million homeowners have received permanent mortgage modifications through Treasury's program, and as many as half of these borrowers will ultimately redefault and lose their homes.

Recently, as the goal of preventing three to four million foreclosures has appeared increasingly distant, Treasury has redefined its aim. The goal, Treasury now says, is to offer a temporary mortgage modification to three to four million homeowners. The distinction may sound subtle, but the difference is vast. Borrowers who are offered temporary modifications may not accept. Those who accept may not complete the steps required to receive a permanent modification. Those who receive a permanent modification may redefault and lose their homes. At the rate that homeowners are falling through these cracks today, three million modification offers may translate into only a few hundred thousand foreclosures prevented.

For all of these reasons, a goal of offering three to four million modifications is hardly a goal at all. It divorces the program's measurement of success from its ultimate aim: to keep homeowners in their homes. In many ways, it is like a major league batter pledging to swing at every pitch. What matters is not how often you swing the bat, but how often you reach the bases.

Congressional Oversight Panel

I hope that Treasury takes today's hearing as an opportunity to define, in a detailed, public way, more concrete goals for success in foreclosure prevention. Most fundamentally, how many foreclosures must be prevented? What redefault rate can we expect? How many temporary modifications will convert to permanent status? Clear answers are critical not only to our oversight work but to Treasury's own ability to measure and improve its results.

I also hope to hear evidence that the foreclosure picture improved dramatically since the Panel last examined the issue. Yet all evidence appears to be to the contrary. Of particular concern are reports that banks and loan servicers may have rushed the foreclosure process by relying on affidavits "robo-signed" by employees with no knowledge of the underlying facts. These reports are already undermining investor and homeowner confidence in the mortgage market, and they threaten to undermine Americans' fundamental faith in due process.

If these reports reflect a disregard on the part of banks for the legal requirements of foreclosure, that alone would be unconscionable. Yet it is conceivable that the problem is even worse: that banks have failed to follow the legal steps necessary to ensure clear title. If investors lose confidence in the ability of banks to document their ownership of mortgages, the financial industry could suffer staggering losses. The possibility is especially alarming coming so soon after taxpayers spent billions of dollars to bail out these very same institutions.

I do not want to prejudge what we will hear from today's witnesses, but I must say this: I am concerned. I am concerned in part because it is this Panel's mandate to oversee Treasury's foreclosure programs and the overall stability of the financial system. But much more critically, I am concerned because, across America, our mothers and fathers and sons and daughters are losing their homes.

I do not pretend that every foreclosure in this country can or should be prevented – but even so, every foreclosure is a tragedy. Every time a family is cast out of their home, their future is cast into doubt, their neighborhood's home prices plummet, and their town's stability diminishes. The American dream takes a step backward. Treasury cannot and should not prevent every foreclosure in this country, but it can and must do far, far better.

Before we proceed, I would like to offer my colleagues on the Panel an opportunity to make their own opening remarks.

STATEMENT OF J. MARK McWATTERS, MEMBER, CONGRESSIONAL OVERSIGHT PANEL

Mr. McWATTERS. Thank you, Senator.

Since this Panel last addressed Treasury's foreclosure mitigation programs funded under the TARP, questions have arisen regarding the identity of the true legal owners of countless mortgage loans that serve as collateral for residential mortgage-backed securities, or what are referred to as RMBS, and whether the alleged owners may deliver clear title upon foreclosure or other transfer of the mortgaged properties.

Although the securitization trust organized with respect to each RMBS should hold clear legal title to the mortgage loans, such assertion is not free from doubt. It is possible that some of these special purpose entities may be divested of their putative ownership rights in their mortgage loans are required to incur substantial fees and expenses so as to reflect the proper chain of title to the promissory notes, mortgage liens, and security interests in accordance with applicable law.

Investors in RMBS are also beginning to assert that mortgage loan originators breached representations and warranties provided in their RMBS securitization documents and that the securitization trusts and their servicers should undertake to put individual residential mortgage loans back to their loan originators. These investors may also initiate claims against the securitization trusts and their sponsors and servicers for breach of contract, failure to comply with applicable law, and fraud.

Individual mortgage loan borrowers or a class of such borrowers may also initiate wrongful foreclosure and other actions against the RMBS securitization trusts and their servicers. Such claims may be compounded as the rights and obligations of parties to collateralized debt obligations and synthetic collateralized debt obligations are considered.

Since TARP recipients and other financial institutions acted as mortgage loan originators, RMBS sponsors and servicers, credit default protection buyers and protection sellers under synthetic CDOs, and RMBS and CDO investors, they could suffer substantial losses and capital impairment from the exercise of these legal rights and remedies.

Further, since Fannie Mae and Freddie Mac had also acted as RMBS sponsors, and given Treasury's unlimited support for the GSEs, Fannie and Freddie may also serve as targets for aggrieved RMBS investors and mortgage loan borrowers.

Conversely, the GSEs, acting on behalf of the RMBS securitization trusts that they sponsor, may undertake to put individual residential mortgage loans back to the TARP recipients and other financial institutions that originated the loans or perhaps—perhaps—cancel the guarantees issued for the benefit of the RMBS holders. The enforcement of these rights and remedies would no doubt create much uncertainty for TARP recipients and other financial institutions, as well as for the residential mortgage lending and RMBS markets.

These matters are particularly significant since the operating costs of many TARP recipients are rising due to commercial and consumer loan defaults and foreclosures, while operating revenues

remain relatively tepid due to weak loan demand and an overall sluggish economy. If—if—another liquidity or solvency crunch follows from these events, it is not inconceivable that the rating agencies may downgrade the credit rating of certain mortgage loan originators, RMBS securitization trusts, and investors, and mortgage servicers, which, as noted above, include TARP recipients and other financial institutions. This action could adversely affect the broader economy.

I also wish to note that in my view the Administration's foreclosure mitigation program, including the HAMP and the HARP, have failed to provide meaningful relief to distressed homeowners and, disappointingly, the Administration has inadvertently created a sense of false expectations among millions of homeowners who reasonably anticipated that they would have the opportunity to modify or refinance their troubled mortgage loans under the HAMP and the HARP.

From my perspective, the best foreclosure mitigation tool is a steady job at a fair wage, and not a hodgepodge of government subsidized programs that create and perpetuate moral hazard risks and all but establish the government as the implicit guarantee of distressed homeowners.

I question why the taxpayers should subsidize mortgage lenders and RMBS participants when it is most often in the best interest of such parties to forgive principal—to forgive principal—and to modify or refinance troubled mortgage loans without government assistance. Why should the taxpayers provide incentives when they are not needed or merited?

As such, I strongly recommend that each mortgage loan holder and RMBS investor and servicer work with each of their homeowners in a professional, good faith, transparent, and accountable manner to reach an economically reasonable resolution prior to proceeding with a foreclosure remedy. In my view, foreclosure should serve as the exception to the rule that only follows from the transparent and objective failure of the parties to modify or refinance a troubled mortgage loan pursuant to market-based terms.

Thank you, and I look forward to our discussion.

[The prepared statement of Mr. McWatters follows:]

SEN. TED KAUFMAN, CHAIRMAN
RICHARD H. NEIMAN
DEAN CHUMBRIS
J. MARK MCWATTERS
KENNETH R. ORUSSAF

202 NORTH CAPITOL STREET, NW
ROOM D-233
WASHINGTON, DC 20401

Congress of the United States

CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of J. Mark McWatters

Congressional Oversight Panel Hearing on TARP and Foreclosure Mitigation Programs

October 27, 2010

Thank you Senator.

Since this Panel last addressed Treasury's foreclosure mitigation programs funded under the TARP, questions have arisen regarding the identity of the true legal owners of countless mortgage loans that serve as collateral for Residential Mortgage-Backed Securities, or RMBS, and whether the alleged owners may deliver clear legal title[1] upon the foreclosure or other transfer of the mortgaged properties.[2] Although the securitization trust organized with respect to

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[1] Local title insurance companies that issue mortgagee (lender) and mortgagor (borrower) title insurance policies and state court judges will most likely decide what constitutes "the delivery of clear legal title." In other words, a single nationwide standard does not apply.

Questions arise, such as:

How will a potential purchaser know if a securitization trust or a special servicer retained by the securitization trust may deliver clear legal title to a residence purchased out of a foreclosure?

Are title insurance companies prepared to issue clear mortgagee (lender) and mortgagor (borrower) title insurance policies with respect to residential real property purchased out of a foreclosure where the mortgage lien was "recorded" under MERS (Mortgage Electronic Registration Systems, Inc.)?

How does a homeowner know that he or she is paying the correct lender each month?

Are the securitization trusts "holders in due course" of their underlying mortgage notes and are they legally permitted to enforce the notes without being subject to the defenses which the original maker (borrower) of the note would be able to assert against the original payee (lender)?

Have the mortgage servicers or other parties engaged in any criminal activity?

[2] See *Mortgage Investors Join Outcry Against Banks,* ProPublica, Oct. 18, 2010 (online at http://www.propublica.org/article/investors-join-outcry-against-mortgage-servicers). See *Foreclosure Crisis Triggers Debate on Role of Mortgage Registry,* Bloomberg.com, Oct. 19, 2010 (online at http://www.bloomberg.com/news/2010-10-19/u-s-electronic-mortgage-registry-comes-under-fire-in-foreclosure-crisis.html). See *Blackrock, Pimco, Fannie Target Banks Using Texas Lawyer's Clearing House,* Bloomberg.com, Sept. 23, 2010 (online at http://www.bloomberg.com/news/2010-09-23/mortgage-investors-target-banks-using-texas-lawyer-s-novel-clearing-house.html). See *Bondholders Pick a Fight with Banks,* Wall Street Journal, Oct. 19, 2010 (online at http://online.wsj.com/article/SB10001424052702303496104575560621544183834.html?KEYWORDS=bondholders+pick+a+fight+with+banks). See *Battle Lines Forming in Clash over Foreclosures,* New York Times, Oct. 20, 2010 (online at http://www.nytimes.com/2010/10/21/business/21standoff.html?_r=2&ref=business&pagewanted=all). See *U.S.*

each RMBS should hold clear legal title to the mortgage loans, such assertion is not free from doubt.[3] It is *possible* that some of these special purpose entities may be divested of their putative ownership rights in some of their mortgage loans or required to incur substantial fees and expenses so as to reflect the proper chain of title to the promissory notes, mortgage liens, and security interests in accordance with applicable law.[4]

Investors in RMBS[5] are also beginning to assert that mortgage loan originators breached representations and warranties provided in their RMBS securitization documents and that the securitization trusts and their servicers should undertake to "put" individual residential mortgage

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Tries To Ease Wider Worries over Foreclosures, New York Times, Oct. 20, 2010 (online at http://www.nytimes.com/2010/10/21/business/21mortgage.html?ref=business). See *Mortgage Lenders Under Review, Bernanke Says,* New York Times, Oct. 25, 2010 (online at http://www.nytimes.com/2010/10/26/business/economy/26fed.html?hp). See *Short Sales Resisted as Foreclosures Are Revived,* New York Times, Oct. 25, 2010 (online at http://www.nytimes.com/2010/10/25/business/25short.html?scp=1&sq=short%20sales%20resisted&st=cse). See *BofA Finds Foreclosure Document Errors,* Wall Street Journal, Oct. 25, 2010 (online at http://online.wsj.com/article/SB10001424052702303864404575572662815011760.html?mod=WSJ_business_whatsNews). See *Outcome of Foreclosure Mess Rests on Custodians,* American Banker, Oct. 25, 2010 (online at http://www.americanbanker.com/issues/175_204/outcome-of-foreclosure-mess-1027532-1.html). See *Fannie, Freddie Seek End to Freeze,* Wall Street Journal, Oct. 23, 2010 (online at http://online.wsj.com/article/SB10001424052702304354104575568621229952944.html?mod=dist_smartbrief). See *Bank of America, JPMorgan Get Texas Subpoenas on Foreclosures,* Bloomberg.com, Oct. 26, 2010 (online at http://www.bloomberg.com/news/print/2010-10-25/jpmorgan-bank-of-america-subpoenaed-by-texas-attorney-general.html).

[3] See New *Court Rule Says Attorneys Must Verify Foreclosure Papers,* New York Law Journal, Oct. 21, 2010 (online at http://www.law.com/jsp/nylj/PubArticleNY.jsp?id=1202473628860&New_Court_Rule_Says_Attorneys_Must_Verify_Foreclosure_Papers&slreturn=1&hbxlogin=1).

[4] Promissory notes, mortgages/deeds of trust and security agreements generally need to be endorsed and assigned from the loan originators through the proper chain of title to the current holders with necessary filings made in the applicable real property and UCC records. Local jurisdictions generally charge several dollars per page to record legal documents. See, for example, Dallas County Online, Dallas County Clerk Frequently Asked Questions (online at http://www.dallascounty.org/department/countyclerk/faq-recording.html) (accessed Oct. XX, 2010). The MERS system may provide an exception in some jurisdictions.

As legitimate questions of law and fact continue to emerge regarding the true ownership of the residential mortgage loans that collateralize RMBS, it is possible that *some* borrowers who are otherwise current on – or in the process of modifying or refinancing – their mortgage loan obligations may unilaterally elect to stop making their mortgage payments. Although some borrowers may act with the expectation of achieving an inappropriate short-term benefit, others may demur out of concern that they have been paying the wrong mortgage lender or out of a sense of frustration that, notwithstanding their good faith efforts, they have been unable to modify or refinance their mortgage loan due to the problematic delaying tactics – or just plain incompetence – of the their mortgage servicer. Regardless of the justification or lack thereof, the consequences of even a modest borrower-initiated mortgage payment moratorium could have adverse consequences for TARP recipients and other holders of residential mortgage loans and RMBS. This problem will be exacerbated if the role of MERS in facilitating the electronic transfer of residential mortgage loans outside of the traditional land title system is consistently and successfully challenged in the courts.

[5] These purchasers include TARP recipients and other financial institutions, endowments, pension funds, hedge funds, and sovereign wealth funds, among others.

loans back to their loan originators.[6] These investors may also initiate claims against the securitization trusts and their sponsors and servicers for breach of contract, failure to comply with applicable law, and fraud. Individual mortgage loan borrowers – or a class of such borrowers – may also initiate wrongful foreclosure and other actions against the RMBS securitization trusts and their servicers. Such claims may be compounded as rights and obligations of parties to collateralized debt obligations (CDOs) and synthetic CDOs are considered. Since TARP recipients and other financial institutions acted as mortgage loan originators, RMBS sponsors and servicers, credit default swap (CDS) protection buyers and protection sellers under synthetic CDOs and RMBS, and CDO investors, they could suffer substantial losses and capital impairment from the exercise of these legal rights and remedies.[7]

Further, since Fannie Mae and Freddie Mac also have acted as RMBS sponsors and given Treasury's unlimited support for the government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac may also serve as targets for aggrieved RMBS investors and mortgage loan borrowers.[8] Conversely, the GSEs, acting on behalf of the RMBS securitization trusts that they sponsored, may undertake to "put" individual residential mortgage loans back to TARP recipients and other financial institutions that originated the loans, or, perhaps, cancel the guarantees issued for the benefit of the RMBS holders.[9] The enforcement of these rights and remedies would no doubt create much uncertainly for TARP recipients and other financial institutions as well as for the residential mortgage lending and RMBS markets.[10]

These matters are particularly significant since the operating costs of many TARP recipients and other financial institutions are rising due to commercial and consumer loan defaults and foreclosures while operating revenues remain relatively tepid due to weak loan demand and an overall sluggish economy.[11] *If* another liquidity or solvency crunch follows from these events, it is not inconceivable that the rating agencies may downgrade the credit ratings of certain mortgage loan originators, RMBS securitization trusts and investors, and mortgage servicers,

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[6] RMBS securitization trusts and their servicers may also undertake to "put" individual mortgage loans back to their loan originators following the discovery of the breach of a representation or warranty made by the originator for the benefit of the securitization trust.

[7] Further, any attempt to cure the compliance defects may require the payment of delinquent filing fees and penalties as well as the resolution of complex inter-creditor and lien priority issues.

[8] Among other theories, the RMBS investors may sue Fannie Mae and Freddie Mac over the failure of the securitization trusts to hold clear legal title to the residential mortgage notes and liens deposited in the trusts and over the failure of the securitization trusts to have performed appropriate due diligence investigations regarding the credit quality of the mortgage notes and liens deposited in the trusts, and the mortgage loan borrowers may sue for wrongful foreclosure.

[9] The GSE guarantees may be conditioned upon the satisfaction of certain conditions precedent and subsequent, the accuracy of certain representations and warranties, and the ongoing compliance with certain affirmative, negative, and financial covenants.

[10] Such action could also adversely affect any RMBS-based quantitative easing program undertaken by the Federal Reserve to the extent the GSEs walk away from their RMBS guarantees. Without the GSE guarantees, the fair market value of the RMBS would most likely drop precipitously and trigger loss recognition and adverse capital adjustments upon the disposition of the RMBS by the holders of such instruments to the Federal Reserve under its quantitative easing program or otherwise.

[11] See *Banks Face Two-Front War on Bad Mortgages, Foreclosures,* Bloomberg.com, Oct. 20, 2010 (online at http://www.bloomberg.com/news/2010-10-21/banks-face-two-front-war-on-bad-u-s-mortgages-flawed-foreclosure-process.html). See *Task Force Probing Whether Banks Broke Federal Laws During Home Seizures,* Washington Post, Oct. 20, 2010 (online at http://www.washingtonpost.com/wp-dyn/content/article/2010/10/19/AR2010101904845.html?hpid=topnews).

which, as noted above, include TARP recipients and other financial institutions. This action could adversely affect the broader economy.[12]

I also wish to note that in my view, the Administration's foreclosure mitigation programs – including the Home Affordable Modification Program (HAMP) and the Home Affordable Refinancing Program (HARP) – have failed to provide meaningful relief to distressed homeowners and, disappointingly, the Administration has inadvertently created a sense of false expectations among millions of homeowners who reasonably anticipated that they would have the opportunity to modify or refinance their troubled mortgage loans under HAMP and HARP.[13] In fairness, however, to the efforts of the Administration, I remain unconvinced that government-sponsored foreclosure mitigation programs are necessarily capable of lifting millions of American families out of their underwater home mortgage loans.[14] From my perspective, the best foreclosure mitigation tool is a steady job at a fair wage[15] and not a hodgepodge of government-subsidized programs that create and perpetuate moral hazard risks and all but establish the government as the implicit guarantor of distressed homeowners.[16] I question why the taxpayers should subsidize mortgage lenders and RMBS participants when it is most often in the best interest of such parties to forgive principal and modify or refinance troubled mortgage

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[12] This action *could* – but not necessarily will – cause the commercial paper, repo, and other credit markets to degrade. Since TARP authority has expired, a new financial crisis would serve as an early test of the resolution authority included in the recently enacted Dodd-Frank Act.

[13] See *Mortgage Modifications Slow in September,* New York Times, Oct. 25, 2010 (online at http://www.nytimes.com/2010/10/26/business/economy/26mortgage.html?hpw).

[14] While many homeowners have recently lost equity value in their residences, others have suffered substantial losses in their investment portfolios including their 401(k) and IRA plans. Why should the taxpayers bail out a homeowner who has lost $100,000 of home equity value and neglect another taxpayer who has suffered a $100,000 loss of 401(k) and IRA retirement savings? This is particularly true if the homeowner was able to cash out of some or all of the homeowner's equity appreciation. That is, what public policy goal is served by bailing out the homeowner who received a ski boat, trailer, and all-wheel drive SUV as proceeds from a $100,000 home equity loan while neglecting the taxpayer who suffered a $100,000 investment loss in her 401(k) and IRA accounts?

What about (i) the retired homeowner whose residence drops in value by $100,000 after she has diligently paid each installment on her $300,000 mortgage over 30 years, (ii) the taxpayer who rents her primary residence and purchases (with a $300,000 mortgage loan) real property for investment purposes that subsequently drops in value by $100,000, and (iii) the homeowner suffering from a protracted illness or disability who loses $100,000 of equity value upon the foreclosure of her residence for failure to pay property taxes? HAMP and the other programs offered by the Administration offer no assistance to these taxpayers.

Since it is neither possible nor prudent for the government to subsidize the taxpayers for the trillions of dollars of economic losses that have arisen over the past two years, the government should not undertake to allocate its limited resources to one group of taxpayers while ignoring the equally (or more) legitimate economic losses incurred by other groups.

[15] It is particularly frustrating – although not surprising – that many of the hardest hit housing markets are also suffering from seemingly intractable rates of unemployment and underemployment.

[16] The tax and regulatory policies of the Administration have injected a substantial and relentless element of uncertainty into the private sector. Significant job growth will arguably not return in earnest until the business and investment communities have been afforded sufficient opportunity to assess and assimilate the daunting array of tax increases and enhanced regulatory burdens that have arisen over the past 18 months. If the Administration continues to introduce and actively promote new taxes and regulatory changes, it is not unreasonable to suggest that the recovery of the employment and housing markets will proceed at a less than optimum pace.

loans without government assistance.[17] Why should the taxpayers provide incentives when they appear to be neither needed nor merited?

I remain troubled that HAMP itself may have exacerbated the mortgage loan delinquency and foreclosure problem by encouraging homeowners to refrain from remitting their monthly mortgage installments based upon the expectation that they would ultimately receive a favorable restructure or principal reduction subsidized by the taxpayers. The curious incentives offered by HAMP arguably convert the concept of home ownership into the economic equivalent of a "put option" – as long as a homeowner's residence continues to appreciate in value the homeowner will not exercise the put option, but as soon as the residence falls in value the homeowner will elect to exercise the put option and walk away – or threaten to walk away – if a favorable bailout is not offered.

The TARP-funded HAMP carries a 100-percent subsidy rate according to the Congressional Budget Office. This means that the U.S. government expects to recover none of the $50 billion of taxpayer-sourced TARP funds invested in the HAMP foreclosure mitigation program. Since Treasury is charged with protecting the interests of the taxpayers who funded HAMP and other TARP programs, I recommend that Treasury's foreclosure mitigation efforts be structured so as to incorporate an effective exit strategy by allowing Treasury to participate in any subsequent appreciation in the home equity of any mortgagor whose loan is modified under HAMP or any other taxpayer subsidized program. An equity appreciation right – the functional equivalent of a warrant in a noncommercial transaction – will also mitigate the moral hazard risk of homeowners who may undertake risky loans in the future based on the assumption that the government will act as a backstop with no strings attached.

It is critical to note that this analysis is in no way intended to diminish the financial hardship that many Americans are suffering as they attempt to modify or refinance their underwater home mortgage loans, and I fully acknowledge and empathize with the stress and economic uncertainty created from the bursting of the housing bubble. As such, I *strongly encourage* each mortgage loan holder and RMBS investor and servicer to work with each of their borrowers in a *professional, good faith, transparent, and accountable manner* to reach an economically reasonable resolution prior to pursuing a foreclosure remedy. In my view, foreclosure should serve as the exception to the rule that only follows from the transparent and objective failure of the parties to modify or refinance a troubled mortgage loan pursuant to market-based terms.

Thank you and I look forward to our discussion.

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[17] In the Panel's October 2009 report on foreclosure mitigation, Professor Alan M. White reported to the Panel that, subject to certain reasonable assumptions, the mortgage loan investor's net gain from a non-subsidized mortgage modification could average $80,000 or more per loan over the foreclosure of the property securing the mortgage loan. If Professor White is correct in his assessment (or even if the preference for modification over foreclosure is relatively modest as more recent studies indicate), why should Treasury mandate that the taxpayers fund payments so as to motivate investors in mortgage loans and securitized debt instruments to take actions that are in their own best interests absent the subsidies?

The CHAIRMAN. Thank you.
Mr. Silvers.

STATEMENT OF DAMON SILVERS, DEPUTY CHAIR, CONGRESSIONAL OVERSIGHT PANEL

Mr. SILVERS. Thank you, Mr. Chairman.

Good morning. Before I begin with my statement, I just want to say that I want to associate myself with the comments of the Chair and my colleague Mr. McWatters. I haven't heard the comments of my other colleagues. Perhaps I'll wish to associate myself with them once I've heard them.

Today's hearing is the fourth that this Panel has held addressing the foreclosure crisis. Congress explicitly required in the Emergency Economic Stabilization Act of 2008 that the powers it granted the Treasury Department in the Act be used in part to reduce the incidence of foreclosures. In response, the Treasury Department in the spring of 2009 created the HAMP program, and since then the Treasury has created a number of other programs aimed at reducing foreclosures. I'm pleased to welcome Ms. Caldwell as the director of those programs on behalf of the Treasury Department.

As I've said at every hearing on this subject since this Panel was created, foreclosing on a family's home is not a mere financial transaction. It marks a profound financial loss for the family and often devastating emotional defeat for the adults in that family, psychological trauma and social dislocation for the homeowners' children, falling property values and destabilized communities for the homeowners' neighbors.

Mass foreclosures are a sure sign of a failing economy and a society that has been unable to provide basic economic security to its citizens. Mass foreclosures should no more be encouraged by our public officials than should contagious diseases or catastrophic floods or organized crime.

These reasons alone would justify aggressive government action to prevent foreclosures in the wake of the housing bubble and the epidemic of exploitative lending practices by our financial institutions. But the social impact of foreclosures is not by any means the full story of the harm done to our country by the foreclosure epidemic. Mass foreclosures drive down real estate prices. You can see that in the price numbers that were announced this week. They shrink the wealth of American households, not of the people being foreclosed, but of all homeowners. Mass foreclosures weaken consumer confidence, which underlies whether or not our economy will recover from the economic crisis. And mass foreclosures, as my fellow panelists and our Chair have mentioned already, threaten the solvency of our financial system through their effect on the strength of the real estate market.

Now, it has been clear since the beginning of the financial crisis that borrowers, lenders, and the public at large had a profound interest in restructuring loans to enable homeowners who had the ability to make lower payments to stay in their homes. By the way, for those who are concerned that somehow there's something morally suspect about restructuring loans, I should note that every day on Wall Street people of power and privilege in this society restructure their debt. It is commonplace for everyone but the poor.

Yet, as the financial crisis escalated, the banks in their role as mortgage servicers simply did not restructure the loans. The Treasury Department created HAMP, offering $50 billion in incentives for the banks to restructure the loans. And yet, a year and a half later we have only 467,000 permanent modifications, genuine restructurings, compared to 7 million homeowners in the process of foreclosure.

Let me note—and perhaps this is a slightly different emphasis than my fellow panelists who have spoken before—that I think that helping 467,000 families avoid foreclosure is a good thing. In fact, it's a very good thing. It's substantially better than not helping them. But it does not appear by any means, by any measure, to be good enough.

Now we have learned that the foreclosure process itself and our system of property law is cracking under the strain of the bubble and the bust in residential real estate markets. There appears to be strong evidence, being investigated by 50 states attorneys general and a Federal task force, that servicer banks have improperly executed and filed with the courts a large number of affidavits in the pursuit of foreclosures. Worse yet, since the affidavit revelations, evidence has mounted that there are substantive problems with the liens that support significant numbers of securitized mortgages.

Today I hope we can shed light on whether 467,000 permanent modifications plus another 20,000 or so a month is the best we can hope for from HAMP. In particular, I am puzzled and mystified as to why one community group that I am familiar with, NACA, with a budget of less than $20 million, less than a thousandth of the budget of HAMP, can process 20,000 people a week in one city seeking mortgage modifications, whereas we get permanent modifications on an annual number of 20,000 a year across the whole country from HAMP.

By the way, I've seen the community group NACA do this. I've watched 20,000 people come through the Washington Convention Center not six blocks from here in a week. So I don't understand what is going on here.

Secondly, I would like to know whether HAMP has paid out money to servicers to ensure that they did not foreclose on homeowners in situations where the servicer did not actually have a valid lien or had filed a false affidavit with a court. Further, I would like to know what plans the Treasury Department has for finding out whether this sort of thing has occurred and whether public moneys have been paid out effectively under false pretenses or based on false affidavits.

Finally, I would like to know what plans the Treasury Department and the OCC on our next panel have for dealing with the possibility that either the major servicer banks will be held liable for their failures to properly service $7 trillion in mortgages or that the collateral for significant amounts of mortgage loans will turn out to be invalid. These possibilities would appear to present systemic risks of the type that TARP was enacted to address, and in particular would appear to have grave consequences for the very institutions that TARP initially capitalized and who were allowed to exit TARP on the theory that they were now healthy.

This hearing involves some of the most important issues facing our country today. I look forward to the witnesses' testimony. Mr. Chairman, I thank you for your indulgence.

[The prepared statement of Mr. Silvers follows:]

SEN. TED KAUFMAN, CHAIRMAN
RICHARD H. NEIMAN
DAMON SILVERS
J. MARK McWATTERS
KENNETH R. THORKE

732 NORTH CAPITOL STREET, NW
ROOM C-320
WASHINGTON, DC 20401

Congress of the United States
CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of Damon Silvers

Congressional Oversight Panel Hearing on TARP Foreclosure Mitigation Programs

October 27, 2010

Good morning. Today's hearing is the fourth this Panel has held addressing the foreclosure crisis. Congress explicitly required in the Emergency Economic Stabilization Act of 2008 that the powers it granted the Treasury Department in the Act be used in part to reduce the incidence of foreclosures. In response, the Treasury Department in the spring of 2009 created the HAMP program and since then has created a number of other programs aimed at reducing foreclosures.

As I have said at every hearing on this subject, foreclosing on a family's home is not a mere financial transaction. It marks a profound financial loss and often devastating emotional defeat for the homeowner, psychological trauma and social dislocation for the homeowners' children, falling property values and destabilized communities for the homeowners' neighbors. Mass foreclosures are a sure sign of a failing economy and a society that has been unable to provide basic economic security to its citizens. Mass foreclosures should no more be encouraged by our government than should contagious diseases or catastrophic floods.

These reasons alone would justify aggressive government action to prevent foreclosures in the wake of the housing bubble and the epidemic of exploitative lending practices by our financial institutions. But the social impact of foreclosures is not by any means the full story of the harm done to our country by the foreclosure epidemic. Mass foreclosures drive down real estate prices—shrinking the wealth of American households, weakening consumer confidence and the solvency of our financial system.

It has been clear since the beginning of the financial crisis that borrowers, lenders, and the public at large had a profound interest in restructuring loans to enable homeowners who had the ability to make lower payments to stay in their homes. And yet as the financial crisis escalated, the banks in their role as mortgage servicers simply did not restructure the loans. The Treasury Department created HAMP, offering $50 billion in incentives for the banks to restructure the loans—and a year and a half later, we have only 467,000 permanent modifications, compared to 7 million homeowners in the process of foreclosure. Let me note that I think that helping 467,000 families avoid foreclosure is a good thing. But it does not appear to be good enough.

And now we have learned that the foreclosure process itself, and our system of property law itself is cracking under the strain of the bubble and the bust. There appears to be strong evidence

that servicer banks have improperly executed and filed with the courts a large number of affidavits in the pursuit of foreclosures. Worse yet, since the affidavit revelations, evidence has mounted that there are substantive problems with the liens that support significant numbers of securitized mortgages.

Today I hope we can shed light on whether 467,000 permanent modifications, plus another 20,000 or so permanent modifications a month is the best that we can hope for from HAMP. In particular I would like to understand why NACA, a housing advocate group with a budget of less than $20 million, can process 20,000 people seeking mortgage modifications in one week in one city, and the United States government with a budget of $50 billion can only do 20,000 permanent modifications a month across the whole country.

Second, I would like to know whether HAMP has paid out money to servicers to ensure they did not foreclose on homeowners in situations where the servicer did not actually have a valid lien, or had filed a false affidavit with a court. Further I would like to know what plans the Treasury Department has for finding out whether this has occurred.

Finally, I would like to know what plans the Treasury Department and the OCC have for dealing with the possibility that either the major servicer banks will be held liable for their failures to properly service $7 trillion in mortgages, or that the collateral for significant amounts of mortgage loans will turn out to be invalid. These possibilities would appear to present systemic risks of the type that TARP was enacted to address, and in particular, would appear to have grave consequences for the very institutions that TARP initially capitalized, and who were allowed to exit TARP on the theory they were now healthy.

This hearing involves some of the most important issues facing our country today. I look forward to the witnesses' testimony.

The CHAIRMAN. Thank you.
Dr. Troske.

STATEMENT OF KENNETH R. TROSKE, MEMBER, CONGRESSIONAL OVERSIGHT PANEL

Dr. TROSKE. Thank you, Senator Kaufman.

So the issue before us today, foreclosures and the government's efforts to mitigate foreclosures, remains, obviously, quite contentious and fraught with strong feelings among the people debating this issue and making policy. However, when considering the effectiveness of programs designed to mitigate foreclosures, in my opinion, it is important to keep in mind that one of the primary goals and one of the goals I believe of the original legislation is to return the economy to a place where it can begin to grow at a pace that helps everyone currently in distress.

Certainly all of us would like to return to a world where we have steadily rising home prices, low unemployment rates, and an economy that is growing at 4 to 5 percent per year. However, this is not the world we currently live in. Instead, we are in an economy where housing prices nationwide have fallen by 14 percent from their peak, where prices in the largest metropolitan areas have fallen by almost one-third, and annual existing home sales have plunged by over 40 percent.

Without a doubt, the housing market has been in disequilibrium for several years, even before the recent discoveries of problems with foreclosures. The important question is what are the best policies for helping the housing market return to stability? Because until we achieve stability in the housing market, the economy will continue to limp along at 1 to 2 percent growth per year and unemployment will remain unacceptably high.

One of the main problems in the housing market is that during the 2004 to 2006 period many people borrowed money to purchase houses or took out home equity loans predicated on the belief that housing prices would continue to rise. As long as home values kept rising, homeowners and other investors could refinance these loans at lower rates based on the accumulation of equity. When housing prices started to decline, many of these people were left with homes that were valued at less than the amount they owed. They were unable to refinance their loans and face loan payments that are beyond their means. The question is, what can we do about this problem now?

One of the government's responses, the Federal Government's responses, is the program that we're focusing on today, the Home Affordable Modification Program, or HAMP. This program is presumably designed to help what Treasury refers to as "at-risk borrowers" stay in their homes. The questions we are grappling with at this hearing are whether the program is effective and how the program affects the broader economy.

HAMP works by reducing the monthly mortgage payments of borrowers through capitalization of arrears, a term extension of forbearance, and/or a reduction of interest rates or principal for up to five years. Then the program ends and the interest rates can gradually return to the prevailing rate in place at the time the modification was made.

Given the structure of the program, it seems unlikely that borrowers, especially those with negative equity, will be able to keep their homes, unless we see dramatic improvements in the housing market, which seems unlikely at this point. The median borrower in the program has monthly debt payments equal to 80 percent of their income and it is hard to imagine any government program putting a significant dent in this number. This program is focused on borrowers who can't make their monthly payments, even though they are currently employed and not underwater, this despite evidence from researchers at the Federal Reserve Banks of Atlanta and Boston showing that helping workers who have experienced temporary shocks, such as losing their jobs, is much more likely to result in the owners keeping their home. In the end, it appears that for most participants HAMP will only postpone the inevitable.

So what would be the downside if all HAMP does is postpone foreclosures for a few years? Well, as my fellow panelist Mark McWatters has pointed out in an earlier Panel report, despite all the attention they have received, homeowners with mortgages were not the only group hurt by the financial crisis. Millions of homeowners who didn't have mortgages saw the value of their homes plummet, and this was devastating for those who were going to use the equity in their home to finance their retirement. Millions of others saw the value of their retirement savings decline significantly and families lost substantial amounts in their children's college savings accounts.

For all of these people, relief will only come once the economy starts growing again. That growth will only occur once the housing market is stabilized and that stability will not develop until people move out of homes with mortgages that they cannot afford and into housing they can afford. So to the extent that HAMP simply kicks the foreclosure can down the road, it ends up hurting all of these people who are desperate for the economy to start growing again so that their lives can return to normal.

I want to be clear. I recognize that some borrowers may have been misled into taking out loans they could not afford, and to the extent that people were defrauded, the perpetrators need to be prosecuted. I also recognize that there have been serious mistakes and perhaps fraud committed by servicers and lenders in the lending and foreclosure process, and any illegal activity on the part of banks needs to be fully prosecuted. Finally, I recognize the tremendous pain that accompanies any foreclosure. Homelessness is devastating for families and needs to be avoided whenever possible.

However, there is $30 billion allocated to HAMP and I believe we need to ask whether it could be used more effectively to help all homeowners in need move towards stable and more economically appropriate housing arrangements. In other words, perhaps we need to start examining whether HAMP is a program that will bring stability to the housing market so that the economy can start growing again. I am hopeful that our discussion today can assist us with this evaluation.

[The prepared statement of Dr. Troske follows:]

SEN. TED KAUFMAN, CHAIRMAN
RICHARD H. NEIMAN
DAMON SILVERS
J. MARK McWATTERS
KENNETH P. TROSKE

732 North Capitol Street, NW
Room C-200
Washington, DC 20401

Congress of the United States

CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of Kenneth Troske

Congressional Oversight Panel Hearing on TARP Foreclosure Mitigation Programs

October 27, 2010

Thank you Senator Kaufman.

I would like to start by thanking the witnesses for taking time out of their busy schedules to appear before us today.

The issue before us today—foreclosures and the government's efforts to help keep families in their homes—remains quite contentious and fraught with strong feelings among people debating this issue. However, when considering the effectiveness of programs designed to mitigate foreclosures, it is important to keep in mind that one of our primary goals should be returning the economy to a place where it can begin to grow at a pace that helps everyone currently in distress.

Certainly all of us would like to return to a world where we have steadily rising housing prices, low unemployment rates, and an economy that is growing at 4% to 5% per year. However, this is not the world we currently live in. Instead, we are in an economy where housing prices nationwide have fallen by 14% from their peak, where prices in the largest metropolitan areas have fallen by almost one-third, and annual existing home sales have plunged by over 40%. Without a doubt, the housing market has been in disequilibrium for several years, even before the recent discoveries of problems with foreclosures. The important question is what are the best policies for helping the housing market return to stability? Because until we achieve stability in the housing market, the economy will continue to limp along at 1% to 2% growth per year and unemployment will remain unacceptably high.

One of the main problems in the housing market is that during 2005 and 2006, many people borrowed money to purchase houses, or took out home-equity loans, predicated on the belief that housing prices would continue rising. As long as home values kept rising, homeowners and other investors could refinance these loans at lower rates based on the accumulation of equity. When housing prices started to decline in 2006, many of these people were left with homes that were valued at less than the amount they owed. They were unable to refinance their loans and faced loan payments that are beyond their means. The question is, what can we do about this problem now?

One response from the federal government, and what we are focusing on today, is the Home Affordable Modification Program or HAMP. This program is presumably designed to help what Treasury refers to as at risk borrowers stay in their homes. The questions we are grappling with at this hearing are whether the program is effective and how the program affects the broader economy. HAMP works by reducing the monthly mortgage payments of borrowers through a capitalization of arrearages, a term extension, a

forbearance, and/or a reduction of interest rates or principal for up to five years. Then the program ends and the interest rate can gradually rise to the prevailing rate in place at the time the modification was made. Given the structure of the program, it seems unlikely that borrowers, especially those with negative equity, will be able to keep their homes unless we see dramatic improvements in the housing market, which seems unlikely. The median borrower in the program had monthly debt payments equal to 80% of their income and it is hard to imagine any government program putting a significant dent in this number. Additionally, instead of being directed at borrowers who are in trouble because of a sudden, unexpected occurrence, such as losing a job or having the value of their home fall below the balance of their mortgage, this program is focused on borrowers who cannot make their monthly payments even though they are currently employed and not underwater. This despite evidence from researchers at the Federal Reserve Banks of Atlanta and Boston which shows that helping workers with temporary shocks is much more likely to result in the owner keeping their home.[1] In the end it appears that, for most participants, HAMP will only postpone the inevitable.

So, what would be the downside if all HAMP does is postpone foreclosures for a few years? Well, as my fellow panelist Mark McWatters pointed out in an earlier Panel report,[2] despite all the attention they have received, homeowners with mortgages were not the only group hurt by the financial crisis. Millions of homeowners who did not have mortgages saw the value of their home plummet, and this was devastating for those who were going to use the equity in their home to finance their retirement. Millions of others saw the value of their retirement savings decline significantly, and families lost substantial amounts in their children's college savings accounts. For all of these people, relief will only come once the economy starts growing again. That growth will only occur once the housing market has stabilized, and that stability will not develop until people move out of homes with mortgages they cannot afford and into housing they can afford. So to the extent that HAMP simply kicks the foreclosure can down the road, it ends up hurting all of the people who are desperate for the economy to start growing again so that their lives can return to normal.

I want to be clear that I recognize that some borrowers may have been mislead into taking out loans they could not afford, and to the extent that people were defrauded, the perpetrators need to be prosecuted. I also recognize that there have been serious mistakes, and perhaps fraud, committed by servicers and lenders in the lending and foreclosure process, and any illegal activity on the part of banks needs to be fully prosecuted. Finally, I recognize the tremendous pain that accompanies any foreclosure. Homelessness is devastating for families and needs to be avoided whenever possible. However, $30 billion is allocated to HAMP and I believe we need to ask whether it could be used more effectively to help all homeowners in need move towards more stable and economically appropriate housing arrangements. In other words, perhaps we need to start examining whether HAMP is a program that will bring stability to the housing market so that the economy can start growing again. I am hopeful that our discussion today can assist us with this evaluation.

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[1] Foote, Christopher, Kristopher Gerardi, Lorenz Goette, Paul Willen (2009). "Reducing Foreclosures: No Easy Answers," NBER Working Paper #15063, Cambridge, MA (June).

[2] Congressional Oversight Panel, *April Oversight Report: Evaluating Progress on TARP Foreclosure Mitigation Programs* (April 14, 2010).

The CHAIRMAN. Thank you.
Superintendent Neiman.

STATEMENT OF RICHARD H. NEIMAN, MEMBER, CONGRESSIONAL OVERSIGHT PANEL

Mr. NEIMAN. Thank you, Mr. Chairman.

Ms. Caldwell, you and the Department of the Treasury deserve substantial credit for pushing an industry toward mortgage modifications and preventing avoidable foreclosures in a standardized format when the industry itself failed to appropriately act. In this way, Treasury's HAMP program has shown great potential. Thanks to your work, we have a new industry standard that has kept more people in their homes than otherwise would have been able, certainly more than HAMP's monthly reports demonstrate on their own.

But to be frank, it's been a major disappointment that the public and this Panel have no way of meaningfully measuring success pertaining to the alternative non-HAMP mortgage modifications that Treasury points to in defense of HAMP. The available sources of data are simply inadequate for anyone to meaningfully assess performance among servicers or determine that these proprietary modifications are indeed helping, successfully helping, people. In addition, the current reports do not provide the public an effective means to assess performance among servicers or to serve as an effective supervisory tool.

HAMP's metrics on their own—and people in Treasury have publicly stated this—have fallen fall short of our hopes. We now have nearly 700,000 families who have been kicked out of HAMP's trial modifications, many of whom may be worse off, despite the fact that they were making timely monthly payments for many, many months. Even worse, these 700,000 families far exceed the 500,000 families who remain in the program with permanent modifications.

The future also looks somewhat bleak. The number of new homeowners entering the program each month is now near its lowest point, and there have been more than enough redefaults after a long-term modification has successfully occurred to raise serous questions.

Now, this may be our last hearing on Treasury's foreclosure mitigation initiatives, so it is not just critical that we help the public fully understand HAMP's success and failures, but we must also get to the bottom of the biggest question: Is HAMP really the best the government can do to demonstrate a way forward?

Ms. Caldwell, for whom I have the greatest respect, knows better than anyone that unemployment and deep negative equity have been driving foreclosures in a manner that HAMP simply cannot address. And these forces will continue to hit families hard. Treasury announced several new unemployment and negative equity initiatives in response. But again, it is disappointing that six months later the public still has no meaningful way to ascertain how these new initiatives are performing.

As a final matter, I intend to explore with all our witnesses the issue of confidence. Given many of the mortgage servicers' poor track records of errors, including losing homeowners' submitted documents, how do we continue to look homeowners in the eye and

ask them to continue to work with their servicers, given the latest news pertaining to faulty documents and fraudulent affidavits? The servicers at a minimum now have even a higher burden of proof in demonstrating that they are serious about their stated efforts to work with American families.

I am grateful to you for being here today and I want to thank you and highlight not just your public service at Treasury, Ms. Caldwell, but throughout a long career of work for the underserved. I also very much look forward to speaking with our other five knowledgeable witnesses today and look forward to our question and answer session.

Thank you.

[The prepared statement of Mr. Neiman follows:]

SEN. TED KAUFMAN, CHAIRMAN
RICHARD H. NEIMAN
DAMON SILVERS
J. MARK McWATTERS
KENNETH R. TROSKE

732 North Capitol Street, NW
Room E-320
Washington, DC 20401

Congress of the United States
CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of Richard Neiman

Congressional Oversight Panel Hearing on TARP and Foreclosure Mitigation Programs

October 27, 2010

Ms. Caldwell, you and the Department of Treasury deserve substantial credit for pushing an industry towards mortgage modifications and preventing avoidable foreclosures when that industry failed to appropriately act. In this way, Treasury's HAMP program has shown great potential. Thanks to your work, we have a new industry standard that has kept more people in their homes than otherwise would have been able – certainly more than HAMP's monthly reports demonstrate on their own.

But to be frank, it has been a major disappointment that the public and this Panel have no way of meaningfully measuring success pertaining to the alternative non-HAMP mortgage modifications that Treasury points to in defense of HAMP. The available sources of data are simply inadequate for anyone to meaningfully determine that these non-HAMP modifications are indeed successfully helping people.

HAMP's metrics on their own – and people in Treasury have publicly stated this –
have fallen far short of our hopes. We now have nearly 700,000 families who have been kicked out of HAMP's trial modifications, which is far more than the 500,000 families who remain in the program with long-term modifications. The future also looks somewhat bleak. The number of new homeowners entering the program each month is now near its lowest point, and there have been more than enough re-defaults after a long-term modification has successfully occurred to raise serious question.

This may be our last hearing on Treasury's foreclosure mitigation initiatives, so it is not just critical that we help the public fully understand HAMP's successes and failures, but we must also get the bottom of the bigger question: Is HAMP really the best the government can do to demonstrate a way forward?

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As a final matter, I intend to explore with all of our witnesses the issue of confidence. Given many of the mortgage servicers' poor track record of errors, including losing homeowners' submitted documents, how do we continue to look homeowners in the eye and ask them to continue to work with their servicers given the latest news pertaining to robo-signings? The servicers, at a minimum, now have an even high burden of proof in demonstrating that they are serious about their stated efforts to work with American families.

Congressional Oversight Panel

I am grateful to you for being here today Ms. Caldwell, and want to thank you and highlight not just your service at Treasury but throughout a long career of work for the underserved. I also very much look forward to speaking with our five other knowledgeable witnesses today.

The CHAIRMAN. Thank you.

I am pleased to welcome, genuinely pleased to welcome, our first witness, Phyllis Caldwell, the Chief of the Department of the Treasury's Office of Home Ownership Preservation. Ms. Caldwell, thank you for joining us and thank you for your truly great public service.

We'll ask you to keep your oral testimony to five minutes so that we'll have adequate time for questions. Your complete written statement will be printed in the official record of the hearing. Please proceed with your testimony.

STATEMENT OF PHYLLIS CALDWELL, CHIEF, HOME OWNERSHIP PRESERVATION OFFICE, U.S. DEPARTMENT OF THE TREASURY

Ms. CALDWELL. Chairman Kaufman and members of the Congressional Oversight Panel: Thank you for the opportunity to testify before you today on progress the Administration is making on helping responsible homeowners stay in their homes and stabilizing the housing market.

My opening remarks will focus on three things: one, the Administration's response to recently reported problems in the foreclosure process; two, efforts that Treasury is taking to ensure servicer compliance with HAMP guidelines; and three, a look at the impact the HAMP program has had to date.

There are three key points on the recently reported foreclosure process problems. First, we expect banks to follow the laws. Any bank that hasn't done so should be held accountable and should take prompt action to correct its mistakes. The Administration supports the efforts of the 50 state attorneys general in their investigations of foreclosure irregularities and reviews by the Department of Justice and other Federal agencies.

Second, we have been working closely with the broad range of Federal agencies and with the state attorneys general to get to the bottom of these problems as quickly as possible. Last Wednesday, Secretaries Donovan and Geithner met with representatives from ten different Federal and regulatory agencies for the latest in a series of meetings to coordinate reviews on this issue. These state and Federal agencies and regulators are requiring major banks to look at their servicing across the board, not just on this issue.

Third, there have been recent calls for a national moratorium and I'd like to address that. An important part of assuring longer term stability in the market is to enable properties to be resold to families who can afford to purchase them. President Obama has said that we can't stop every foreclosure and he's right. But we are making progress.

I'd like to now turn to the relationship of these foreclosure problems to the Administration's Making Home Affordable program, of which HAMP is a part. HAMP is intended to help eligible homeowners before they are in foreclosure. HAMP does not require a judicial process for homeowners to receive a modification, nor does it require affidavits to be filed with the courts. Therefore, HAMP is not directly affected by the robo-signers or false affidavits with state courts.

Under HAMP guidelines, participating servicers must evaluate all eligible homeowners for HAMP modification prior to referring them to foreclosure. Should a homeowner not qualify for HAMP or if the homeowner falls out of HAMP or cancels the modification, participating servicers are required to evaluate that homeowner for alternative foreclosure prevention programs, such as one of the servicers' proprietary modifications or even the Administration's short sale program.

If all of these efforts are unsuccessful, HAMP servicers may not proceed to foreclosure unless they have issued a written certification to their foreclosure attorney or trustee stating that all avoidable loss mitigation alternatives have been exhausted a non-foreclosure option could not be reached. Only after these steps are taken and the certification is delivered may the foreclosure process proceed.

To date, HAMP has achieved three critical goals. It has provided immediate relief to struggling homeowners; it has used taxpayer resources efficiently; and it has helped transform the way the entire mortgage servicing industry operates. HAMP established a universal affordability standard, a 31 percent debt to income ratio. More than 460,000 homeowners who are currently in permanent modifications have experienced a 36 percent median reduction in their mortgage payments, or more than $500 per month.

In the year following initiation of HAMP, home retention strategies changed dramatically. In the first quarter of 2009, nearly half of mortgage modifications increased borrowers' payments or left their payments unchanged. By the second quarter of 2010, 90 percent of mortgage modifications lowered payments for the borrower. This means homeowners are receiving better solutions.

HAMP uses taxpayer resources efficiently. HAMP's pay-for-success design utilizes a trial period to ensure that taxpayer-funded incentives are used only to support homeowners who are committed to staying in their homes and making monthly payments.

While the housing market is showing signs of stabilization, it still remains fragile and too many homeowners are suffering. The nature of this crisis has changed and we will continue to focus our efforts on stabilizing the housing market and preventing avoidable foreclosures.

Thank you and I look forward to taking your questions.

[The prepared statement of Ms. Caldwell follows:]

Written Testimony of Phyllis Caldwell,
Chief of Homeownership Preservation Office,
U.S. Department of the Treasury
Before the Congressional Oversight Panel
October 27, 2010

Chairman Kaufman, Members of the Panel, thank you for the opportunity to testify today regarding Treasury's efforts under the Emergency Economic Stabilization Act of 2008 (EESA) and the Troubled Asset Relief Program (TARP) to address the housing crisis.

We recently passed the two year anniversary of TARP, and the end of Treasury's ability to make new commitments of TARP funds. In the context of that anniversary, I would like to discuss the development of the Making Home Affordable (MHA) program and the Administration's other TARP-funded housing programs, and how Treasury's response to the housing crisis has developed as the nature of the housing problems has changed over time. It is also important to analyze the progress of the MHA program and the Administration's efforts at stemming the tide of foreclosures in a broader economic context. In addition, early data indicate that MHA's Home Affordable Modification Program (HAMP) permanent modifications are performing well over time, with lower delinquency rates than those reported by the industry at large.

I also would like to take the opportunity to address the recent reports of faulty documentation and potentially fraudulent affidavits within the foreclosure process, and its relationship to MHA in particular. The reported behavior of these mortgage servicers is unacceptable. Servicers must comply with the law and Treasury is working with other Federal agencies to ensure that servicers improve their foreclosure processes. Because MHA and HAMP intended to keep homeowners out of foreclosure, and are primarily based around the concept of modifying a loan to keep a borrower in their home, it is not directly affected by "robo-signers" or false affidavits. MHA has strong compliance mechanisms in place to ensure that servicers follow our program's guidelines. I will discuss these recent developments, and the Administration's response, in more detail below.

The Development and Expansion of MHA

The impact of MHA should not be measured solely by the number of borrowers who have received modifications, but also by how the program has helped reduce the number of foreclosures and helped transform the way the mortgage industry views the modification of mortgage loans. Just over two years ago, distressed borrowers had few options to stay in their homes – either a "work out" plan that increased payments over time, or foreclosure. Today because of the standards that MHA set, distressed borrowers have more options to avoid foreclosures, including modifications under MHA's first lien modification component, the Home Affordable Modification Program (HAMP), proprietary modifications built on the HAMP model, and short sales. To date, more than 1.3 million borrowers have started HAMP trials. While many of these borrowers did not convert to permanent modifications, they were afforded much needed breathing room. In addition, the majority of borrowers who did not receive permanent HAMP modifications moved into alternative modifications or became current through other means.

It is important to consider how the housing crisis has changed rapidly over time. When EESA was enacted, the housing collapse was primarily considered to have been caused by a collapse in the subprime lending market. Many of these subprime loans were overleveraged and had adjustable-rates that were re-setting to higher fixed monthly payments, which triggered widespread defaults. But as the recession deepened, unemployment surged and house prices declined, often dramatically. Today, the primary reason the housing crisis continues is due to (1)

borrowers becoming unemployed (or under-employed) and (2) the severity with which borrowers find themselves underwater on their homes.

Over the past several months, we have enhanced MHA to address these changes to the housing crisis. Treasury has launched enhancements to MHA that incentivize principal reduction, streamline foreclosure alternatives, provide additional time for unemployed borrowers to stay in their homes while searching for other employment, and simultaneously modify second liens with the first. We will begin to see the full impact of these enhancements early next year, but it is safe to say that MHA will continue to be dynamic in reaching distressed borrowers, and will continue to set standards for the industry in helping homeowners stay in their homes or otherwise avoid foreclosures.

The Initial Response to the Housing Crisis

The Obama Administration took office in the midst of the most serious housing crisis in decades. Home values had fallen by nearly one-third and were expected to fall by another five percent by the end of 2009. Stresses in the financial system had reduced the supply of mortgage credit, limiting the ability of Americans to buy homes. Millions of responsible American families who were making their monthly payments – despite in many cases having lost jobs or income – saw their property values fall, and were unable to sell or refinance at lower mortgage rates. The combination of falling home prices and economic contraction dramatically increased the financial strains on many responsible homeowners.

There was no consensus among loan servicers about how to respond to responsible borrowers who were willing to continue making payments but in need of some mortgage assistance. There were no accepted timeframes for servicer decisions. Servicers were paralyzed by the need to seek approval from investors on an individual, mortgage-by-mortgage basis. And, perhaps most critically, there was no affordability standard for monthly mortgage payments. As a result of the absence of an accepted affordability standard and a systematic process for evaluating modification requests, the solutions offered by servicers often achieved nothing other than adding unpaid interest and fees to the mortgage balance, resulting in higher – not lower – payments for homeowners. Millions of responsible American families simply lost their homes.

During its first month in office, the Obama Administration took aggressive action to address the housing crisis. In February 2009, President Obama announced the Homeowner Affordability and Stability Plan. As part of this plan and through other housing initiatives, the Administration took the following actions to strengthen the housing market:

- Launched the HAMP, which would permanently reduce mortgage payments to affordable levels for qualifying borrowers;
- Provided strong support to Fannie Mae and Freddie Mac to ensure continued access to affordable mortgage credit across the market;
- Purchased over $200 billion in agency mortgage backed securities as part of the combined purchases with the Federal Reserve of more than $1.4 trillion in agency mortgage backed securities and agency debt securities, which helped keep mortgage rates at historic lows, allowing homeowners to access credit to purchase new homes and refinance into more affordable monthly payments;

- Through the Federal Housing Administration (FHA), provided liquidity for housing purchases at a time when private lending had declined, playing an important counter-cyclical role;
- Supported expanding the limits for loans guaranteed by Fannie Mae, Freddie Mac, and FHA from previous limits up to $625,500 per loan to $729,750;
- Expanded refinancing options for Fannie Mae and Freddie Mac loans, particularly for borrowers with negative equity, to allow more Americans to refinance;
- Supported a tax credit for first time homebuyers, which helped 2.5 million American families purchase homes; and
- Through the American Recovery and Reinvestment Act of 2009 (ARRA), provided more than $5 billion in support for affordable rental housing through low income housing tax credit programs and $2 billion in support for a neighborhood stabilization program (bringing the total neighborhood stabilization program funding to close to $7 billion when funding from the Dodd-Frank Financial Reform Act and the Housing and Economic Recovery Act of 2008 is included) to restore neighborhoods suffering concentrated foreclosures.

These efforts are part of a comprehensive approach designed to stabilize the housing market. As Mark Zandi (a former economic adviser for Senator John McCain's 2008 presidential campaign) and Alan S. Blinder (a former economic adviser for President Clinton) noted in a paper released in July 2010, the government's financial and fiscal policies tend to reinforce each other, such that the combined effect exceeds the sum of the parts. For example, Zandi and Blinder observed that providing housing tax credits as part of the stimulus boosted housing demand and therefore house prices - foreclosures decreased, and the financial system suffered smaller losses, which, in turn, enhanced the effectiveness of the government's efforts to stabilize the financial system.

Design of MHA

As part of the Homeowner Affordability and Stability Plan, under the authority granted in EESA, the Treasury Department began work on a program to improve the affordability of mortgages for responsible homeowners, consistent with the mandate of EESA to promote financial stability while protecting taxpayers. Developing the program posed very difficult and challenging policy tradeoffs—how to make meaningful interventions that would yield a high probability of participation and broadly support borrower success while minimizing the cost to the government, moral hazard, adverse selection, and operational and financial risks and complexity.

In addition, legal and other constraints required Treasury to develop a voluntary program that would support servicers' efforts to modify mortgages. EESA authorized certain types of programs to assist homeowners but constrained Treasury's ability to set up a mandatory modification program. Consequently, these legal constraints forced Treasury to seek the voluntary cooperation of mortgage servicers and investors.

Designing a program to improve the affordability of mortgages for responsible homeowners was difficult. Loan servicers were simply not equipped to manage the magnitude of the crisis before them. They did not have the systems, staffing, operational capacity or incentives to engage with homeowners on a large scale and offer meaningful relief from unaffordable mortgages. Moreover, the expansion of private securitizations during the housing boom left servicers in a complicated legal situation; contractual language designed during the heady days

of the bubble bound them in general terms to maximize investor returns, but little specific guidance existed on how that might be accomplished if house prices were to fall in conjunction with a rapidly rising number of defaults.

The Administration challenged itself to develop a program that would protect taxpayers at the same time that it broadly offered responsible, but struggling, homeowners the opportunity to remain in their homes at more affordable payment levels. The Administration determined that in order to achieve these objectives simultaneously, it was critical, with respect to the HAMP program, to leave the financial risk of modification re-default with the investors. Ultimately, the program should offer the opportunity to remain in their homes to many borrowers, but the taxpayer will only pay to the extent the distressed borrower is assisted by a permanent modification that remains in effect.

It is important to emphasize that HAMP was not intended to help all borrowers, but was intended to help an important segment of borrowers – specifically, owner-occupants whose mortgages were originated prior to 2009 with conforming loan balances ($729,750 or less), and who were currently at risk of foreclosure or who would be at risk prior to the end of 2012. HAMP was built around four core principles, designed to help the large segment of at-risk homeowners for whom foreclosure is avoidable and who want to stay in their homes.

First, the program focused on affordability — every modification under the program would be required to lower the borrower's monthly mortgage payment to 31 percent of the borrower's monthly gross income, a level estimated to provide reasonable assurance that the modification would be sustainable. The borrower's modified monthly payment would remain in place for five years, which Treasury expected would provide sufficient time for the housing market and the financial system to recover.

Second, HAMP would protect the taxpayer by employing an innovative pay-for-success structure and requiring the investor in the mortgage to retain the risk of future re-default. This structure aligned the interests of borrowers, taxpayers, investors and servicers and encouraged loan modifications that would be both affordable for borrowers over the long term and cost-effective for taxpayers.

Third, any servicer that signed up for the program would be required to evaluate every eligible loan using a standard net present value (NPV) test. If the test was positive, the servicer would be required to modify the loan.

Fourth, unemployed borrowers would be allowed to participate in the program. Unemployed borrowers who had nine months or more of unemployment insurance remaining would be eligible to include it in their income for consideration in the NPV calculation. Unemployed borrowers would also be allowed to include other sources of passive income like rental income and income from an employed spouse. In addition, in response to the growing problem of unemployment and its impact on borrower incomes, in May Treasury launched UP, the forbearance program for unemployed borrowers. UP requires servicers to provide a minimum of 3 month forbearance to unemployed borrowers.

The basic HAMP terms were as follows: a participating HAMP servicer applies a series of modification steps to reduce the homeowner's monthly mortgage payment to 31 percent of the homeowner's gross (pre-tax) income, in the following order: rate reduction to as low as two percent; term extension up to 40 years; and principal deferral (or forbearance, at the servicer's option). The modified interest rate is fixed for a minimum of five years. Beginning in year six, the rate may increase no more than one percentage point per year until it reaches the Freddie Mac Primary Mortgage Market Survey rate (essentially the market interest rate) at the time the permanent modification agreement was prepared.

Before a mortgage is permanently modified, the homeowner must submit the necessary documentation and make the new, reduced monthly mortgage payment on time and in full during a trial period of three months to demonstrate that the modified monthly payment is sustainable. Homeowners who make payments on permanently modified loans on time accrue an incentive of $1,000 per year to reduce the amount of principal they owe up to a maximum of $5,000.

Any modification offer will provide a binding reduction in payments for borrowers who continue to meet the full terms of the modification, whether in the trial phase or after having converted to a permanent modification.

Measuring Success

The Administration originally projected that the new program would offer help to three to four million families through the end of 2012, expecting most of these families to act on the offer of help and to receive a permanent modification. When a trial modification did not convert to a permanent solution, Treasury developed other strategies to transition borrowers out of homeownership in the manner least disruptive to them or their communities.

Early Success and Challenges

Nearly 1.6 million borrowers were in contact with their servicers and were approved for and extended a modification offer, with more than 1.3 million of these approved offers resulting in modification trials. The run rate of eligible borrowers approved for and starting modifications was at or above the target rate set internally by Treasury of 20,000 – 25,000 per week. To date, borrowers who started HAMP permanent modifications had their payments reduced by a median amount of more than $500 per month.

Conversion challenges

While the overall number of borrowers in permanent modifications rose substantially, the conversion rate to permanent modifications was below anticipated levels. When the program launched in April 2009, servicers were explicitly provided flexibility to approve borrowers for trial modifications without documentation of income in order to reach more borrowers more quickly. They were required to verify the income prior to granting a permanent modification. In the early fall and over the coming months, as the first large numbers of borrowers reached a trial length that would allow them to become eligible for conversion to a permanent modification, servicers experienced substantial difficulty in collecting and processing applications and making decisions based on the limited documentation provided.

Steps Taken to Ensure Greater Conversions

On January 28, 2010, Treasury issued new guidance requiring servicers to begin verifying income upfront no later than June 1, 2010. This was done in direct response to the challenges of collecting documents during the trial period, and to help better ensure that more borrowers who started modifications were able to convert to permanent status.

In the spring of 2010, the move to collect documents upfront to achieve better overall conversions reduced the pace of modification offers materially; however, Treasury expects that over time, requiring documentation up front will substantially improve the success rate of trial modifications and speed determinations.

Cancelled Borrowers still have a Number of Foreclosure Alternatives

A cancelled trial modification does not mean that the program has failed a homeowner or that the borrower will inevitably face foreclosure: HAMP explicitly requires servicers to consider these borrowers for other foreclosure prevention options including proprietary modifications, short sales or deeds-in-lieu of foreclosure that also prevent a foreclosure sale. Based on survey data from the eight largest servicers, it is estimated that a majority of borrowers who are turned down for a trial modification are offered a foreclosure alternative – usually a modification proprietary to the servicer, or a short sale – rather than proceeding directly to foreclosure.

HAMP Permanent Modifications Have Been Performing Well

The overall sustainability of HAMP permanent modifications appears promising. Early data indicate that HAMP permanent modifications are performing well over time, with lower delinquency rates than those reported by the industry at large. At nine months, almost 90 percent of homeowners remain in their permanent HAMP modification and less than 16 percent of permanent modifications are 60+ days delinquent. And while it is still early, so far, there does not appear to be a correlation between back-end debt-to-income ratio (DTI) and the performance of borrowers with permanent modifications. Performance is consistent across all ratios of back-end DTI, including very high end DTI homeowners. In addition, based on early data, there does not appear to be a correlation between how underwater borrowers were on their loans before modification (in other words, their mark-to-market loan-to-value ratio before the modification), and the performance of those borrowers on their permanent modifications. Performance appears consistent across all loan-to-value ratios.

There are a range of important measures of success; keeping in mind the measures mentioned above, as well as others like the effect of HAMP on neighborhood and housing market stabilization, Treasury continues to monitor progress and push for improved results. HAMP has had a substantial impact on avoiding foreclosures so far (under HAMP's guidelines, servicers were always prohibited foreclosure sales while borrowers were being evaluated for HAMP), and very few borrowers that have qualified for HAMP (including the ability to make a reasonable payment on a modified loan as measured by income sufficient to pass an NPV model) have gone through foreclosure sale to date. Recently, Treasury strengthened homeowner protections by (a) requiring servicers to evaluate delinquent borrowers for HAMP before initiating a foreclosure sale, and (b) halting foreclosure proceedings for those borrowers who are already in HAMP trial periods.

MHA has been a Catalyst – Setting the Benchmark for Sustainable Modifications

MHA has transformed the way the mortgage servicing industry treats borrowers in distress. Because of MHA, servicers have developed constructive private-sector options. Where there was once no consensus plan among loan servicers about how to respond to borrowers in need of mortgage assistance, MHA has established a universal affordability standard, a 31 percent debt-to-income ratio. This has enhanced servicers' ability to reduce mortgage payments to sustainable levels while simultaneously providing investors with a justification for modifications.

Taking into account MHA's effect on standardizing and expanding proprietary modifications in the mortgage industry, the number of mortgage modifications has been double the number of foreclosure completions: More than 3.35 million modifications were arranged from April 2009 through the end of July 2010. This includes more than 1.3 million HAMP trial modifications started, more than 510,000 Federal Housing Administration (FHA) loss mitigation and early delinquency interventions, and nearly 1.6 million private sector modifications performed by members of the HOPE Now alliance. Given the complexity of the mortgage modification process and the number

of government and non-government modification programs available, homeowners often receive more than one modification arrangement. Therefore it is difficult to determine the exact number of homeowners assisted by multiple programs.

On the measure of neighborhood and housing market stabilization, the substantial number of foreclosure sales avoided has contributed to a material improvement in market expectations for house prices and to many successive months of stability in home prices in much of the country. But, as discussed, efforts must continue to capitalize on early encouraging signs and overcome remaining challenges. There are still a number of risk factors that will challenge the stability of the housing markets, including the potential for mortgage rates to rise, continuing elevated levels of delinquency exacerbated by unemployment and the large number of underwater borrowers, and the associated potential for a substantial increase in the number of foreclosure starts.

Further, it is important to keep in mind that MHA is only one of many Administration housing efforts targeting these challenges: the Administration has also provided substantial support for the housing markets through investment in Fannie Mae and Freddie Mac to help keep mortgage rates affordable; purchase of agency mortgage-backed securities; refinancing opportunities that have allowed more than four million borrowers to refinance since the launch of the MHA; and an initiative to provide support and financing to state and local Housing Finance Agencies. These Housing Finance Agencies provide, in turn, tens of thousands of affordable mortgages to first time homebuyers and help develop tens of thousands of affordable rental units for working families, including those displaced by the housing crisis and foreclosures.

Responding to a Changing Housing Crisis

MHA was designed to be a versatile program. As the mortgage crisis evolved, Treasury enhanced MHA and developed new programs designed to meet the changing landscape. Treasury expanded MHA to include a second lien modification program, a foreclosure alternatives program that promoted short sales and deeds-in-lieu of foreclosures, and an unemployment forbearance program. Treasury expanded HAMP to include FHA and Rural Development mortgage loans through the FHA-HAMP and RD-HAMP program, and also introduced a principal reduction option. Finally, Treasury introduced a program to allow the hardest-hit states to tailor housing assistance to their areas, and worked with FHA to introduce an option for homeowners with high negative equity to refinance into a new FHA loan if their lender agrees to reduce principal on the original loan by at least 10%.

Second Lien Modification Program

A few months after launching HAMP, Treasury rolled out its first major expansion of the program, the Second Lien Modification Program (referred to as 2MP). Under 2MP, when a borrower's first lien is modified under HAMP and the servicer of the second lien is a 2MP participant, that servicer must offer to modify the borrower's second lien according to a defined protocol, which provides for a lump sum payment from Treasury in exchange for full extinguishment of the second lien, or a reduced lump sum payment from Treasury in exchange for a partial extinguishment and modification of the borrower's remaining second lien. Although 2MP was initially met with reluctance from servicers and investors who did not want to recognize losses on their second lien portfolios, as of October 3, 2010, Treasury has signed up seventeen2MP servicers, which includes the four largest mortgage servicers, who in aggregate service approximately 60 percent of outstanding second liens.

Home Affordable Foreclosure Alternatives Program

Any modification program seeking to avoid preventable foreclosures has limits, HAMP included. HAMP does not, nor was it ever intended to, address every delinquent loan. Borrowers not qualifying for HAMP may benefit from an alternative program that helps the borrower transition to more affordable housing and avoid the substantial costs of a foreclosure. On April 5, 2010, the Home Affordable Foreclosure Alternatives (HAFA) Program became effective, pursuant to which Treasury provides incentives for short sales and deeds-in-lieu of foreclosure for circumstances in which borrowers are unable or unwilling to complete the HAMP modification process. Borrowers are eligible for a relocation assistance payment, and servicers receive an incentive for completing a short sale or deed-in-lieu of foreclosure. In addition, investors are paid additional incentives for allowing some short sale proceeds to be distributed to subordinate lien holders.

Unemployment Program

In March 2010, the Obama Administration announced enhancements to HAMP aimed at the unemployment problems by requiring servicers to provide temporary mortgage assistance to many unemployed homeowners. The Unemployment Program (UP) requires servicers to grant qualified unemployed borrowers a forbearance period during which their mortgage payments are temporarily reduced for a minimum of three months, and up to six months for some borrowers, while they look for a new job. Servicers are prohibited from initiating a foreclosure action or conducting a foreclosure sale while the borrower is being evaluated for UP, after a foreclosure plan notice is mailed, during the UP forbearance or extension, and while the borrower is being evaluated for or participating in HAMP or HAFA following the UP forbearance period.

Principal Reduction Alternative

The Administration announced further enhancements to HAMP in March 2010 by encouraging servicers to write down mortgage debt as part of a HAMP modification (the Principal Reduction Alternative, or PRA). Under PRA, servicers are required to evaluate the benefit of principal reduction and are encouraged to offer principal reduction whenever the NPV result of a HAMP modification using PRA is greater than the NPV result without considering principal reduction. The principal reduction and the incentives based on the dollar value of the principal reduced will be earned by the borrower and investor based on a pay-for-success structure. Under the contract with each servicer, Treasury cannot compel a servicer to select PRA over the standard HAMP modification even if the NPV of PRA is greater than the NPV of regular HAMP.

FHA Short Refinance

Also in March 2010, the Administration announced adjustments to existing FHA programs that permit lenders to provide additional refinancing options to homeowners who owe more than their homes are worth because of large declines in home prices in their local markets. This program, known as the FHA Short Refinance option, will provide more opportunities for qualifying mortgage loans to be restructured and refinanced into FHA-insured loans.

In order to qualify for this program, a homeowner must be current on their existing first lien mortgage; the homeowner must occupy the home as a primary residence and have a qualifying credit score; the mortgage owner must reduce the amount owed on the original loan by at least 10 percent; the new FHA loan must have a balance no more than 97.75% of the current value of the home; and total mortgage debt for the borrower after the refinancing, including both the first lien mortgage and any other junior liens, cannot be greater than 115% of the

current value of the home – giving homeowners a path to regain equity in their homes and affordable monthly payments. TARP funds will be made available up to $11 billion in the aggregate to provide additional coverage to lenders for a share of potential losses on these loans and to provide incentives to support the write-downs of second liens.

HFA Hardest-Hit Fund

On February 19, 2010, the Administration announced the Housing Finance Agency Innovation Fund for the Hardest Hit Housing Markets (HFA Hardest Hit Fund) for state housing finance agencies (known as HFAs) in the nation's hardest-hit housing markets to design innovative, locally targeted foreclosure prevention programs. In total, $7.6 billion has been allocated to 18 states (Alabama, Arizona, California, Florida, Georgia, Illinois, Indiana, Kentucky, Michigan, Mississippi, Nevada, New Jersey, North Carolina, Ohio, Oregon, Rhode Island, South Carolina, and Tennessee) and the District of Columbia in four rounds of funding under the HFA Hardest Hit Fund.

Allocations under the HFA Hardest Hit Fund were made using several different metrics. Some of the funds were allocated to states that have suffered average home price drops of more than 20% from their peak, while other funds were allocated to states with the highest concentration of their populations living in counties with unemployment rates greater than 12 percent or unemployment rates that were at or above the national average. In addition, some funds were allocated to all the states and jurisdictions already participating in the HFA Hardest Hit Fund to expand the reach of their programs to help more struggling homeowners. The applicable HFAs designed the state programs themselves, tailoring the housing assistance to their local needs, although $2 billion of the funding is required to be used by states for targeted unemployment programs that provide temporary assistance to eligible homeowners to help them pay their mortgages while they seek re-employment or additional employment or undertake job training. Treasury also required that all of the programs comply with the requirements of EESA, which include that they must be designed to prevent avoidable foreclosures. All of the funded program designs are posted online at http://www.FinancialStability.gov/roadtostability/hardesthitfund.html.

Accomplishments

To date, HAMP has achieved three critical goals: it has provided immediate relief to many struggling homeowners; it has used taxpayer resources efficiently; and it has helped transform the way the entire mortgage servicing industry operates.

HAMP established a universal affordability standard: a 31 percent debt-to-income ratio, which dramatically enhanced servicers' ability to reduce mortgage payments to sustainable levels while simultaneously providing the necessary justification to investors for the size and type of modification. Eighteen months into the program, HAMP has helped more than 1.3 million homeowners by reducing their monthly mortgage payments to more affordable levels. This includes more than 460,000 homeowners who are currently in permanent modifications. These homeowners have experienced a 36 percent median reduction in their mortgage payments—more than $500 per month—amounting to a total, program-wide savings of nearly $3.2 billion for homeowners. In short, hundreds of thousands of American families have been able to avoid foreclosure and keep their homes because of HAMP.

In the year following initiation of HAMP, home retention strategies changed dramatically. Wells Fargo Co-President Michael Heid testified that "HAMP serve[d] as a catalyst...a mobilizing event to push servicers to take broader actions at a more rapid pace" and noted that "it pushed other investors, including Fannie and Freddie, to move in a direction of programmatic home loan modifications." Bank of America Home Loan President Barbara

DeSoer noted that "one of the significant advantages of HAMP has been the establishment of standards. And in particular, the debt-to-income ratio that was used, even on our proprietary programs prior to HAMP, was higher than 31 percent." In the first quarter of 2009, nearly half of mortgage modifications increased borrowers' monthly payments or left their payments unchanged. By the second quarter of 2010, 90 percent of mortgage modifications lowered payments for the borrower. This change means borrowers are receiving better solutions. Modifications with payment reductions perform materially better than modifications that increase payments or leave them unchanged.

Moreover, even holding the percentage payment reduction constant, the quality of modifications made by servicers appears to have improved since 2008. For modifications made in 2008, 15.8 percent of modifications that received a 20 percent payment reduction were 60 days or more delinquent three months into the modification. For the 2010 vintage, that delinquency rate has fallen almost in half, to 8.2 percent. The OCC's Mortgage Metrics Report from 2010:Q2 attributes the improvement in mortgage performance to "servicer emphasis on repayment sustainability and the borrower's ability to repay the debt."

Early indications suggest that the re-default rate for permanent HAMP modifications is significantly lower than for historical private-sector modifications—a result of the program's focus on properly aligning incentives and achieving greater affordability. For HAMP modifications made in the fourth quarter of 2009, OCC records show that 7.9 percent of loans were delinquent three months into the modification and just 10.8 percent were delinquent six months into the modification. The comparable delinquency rates for non-HAMP modifications made in the same quarter were 12.1 percent and 22.4 percent, respectively. For modifications made in the first quarter of 2010, the delinquency rates for HAMP and non-HAMP modifications are similar – 10.5 percent and 11.6 percent delinquent at three months, respectively. Convergence between the HAMP and non-HAMP re-default rates going forward may suggest that the industry is adopting the HAMP modification standard.

Borrowers who do not ultimately qualify for HAMP modifications often receive alternative forms of assistance. Approximately one-half of homeowners who apply for HAMP modifications but do not qualify have received some form of private-sector modification. Less than ten percent have lost their homes through foreclosure. Industry representatives testifying at foreclosure prevention hearings before the Committee on Oversight and Government Reform in the United States House of Representatives on June 24, 2010 indicated that many of their private-sector modifications are intended to assist borrowers who are not eligible for HAMP.

HAMP uses taxpayer resources efficiently. HAMP's "pay-for-success" design utilizes a trial period to ensure that taxpayer-funded incentives are used only to support borrowers who are committed to staying in their homes and making monthly payments, and the investor retains the risk of the borrower re-defaulting into foreclosure. No taxpayer funds are paid to a servicer or an investor until a borrower has made three modified mortgage payments on time and in full. The majority of payments are made over a five-year period only if the borrower continues to fulfill this responsibility. These safeguards ensure that spending is limited to high-quality modifications.

The Administration originally projected that HAMP would offer help to three to four million families through the end of 2012, expecting most of these families to act on the offer of help and to receive a permanent modification. From one perspective, counting borrowers who get a HAMP permanent modification or an FHA Short Refinance loan is over-inclusive, because some of the families will re-default and end up in foreclosure in any event, although these programs will increase the odds that they can prevent foreclosure and receive valuable temporary relief (up to $6,000 per year) as long as they remain current.

However from another perspective, the "count" of borrowers who get a HAMP permanent modification is also under-inclusive, because measures to reduce foreclosures help to stabilize housing markets and avoid community-wide costs of foreclosure. The measure is also under-inclusive because every person who is in a temporary modification is getting a significant benefit – the family has several months to remain in the home with a reduced payment to try to remedy the situation and avoid foreclosure. It is under-inclusive because homeowners who are able to take advantage of HAFA will receive significant help transitioning more quickly and less traumatically to new housing they can afford than they would if they suffered foreclosure. Lastly, it is under-inclusive because many of the unemployed homeowners who receive a temporary forbearance through UP are likely to become re-employed and resume mortgage payments. This is especially important in the case of the FHA Short Refinance option, which will encourage lenders and borrowers to work together where appropriate to restructure debts and provide more opportunities for qualifying mortgage loans to be refinanced into a FHA mortgage at today's low rates, and the HFA Hardest-Hit Fund, which helps states provide targeted assistance to combat deteriorating conditions in local markets.

Finally, the projection of three to four million borrowers does not include all of the new mortgages provided to families at reasonable cost because of FHA and government interventions with Fannie Mae and Freddie Mac. In many cases, these mortgages have provided financing to help families purchase foreclosed homes and become homeowners themselves, often for the first time since housing has become so much more affordable as a result of the crisis.

Transparency and Accountability

To protect taxpayers and ensure that every TARP dollar is directed toward promoting financial stability, Treasury established rigorous transparency and accountability measures for all of its programs, including MHA and the other housing programs. In addition, every borrower is entitled to a clear explanation if he or she is determined to be ineligible for a HAMP modification. Treasury requires servicers to report the reason for modification denials in writing to Treasury.

In order to improve transparency of the NPV model, which is a key component of the eligibility test for HAMP, Treasury increased public access to the NPV white paper, which explains the methodology used in the NPV model. To ensure accuracy and reliability, Freddie Mac, Treasury's compliance agent, conducts periodic audits of servicers' implementation of the model. If servicers' models do not meet Treasury's NPV specifications, Freddie Mac will require the servicers to discontinue use of their own implementation of the model and revert back to the NPV application available from Treasury through the MHA Servicer Portal. As required by the Dodd-Frank Wall Street Reform and Consumer Protection Act, Treasury is preparing to establish a web portal that borrowers can access to run a NPV analysis using input data regarding their own mortgages, and to provide to borrowers who are turned down for a HAMP modification the input data used in evaluating the application.

Servicers are subject to periodic, on-site compliance reviews performed by Treasury's compliance agent, Making Home Affordable-Compliance (MHA-C), which is a separate, independent division of Freddie Mac. MHA-C ensures that servicers satisfy their obligations under HAMP requirements. Treasury works closely with MHA-C to design and refine the compliance program and conducts quality assessments of the activities performed by MHA-C. Following these reviews, MHA-C provides Treasury with assessments of each servicer's compliance with HAMP requirements. If appropriate, Treasury may implement remedies for non-compliance. These remedies may include requiring additional servicer oversight, or withholding or reducing incentive payments to servicers, or requiring repayments of prior incentive payments made to servicers with respect to affected loans.

Loss Mitigation versus Foreclosure Activities

I would like to take the opportunity to address the recent reports of faulty documentation and potentially fraudulent affidavits within the foreclosure process. Representatives from Ally Financial, JPMorgan Chase and Bank of America, among other servicers, have stated that they may have filed faulty affidavits in foreclosure cases in the 23 states that have judicial foreclosure proceedings. Based on these statements, these servicers announced voluntary efforts to correct and re-file flawed documents before proceeding with foreclosures.

The reported behavior of these mortgage servicers is unacceptable. Servicers must comply with all applicable laws and regulations and be held accountable if they do not. We are working with our partner agencies to ensure that servicers improve their foreclosure processes.

MHA and Foreclosures

Although the issues around the affidavits and compliance with MHA guidelines are separate issues, I assure you that Treasury, with its federal partners, is monitoring this situation closely and is working to ensure that servicers are adhering to MHA guidelines. The MHA programs are intended to help eligible homeowners avoid foreclosure. Neither MHA nor HAMP requires a judicial process for a homeowner to receive a modification, nor does it require affidavits to be filed with courts. Therefore MHA is not directly affected by "robo-signers" or false affidavits filed with state courts.

However, while these two issues are unrelated, Treasury has stepped up compliance efforts around servicer adherence to HAMP loss mitigation guidelines. These guidelines require servicers to certify to their foreclosure lawyers that all loss mitigation options have been exhausted. This certification is required before servicers can proceed to foreclosure sale. The goal of our compliance program is to ensure all eligible homeowners who qualify for the program receive modifications or other alternatives to a foreclosure.

Under MHA guidelines, participating servicers must evaluate all eligible homeowners for a HAMP modification before referring them to foreclosure. For those homeowners that were already in foreclosure proceedings, Treasury guidelines require servicers to stop the foreclosure proceedings while the homeowners are being evaluated for HAMP. Should a homeowner not qualify for HAMP (or if the homeowner fails or cancels the modification), participating servicers are required to evaluate that homeowner for alternative loss mitigation modifications, such as HAFA, or one of the servicer's own modification programs. If a homeowner proves ineligible for an alternative modification, servicers are required to evaluate that homeowner for a short sale or deed-in-lieu of foreclosure.

If all of these efforts are unsuccessful, participating servicers may not proceed to foreclosure unless they have issued a written certification to their foreclosure attorney or trustee stating that "all available loss mitigation alternatives have been exhausted and a non-foreclosure option could not be reached." Only after these steps are taken and the certification delivered, may the foreclosure process proceed.

On October 6th, Treasury issued guidance to servicers reiterating the fact that they are to comply with all applicable federal and state laws, and are also prohibited from conducting a foreclosure sale until the HAMP-required written certifications to foreclosure counsel or the trustees have been issued.

The compliance agent for MHA, Making Home Affordable — Compliance (MHA-C), regularly reviews participating servicers' operations to ensure that they are adhering to program guidelines, including the HAMP

pre-foreclosure certification requirement. Treasury has recently instructed MHA-C to review the ten largest servicers' internal policies and procedures for completing the pre-foreclosure certifications.

If MHA-C finds incidents of non-compliance during a servicer review, corrective action options include requiring servicers to re-evaluate homeowners, and requiring that foreclosure proceedings be suspended while borrowers are re-evaluated. MHA-C also monitors servicers for compliance with these requirements through the "Second Look" process, which audits loans that were foreclosed without the benefit of a modification. Finally, if instances of systemic non-compliance remain un-corrected, Treasury does have the ability to claw back or withhold incentive payments.

Federal and State Response to the Foreclosure Crisis

Because foreclosure rules and requirements are determined under state law, the attorneys general for all 50 states and the District of Columbia have launched a joint investigation into alleged mishandling of documentation regarding foreclosures. In addition, some of the state attorneys general have launched investigations into other participants in the foreclosure process, including law firms, third party contractors, and process servers. We strongly support the state attorneys general with these investigations.

Treasury is working with other federal agencies and regulators to fully investigate the issues that have been raised, including taking the following actions:

- The FHA has been reviewing servicers for compliance with loss mitigation requirements. These reviews are being broadened to include a larger range of processes, focusing in particular on servicer procedures during the final stages of the foreclosure process.
- The Financial Fraud Enforcement Task Force (FFETF), led by the Department of Justice and with the participation of Treasury's Financial Crimes Enforcement Network (FinCEN), has brought together more than 20 federal agencies, 94 U.S. Attorney's offices and dozens of state and local partners to share information about foreclosure and servicing practices. The FFETF's collaborative efforts are ensuring that the full resources of the federal and state regulatory and enforcement authorities are being brought to bear in addressing this issue. In addition, the FFETF has also been coordinating with state attorneys general in their investigations.
- The United States Department of Justice is also working with regulators to investigate and, if material violations of the law are discovered, litigate against servicers, their law firms, and third-party providers regarding their foreclosure and bankruptcy processes.
- The Federal Housing Finance Agency (FHFA) directed Fannie Mae and Freddie Mac to remind servicers of their contractual and legal responsibilities in foreclosure processing. On October 13, FHFA directed Fannie Mae and Freddie Mac to implement a policy framework for dealing with possible foreclosure process deficiencies that requires servicers to review their foreclosure processes and fix any processing problems they identify. The FHFA policy framework includes specific steps servicers should take to remedy mistakes in foreclosure affidavits so that the information contained in the affidavits is correct and that the affidavits are completed in compliance with applicable law.
- Treasury's Office of the Comptroller of the Currency (OCC) directed all large national bank servicers on September 29 to review their foreclosure management processes, including file review, affidavit processing and signatures, to ensure that the processes are fully compliant with all applicable state laws.

- The OCC and the Federal Reserve System are jointly examining foreclosure and securitization practices at the nation's largest servicers. The examinations will include intensive review of the firms' policies, procedures, and internal controls related to loan modifications, foreclosures and securitizations seeking to determine whether systematic weaknesses are leading to improper foreclosures. The reviews will also evaluate controls over the selection and management of third-party service providers.
- In coordination with the work of the other agencies, the Office of Thrift Supervision (OTS) is reviewing the mortgage related policies, foreclosure processes and staffing levels of the largest servicers it supervises. The OTS issued correspondence on October 8 to all savings associations involved in servicing residential mortgages requiring the immediate review of their actual practices associated with the execution of documents related to the foreclosure process.
- The Federal Deposit Insurance Corporation (FDIC) is participating in the reviews by the OCC, the Federal Reserve System, and the OTS of the foreclosure and securitization practices of the largest mortgage servicers in its role as back-up supervisor. The FDIC also is verifying that the servicers it supervises do not exhibit the problems that others have identified as well as reviewing the processes used by servicers of loans subject to loss share agreements and other loans from receiverships of failed banks. These regulators are also evaluating foreclosure and securitization practices in electronic registration systems.
- The Federal Trade Commission (FTC) is monitoring servicers under existing public orders to confirm proper servicing and foreclosure processes, is conducting reviews in line with past servicing abuses and monitoring the market closely for any fraud or foreclosure scams.
- The Securities and Exchange Commission (SEC) has issued proposed rules that would provide greater transparency and disclosures in the securitization market and provide investors with additional tools to evaluate actions in the securitization market.

Administration Objectives

The Administration has three primary goals in addressing these issues which have been raised: raising accountability, sustainability for borrowers and clarity for the housing market. First, we seek to hold lenders and servicers accountable while maintaining the stability and functionality of one of our economy's most fundamental economic markets. This must be done while recognizing the differences between different states and different types of lenders, who have varying practices and standards and legal requirements.

Second, the Administration seeks to help struggling borrowers into sustainable housing situations. To that end, as described above, we have created a series of programs designed to benefit responsible homeowners. These include modification programs for homeowners who are facing financial hardship or have lost their jobs, refinancing programs for underwater homeowners, and incentives to promote alternatives to foreclosure such as short sales and deeds-in-lieu of foreclosure.

Third, the Administration seeks to resolve the significant uncertainty that this controversy has raised for borrowers and the housing market. The issues that have been alleged raise significant questions about the accuracy, fairness and even legality of several mortgage processes. We are working to address those issues that are problematic, and to clarify for the public those issues raised that are not in fact problems.

Possible Economic Effects of Suspension of Foreclosure Proceedings

The time required to resolve these recent foreclosure issues by the servicers and state courts, and delays due to the related law enforcement investigations, could delay thousands of foreclosures for several months, which may have

both immediate and longer term consequences. Longer foreclosure timelines will likely lead to lower sales prices of houses that are already in the foreclosure process. Vacant houses, in particular, are likely to not only sell for lower prices once they are ultimately put on the market but may also drag down the value of nearby houses in the present as long as they remain unsold. Further, uncertainty about the status of foreclosed houses, including uncertainty with title insurance, and whether based on the documented problems in these banks or not, may discourage purchases of foreclosed houses until the uncertainty is resolved. This would hurt homeowners and home-buyers alike at a time when foreclosed homes make up 25 percent of home sales. Together these two factors may exert downward pressure on overall housing prices both in the short and long-run.

Right now, families who have watched their home values decline over the last few years want nothing more than new homebuyers to buy the vacant homes so that their neighborhoods can start the process of recovery. While the foreclosure reviews may reduce the near-term supply by delaying the sale of distressed homes, we expect that most of the affected houses will eventually come on the market.

Looking Ahead for Housing

Since EESA was enacted, the housing market has remained distressed, and although there are promising signs of stabilization, the nature of that distress has changed. In late 2008 and 2009, the nation's housing market was in broad decline, as a result of the subprime mortgage collapse and the effects of the financial crisis and the severe recession. Following the implementation of TARP, housing markets began showing some signs of stabilizing and wealth recovery for U.S. households. Thanks in part to federal government financial policies, mortgage rates remain near historic lows. Home prices stabilized in March 2009, following consistent declines since 2006. For example, the S&P/Case-Shiller U.S. 20-City Composite Home Price Index experienced a 3 percent year-to-year increase in July, compared to a 19 percent year-to-year decline in March 2009.

However, certain areas of the country continue to struggle as the nature of the stress in the housing market has evolved to concentrated unemployment, negative equity, excess housing inventory, and rising foreclosures, which act as a drag on housing prices and economic recovery in those communities. As described above, the Administration has responded by expanding MHA beyond the initial version of HAMP, the first lien modification program. MHA has been modified to include unemployment programs, second lien relief, short sales and deeds-in-lieu of foreclosure and principal reduction programs. Recognizing that the housing market conditions vary widely by locality, and are especially stressed by continued unemployment, the Administration has quickly rolled out the HFA Hardest Hit Fund for those states most affected by these issues. In addition, to combat negative equity and improve affordability, Treasury has partnered with FHA to expand refinance opportunities through the FHA Short Refinance option.

These programs will allow Federal assistance to reach more distressed homeowners and provide additional stability to the housing market going forward. In much the same way that HAMP's first lien modification program has provided a national blueprint for mortgage modifications, these new programs will continue to shape the mortgage servicing industry and act as a catalyst for industry standardization of short sale, refinance and principal reduction programs. The interplay of all these programs will provide a much more flexible response to changes in the housing market over the next two years. While TARP is ending, TARP's positive effects on the housing market are expected to continue over time.

I appreciate the opportunity to discuss these important issues and am happy to take your questions.

The CHAIRMAN. Thank you, Ms. Caldwell.

HAMP—I'm trying to get at some of these hard objectives. I think it's hard to do oversight and I think it's definitely hard, as I said in my statement, to run a Department if you don't have some hard objectives. Realizing that you don't always make the hard objectives, but, just like when John Kennedy said we'd get to the Moon by the end of the decade, it worked out. So I think it's hard objectives.

So one of my concerns is HAMP was announced 18 months ago. How much now do you think you're going to spend on the HAMP program?

Ms. CALDWELL. For the HAMP program, we currently have $29 billion in TARP funds allocated to the Making Home Affordable program, which includes HAMP's financial funding first lien modifications, the second lien modifications, and some of the enhancements for principal reduction, as well as a little bit for the FHA short refinance program. So it's really all of the housing programs.

The CHAIRMAN. $29 billion?

Ms. CALDWELL. $29 billion.

The CHAIRMAN. And how many foreclosures do you think you'll be preventing?

Ms. CALDWELL. Our goal still remains to help up to 3 to 4 million homeowners avoid foreclosure, and we continue to expand and enhance the programs to respond to the changing housing crisis. So our programs targeting unemployment and negative equity are just under way and we continue to focus our efforts on making sure we reach as many homeowners as possible.

The CHAIRMAN. What was this 3 to 4 million offers that I've read in some of the testimony from Treasury, that the objective of the program was to make 3 to 4 million offers?

Ms. CALDWELL. I think, as you said, there is an objective. The GAO in its August 2009 report also confirmed that the goal is offers. And while we at Treasury agree that offers do not always translate into modifications, and while we can measure the offers because that is something we control, we also measure how many of those offers are accepted, and then how many of those offers perform, and for those that don't perform, where they go. Then we learn from those and continue to expand our programs, with the still overall objective of assisting 3 to 4 million people avoid foreclosure.

The CHAIRMAN. Great. And what's your forecast for redefaults over a 5-year period?

Ms. CALDWELL. It's still very early to tell. We've had very few modifications in the program for more than a year. Early indications are that HAMP modifications will perform better than historical modifications, which have been 60, 75 percent redefault. In the permanent modifications in HAMP at 9 months, over 90 percent of homeowners still remain in the program. So the data is young, but early signs indicate the same. The OCC–OTS metrics report also confirmed that HAMP modifications are performing well and attribute it to the trial period program that makes sure homeowners are committed to staying in the home, the collection of documentation, and the 31 percent affordability standard.

The CHAIRMAN. Do you have any projection on what the default rate will be?

Ms. CALDWELL. No, we don't. Again, we are watching it very closely, but early signs are that HAMP modifications will perform well.

The CHAIRMAN. I'd recommend you try to come up with some kind of an objective for where you're shooting for. You've got a lot of data on it now. So I'm looking forward to what the redefault rate is.

How many temporary modifications do you think become permanent modifications?

Ms. CALDWELL. During the first year of the program, less than 40 percent of temporary modifications became permanent. But that was because, in response to the crisis, we gave servicers the ability to offer homeowners a trial modification and then submit documentation. Those servicers that collected documentation up front experienced conversion rates to permanent modification in the 75 to 80 percent range.

Beginning in June, Treasury's program requires upfront documentation so we expect that trial modifications will slow, but the conversions for permanent will be much, much higher.

The CHAIRMAN. How do you think the widespread problems with foreclosure documents will impact on the stability of our financial markets?

Ms. CALDWELL. That's something we're following closely. At this point in time there is no evidence that there is a systemic risk to the financial system. But we are making sure that, one, in our programs focused on foreclosure prevention, that servicers are doing everything that they are supposed to do. Second, we are making sure that we're coordinating with agencies across the Federal Government and the state and local attorneys general to make sure that those servicers that are breaking the law are held accountable. And three, we're very closely monitoring any of the litigation risk to see if there is any systemic threat. But at this point there's no indication that there is.

The CHAIRMAN. Thank you.

Mr. McWatters.

Mr. MCWATTERS. Thank you, Senator.

And thank you, Ms. Caldwell, for appearing here today. When you consider these factors—the foreclosure documentation irregularities, that's one. Two is the failure of some securitization sponsors to assign, properly assign, notes and to record transfers of mortgage and deeds of trust in accordance with applicable law; that's number two. As well as the exercise of the put rights by securitization trusts to force the mortgage loan originators to in effect buy back the loans. And given that a lot of those mortgage loan originators are TARP recipients, other financial institutions, is Treasury concerned, given these three factors, and particularly the put rights—and that's an emerging thing particularly now that the RMBS investors are beginning to coordinate their efforts and file lawsuits and the like—is Treasury concerned that any of the large, "too big to fail" financial institutions may experience a solvency or liquidity or a capital crisis over the next few years?

Ms. CALDWELL. Thank you for the question. As I said earlier, we're still very early in this issue and are monitoring it closely. I think, as you suggested in the question, there are really three separate issues. In terms of the robo-signing, the documentation issue, that is one that we are following closely and we are anticipating that servicers will do what they need to do and fix those problems, and where they have not been following the law be held accountable.

The second one that you discussed, the litigation. While I'm not a lawyer, and I don't want to go through all the legal structure, it is something as a practitioner that has been in the industry for a long time and the courts are used to dealing with that, and they will continue to deal with that. It's certainly, because of the affidavit issue, increased in visibility. But it's not a new issue in the market. But it is one that we are following very, very closely.

Then third, the put-back risk on the large financial institutions. Again, we are looking at the situation very, very closely and will be following the institutions to make sure. But at this point there is no evidence of a systemic risk.

Mr. MCWATTERS Is this being discussed within Treasury? I mean, there was a lawsuit I think filed the other day, a put-back right of $47 billion to a Bank of America loan. That was one. That was one lawsuit. I suspect there will be many, many more to come.

I believe in one of the other—on panel two, one of the panelists I think projected there were something like $2.8 trillion of subprime loans, and that even if a relatively small percentage of those are put back and the banks have to buy them back at face, this could be a substantial problem.

Also, considering that this is not just a one-shot deal. I mean, when a mortgage is originated and put in an RMBS it may be multiplied through synthetic CDOs. So you may have the synthetic CDO problems also going back to the banks.

So it sounds like Treasury as of today has not done even a back of the envelope sketch as to what the potential put-back rights could be to the TARP financial institutions.

Ms. CALDWELL. Let me just say that at Treasury we are monitoring this situation daily. The news continues to have a wide range of projections and numbers, so I'm not prepared to say that there is a particular scenario. But it is something that Treasury is working closely with all of the Federal agencies involved with these institutions, including the regulators and including the reporting agencies, to make sure that the risks are appropriately disclosed and measured and that we have a better understanding of what the potential risks could be. But it is something that we're monitoring daily.

Mr. MCWATTERS Okay. I would certainly encourage you to do that.

One of the problems is the inability of some of these securitization trusts to deal with the local land title records, in other words to properly endorse notes and to assign deeds of trust and mortgages. So I ask you this: When an American homeowner sits down at the kitchen table to write the monthly mortgage check, how does that homeowner know that he or she is paying the correct lender?

Ms. CALDWELL. That's a very important question, and I think it's important to separate the legal framework of the mortgage securitization process versus the steps that individual servicers are taking to make sure they follow the law. As I said earlier, we have a group of Federal agencies and state attorneys general in with these entities making sure that they are following the law, and those entities that are not following the law should and will be held accountable.

So again, it's important to separate the legal structure from what is actually happening.

Mr. MCWATTERS. Okay, thank you. My time is up, but I'll just make one quick comment. There are courts, state courts, which have held the MER System, the Mortgage Electronic Registration System, which I know Fannie and Freddie uses, and others, to simply not work. So the deeds of trust and the mortgages assigned under those, under MERS, doesn't work. Endorsement of the notes, unless it was done in accordance with applicable state law, doesn't work also, and that can create a problem.

Thank you.

The CHAIRMAN. Thank you.

Mr. Silvers.

Mr. SILVERS. Ms. Caldwell, I would like to continue to pursue Mr. McWatters' train of thought. I'm concerned about Treasury making representations categorically that you don't see a systemic risk. Let me walk you through exactly why.

Mr. McWatters referred to a demand letter sent by a number of bondholders, including the Federal Reserve Bank of New York, one of the institutions I believe that is encompassed by your list of regulators and the like that Treasury coordinates with. You're familiar with that letter?

Ms. CALDWELL: Yes, I am.

Mr. SILVERS. All right. That letter asks for $47 billion of mortgages to be—of mortgage-backed securities to be repurchased at par. Do you know what those mortgages are currently carried—what those bonds, the market value of those bonds today?

Ms. CALDWELL. At this point, I'm not prepared to comment on pending litigation.

Mr. SILVERS. Okay, fine. Let me tell you what the Fed says they're worth. The Fed tells us they're worth 50 cents on the dollar. So if the Fed's request of Bank of America is honored, Bank of America, assuming they are carrying these bonds—assuming when they buy them back they mark them to market, Bank of America will take a $23 billion loss.

The Federal Reserve further informs us that there is nothing particularly unique about that particular set of mortgage-backed securities, meaning they have not been chosen because they're particularly bad. They believe they are of a common quality with the rest of Bank of America's underwritten mortgage-backed securities. There are $2 trillion of Bank of America's underwritten mortgage-backed securities.

Five such deals, five such requests, if honored, to Bank of America, will amount to more than the current market capitalization of Bank of America, which is $115 billion.

Now, do you wish to retract your statement that there is no systemic risk in this situation? And the word is "risk," not "certainty," but "risk." I would urge you to do so, because these things can be embarrassing later.

Ms. CALDWELL. My statement, as I said earlier, is that it is still early. We're working very closely with 11 regulatory and Federal agencies. We are watching this every day. And that at this stage there appears to be no evidence of a systemic risk. But again, it is early, and it is something we are monitoring daily.

Mr. SILVERS. Let me suggest to you that the "it is still early" is a perfectly acceptable position. The notion that there is no—is it your position that Bank of America honoring five of these things would not present a systemic risk? Five of these requests, the first of which has been made by the Federal Reserve. Is Bank of America not systemically significant?

Ms. CALDWELL. At this point I'm not prepared to comment on a particular institution, but I think as we look at the put-back risk, the litigation involved, the severity and the probability, and the time that it would take to go through these, those are all important factors to be considered in looking at the risk. And again just to reaffirm, we didn't say there was no risk. We said there didn't appear to be evidence of a major systemic risk.

Mr. SILVERS. I hope that if we come—if the Treasury comes back to us and is discussing whether or not we need to deploy further public funds to rescue Bank of America or such other institutions as might be affected by these events, that we get a similar kind of indifference to their fate after it's too late, because it strikes me that, in light of the mathematics I've gone through with you, it is not a plausible position that there is no systemic risk here.

I want to take up two other statements you made that I think are just simply not plausible. The first is, you suggest at the beginning of your statement—and I can't quote it because my memory's not that good, but you suggested that it is a good thing that more homes be put on the market as a result of foreclosure. Is that the Administration's position?

Ms. CALDWELL. When you look at the current market for sale, close to——

Mr. SILVERS. Do we want more homes put on the market right now, as prices are falling?

Ms. CALDWELL. We want homes to be sold to homeowners that can afford them and stay in them.

Mr. SILVERS. That's not my question. My question is do we want to increase the inventory right now in the marketplace and drive down home prices? Is that the public position? Is that the position of the Administration as to what is good for our country right now?

Ms. CALDWELL. I think the position is we want houses to be sold to homeowners that can afford them.

Mr. SILVERS. But do we want more or less? I'm asking you a binary question: More houses on the market right now, less houses on the market right now?

Ms. CALDWELL. I would just say that if you have a home, whether it's in inventory for sale in the market——

Mr. SILVERS. You're not answering my question. Yes or no? More or less?

Ms. CALDWELL. We need to have the homes on the market to go through and be resold to homeowners who can purchase them and afford to stay in them and stabilize neighborhoods. Many of the homes that are in REO are vacant and that hurts the neighborhood.

Mr. SILVERS. You still haven't answered my question.

You still haven't answered my question. Do we want to drive housing prices down? Are we so concerned at ensuring that the banks don't have to write these loans down that we would rather drive housing prices down?

Ms. CALDWELL. Again——

Mr. SILVERS. How can it possibly be the position of the United States Government that it is in the national interest to drive down housing prices?

Thank you.

The CHAIRMAN. Thank you.

Dr. Troske.

Dr. TROSKE. I'm going to change gears a little bit, and not because I'm not concerned about the issues that my fellow panelists have raised, but I think they've raised them quite strongly and I have other concerns about the program I'd like to explore.

Your stated goals, at least the goals that you've been willing to articulate, are that you'd like HAMP to help 3 to 4 million borrowers, and "help" you're defining now is even people just entering temporary modifications. 1.2, 1.3 million people have entered temporary modifications so far, I think. Many of these people entered the HAMP program when about 150,000 borrowers a month were entering the program. Currently I think we're at the rate of about 20,000 to 30,000 a month are entering the program. The program's got about 24 months to run.

If my math is correct, we're at 1.2 million. We're getting about 20 to 30,000 more a month for 24 months. We're not going to get to 2 million. So can you tell me how you're going to judge it a success if we're not even going to make the minimum standard that you've already articulated as one of the goals, given the rate that people are entering the program?

Ms. CALDWELL. That's a question we talk about very regularly in my office. The numbers that you stated are correct about the first lien modification. If you look back on what HAMP was started to address, it was unaffordable payments resulting from a reset of mortgage rates. As the crisis has moved to unemployment and principal reduction, our programs have changed. So the numbers that you're discussing relate to the first lien modification. In addition to that, we have the unemployment forbearance program, which became effective in August. We have a partnership with the FHA program on a refinance program that became effective in September, that allows principal reduction and refinance into an FHA mortgage. We also have additional incentives for principal reduction along with the Hardest Hit Fund initiative.

So we have to look across all of those programs and respond to a changing housing market in our efforts to reach 3 to 4 million.

Dr. TROSKE. I guess originally your goals were stated for the HAMP program, and these are other programs that are outside the HAMP program; am I mistaken about that? So you're sort of saying

as we add more things we can sort of—presumably, we're trying to help additional people. The goal we set for the HAMP program, sort of we lower that?

So I guess, what's your goal for the HAMP program, the modifications that are running through the traditional HAMP program? Is it no longer 3 to 4 million? Is it lower than that now?

Ms. CALDWELL. The other programs, the add-on programs for unemployment and principal reduction, are in fact part of the HAMP program. They're ways that we have adapted the HAMP program to change with the economy. The one program I mentioned that is not officially part of HAMP is our help for the hardest-hit markets, where we took $7.6 billion out of the HAMP allocation and moved it over to enable state housing finance agencies to provide tailored assistance to unemployed homeowners and work with principal reduction in those markets.

Dr. TROSKE. Another question. You talked about redefaults and I think you correctly stated that it's still early. But let me ask you about, so the permanent modification under these programs is for 5 years. It's not permanent. It's a 5–year modification. And when that 5-year period is up, borrowers return to their previous payment levels.

Presumably, if something hasn't changed in the housing market, like a significant increase in prices, at least back to 2006 levels, these are going to be borrowers who are still seriously underwater, with rates that have reset, back to making payments that they can't currently afford. So why do we think in 5 years they're going to be able to afford the payments that they can't afford now? What's going to change between now and 5 years that's going to result in something close to a success, that's not going to produce an enormous increase in redefaults when they reset in 5 years?

Ms. CALDWELL. Thank you. Let me first just make a clarification to the permanent modification and the reset. After 5 years, the rates adjust to the current rate, the current Freddie Mac rate. So while there will be some adjustment up from 2 percent, it will be an adjustment up to rates that are still consistent with today's historic low rates.

In terms of the 5 years, the homeowner has gotten some additional principal reduction because of the amortization at a very low rate. So they have paid down more principal than they otherwise would have. In addition, homeowners that stay current on their HAMP modification receive $1,000 a year in principal reduction, or $5,000 over the 5-year period, which is some meaningful principal reduction at certain house values.

Then there is time for the employment situation or other hardship in that family's circumstance to improve, and certainly over 60 percent of homeowners in HAMP permanent modifications have had either a reduction in wage or loss of a job of one of the wage earners.

Dr. TROSKE. Thank you.

The CHAIRMAN. Thank you.

Superintendent Neiman.

Mr. NEIMAN. Thank you.

Ms. Caldwell, as I stated in my opening, Treasury often in its defense of HAMP, defense of the success of HAMP, refers to the sig-

nificant number of non-HAMP proprietary modifications. Year to date there have probably been more than twice as many non-HAMP mods as HAMP mods. And while it's positive that these borrowers are not currently in foreclosure, questions still remain on the sustainability of these proprietary mods and whether homeowners are actually better off.

The quarterly OCC and OTS reports on the issue and the HOPE NOW reports are a step forward. But we really do need to know more information about the specific terms of these proprietary mods in order to compare them among servicers as well as to serve as an effective supervisory tool. Will Treasury or HOPE NOW be providing additional data with respect to non-HAMP mods?

Ms. CALDWELL. Thank you. This is something that you and I have both discussed and something that we spend a lot of time thinking about within Treasury. In terms of the HAMP contracts with servicers, our contractual relationship with the servicers goes to those modifications where we're paying taxpayer incentives. We don't have supervisory authority over those modifications outside of HAMP.

But because we are very focused on what happens and very concerned about that, we have asked HAMP servicers, the large ones, to participate in a monthly survey about what happens to homeowners that are either not approved and not accepted for HAMP, and what happens to homeowners who are in a trial modification that gets cancelled. And we do publish those results.

In addition, we work very closely with HOPE NOW and with OCC–OTS metrics to try and use that as a validator or a reality check for what we're getting in the survey data. But we have no contractual authority over those.

Mr. NEIMAN. So I've been going over in the last few days the various reports issued by Treasury in your monthly reports, HOPE NOW in their monthly reports, and the OTS in their quarterly reports. And though each of these reports continues to expand, it is still not that easy for the public, nor for the Oversight Panel, or for Congress to really assess the effectiveness of these proprietary mods.

In fact, in many cases in the OCC report you cannot understand what the actual terms are of some of those monthly modifications. There's often groupings of all modifications and then HAMP modifications, so that the numbers are not always broken out for proprietary, non-HAMP mods, in order to determine whether these reductions—are they for 1 year, 2 years, and to understand the impact of these mods, do they include lump sum payments for late fees? How sustainable are these really in the interests of the borrower?

Ms. CALDWELL. Again, we share that concern and are committed to transparency in the HAMP program. We expanded our survey in the spring to include the disposition. As we continue to follow this issue, we continue to expand our survey requirements of the servicers, because we do recognize that within HAMP we have contractual relationships with servicers that are regulated by a number of different agencies, and this is one place where we can try to put it all together.

Mr. NEIMAN. I think we all support those provisions in the Treasury's monthly report that breaks down performance by servicers.

What you don't see is that in the OCC report. So it is not—it cannot provide the public a means to distinguish servicers' performance with respect to proprietary mods.

Would you support a greater ability for the OCC to provide a breakdown by servicer with respect to proprietary mods?

Ms. CALDWELL. I really can speak just for the Treasury programs and just say that we are very committed to transparency and we continue, as you know, to expand the reports every month and put demands on servicers for more information, such that they would almost say it's overload on reporting. So we are committed.

Mr. NEIMAN. So because of the gaps, because your reports are only with those servicers that have contracted, because the OCC only covers 65 percent of the market, because HOPE NOW is also a survey, would you support the need or recognize the need for a national reporting requirement for mortgage performance data similar to what banks are required to provide in mortgage origination under HMDA?

Ms. CALDWELL. We support transparency in the mortgage modification business to make sure that the taxpayer dollars are going to servicers for programs that are meeting guidelines and following all applicable laws.

Mr. NEIMAN. Thank you, and I obviously intend to follow up with the members on the next panel.

Thanks.

The CHAIRMAN. Great. Now we start a second round of questions.

Can you tell us how many second liens have been modified or extinguished through the relevant programs?

Ms. CALDWELL. If I understand your question, you want to know the second liens modified through all the relevant programs?

The CHAIRMAN. Right.

Ms. CALDWELL. That data we don't have for all the financial institutions. We're beginning to collect data on the Treasury program's second lien modification program, which is an enhancement to HAMP, that has the major servicers and some others. Again, we don't have data to report yet as the program really got started at the beginning of October, but we will be reporting that.

The CHAIRMAN. So you'll send that to us as soon as you get that?

Ms. CALDWELL. We will be putting it in our public report when we have the data.

The CHAIRMAN. What about the reluctance of some financial institutions to extinguish second liens because they're carried on the books at 90 percent of value?

Ms. CALDWELL. That particular thing we hear a lot. The impact of second liens in the modification market is something that we're very, very concerned about. It was why we put together the second lien program in HAMP, which addresses something that we hear from second lienholders about—it's current and they may not know when a first mortgage is modified. So that program has a platform that matches the first and second, and then the second lienholder has to write it down.

In addition, as part of our program for refinance into FHA we offer incentives to reduce the second lien to enable the first homeowner to refinance. So while we don't mandate second lien writedowns, we're indifferent to it in the first lien program and we

try to provide incentives as best we can to encourage second lien reductions to have more sustainable mortgages.

The CHAIRMAN. But you talked in the beginning, and I think you're right, in terms of your model, that HAMP is a model, and one of the big things you did is set out a new standard. I mean, isn't it pretty standard in the industry that you write down the second liens first and then move to the first liens?

Ms. CALDWELL. From a lien priority standpoint, that should be the way it operates, yes.

The CHAIRMAN. So really shouldn't we be, as a model, be putting the emphasis on that, so that people aren't carrying the second liens at 90 percent? It seems to me the only reason they're carrying the second liens is because they don't want to write them down because they're carrying them at 90 percent of value and they're worth nowhere near 90 percent of value.

Ms. CALDWELL. Right, and they continue to be current. I think that's a very important piece of the program—making sure those firsts and seconds are matched.

The CHAIRMAN. In your testimony you say every person in a temporary modification is getting significant benefit. Can you kind of explain that? Because if a temporary modification fails, then the person has to pay the money back, right? So what is the benefit, the significant benefit, of every person who's in a temporary modification?

Ms. CALDWELL. Let me first talk about the permanent modifications. Now, beginning June 1st, homeowners provide upfront documentation and the homeowner is expected to convert to a permanent modification. The only reason to not convert would be failure to make payments. So they are getting a second chance to qualify.

If you go back to where we were at the beginning of the program, there was a huge backlog of homeowners who were severely delinquent on their mortgages, struggling to find their servicer, and struggling to get a modification. By coming into the HAMP program, what those homeowners got was an immediate reduction in their payments and an opportunity for additional time to figure out if staying in the home was going to be a sustainable solution for them or to make other living arrangements. So it bought time.

The CHAIRMAN. To follow up on Mr. Silvers' question, GMAC still has $17.2 billion in taxpayer funds and has been involved in the document irregularities. What's Treasury doing to ensure that financial institutions supported by the taxpayers are not acting improperly?

Ms. CALDWELL. Thanks. As I know this Panel knows very clearly, Treasury has an investment in GMAC, but is not on the board or management. But immediately upon learning of the alleged robo-signing issues, we were in touch with management at GMAC, and continue to be in touch with them regularly. They have reported back, at least at this point, that other than the time to correct some of those documentation problems, which they are doing promptly, they don't see a major risk in their system. But we are again watching that very, very closely and take it very seriously.

The CHAIRMAN. So you're not sending anyone out to actually find out whether they hold the mortgages, and some of the stories we've heard about the robo-signing, that they actually have the mortgage

that they think they have or that MERS has the mortgages for GMAC, or any kind of physical followup on the fact that there are mortgages out there, do they actually have the mortgages and they actually have title to the land that they are trying to foreclose on?

Ms. CALDWELL. At this point, we are supporting all of the agencies that are doing investigations of those servicers, including the GSEs, and are monitoring closely and will take followup action when there are facts that we get from those reviews.

The CHAIRMAN. So there really is no—Treasury is not doing anything independently to determine that mortgages modified under HAMP have all necessary loan documentation and a clear chain of title? You're just taking the word of the people, of the folks, the banks and financial institutions you're dealing with, that they do have loan documentation and a clear chain of title?

I think it's important for all these other people to look into it, but it seems to me that these are programs where Treasury has a direct involvement in this as an organization. They're actually involved in the thing, and this seems to me to be a pretty critical part of the process.

Ms. CALDWELL. That is an important issue and something that, at least at this point in time, we're looking at the foreclosure prevention process separate from the actual foreclosure sale process. To modify a mortgage, there is not a need to have clear title. You need information from the note, but you don't need a physical note to modify a mortgage.

So the focus of the HAMP program is to make sure that homeowners stay in their home and don't go to foreclosure sale. But to the extent that is not successful and that goes through, we certainly expect all HAMP participating servicers to follow the law.

The CHAIRMAN. Thank you.

Mr. McWatters.

Mr. MCWATTERS. Thank you, Senator.

Ms. Caldwell, let's say I want to buy a house, and the house is foreclosed. How do I know that when I buy that house I will receive good legal title to that house? I mean, there are all sorts of questions about whether or not the securitization trust or the servicer can deliver good legal title. How do I know?

Ms. CALDWELL. Homeowners buying a house get title insurance. I think one of the things that we're very concerned about in the overall recovery of the housing market is making sure that homeowners have trust in the system and continue to buy homes and don't have a lack of trust in that, because, certainly reading the news, homeowners would have reason to be concerned.

Mr. MCWATTERS. Right. You anticipated my next question. Are title insurance companies issuing clean mortgagor and mortgagee title insurance policies today where the property liens are recorded under the MERS system?

Ms. CALDWELL. I think we have to separate the MERS system, which certainly has a lot of discussion in court, from how servicers are following the processes under MERS. To the extent a home has gone through foreclosure, whether it's foreclosed with the physical note or foreclosed with a judge, the judge has granted title and the title has been insured, the homeowner should be able to purchase the home and have title insurance.

Again, as I said earlier in my testimony, I'm aware of the litigation around MERS. It's still in the lower courts. So I can't really wade down for what will be the outcome, but certainly we're watching the uncertainty in the market that could be attributed to MERS.

Mr. MCWATTERS. I read somewhere in the paper that one of the "too big to fail" institutions went to title insurance companies who were balking on issuing title insurance policies and said: Hey, we'll indemnify you. Well, if a "too big to fail" indemnifies and it blows up, guess who pays for it? We have TARP II, unless Dodd-Frank liquidates them, which is not a good answer to anyone.

So I think this thing is, as you said, is in play, but it's a little bit frightening.

Speaking of frightening, I'll move on to Fannie and Freddie, who are also co-owners of MERS and apparently did billions of dollars of securitizations based upon MERS. So surely someone at Fannie and Freddie thought about MERS. I mean, what diligence did they do? Did Fannie and Freddie receive legal opinions, and if they did could we see those legal opinions, as to the efficacy of the MERS program?

Ms. CALDWELL. I can't testify to what Fannie and Freddie did in terms of MERS, but can just say that MERS has been a part of the mortgage securitization system for a long time. There have been a lot of legal cases on it.

Mr. MCWATTERS. Let me ask this question. Is it the opinion of the Department of Treasury that the MERS system works to deliver good legal title to property, that it properly allows notes to be endorsed, it allows for the proper assignment of mortgages and deeds of trust?

Ms. CALDWELL. This is something that we're still continuing to dig deeper on. But at this early stage, it does not appear to be a fundamental legal structural risk or issue with MERS, but rather how MERS is used based on the different state and local laws governing the real estate transactions across the country. So there's still more work to be done there.

Mr. MCWATTERS. Okay. Let's say that I'm a CEO of a "too big to fail" and I've made a lot of second mortgage loans. And I know that people are encouraging me to write those off, and if I do my capital's going to be impaired and I'm going to book a substantial loss and I'm going to be hurt, maybe put out of business.

So my response to people who ask me to write them off is to say: You know, they may be out of the money today, but in another year or 2 years I expect the housing market will recover; and maybe I'm out of the market today, but maybe I get 40 cents on the dollar in 2 years. So if I write them off today, then my shareholders are going to sue me because they go to the same economists and the economists tell them also, in 2 years you're going to get 40 cents on the dollar.

What do I do? I'm just not sure what to do.

Ms. CALDWELL. You summarized the reason why principal forgiveness is one of the most complicated parts of the mortgage modification business, because once you take it you lose that opportunity to get it back.

In the principal reduction alternative that we have under HAMP, we require servicers to run two net present value calculations, one with principal reduction, one without. And in those cases where it is net present value positive to reduce principal, we think there is a justification there for reducing it.

Mr. MCWATTERS. What if I say to you, yeah, okay, I'll write these things down. That may start solving a lot of problems. But I want an equity kicker here. So if this house turns around, appreciates in value over the next 2, 3, 4, 5 years, I get a piece of that. In fact, we're going to share that equity appreciation three ways. We're going to give some of it to me because I wrote it off. We're going to give some of it to Treasury because Treasury expended taxpayer funds. And we're going to give a substantial portion of it to the borrower because I want to keep the borrower interested in staying in the house and making the payments, keeping the house up and the neighborhood up.

Is there a problem with that approach?

Ms. CALDWELL. There is not. In fact, the principal reduction alternative under HAMP does not prohibit shared appreciation. I think at this point in time I'm not sure the servicing industry has capacity to administer shared appreciation, but it's not something that is prohibited, and we put the guidance out with the expectation that that could be something that changes in the marketplace.

Mr. MCWATTERS. Okay. What I can say to them, it's a one-page document. It's not a big deal.

Okay, thanks.

The CHAIRMAN. Thank you.

Mr. Silvers.

Mr. SILVERS. Ms. Caldwell, I want to explore very briefly this question of the relevance of irregularities in the title system to HAMP. It's my understanding—I accept your testimony earlier that, of course, you're not in foreclosure when you get HAMP assistance. But HAMP does make payments to servicers, correct, up front? Isn't there an assumption that that servicer is representing someone with a good lien? Why would we make the payment if that wasn't true?

Ms. CALDWELL. There certainly is the assumption that the servicer is following the laws, because that's required in the contract. If we learn something after the fact that contradicts that, we do have the ability to go in and claw back the incentive.

Mr. SILVERS. So my question in my opening statement was, how do we know, in light of all of the discussions—and I think Mr. McWatters has ably summarized what the issues are, and the chairman has as well. How do we know that we're not—and in light of all the state law issues that you mentioned a moment ago—how do we know that people who don't have good liens aren't getting public money essentially under the false pretense that they have a good lien?

Ms. CALDWELL. Again, we don't. Our focus at this point has been on making——

Mr. SILVERS. Okay. So that's the—hold it. That's the issue. The issue that I would hope the Treasury would be diligent about looking into is trying to answer. You say no, we don't. I think that's

fair enough. These are very complicated questions. The data is huge, the legal issues vary from state to state.

In view of the fact that what's potentially at play is servicers and banks getting public money under false pretenses, we ought to try to figure out whether that's true or not. I take from your answer that you're looking into it.

Ms. CALDWELL. Right, I would agree.

Mr. SILVERS. I would hope that that clarifies the fact that there is a relevance between the irregularities and the HAMP. We've identified it here. I look forward to hearing what you find.

Let me shift then from there to something that I'm very supportive of Treasury's direction. I want to hear more about how you intend to do it. I gather from your opening statement and from your response to my fellow panelists' questions that you want to expand the reach of Treasury's mortgage foreclosure mitigation programs, that you feel the current numbers of permanent mods and the like should be expanded, that you want to reach the unemployed and be of greater assistance there, and so forth. Did I hear you correctly?

Ms. CALDWELL. Yes.

Mr. SILVERS. What do you see as the major obstacles to doing that? What do you see? Are we having difficulty reaching and involving people in these programs?

Ms. CALDWELL. I think there are a few points we can say about unemployment. One is it differs across markets, and HAMP is a national, one-size-fits-all program. So one of the changes that we made to respond to the local nature of unemployment was the Hardest Hit Fund, so that different states could create programs to better target the unemployed in their own market. So one is just making sure we can tailor programs to local market conditions.

Second is outreach. Struggling homeowners are scared. They're getting bills, not sure who to respond to, who to call. So we do run outreach events. We've had 40 across the country in the last year to reach homeowners.

Mr. SILVERS. How many people have attended your outreach events?

Ms. CALDWELL. I don't have the number offhand, but I'd estimate in the 30,000 range.

Mr. SILVERS. Are you familiar with the Neighborhood Assistance Corporation of America, called "NACA," that I referred to earlier?

Ms. CALDWELL. I am.

Mr. SILVERS. They have represented in a letter to us, to our Panel, which I will introduce into the record, that in 23 outreach events of theirs they have had approximately 700,000 people attend. Do you have any reason to doubt that that's true?

Ms. CALDWELL. I don't have any reason to doubt, but I'm not familiar with all of them.

Mr. SILVERS. No, I understand. So can we learn something from that? Is there a way that we can—that Treasury, with its vast resources, can get to that level of participation? I'm not talking about the back end about outcomes, but just getting people in the door.

Ms. CALDWELL. I think we work with a number of housing counselors and state and local mediators, including NACA, to figure out

the best way to have outreach to homeowners. Certainly NACA mods, where eligible, can get HAMP incentives.

Mr. SILVERS. I'm actually not so much focused on the mods, but I'm focused on the intake. You said 30,000 people for all of your events around the country. NACA got more than that to a single event in D.C. a few weeks ago. I visited that event. I saw 5,000 people at the Convention Center on a Friday night at 10:00 o'clock at night.

Surely we can learn something from them, if nothing else, how to get people in the door.

Anyway, my time has expired. Thank you.

The CHAIRMAN. Thank you.

Dr. Troske.

Dr. TROSKE. Thank you, Senator.

So help me here about something I still don't understand about the program, and I'm still relatively—I was not involved in the last report. But my understanding is if the NPV model shows that the net difference between the modified mortgage and the original mortgage is positive, this suggests that it's in the best interests of the borrowers and the lenders to modify the mortgage.

If that's the case, why do we have to pay them to do it? Why do we have to pay people to do something that seemingly is in their best interest? What's preventing them from doing it on their own?

Ms. CALDWELL. That's a very important question. Two things to think about there. One, on the HAMP program, part of the incentives for servicers is actually compensation for moving to an affordability standard and certain protocols that required a full change in their business model. So it is compensation for things that they have had to do in a different way.

Second, within the HAMP program there are some cases where the investor incentives are an important piece of the modification being NPV positive.

Dr. TROSKE. So let me—the first question—your first response was that there seem to be things apparently outside the NPV model. The NPV model is not taking into account the costs of changing the business model, so you have to pay them because the NPV model doesn't include all the costs. Is that a way of interpreting what you just said?

Ms. CALDWELL. No. When you look back at the beginning of the program, again, HAMP is a voluntary program, getting the servicers, the investors, and the homeowners to the table and to change the business model to do that required some incentives. Even with those incentives, there was some doubt that servicers would sign up, and indeed it took a full year to get close to 100 non-GSE servicers signed up for HAMP, even with those incentives.

Dr. TROSKE. So let me build on that a little. So much of your claim about the success of HAMP has been that it set a standard, that you've changed the way people are doing business in this market. We can discuss it, but find, I'll give that to you, great. You've set a new standard. You've shown servicers there's a better way of doing business.

Why do you need to keep doing anything? What are you accomplishing now that you've set a standard, everybody recognizes the

standard? Great, fantastic. They're now free to live by the standard, recognize the benefits from the standard, go to town. So why do we still need Treasury involved in this once you've set the standard?

Ms. CALDWELL. The HAMP program does a couple of important things. One, because servicers that participate in HAMP are required to evaluate homeowners first for HAMP, it keeps a consistency across the industry in terms of at least where homeowners are evaluated first.

Second, as this Panel has pointed out certainly to Treasury a number of times, there's inconsistency in reporting across a number of different servicing entities, and during a time of crisis HAMP provides a standard platform on which other modifications can be based.

Dr. TROSKE. But again, once the standard platform is established, once you've established that platform, I'm still struggling to understand what is there left to do? You've established it. Now everybody knows what they should be doing. Everybody should be doing it Treasury says.

Ms. CALDWELL. I think that for the first lien program, certainly we can talk about the change in the industry standard. It's important, again as you've pointed out, that there is the unemployment program that is still new in Treasury. There is the entire platform for how short sales and deeds in lieu of foreclosure are handled, that are still operating under HAMP.

So having that standard platform can change a number of things beyond first lien modifications.

Dr. TROSKE. Let me—I want to build on a little bit of my fellow panelist Mr. Neiman's question. In her written testimony—and we haven't heard it yet, but—Julia Gordon claims that HAMP trial modifications make borrowers who do not move into permanent modifications worse off, because they are reported as being delinquent to credit bureaus and have late fees and interest continues to accumulate, resulting in larger arrears due at the end of the trial modification program.

So she—you've said that it makes them better off. She says it makes them worse off. Is she right, and what's the difference between what she's claiming and what you're claiming?

Ms. CALDWELL. Again, when we talk about the trial modifications, I think it's important to refer to early on in the program where people could come in without documentation and just call up and get immediate payment relief. When I'm talking about being better off, I'm talking about program-wide, on the whole, having that many homeowners at that time in crisis receive immediate assistance and get time was an overall benefit.

Certainly when you provide time to a large number of people, there are going to be cases where individuals say: You know, if I knew it was going to be bad news, I'd rather have the bad news now. We do hear of those cases and we take them seriously and it's very troubling. But when you look at the million homeowners that got immediate relief last year at the time of the crisis, on balance I think it's the right thing.

Dr. TROSKE. Thank you.

The CHAIRMAN. Thank you.

Superintendent Neiman.

Mr. NEIMAN. I'd like to kind of follow up on your discussion with Damon regarding your unemployment programs, because I think even in your opening testimony you acknowledge that unemployment is really going to be, particularly going forward, a driving force in driving foreclosures.

I saw it up close when I, on behalf of the Panel, joined your outreach forum in Atlanta. And in talking to both counselors and individual borrowers, it was clear that there were many individuals there who were in financial difficulty with their mortgage because of unemployment or underemployment.

You referenced the Treasury's unemployment program, which provides 3 months of forbearance. When will we be seeing—how do you contemplate providing data to assess the results of that program?

Ms. CALDWELL. Again, that program became effective in August and we will be incorporating data into the public report once it's available and validated.

Mr. NEIMAN. So recognizing that many of the individuals I spoke to there were out of work for 6 to 12 months, behind on their mortgage payments for similar terms, who's the population that this 3-month forbearance is intended to help?

Ms. CALDWELL. A couple things to think about. It's a very important issue, unemployment, in terms of the modification. I think first and foremost, as was said earlier on the Panel, you need a job to pay the mortgage. So unemployment forbearance is really intended to provide temporary assistance for unemployed to enable them to find a job.

Mr. NEIMAN. So people who are just unemployed and expect to find a job within these 3 to 6 months?

Ms. CALDWELL. The national unemployment program in HAMP provides a minimum of 3 months. Servicers can go longer, as long as they want, but it's a minimum of 3 months. Many go up to 6 months.

So it's expected that some will not find a job and may end up in a short sale or something that results in not being in the home. Some may become quickly reemployed and become current on their payment and had some benefit. Some may become reemployed at a lower income level and be eligible for HAMP.

Again, that's a one-size national program. In those markets, 18 states and the District of Columbia, with higher than average unemployment rate, we have tailored programs where each of the housing finance agencies can do something that works in their market, and those include anything from the HFA targeting certain professions that have been hardest hit and sharing the mortgage payment, to some combining them with job counseling and retraining.

Mr. NEIMAN. We look forward to the data on the success of that program.

In my remaining minutes, I want to shift over to the web portal, because this is something that we have talked about for a long time at the Panel and have been urging Treasury to get that web portal up and running so that there is an effective means for bor-

rowers and housing counselors to reach servicers in order to facilitate the approval process.

Can you give me some indications as to where it stands, how many borrowers, how many loans are being processed through the portal?

Mr. NEIMAN. Home loan port.

Ms. CALDWELL. Home loan port.

Again, I can't testify to Home loan port's specific performance, but just say that we at Treasury are very supportive of the Home loan port that's run by the HOPE NOW Alliance and think it's a very important step to not only automate the document collection process, but also to involve counselors who can help assemble those document packages.

So we are very supportive of that effort. In addition, as we've streamlined the documentation within Treasury, we've tried to make sure all of our forms are available to be downloaded on the web on our MakingHomeAffordable.gov website.

Mr. NEIMAN. Will Treasury be using that system or using—or its agents, compliance agents, using the system to test for compliance, to reach out to borrowers, to try to identify areas of concern?

My understanding is it's not currently available for access by regulators.

Ms. CALDWELL. I'll follow up on that.

Mr. NEIMAN. You follow up. Our compliance is really focused on the documentation issues more broadly across all of the channels, whether it's Loan port or mail.

My time has expired.

The CHAIRMAN. Thank you.

Thank you, Ms. Caldwell, for your testimony. Again, thank you for your service.

Will the second panel please come forward.

[Pause.]

The CHAIRMAN. Thank you. This panel is made up of: Faith Schwartz, Senior Advisor for the mortgage industry's HOPE NOW Alliance; Joseph Evers, Deputy Comptroller of the Large Bank Supervision, Office of the Comptroller of the Currency; Katherine Porter, Professor of Law, University of Iowa College of Law; Julia Gordon, Senior Policy Counsel, Center for Responsible Lending; and Mr. Guy Cecala, CEO and Publisher of Inside Mortgage Finance.

Let's start with you, Mr. Cecala.

STATEMENT OF GUY CECALA, CEO AND PUBLISHER, INSIDE MORTGAGE FINANCE PUBLICATIONS, INC.

Mr. CECALA. Thank you, Mr. Chairman and members of the Panel, for inviting me to speak today. My name is Guy Cecala. I'm the CEO of Inside Mortgage Finance, a specialized information firm that publishes a variety of products related to the residential mortgage market and its key players. We are not affiliated with any lenders per se or consumers. We're kind of just objective observers of the facts.

Any opinions expressed today are my personal opinions and don't represent the views of Inside Mortgage Finance or any of its publications.

In my written testimony, I think I've responded to just about every one of the questions you guys have asked. But I'll summarize some major points from that testimony. What I'd really like to do is provide a reality check on what's going on in the mortgage market, because I think sometimes that gets lost.

First of all, the mortgage industry is really divided into two separate businesses. One is the production side and one is the servicing side. Briefly, I'll talk about the production side. There's good news and bad news when we look at the production side of the mortgage business these days. The good news is that long-term mortgage rates are extremely low and there's a plentiful supply of mortgages to borrowers who have good credit and down payments. The bad news is about 90 percent of all the mortgage funding is coming from the government and not a lot of people qualify for that government funding.

What little private sector activity there is is pretty much relegated to home equity and high-balance jumbo mortgage lending, or basically places the government doesn't have any activity.

To make matters worse, we seem stuck in a world where most mortgage funding will continue to come from the government. There is currently no secondary market or investor demand for mortgages or mortgage-backed securities that don't carry a guarantee from the U.S. government. As a result, private lenders really can't compete with the government for mortgage customers.

But we also seem to be afraid to reduce the government's massive support of the mortgage market, for fear of disrupting a very fragile housing market. So it pretty much leaves us in a state of limbo.

Unfortunately, matters are probably worse in the mortgage servicing business. I think to talk about the success or failure of recent mortgage modification efforts or the scope of current foreclosure problems, it's really necessary to look at the massive problems we are attempting to deal with.

Between 2005 and 2007, which is really the housing boom peak period and the mortgage boom peak period of the last few years, about one-third of the $8.5 trillion mortgages that were made, or roughly 13 million loans, could broadly be characterized as nonprime. These loans were made to subprime borrowers, those with little or no documentation, those with low or no down payment, or those that had some other high risk of default characteristic.

It is these groups of mortgages that made up the bulk of mortgage defaults and foreclosures that we've seen over the last 3 years. Add to this mix the fact that nearly one-third of the homes sold during the 3-year boom period were sold to investors or people buying second homes. Now factor in the impact of high unemployment and the sharp nationwide drop in home values, and you get a pretty good idea of the scope of the problems we are facing.

It is literally a perfect storm of mortgage problems that are very difficult to resolve with loan modifications or any other foreclosure avoidance measure. Right now we have a situation where the average borrower facing foreclosure is somewhere around a year and a half behind on their mortgage payments. By traditional mortgage industry standards, 6 months is the point of no return.

I won't go into the HAMP numbers. You guys seem to know it very well and have gone over in terms of it. Needless to say, the number of HAMP modifications or even overall loan modifications have been dwarfed by the number of increases in defaulted mortgages and foreclosures over the past year.

The record high problems in the mortgage market have and continue to take their toll on the housing market. Last month 48 percent of the home purchase transactions in this country involved distressed properties, namely foreclosures or short sales involving properties headed for foreclosures. That was up from 45 percent a year earlier.

Meanwhile, the ongoing flood of problem mortgages and efforts to consider modifications on a loan by loan basis have severely taxed the mortgage servicing industry, used to dealing with one-quarter of the current level of defaults and foreclosures. Is it a surprise mortgage servicers and their agents have been overwhelmed or that some shortcuts have been taken with foreclosures to deal with the backlog of severely defaulted borrowers? No, it isn't surprising, and unfortunately it's a development that can only slow down a housing recovery that is moving at a snail's pace if it is moving at all.

Thank you.

[The prepared statement of Mr. Cecala follows:]

Testimony of Guy Cecala

CEO and Publisher

Inside Mortgage Finance Publications, Inc.

Hearing of the Congressional Oversight Panel

October 27, 2010

Members of the Congressional Oversight Panel, thank you for the opportunity to discuss the current state of the housing market and its effect on the stability of the financial system.

My name is Guy Cecala and I am the CEO *of Inside Mortgage Finance*, a specialized information firm that publishes a variety of products related to the residential mortgage market and its key players. For the past 26 years, my company has tracked the many changes seen in the U.S. mortgage market – the boom and bust in nonprime lending as well as the growth in mortgage securitization. Many of the statistics presented in this testimony comes from the various databases compiled by *Inside Mortgage Finance*.

My testimony today will focus on a number of specific issues that the Panel has asked me to address. Any opinions expressed are my personal opinions and do not represent the views of *Inside Mortgage Finance* or any of its publications.

Current state of the residential mortgage market and trends and economic fundamentals that are driving the market

On the surface the U.S. mortgage market currently is functioning quite well. Long-term interest rates are very low and there is no shortage of mortgage capital available for borrowers with strong credit looking to buy a home or refinance an existing mortgage. But looking deeper we find a mortgage market that is overwhelmingly dependent on government support. About 90 percent of all new mortgages made this year have carried some sort of a government guarantee, according to numbers compiled by *Inside Mortgage Finance* (see Exhibit 1). Currently, the lion's share of new mortgage activity is dependent on the mortgage programs of Fannie Mae, Freddie Mac or FHA. What little private sector mortgage activity there is involves mostly home equity and high balance jumbo mortgage lending, two areas where there is no government financing available.

To put the current mortgage market landscape in perspective, it is important to note that as recently as four years ago the government accounted for only 30 percent of the mortgages made in this country. How did we get here?

A combination of a dramatic rise in nonprime and nontraditional lending and an increased dependence on mortgage securitization created a mortgage market that was extremely dependent on funding from worldwide investors who had little appetite for risk or losses. When the U.S. housing market began to unravel and the risks of nonprime mortgages were exposed, these investors quickly abandoned the non-agency mortgage

securities market and limited their investments to only those mortgage securities that carried a government guarantee.

The current lack of investors for non-agency mortgage securities has limited private-sector mortgage funding to those firms willing and able to hold loans in their own portfolios. Additionally, for competitive and pricing reasons, private-sector lending generally is limited to those mortgages where there is no government funding available.

The impact of HAMP and proprietary loan modifications performed by mortgage servicers on the recovery of the housing market

Between 2005 and 2007, *Inside Mortgage Finance* estimates that $8.5 trillion in new residential mortgages were made in this country. About one-third of that total – or roughly 13 million loans – could broadly be categorized as nonprime mortgages with a high risk of default (see Exhibit 1). The bulk of these loans were made to subprime borrowers, had little or no documentation, involved low or no downpayment, or had some other high risk characteristic. It is this large group of loans that has produced the most defaults and foreclosures to date, although a growing number of problem mortgages can be attributable to prime mortgages involving borrowers who have lost their jobs or seen a significant reduction in their income. Currently, there are about 4.5 million mortgages that are seriously delinquent (more than three months) or already in foreclosure. This has been the primary target group for loan modification efforts.

Since the mortgage industry moved to step up its proprietary loan modification efforts in 2008 and then in mid 2009 shifted its focus to implementing the administration's Home Affordable Modification Program, the number of problem mortgages and borrowers facing foreclosure has risen. While a case can be made that these loan modification efforts may have limited the growth in foreclosures over the past several years, it is hard to claim they have actually reduced either the inventory of seriously delinquent mortgages or the number of new foreclosures, as both have grown.

The large number of problem loans and record level of foreclosures over the past two years have created a housing market where nearly half of all home purchase transactions involve distressed properties – specifically real estate owned (properties acquired by a lender/investor through foreclosure) or short sales (properties sold by a borrower with a mortgage in default for less than the mortgaged amount to avoid foreclosure). According to the *Campbell/Inside Mortgage Finance Monthly Survey of Real Estate Market Conditions*, 47.7 percent of home purchase transactions nationwide in September 2010 involved distressed properties. This was up from an already high 44.8 percent level seen a year earlier (see Exhibit 2).

It is hard to talk about any recovery of the housing market when the share of distressed property transactions remains close to 50 percent. And despite both private and government efforts to modify seriously delinquent mortgages and reduce foreclosures, there has been no meaningful decline in the inventory of distressed properties found in the housing market.

Have these modifications efforts had a significant impact on the housing market?

According to the Department of Housing and Urban Development and the Treasury Department, the total number of successful mortgage modifications that have been made since April of 2009 is about 2.2 million (495,900 HAMP plus 1.68 million proprietary reported by HOPE Now). During the period, the number of problem mortgages and foreclosures outstanding has grown from about 4 million to 4.5 million. From a strictly mortgage market perspective, modification efforts have done little to curb the growth in problem loans and foreclosures. Additionally, the increase in the number of super-delinquent mortgage borrowers (those who have not made a payment for a year or more) has raised the specter that delays in reviewing and approving or rejecting modification requests may have the unintended consequence of increasing the number and severity of unresolved problem mortgages.

The expected re-default rate on modified mortgages (estimates range from 30 to 50 percent) also could create more foreclosures and distressed property sales going forward, although it is too early to tell how modified mortgages will perform in the current high unemployment economic environment. Even a re-default rate at the lower end of estimates would put more than 600,000 additional distressed properties into the housing market at time when it is struggling to unload an already high inventory.

At best, mortgage modifications appear to be deferring – as opposed to permanently resolving – the foreclosure crisis as most modifications offer payment relief for a limited period (generally five years). After that period, most borrowers will face not only a return to higher monthly payments but also possibly a large bill for any previously missed or deferred payments.

Why has the number of proprietary servicer modifications outpaced HAMP modifications?

According to the HUD/Treasury numbers, proprietary servicer modifications have outpaced HAMP modifications by about 3-to-1 since the HAMP program was launched in April of 2009. Significantly, the gap between HAMP and proprietary modifications appears to have increased over the past several months.

There are a number of reasons for this large discrepancy. The main one is the simple fact that proprietary modification programs are much more flexible and easier to administer than HAMP, which has tough government mandated underwriting and documentation requirements. In general, a mortgage servicer can qualify just about any mortgage borrower in default for a loan modification if they decide it is in the best interest of the investor or investors holding the mortgage. This is not the case with HAMP where there are very specific qualifications and documentation requirements that must be met before a modification can be approved.

But another reason for the discrepancy is that proprietary mortgage modifications tend to be less aggressive in terms of payment reductions than HAMP modifications. Historically, proprietary load modifications have involved a restructuring of a defaulted mortgage. These proprietary efforts primarily were aimed at bringing a borrower current on their mortgage payments but not necessarily lowering a borrower's monthly payments.

In contrast, HAMP was established with the primary goal of aggressively reducing a defaulted mortgage borrower's payments to a low affordable level – specifically 31 percent of their income.

While there is relatively little in the way of specific information on changes to borrowers' mortgage payments with proprietary modifications, HOPE Now reported that 78 percent of completed proprietary modifications during the first half of 2010 resulted in some reduced principal and interest payments. This contrasts with HAMP where all successful modifications result in a fairly large reduction in most borrowers' monthly payments. Most proprietary modifications don't offer borrower payment reductions as deep as those mandated by HAMP.

The size and type of mortgage modifications used with troubled loans has been shown to have a big impact on re-default rates. Modified mortgages with little or no payment reductions historically have experienced large re-default rates, 50 percent or higher, within one year of modification. Meanwhile, modified loans with big payment reductions – such as those found with HAMP – have posted re-default rates as low as 25-30 percent.

Nevertheless, it is often hard to compare re-default rates by modification type since economic conditions, which have a major impact on re-defaults, can change significantly during any period of active modifications. For example, unemployment has emerged as a leading cause of re-defaults in recent months and that impacts modifications regardless of the size of mortgage payment reductions.

Review of recent foreclosure paperwork controversy and its impact on the housing market and the overall state of the financial markets

The basic infrastructure of the mortgage servicing industry was created to collect and pass on mortgage payments from borrowers who regularly – if not automatically – pay their bills on time. It is a highly automated process designed for good economic times and with little personal contact in mind. Five years ago, less than 2 percent of all mortgages being serviced – or about 1 million loans – were seriously delinquent or in foreclosure, according to the Mortgage Bankers Association's *National Delinquency Survey*.

Fast forward to 2010 when the volume of problem mortgages has jumped to roughly 4.5 million. While most mortgage servicers have beefed up their staff to deal with the more than four-fold increase in problem mortgages, the industry and its contractors are still overwhelmed with the servicing demands created by record-high mortgage defaults, requests for loan modifications and foreclosures. Meanwhile, basic mortgage servicing fees have remained largely unchanged providing little financial incentive for servicers to substantially increase their overhead costs by hiring more staff.

Given this environment it is not surprising to learn that paperwork or processing shortcuts may have been taken by some servicing-related personnel and contractors, particularly in the paperwork-intensive area of foreclosure filings. Three of the top five mortgage servicers in the country – Bank of America, JPMorgan Chase, and GMAC/Ally Bank – have acknowledged some sort of procedural problems or errors with foreclosures in the

23 states in the country that require court review and approval of foreclosures. These three firms service more than one out of every three mortgages outstanding in the U.S.

But despite temporary freezes on foreclosure evictions and foreclosure sales, all three servicers have indicated their foreclosure paperwork problems are manageable and they reportedly are taking steps to correct and resubmit foreclosure affidavits where necessary. The emerging view in the mortgage industry is that foreclosure problems are largely procedural and can be corrected fairly quickly.

Meanwhile, many if not most state and federal financial institution regulators have announced plans to review mortgage foreclosure practices by servicers. Significantly, all 50 states have signed on to investigate whether any violations of state laws have taken place and whether legal action may be required to protect the rights of consumers and homeowners.

Whether or not the housing market or the larger financial markets feel any major impact from the current foreclosure paperwork controversy depends on whether mortgage servicers can easily correct any deficiencies uncovered with foreclosure filings. The risk is that some of the investigations now underway uncover criminal misconduct or large-scale errors that force foreclosures to be put on hold for an extended period of time.

Any significant delay in foreclosures – three months or more – increases the backlog of distressed properties the housing market must ultimately resolve. Meanwhile, any criminal violations that are uncovered could subject major banks to litigation-related costs – both from investors concerned about delays in foreclosures and from potential damages that courts could award.

Although most mortgage servicers utilize similar resources and procedures for pursuing foreclosures, it is difficult to ascertain how widespread foreclosure processing irregularities may be in the mortgage servicing industry. While some major servicers have readily acknowledged foreclosure errors, others have denied uncovering problems with their procedures and practices.

Title transfer issues and the mortgage securitization process

The recent controversy surrounding foreclosure paperwork and processing has also resurrected legal questions about whether the securitization process of the past decade or more legally transfers ownership of individual properties and legally allows servicers to pursue foreclosures on the behalf of mortgage security investors.

It is hard to imagine that any legal challenge of the title transfer process commonly used with securities will prevail given that this system was originally vetted by a small army of attorneys from the rating services, the two government-sponsored enterprises and even regulators. It has been used in thousands of foreclosure cases in all states for many years. Nevertheless, mortgage servicers generally have the option of foregoing the use of automated title transfers and resorting to more manual title recordings. But it's a process that will further delay foreclosure actions.

Exhibit 1

Government Share of Mortgage Originations

(Dollars in Billions)

Year/ Quarter	VA	FHA	Fannie/Freddie	Total Originations	Agency Volume	Agency Mkt Share
2000	$22.21	$93.12	$375.83	$1,048.00	$491.15	46.9%
2001	$35.43	$131.24	$914.93	$2,215.00	$1,081.60	48.8%
2002	$41.95	$145.05	$1,270.36	$2,885.00	$1,457.35	50.5%
2003	$66.15	$165.33	$1,912.40	$3,945.00	$2,143.89	54.3%
2004	$35.31	$93.66	$892.29	$2,920.00	$1,021.27	35.0%
2005	$24.89	$57.53	$879.13	$3,120.00	$961.54	30.8%
2006	$24.51	$53.73	$816.88	$2,980.00	$895.11	30.0%
2007	$25.16	$79.54	$1,062.02	$2,430.00	$1,166.72	48.0%
2008	$40.58	$253.87	$899.82	$1,500.00	$1,194.28	79.6%
2009	$74.03	$375.79	$1,178.67	$1,815.00	$1,628.49	89.7%
2010-6mos	$29.67	$149.03	$411.18	$660.00	$589.88	89.4%

Source: Inside Mortgage Finance

Share of Nonprime Originations by Year

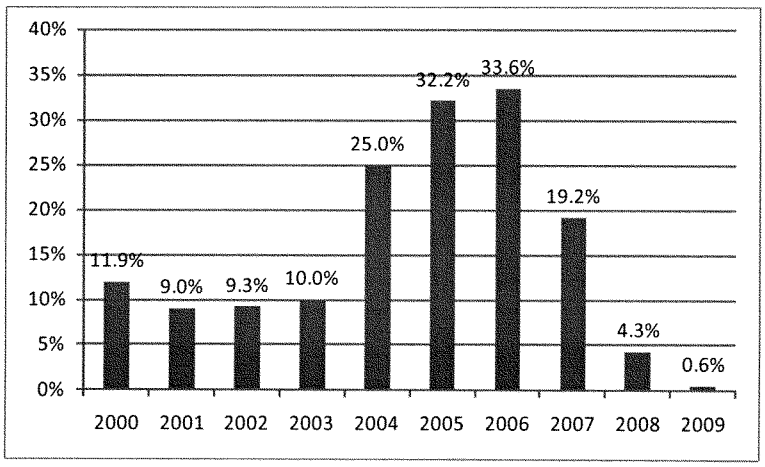
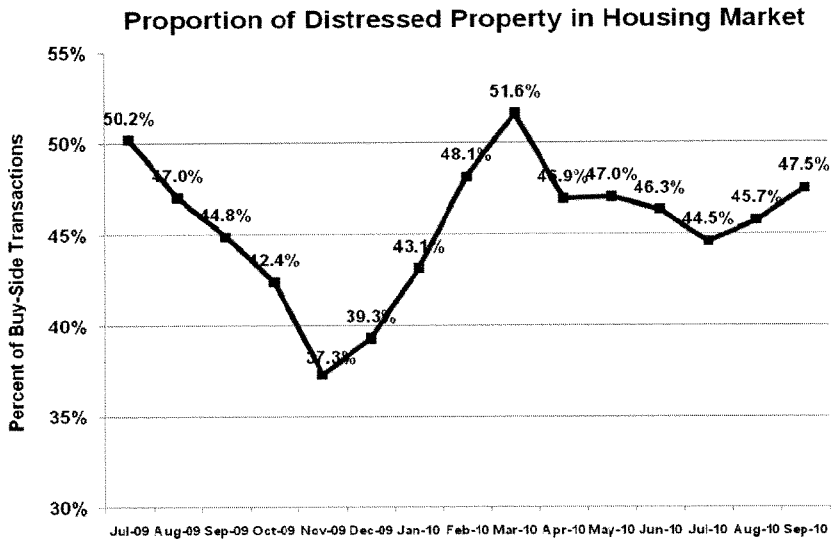
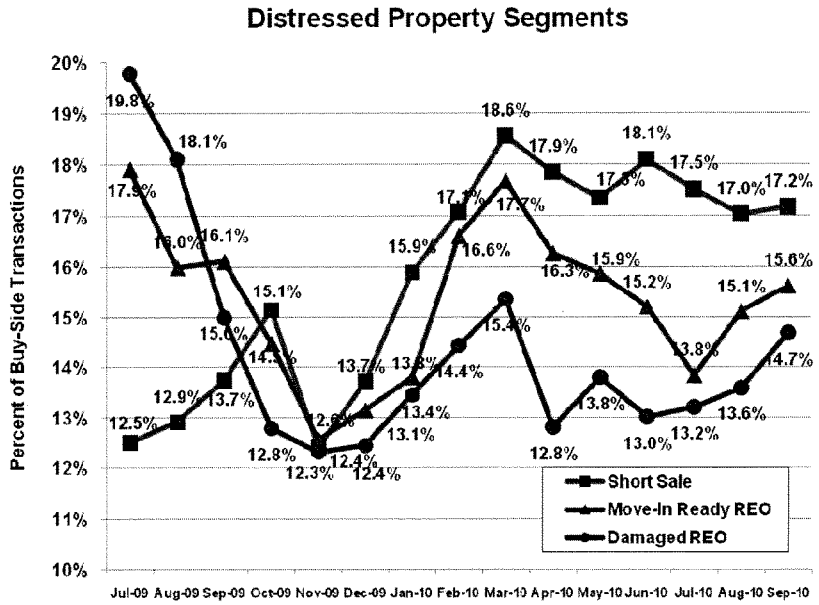


Exhibit 2





Source: Campbell/Inside Mortgage Finance Monthly Survey of Real Estate Market Conditions

The CHAIRMAN. Ms. Gordon.

STATEMENT OF JULIA GORDON, SENIOR POLICY COUNSEL, CENTER FOR RESPONSIBLE LENDING

Ms. GORDON. Good morning, Chairman Kaufman and members of the Panel. Thank you so much for inviting me to address you today. I serve as Senior Policy Counsel at the Center for Responsible Lending, a nonprofit research and policy organization dedicated to protecting home ownership and curbing abusive financial practices.

As we're here today, mortgage servicers are in the process of foreclosing on over 2 million families. About 3 million or so more are just weeks away from receiving a notice of default. Over the next several years, the toxic combination of high unemployment and underwater loans could mean a stunning total of more than 31 million foreclosures.

African-American and Latino families are much more likely than whites to lose their homes, and we estimate that communities of color will lose over $360 billion worth of wealth.

So far, our major government response to this crisis has been HAMP. HAMP, as we've discussed today, has fallen far short of its initial goals and even left families who did not convert to a permanent modification worse off than they were before. Relatively few new trials are starting each month now, replaced by a trend of servicers moving their modification activities outside of HAMP, where there's little transparency or accountability.

The principal reductions we need are not happening in HAMP and they're not really happening out of HAMP either, except in some small portfolios, usually ones that were marked down upon acquisition.

The real problem is that servicers need to foreclose quickly and in volume in order to make money. That's why people get foreclosed on even when they're in the middle of being reviewed for other solutions. That's also led to this utterly unacceptable but routine practice of falsifying court documents when it's too expensive or in some cases impossible to conduct the process legally.

It's increasingly clear that one incomplete payment or one accounting mistake can land you on an apparently unstoppable conveyor belt to eviction.

The crisis didn't need to be this bad. If government had acted quickly and forcefully at the beginning we could have significantly limited the damage. But instead our government believed servicers' early assurances that they would handle the crisis on their own. When that turned out to be wrong, we provided legislative tools such as the investor's safe harbor, we added financial incentives through HAMP and related programs, we cajoled and begged and threatened. None of those strategies have worked. It's quite clear that servicers will not do what needs to be done unless someone makes them do it.

The fact is the HAMP program has never had the tools it really needed to succeed. A key part of the original Administration foreclosure prevention plan was to involve the bankruptcy courts, who serve as our nation's comprehensive resolution authority when debt goes bad. The failed subprime lenders got bankruptcy protection.

So did Lehman Brothers. Bankruptcy courts can modify mortgages on vacation homes, farms, commercial properties, even yachts. But because they're barred from saving the family home, homeowners had no alternative but to rely on the voluntary assistance of the servicers, and servicers had no real incentive to change doing business as usual.

Those bankruptcy laws should be changed. In the meantime, let's broaden and enforce a commonsense practice requiring servicers to review all loans for alternatives to foreclosure, either loan modifications when that makes financial sense or short sales and deed in lieu. Congress and state legislatures, the Administration, the banking regulators, and law enforcement officials all have lots of tools available to do this. In fact, the so-called mandatory loss mitigation standard already is supposed to be in place in the government-backed housing programs.

To make it work in practice, though, homeowners need a chance to stop their foreclosures if their case hasn't been properly reviewed. In many cases homeowners will need access to legal help. Congress should appropriate the $35 million authorized in the Dodd-Frank Act for that purpose. While that's a very small amount compared to what will be spent on the battalions of corporate lawyers for the other side, it will make a real meaningful difference for the many homeowners who can't afford an attorney.

We also recommend that the banking regulators use all their supervisory and enforcement powers to let servicers know they can no longer fly under the regulatory radar. This is a perfect opportunity for the Consumer Financial Protection Bureau to show what a difference it can make when an agency focuses squarely on eliminating practices such as a predatory servicing now taking place.

There's no silver bullet strategy to fix every mortgage and not every foreclosure is avoidable. But even one unnecessary foreclosure is devastating to that family and their neighbors, and multiple unnecessary foreclosures are devastating to all of us. Once and for all, let's make sure the system works, both for families and for those who invest in our economy.

Thank you for your time and I look forward to your questions.

[The prepared statement of Ms. Gordon follows:]

Testimony of Julia Gordon, Center for Responsible Lending Before the Congressional Oversight Panel

HAMP, Servicer Abuses, and Foreclosure Prevention Strategies

October 27, 2010

Good morning Chairman Kaufman and members of the panel. Thank you for the invitation to discuss the Making Home Affordable program and other efforts to respond to the millions of foreclosures that have devastated families, destroyed neighborhoods, and triggered a global financial crisis.

I serve as Senior Policy Counsel at the Center for Responsible Lending (CRL), a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices.

CRL is an affiliate of Self-Help, a nonprofit community development financial institution. For thirty years, Self-Help has focused on creating asset building opportunities for low-income and minority families, primarily through financing safe, affordable home loans. In total, Self-Help has provided over $5.6 billion of financing to 64,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across America. Currently, Self-Help is grappling with many of the same issues encountered by other lenders, including servicer capacity limitations and homeowners who face serious economic challenges. Our testimony today is informed by this experience.

I. Introduction and Summary

Almost four years ago, our organization released a report warning that the reckless and abusive lending practices of the previous two decades would lead to approximately 2 million subprime foreclosures. At the time, our report was denounced by the mortgage industry as absurdly pessimistic. Sadly, the opposite was true. The system was even more larded with risk than we had understood, and the damage has been far worse, spreading from the subprime to the prime sectors, catalyzing a housing-lead recession, and triggering historic levels of unemployment. Since we issued the report, there have already been more than 2.5 million homes lost, and Wall Street analysts recently predicted there could be as many as 11 million more foreclosures filed.[1]

The foreclosure crisis has had catastrophic consequences for families and communities, especially communities of color. Millions of homeowners are in dire straits due to abusive mortgage originations, incompetent and predatory mortgage practices, ineffective government oversight, and a complex securitization system that lacks accountability all the way up and down the chain. Ultimately, the fate of these homeowners impacts all of

us. Foreclosures bring down home values across the board, and devastate communities and municipal budgets. Even worse, since historically the housing sector has led the way out of economic downturns, weakness in the housing sector will likely slow or derail economic recovery and hamper efforts to create jobs and reduce unemployment.

Things did not need to be this bad. If the Bush Administration had moved quickly back in 2007, or if the Obama Administration and Congress had acted more forcefully in early 2009, we could have significantly limited the breadth and depth of the foreclosure crisis. Instead, seemingly hamstrung by concerns about bank capitalization levels and "moral hazard," the government put forth a series of initiatives that relied on voluntary actions from servicers in return for targeted monetary incentives. In evaluating how well this approach has worked, the facts speak for themselves.

In this testimony, we have been asked to focus on the performance of the Home Affordable Modification Program (HAMP), to compare HAMP modifications with proprietary ones, and to suggest ways to improve HAMP and other programs to prevent foreclosure. We have also been asked to comment on the foreclosure process issues that have recently made headlines and the recent calls for a broader foreclosure moratorium.

In our view, HAMP's performance has been disappointing, given initial hopes for its performance and given that it still remains the only significant government response to the crisis. On the positive side, HAMP has provided approximately a half million families with a second chance at homeownership, which is a very significant number of people. HAMP also may have helped standardize the industry approach to modifications and increase the number of modifications reducing the borrower's monthly payments; the apparent sustainability of proprietary modifications has increased significantly since HAMP started.[2]

At the same time, HAMP has fallen far short of its initial goals for helping individual homeowners and has remained well behind the curve of additional foreclosures. Worse, many families encounter an incompetent or even predatory mortgage servicing system once they apply to the program, experiencing delays or denials that are inconsistent with the promise of the program guidelines. Hundreds of thousands of people who received trial modifications during HAMP's initial phase have ended up in a worse financial situation as a result of their participation in the program if they do not get converted to a permanent modification; during the trial period, they are reported as delinquent to the credit bureaus and late fees and interest continue to accumulate, resulting in large arrearages due at the end of the trial modification. There are also troubling questions about what will happen to families' modifications when the interest rates on their new loans begin to reset in five years. The continued insistence by Treasury officials that HAMP is working has contributed to deep cynicism in those who have interacted with participants.[3] The credibility of the program has been further undermined because it has not been transparent and has not created adequate enforcement mechanisms.

HAMP would have been much more successful if the government had implemented other measures, such as changes to the bankruptcy code, to provide a "stick" to complement the

HAMP "carrot" and to give homeowners an alternative to relying on servicers who act in their own interest first. Instead, the system is still entirely at the mercy of those servicers, who frequently have not acted in the best interest of either investors or homeowners, and who have demonstrated a complete disregard for the legal requirements of the foreclosure process. It is also evident that the servicing industry, despite being aware of the oncoming wave of foreclosures for several years now, has failed to develop the capacity and quality control systems to ensure the integrity of the process.

It is also disturbing that the vast majority of modifications continue to be made outside of HAMP. As of August of this year, only 470,000 permanent modifications were made through HAMP, compared to 3.2 million proprietary modifications.[4] Servicers routinely ask borrowers to waive their right to a HAMP modification.[5] Sometimes, servicers transfer their accounts to other entities that are not bound by the HAMP contract with Treasury. While we do not know all the reasons why this happens, some possibilities are: (1) servicers profit more from the proprietary modifications because the HAMP incentives are insufficient to overcome other financial incentives; (2) the design of the HAMP program does not fit the majority of borrowers; (3) servicers do not want to fill out the detailed reports required by HAMP; or (4) servicers wish to avoid oversight. Whatever the reason, the lack of transparency about proprietary modifications makes it very difficult to compare them with HAMP modifications or to analyze their ultimate suitability for borrowers.

Along with their failure to adhere to HAMP guidelines, servicers also are engaging in shoddy, abusive, and even illegal practices related to the foreclosure process itself. The recent media revelations about "robo-signing" highlight just one of the many ways in which servicers or their contractors elevate profits over customer service or duties to their clients, the investors. Other abuses include misapplying payments, force-placing insurance improperly, disregarding requirements to evaluate homeowners for non-foreclosure options, and fabricating documents related to the mortgage's ownership or account status.

While we agree that the housing market is not likely to recover fully until foreclosures level off and the swollen REO inventory is absorbed, recovery is unlikely until participants regain confidence in the process. One key reason that buyers have become skittish about REO purchases is that they believe the title to the home may not be good. To get the market working again, buyers need assurances that the foreclosures are legal and not vulnerable to challenge. Having banks claim to "fix" thousands of mortgages within a couple of weeks without more information is unlikely to restore public confidence in the system.

In our view, a temporary pause in pursuing foreclosures during which defined, objective, and transparent measures are taken to ensure the integrity of the system is the best way to stabilize the market. Otherwise, continued uncertainty will continue to damage the mortgage market.[6]

Today, we urge everyone concerned about the stability of the housing market and the sustainability of our economic recovery to address the foreclosure problem head-on with every tool available. Congress, the Administration, banking regulators, federal and state law enforcement officials, and state legislatures have many ways to ensure that servicers are accountable for producing the results that will best serve investors, homeowners, and the market as a whole. It is time to take the gloves off.

Recommendations for Congress

- Change the bankruptcy code to permit modifications of mortgages on principal residences.
- Mandate loss mitigation prior to foreclosure.
- Level the playing field in court by funding legal assistance for homeowners.
- Ensure that homeowners receiving mortgage debt forgiveness or modifications do not find their new financial security undermined by a burdensome tax bill.

Recommendations for Federal Agencies

- The federal prudential banking regulators should immediately focus on the servicing operations of their supervisees.
- The Consumer Financial Protection Bureau should make regulating servicers one of its first priorities.
- Fannie Mae and Freddie Mac should serve as models to the industry.
- HUD, VA, and other government housing programs should enforce their servicing rules, especially those related to mandatory loss mitigation.

Recommendations for States

- State legislatures should mandate loss mitigation prior to foreclosure.
- States should exercise their supervisory and enforcement authority over servicers doing business in their jurisdiction.

If nothing else, we have learned that HAMP cannot remain the principal response to the problem. Moreover, changes to HAMP are likely to push even more modifications outside of HAMP, so it is important to have a comprehensive approach. However, despite our disappointment with HAMP, it is still the only significant federal response to the foreclosure crisis and has a developed infrastructure, and we therefore support improving it as much as possible. The following recommendations will help optimize HAMP's performance:

- Aggressively enforce HAMP guidelines through serious penalties and sanctions for noncompliance.
- Create an independent, formal appeals process for homeowners.
- Evaluate all borrowers for HAMP, 2MP, and HAFA or other sustainable proprietary solutions before proceeding with foreclosure.

- To ensure that loan modifications are sustainable, require servicers to reduce principal whenever the alternative waterfall yields a positive net present value (NPV) or at least to disclose the positive NPV to investors, require servicers to reduce principal on second liens proportional to any reduction of principal undertaken with respect to the first lien, and require servicers to reduce principal appropriately when the underlying mortgage exhibits predatory characteristics.
- Increase the mandatory forbearance period for unemployed homeowners to six months and reinstitute the counting of unemployment benefits as income.
- Mandate automatic conversions of successful trial modifications and reimburse homeowners who pay their trial modifications but are not converted for any interest and fees paid during that period.
- Make the NPV model transparent and available to homeowners and the public as required by the Dodd-Frank Act.
- Require servicers to provide the homeowner with the relevant written documentation any time a modification is denied due to investor restrictions.
- Share loan-level data with the public to ensure that everyone has access to the most complete source of data on foreclosure prevention.
- Transfer servicing duties to companies that don't have conflicts of interest.
- Permit homeowners who experience additional hardship to be eligible for a new HAMP review and modification.
- Mandate an additional 30 days after HAMP denial to apply for Hardest Hit Program monies and HAMP reconsideration if the HHP application is approved.
- Clarify existing guidelines to streamline the process and carry out the intention of the program.

II. Background: The foreclosure crisis has impacted tens of millions of people directly or through spillover effects, with a particularly severe impact on minority communities, and mortgage servicers have routinely engaged in careless, predatory and illegal practices.

A. The foreclosure crisis impacts millions of people, both directly and through spillover effects.

With one in seven borrowers delinquent on their mortgage or already in foreclosure[7] and nearly one in four mortgages underwater,[8] continued weakness in the housing sector is already impairing economic recovery and hampering efforts to create jobs and reduce unemployment. According to industry analysts, the total number of foreclosures by the time this crisis abates could be anywhere between 8 and 13 million.[9] A recent study by CRL estimated that 2.5 million foreclosure sales were completed between 2007 and 2009 while another 5.7 million borrowers are at imminent risk of foreclosure.[10]

Beyond the impact of the foreclosures on the families losing their homes, foreclosure "spillover" costs to neighbors and communities are massive. Tens of millions of households where the owners have paid their mortgages on time every month are suffering a decrease in their property values that amounts to hundreds of billions of dollars in lost wealth just because they are located near a property in foreclosure. Depending upon the geography and time period, the estimated impact of each foreclosure

ranges from 0.6 percent to 1.6 percent in lost value to nearby homes. CRL estimates that the foreclosures projected to occur between 2009 and 2012 will result in $1.86 trillion in lost wealth, which represents an average loss of over $20,000 for each of the 91.5 million houses affected.[11] These losses are on top of the overall loss in property value due to overall housing price declines.[12]

Furthermore, since African-American and Latino borrowers have disproportionately been impacted by foreclosures, these spillover costs will disproportionately be borne by communities of color. CRL has estimated that African-American and Latino communities will lose over $360 billion dollars in wealth as a result of this spillover cost.

In addition, foreclosures cost states and localities enormous sums of money in lost tax revenue and increased costs for fire, police, and other services because vacant homes attract crime, arson, and squatters. As property values decline further, more foreclosures occur, which only drives values down still more. The Urban Institute estimates that a single foreclosure results in an average of $19,229 in direct costs to the local government.[13]

The crisis also severely impacts tenants in rental housing. According to the National Low-Income Housing Coalition, a fifth of single-family (1-4 unit) properties in foreclosure were rental properties and as many as 40 percent of families affected by foreclosure are tenants.[14] While tenants now have some legal protection against immediate eviction,[15] most of them will ultimately be forced to leave their homes.[16] Furthermore, a great deal of housing stock is now owned by the banks rather than by new owners. Banks are not in the business of renting homes and are not well suited to carry out the duties required of a landlord.

Compounding the problem of renters losing homes to foreclosures is the impact that the crisis has on other sources of affordable housing. A policy brief from the Joint Center for Housing Studies reports that dramatic changes at Freddie Mac and Fannie Mae and coincident changes in credit markets have disrupted and increased the cost of funding for the continued development of multi-family (5+ units) properties, despite the fact that underwriting and performance has fared better in this segment than in single-family housing.[17] As a result, even though a general over-supply of single-family housing persists, the deficit in the long-term supply of affordable rental housing is at risk of increasing.[18]

B. Toxic loan products lie at the heart of the mortgage meltdown.

In response to the foreclosure crisis, many in the mortgage industry have evaded responsibility and fended off government efforts to intervene by blaming homeowners for mortgage failures, saying that lower-income borrowers were not ready for homeownership or that government homeownership policies dictated the writing of risky loans.[19] This argument is both insulting and wrong. Empirical research shows that the elevated risk of foreclosure was an inherent feature of the defective nonprime and exotic loan products that produced this crisis, and that these same borrowers could easily have

qualified for far less risky mortgages that complied with all relevant government policies and regulations.

A number of studies demonstrate that loan performance and loan quality are strongly related. For example, Vertical Capital Solutions found that the least risky loans[20] significantly outperformed riskier mortgages during every year that was studied (2002-2008), regardless of the prevailing economic conditions and in every one of the top 25 metropolitan statistical areas.[21] That study also confirmed that loan originators frequently steered customers to loans with higher interest rates than the rates for which they qualified and loans loaded with risky features, and that 30 percent of the borrowers in the sample (which included all types of loans and borrowers) could have qualified for a safer loan. The Wall Street Journal commissioned a similar study that found 61 percent of subprime loans originated in 2006 "went to people with credit scores high enough to often qualify for conventional [i.e., prime] loans with far better terms."[22]

Even applicants who did not qualify for prime loans could have received sustainable, thirty-year, fixed-rate subprime loans for—at most—half to eight tenths of a percent above the initial rate on the risky ARM loans they were given.[23]

CRL's own research has demonstrated that common subprime loans with terms such as adjustable rates with steep built-in payment increases and lengthy and expensive prepayment penalties presented an elevated risk of foreclosure *even after accounting for differences in borrowers' credit scores*.[24] A complementary 2008 study from the University of North Carolina at Chapel Hill supports the conclusion that risk was inherent in the structure of the loans themselves.[25] In this study, the authors found a cumulative default rate for recent borrowers with subprime loans to be more than three times that of comparable borrowers with lower-rate loans. Furthermore, the authors found that adjustable interest rates, prepayment penalties, and mortgages sold by brokers were all associated with higher loan defaults. In fact, when risky features were layered into the same loan, the resulting risk of default for a subprime borrower was four to five times higher than for a comparable borrower with the lower- and fixed-rate mortgage from a retail lender.

Finally, CRL conducted a more targeted study to focus on the cost differences between loans originated by independent mortgage brokers and those originated by retail lenders. In that study, we found that for subprime borrowers, broker-originated loans were consistently far more expensive than retail-originated loans, with additional interest payments ranging from $17,000 to $43,000 per $100,000 borrowed over the scheduled life of the loan.[26] Even in the first four years of a mortgage, a typical subprime borrower who used a broker paid $5,222 more than a borrower with similar creditworthiness who received a loan directly from a lender.[27] The data overwhelmingly supports that irresponsible lending and toxic loan products lie at the heart of the crisis.

C. Minority families and communities of color bear a disproportionate burden of the foreclosure crisis.

It is well documented that African-American and Latino families disproportionately received the most expensive and dangerous types of loans during the heyday of the subprime market.[28] New CRL research released this summer shows that, not surprisingly, minorities are now disproportionately experiencing foreclosure.

In June, our report entitled "Foreclosures by Race and Ethnicity: The Demographics of a Crisis" shows that African-Americans and Latinos have experienced completed foreclosures at much higher rates than whites, even after controlling for income.[29] While an estimated 56% involved a white family, when looking at rates within racial and ethnic groups, nearly 8% of both African-Americans and Latinos have already lost a home, compared to 4.5% of white borrowers. We estimate that, among homeowners in 2006, 17% of Latino and 11% of African-American homeowners have lost or are at imminent risk of losing their home, compared with 7% of non-Hispanic white homeowners. The losses extend beyond families who lose their home: From 2009 to 2012, those living near a foreclosed property in African American and Latino communities will have seen their home values drop more than $350 billion.

Another CRL report issued in August, "Dreams Deferred: Impacts and Characteristics of the California Foreclosure Crisis," shows that more than half of all foreclosures in that state involved Latinos and African Americans.[30] Contrary to the popular narrative, most homes lost were not sprawling "McMansions," but rather modest properties that typically were valued significantly below area median values when the home loan was made.

The impact of this crisis on families and communities of color is devastating. Homeownership is the primary source of family wealth in this country, and people often tap home equity to start a new business, pay for higher education and secure a comfortable retirement. In addition, home equity provides a financial cushion against unexpected financial hardships, such as job loss, divorce or medical expenses. Perhaps most important, homeownership is the primary means by which wealth is transferred from one generation to the next, which enables the younger generation to advance further than the previous one. Minority families already have much lower levels of wealth than white families, and therefore this crisis is not only threatening the financial stability and mobility of individual families, but it is also exacerbating an already enormous wealth gap between whites and communities of color.[31]

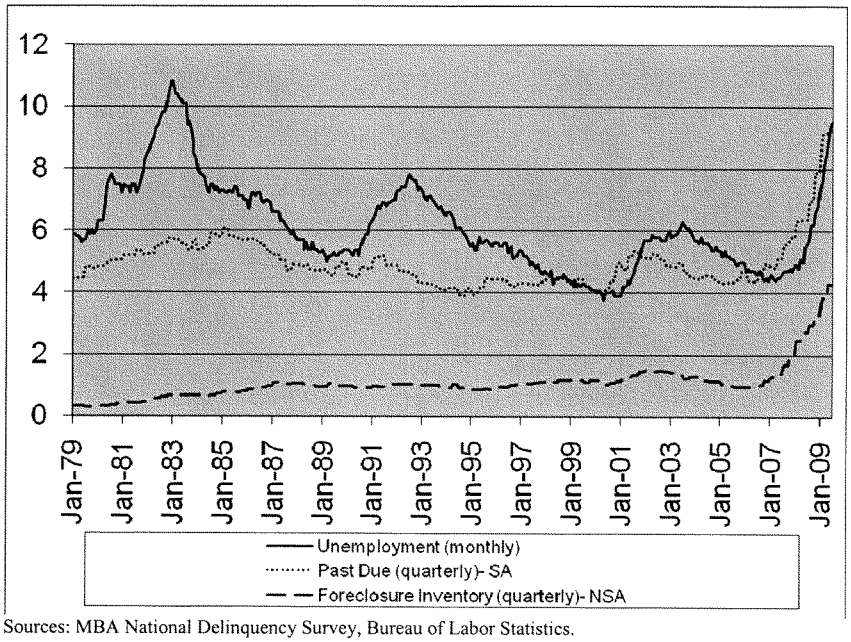
D. Unemployment is exacerbating the crisis but didn't cause it.

High unemployment did not cause the foreclosure crisis, but because of the crash of the housing market, unemployment is now far more likely to trigger mortgage default than in the past, largely due to widespread negative equity. In past recessions, homeownership served as a buffer against income interruptions because homeowners facing unemployment could sell their homes or tap into their home equity to tide them over.

Today, selling homes is difficult to impossible in many markets, and even when sales take place, the seller sees no net proceeds from the sale. Figure 1 below shows that during previous periods of very high unemployment, foreclosure numbers remained essentially flat. Delinquency levels did rise somewhat, but they rose far less than they have risen during the recent crisis.[32] Other research confirms that the risk of default due to unemployment rises mainly in situations where homeowners are underwater on their mortgage.[33]

And why are so many homeowners underwater? It is because the glut of toxic mortgages contributed to inflating the housing bubble and then led to the bursting of the bubble, followed by a self-reinforcing downward spiral of home prices.

Figure 1: Historical relationship of unemployment and foreclosure rate

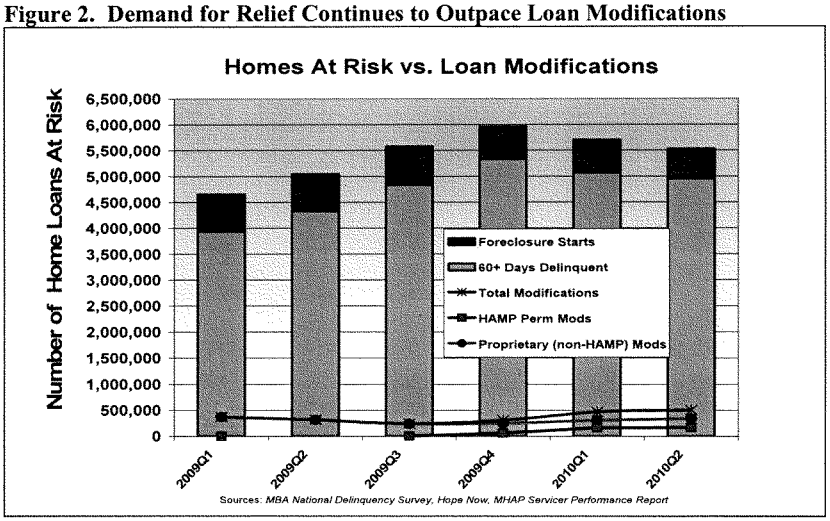


Sources: MBA National Delinquency Survey, Bureau of Labor Statistics.

E. Foreclosures continue to outstrip loan modifications.

Despite both HAMP and proprietary modifications, the number of homeowners in need of assistance continues to overwhelm the number of borrowers who have received a permanent loan modification by ten to one (see Figure 2).

Figure 2. Demand for Relief Continues to Outpace Loan Modifications



About 4.6 million mortgages are in foreclosure or 90 days or more delinquent as of June 30.[34] New foreclosure starts were over 225,000 per month in July and August, having fallen below 200,000 in each of the previous three months. There were roughly 33,000 permanent HAMP modifications in August and 116,000 proprietary modifications.[35] According to the State Foreclosure Prevention Working Group, more than 60% of homeowners with serious delinquent loans are still not involved in any loss mitigation activity.[36]

F. Recent legal developments have revealed pervasive abuses in the mortgage servicing industry.

For at least a decade, community-based organizations, housing counselors and advocates nationwide have documented a pattern of shoddy, abusive and illegal practices by mortgage servicers whose staff are trained for collection activities rather than loss mitigation, whose infrastructure cannot handle the volume and intensity of demand, and whose business records are a mess.[37]

The most egregious of these abuses include:

- misapplication of borrower payments, which results in inappropriate and unauthorized late fees and other charges, as well as misuse of borrower funds improperly placed in "suspense" accounts to create income for servicers.
- force-placing very expensive hazard insurance and charging the borrower's account when the borrower's hazard insurance has not lapsed, often driving an otherwise current borrower into delinquency and even foreclosure.

- charging unlawful default- and delinquency-related fees for property monitoring and broker price opinions.
- failing or refusing to provide payoff quotations to borrowers, preventing refinancings and short sales.
- improperly managing borrower accounts for real estate tax and insurance escrows, including failure to timely disburse payments for insurance and taxes, causing cancellation and then improper force-placing of insurance as well as tax delinquencies and tax sales.
- abuses in the default and delinquency process, including failing to properly send notices of default, prematurely initiating foreclosures during right to cure periods and immediately following transfer from another servicer and without proper notices to borrowers, initiating foreclosure when borrower is not in default or when borrower has cured the default by paying the required amount, and failing to adhere to loss mitigation requirements of investors.

These practices have become so ingrained in the servicing culture that they are now endemic in the industry. The harm to which borrowers have been subjected as a result of these abuses cannot be overstated. Numerous homeowners are burdened with unsupported and inflated mortgage balances and have been subjected to unnecessary defaults and wrongful foreclosures even when they are not delinquent. Countless families have been removed from their homes despite the absence of a valid claim that their mortgage was in arrears.

In addition, perverse financial incentives in pooling and servicing contracts illustrate why servicers press forward with foreclosures when other solutions are more advantageous to both homeowner and investor. For example, servicers are entitled to charge and collect a variety of fees after the homeowner goes into default and can recover the full amount of those fees off the top of the foreclosure proceeds.

In recent weeks, legal proceedings have uncovered the servicing industry's stunning disregard of basic due process requirements.[38] Numerous servicers have engaged in widespread fraud in pursuing foreclosures through the courts and, in non-judicial foreclosure states, through power of sale clauses. Depositions of employees from a broad range of lenders, servicers and law firms have confirmed what many homeowners' advocates have long known: Fraud and deception is rampant in the servicing industry and has culminated in the unjustified and sometimes criminal seizing of family homes. It is becoming more and more apparent that servicers falsify court documents not just to save time and money, but because they simply have not kept the accurate records of ownership, payments and escrow accounts that would enable them to proceed legally. The public is also now learning what foreclosure defense attorneys have asserted for years: the ownership of potentially millions of mortgages is in question due to "innovations" and short-cuts designed to speed the mortgage securitization process.

The illegal practices of servicers during the foreclosure process are not simply a technical problem. Due process when taking private property is a cornerstone of our legal system, and case after case reveals that this is not just a question of dotting the I's and crossing

the T's, but of unnecessary and even wrongful foreclosures. The rules that the banks have broken in their rush to foreclose are designed to give people a fair chance to save their homes.

III. It is time for a comprehensive approach to foreclosure prevention that uses all the tools in the toolbox.

A. Congress can pass legislation that would meaningfully realign incentives among servicers, investors, and homeowners.

1. Change the bankruptcy code to permit modifications of mortgages on principal residences.

Our country's well established system for handling problems related to consumer debt is bankruptcy court. The availability of this remedy is so crucial for both creditors and debtors that the Framers established it in the Constitution, and the first bankruptcy legislation passed in 1800. Today, bankruptcy judges restructure debt for corporations and individuals alike.

Shockingly, however, when it comes to the family home -- the primary asset for most people in our country -- these experienced judges are powerless: current law makes a mortgage on a primary residence the only debt that bankruptcy courts are not permitted to modify in Chapter 13 payment plans. Owners of vacation homes, commercial real estate and yachts can have their mortgage modified in bankruptcy court (and the peddlers of predatory mortgages such as New Century or over-leveraged investment banks like Lehman Bros. can have all their debt restructured) but an individual homeowner is left without remedy.

Addressing this legal anomaly would solve almost in one fell swoop a range of problems that have beset efforts to combat foreclosures. First and foremost, bankruptcy does not leave foreclosure prevention to the voluntary efforts of servicers. Instead, a trusted third party can examine documents, review accounting records, and ensure that both the mortgagor and mortgagee are putting all their cards on the table. Moreover, the homeowner is the one who controls when this remedy is sought, rather than the servicer.

Second, in bankruptcy, the judge can reduce the level of the mortgage to the current market value of the property. This stripdown (some call it cramdown), or principal reduction, can help put homeowners in a position to begin to accumulate equity on their home again, thereby shielding them against future income shocks and increasing their incentive to make regular mortgage payments.

Third, a bankruptcy judge has the power to deal with the full debt picture of the homeowner, including any junior liens on the family home and other consumer debt such as medical bills, credit cards, or student loans. Second liens have proven to be one of the most vexing problems facing many foreclosure prevention efforts, and high consumer debt can threaten the sustainability of any mortgage modification made in a vacuum.[39]

Fourth, bankruptcy addresses "moral hazard" objections, meaning the concern that people will want relief even when they don't need or deserve it. Filing a Chapter 13 claim is an onerous process that a person would rarely undertake lightly. Any relief from debt comes at a substantial cost to the homeowner -- including marring the homeowner's credit report for years to come and subjecting the homeowner's personal finances to strict court scrutiny.

Fifth, the availability of this remedy would in large part be the very reason why it would not need to be used very often. Once mortgages were being restructured regularly in bankruptcy court, a "template" would emerge as it has with other debts, and servicers would know what they could expect in court, making it much more likely that servicers would modify the mortgages themselves to avoid being under the control of the court. Similarly, the fact that a homeowner had the power to seek bankruptcy would serve as the now-missing stick to the financial incentive carrots provided by other foreclosure prevention programs.

Permitting judges to modify mortgages on principal residences, which carries *zero cost to the U.S. taxpayer*, could potentially help more than a million families stuck in bad loans keep their homes.[40] As foreclosures continue to worsen, more and more analysts and interested parties are realizing the many benefits this legislation could have.[41] Recently, the Federal Reserve Bank of Cleveland published an analysis of using bankruptcy courts to address the farm foreclosure crisis of the 1980s, concluding that using bankruptcy to address that crisis did not have a negative impact on availability or cost of credit.[42]

2. Mandate loss mitigation prior to foreclosure.

Congress has the power to require that all servicers, industry-wide, must engage in loss mitigation, and that the failure to do so is a defense to foreclosure. For many servicers, only a legal requirement will cause them to build the systemic safeguards necessary to ensure that such evaluations occur.

In the Senate, a bill introduced by Senator Jack Reed (S. 1431) would address this problem. Similar legislation was introduced in the House of Representatives by Representative Maxine Waters (HR 3451), but the Waters bill needs to be extended to cover existing loans.

3. Level the playing field in court by funding legal assistance for homeowners.

All banks and servicers are represented by attorneys, but most homeowners in default or foreclosure cannot afford an attorney. Housing counselors can help people with their mortgages, but only attorneys can contest foreclosures in court. Programs offering free legal assistance can play an integral role in foreclosure prevention, including:

- identifying violations of mortgage lending laws and laws related to the foreclosure process.

- assisting with loan modification applications and the modification process.
- advising homeowners on existing bankruptcy options.
- helping homeowners seek alternatives to foreclosure.
- defending tenants who are being forced out following foreclosure.
- educating homeowners and tenants about the foreclosure process and legal rights.

Recognizing the importance of borrower representation, the Dodd-Frank Act authorized $35 million to establish a Foreclosure Legal Assistance Program through HUD that would direct funding to legal assistance programs in the 125 hardest hit metropolitan areas. Unfortunately, that money has not yet been appropriated.

As the foreclosure crisis continues unabated, other funding for foreclosure legal assistance is drying up. State-administered Interest on Lawyer Trust Account (IOLTA) revenue, a major source of funding for legal aid programs, has declined 75 percent due to interest rate decreases. State budget crises have forced the slashing of legislative appropriations that fund legal aid. Another major private source of funding for anti-foreclosure work, a grant program run by the Institute for Foreclosure Legal Assistance (IFLA), has already made the last grants it can make under current funding and will end in 2011.[43]

Without additional funding, the attorneys who have developed expertise in this area may well lose their jobs, and legal aid groups will not be able to keep pace with the spike in foreclosure-related needs. Already, legal aid programs turn away hundreds of cases. For these reasons, it is crucial to fund the $35 million Foreclosure Legal Assistance Program authorized by the Dodd-Frank Act.

Congress also should instruct Treasury to permit States participating in the Hardest Hit Program to use that funding for legal assistance when appropriate as part of their overall plan. On the advice of outside counsel, Treasury permits the use of funding for housing counselors, but not for attorneys. This is a perverse result, especially given the unique role that attorneys play in foreclosure prevention.

4. Ensure that homeowners receiving mortgage debt forgiveness or modifications do not find their new financial security undermined by a burdensome tax bill.

Even principal forgiveness or the most carefully structured loan modifications can be seriously undermined if struggling homeowners must treat the forgiven mortgage debt as taxable income. Solving this tax problem has been flagged as a priority by the IRS's Office of the National Taxpayer Advocate.[44]

When lenders forgive any mortgage debt, whether in the context of a short sale, a deed-in-lieu-of-foreclosure, foreclosure, or principal reduction in a loan modification, that amount of forgiven debt is considered income to the homeowner and tax must therefore be paid on it unless the homeowner qualifies for some kind of exclusion to that tax. In 2007, Congress passed the Mortgage Forgiveness Debt Relief Act of 2007 to prevent

adverse tax consequences to homeowners in trouble. After passage of this bill, most policymakers considered the problem to have been solved.

Unfortunately, many homeowners are not covered by that legislation because they took cash out of their home during a refinancing to make home repairs, pay for the refinancing, or consolidate other debt.[45] Moreover, even those homeowners already fully covered by the Mortgage Forgiveness Debt Relief Act often fail to take advantage of this exclusion because it is complicated and they do not understand the need to do so to avoid owing additional taxes. [46]The National Taxpayer Advocate reports that in 2007, less than one percent of electronic filers eligible for the exclusion claimed it.[47] If the definition of qualified mortgage debt is expanded, the IRS can take steps through its tax forms to simplify the process for taxpayers claiming the mortgage debt exclusion.

Finally, while the sunset date on this legislation was already extended through 2012, it needs to be extended further, and preferably made permanent, since this particular part of the tax code was originally aimed at corporate deals (where the vast majority of the related tax revenues are generated) rather than at individual consumer debt issues.

B. Federal agencies have significant authority to help fight foreclosures.

There are a number of agencies with authority to help fight foreclosures. In a later section, we will provide extensive recommendations for improvements that Treasury can make to HAMP. In this section, we provide other suggestions.

1. The federal prudential banking regulators should immediately focus on the servicing operations of their supervisees.

Federal supervisory banking regulators should use their examination authority and supervisory authority to focus on the servicing operations of their supervisees, with a focus on the legality and propriety of accounting inaccuracies, inappropriate fees and charges, failure to comply with loss mitigation requirements, and other problems identified in this testimony.

2. The Consumer Financial Protection Bureau should make regulating servicers one of its first priorities.

The Consumer Financial Protection Bureau (CFPB) already has concurrent supervision authority with federal banking regulators over large banks to examine them for compliance and to assess risks to consumers and markets.[48] Since some of the largest banks are also large servicers, the CFPB and the relevant federal prudential regulators should immediately begin to exercise this supervisory function by closely examining servicers for compliance with all relevant laws and regulations as well as adherence to the provisions of contracts with investors and government agencies such as FHA and VA.

As of July 2011, the CFPB will acquire rule-making authority to prevent abusive, unfair, deceptive and harmful acts and practices and to ensure fair and equal access to products

and services that promote financial stability and asset-building on a market-wide basis. It will also have strong enforcement tools, and the States will have concurrent authority to enforce the rules against violators in their jurisdictions. The CFPB should quickly move to regulate the servicing industry to prevent the abuses of the past.

3. Fannie Mae and Freddie Mac should serve as models to the industry.

Fannie Mae and Freddie Mac (the GSEs), now in conservatorship and supported by taxpayers, should serve as a model for how to prevent unnecessary foreclosures. While it has been a GSE priority to ensure that foreclosures proceed in a timely way, it is important that the desire to avoid delay does not prevent their servicers and attorneys from scrupulously adhering to all laws and guidelines, particularly those regarding loss mitigation reviews. In addition, the GSEs should consider reducing principal on loans when a modification with principal reduction as a positive net present value, rather than having a blanket policy against all principal reductions.

4. HUD, VA, and other government housing programs should enforce their servicing rules, especially those related to mandatory loss mitigation.

FHA, VA, and other government-insured housing finance programs should ensure that their servicers are conducting the required loss mitigation reviews and following all relevant laws and guidelines. In a recent press conference, HUD Secretary Shaun Donovan admitted that an internal HUD investigation indicated that FHA servicers were not always conducting the loss mitigation reviews required by FHA. In addition to recommending that HUD terminate contracts with servicers that are not adhering to the provisions of those contracts, we recommend that HUD release public information concerning the loss mitigation track records of its servicers.

C. State foreclosure laws provide an opportunity for States to prevent servicing abuses and save homes.

1. State legislatures should mandate loss mitigation prior to foreclosure.

While states have been hit hard by the current crisis as foreclosures drain resources from already-strapped budgets, states are also in a strong position to prevent foreclosures. Although mandatory loss mitigation standards exist in many parts of the market now, lack of enforcement has diminished their impact, and they are not industry-wide. By exercising their control over the foreclosure process, states can require that servicers assess whether foreclosure is in the financial interest of the investor before proceeding to foreclosure. A mandatory loss mitigation standard will function as a low-cost, high-impact foreclosure prevention tool that ensures foreclosure is a last resort.[49]

Like the NPV test required by HAMP, a mandatory loss mitigation standard would require that servicers weigh the investor's cost of foreclosure against the investor's anticipated cash flow from future modified mortgage payments.[50] By mandating this additional step, states can impose uniform standards, which promote fairness and transparency, across all mortgage servicers and financial institutions, regardless of their charter or affiliation.

While ideally states would require servicers to perform a loss mitigation analysis prior to filing for foreclosure, existing laws have incorporated elements of a mandatory loss mitigation standard at various stages of the foreclosure process. There are four ways in which a loss mitigation component has been integrated into state foreclosure laws, either implicitly or explicitly: (1) as a pre-condition to foreclosure filing; (2) as part of a foreclosure mediation program; (3) as a pre-condition to foreclosure sale; and (4) as the basis for a challenge post-foreclosure sale.

This range of approaches demonstrates the extent to which a loss mitigation standard can be adapted to any foreclosure process. Because not all foreclosures are preventable, the implementation of this standard will not limit the right of creditors to foreclose on a property where appropriate, but would ensure that the foreclosure sale is a last resort, after all other foreclosure prevention strategies have been considered.

The HAMP qualification process has repeatedly been criticized for its lack of transparency by both borrowers and their advocates. In fact, no mechanism currently exists to provide borrowers with a standardized and meaningful explanation of the reasons they are denied a modification. Without a standardized modification denial process with possibility of appeal, borrowers are unable to know whether their modification application was denied based on accurate information. States can promote transparency and accountability by combining a mandatory loss mitigation standard with basic disclosures of the inputs used in the NPV calculation and the results of the calculation, which can be contested by appeal.

To be most effective, a flexible mandatory loss mitigation standard should be combined with:

- a requirement that the foreclosing party provide homeowners with a loss mitigation application in tandem with any pre-foreclosure notice or pre-foreclosure communication;

- a requirement that the foreclosing party submit an affidavit disclosing the specific basis for the denial of a loan modification, including the inputs and outputs of any loss mitigation calculations;

- a defense to foreclosure (or equivalent right in non-judicial foreclosure states) based on failure of the foreclosing party to engage in a good faith review of foreclosure alternatives; and

- public enforcement mechanisms to safeguard against systemic abuses.
- states with a mediation program or considering creating one could use the program as an appeal process when an adverse loss mitigation determination is made.[51]

Finally, state authority to regulate and license mortgage servicers provides another avenue through which States can promote servicer accountability and incorporate mandatory loss mitigation.[52]

2. States should exercise their supervisory and enforcement authority over servicers doing business in their jurisdiction.

Where state banking agencies have examination and enforcement authority over servicers operating in their jurisdiction, they, too, should focus on the legality, propriety, and accuracy of accounting, inappropriate or unnecessary fees and charges, failure to comply with loss mitigation requirements, and other problems identified in this testimony.

The recently announced investigation by the state attorneys general should encompass these same matters, as well as the mortgage ownership and "robo-signing" problems.

IV. To fight foreclosures effectively, the Treasury Department should make a number of important changes to the HAMP program.

A. Although HAMP has had some accomplishments, its overall performance has failed to live up to expectations and has not significantly changed the trajectory of the foreclosure crisis.

The Making Home Affordable program was launched about a year and a half ago. It has two components. One component is the HARP program, which is a refinancing program for homeowners with GSE mortgages and which we will not address in this testimony.[53] The other component -- and the one that has drawn far more public attention -- is the HAMP program, which provides incentives for participating servicers to make loan modifications when the net NPV of the modification is greater than that of foreclosure. As of September, approximately 470,000 homeowners had received and were still active in a permanent modification.[54]

While saving almost a half million homes is a significant accomplishment, it falls far short of the original estimate that HAMP would assist 3-4 million borrowers.[55] The number of new trial modifications has dropped significantly since HAMP changed its guidelines to require up-front underwriting of the modifications, and the number of conversions to permanent modifications is also declining, with fewer than 28,000 permanent modifications made in September. Given that trajectory, it seems unlikely that the total number of permanent modifications by the end of 2012 will exceed one million.[56]

Also, the efforts have come at a significant cost. Almost 700,000 homeowners who received trial modifications have seen their modifications cancelled, and many of those have ended up in a worse financial situation as a result of their participation: during the trial period, not only did they make payments on a home that they might ultimately lose, but they also were reported as delinquent to the credit bureaus and they continued to accumulate late fees, interest, and attorneys fees, resulting in large arrearages due at the end of the trial modification.

Perhaps even more important is the widespread negative experience that so many homeowners and their advocates have had with the program. For a whole range of reasons ranging from lack of capacity to conflicts of interest, mortgage servicers in many cases fail to provide many homeowners with a HAMP review that is timely, accurate, and adheres to HAMP guidelines. Stories abound of servicers who have had stunningly bad experiences with the program.

For example, Ms. L., a Latina homeowner in California, first applied for a HAMP modification in April 2009. In August 2009, SunTrust finally approved Ms. L. for a three-month HAMP trial plan with payments of $1,000 per month beginning in September 2009. Despite the fact that Ms. L. was making every payment under the plan, SunTrust caused a Notice of Default to be recorded against her home in November 2009. Ms. L found a nonprofit attorney, who first contacted SunTrust in January 2010 and was told Ms. L. had been denied a HAMP modification because of insufficient income. However, the income information SunTrust stated was in Ms. L's file was inaccurate. Her attorney requested reconsideration on that basis and provided the correct income information. SunTrust said it would reconsider the denial. SunTrust said the modification may have been rejected because of SunTrust's overstatement of insurance costs and requested proof of insurance and updated financial documents from Ms. L., which the attorney provided. SunTrust said its initial calculations showed that Ms. L. was eligible for HAMP, and that the foreclosure sale of her home had been "put on hold." Ms. L continued to make her payments every month. Nevertheless, in April, Ms. L.'s son returned home to find a Notice of Trustee Sale posted on the client's door.

From the perspective of nonprofit attorneys and housing counselors, Ms. L's story is a very typical interaction with the HAMP program. This experience is especially astonishing given that most borrowers who have an attorney or housing counselor submitted all their financial information at the front end of their modification, rather than obtaining a so-called "stated-income" modification. Subsequently, it has become clear that, prior to the new HAMP requirement of pre-trial modification underwriting, even when a fully documented package was submitted, the servicer did not use this information and just made a trial modification on a stated income basis. This results in far more reevaluations than would have otherwise have been necessary, both slowing the rate of conversation and raising the rate of program dropouts.

However, given the way HAMP was created and implemented, many of these problems are no surprise. First, the program repeatedly raised public expectations that were then dashed when programs were not already operational. This pattern began at the inception

of the program, when HAMP was announced to the public well before its infrastructure was in place. Servicers were quickly overwhelmed by requests when they were not yet prepared to qualify people for the program, thereby causing many homeowners to be very disappointed early on. Despite this initial bad experience with a lag between public announcement and rollout, Treasury continued to make every subsequent program change the same way. Rather than inform the servicers and wait for them to be ready before informing the public, Treasury's routine was to release the broad outline of a new initiative or guideline change and then have an implementation date months away.

Second, the Administration did not make its foreclosure prevention program a priority on its own agenda. For example, Treasury did not appoint the permanent head of the Office of Homeownership Preservation until about six months after the program had been launched. Key leadership in HAMP's early days came from Bush Administration holdovers, who were knowledgeable about the issues but not part of the inner circle of Administration decision-makers.

Third, because program changes were occurring on a rolling basis, servicers had to engage in continual retooling of the already strained systems with which they were working. Servicers already were scrambling to staff up their loan modification operations, often hiring staff with very little if any experience to do a job that is normally done by experienced underwriters. With continual changes to the program, the difficult challenge of training these staff became virtually impossible.

Fourth, and perhaps most important, the HAMP program originally was intended to be only one part of the foreclosure prevention program, with the other part being a reform to the bankruptcy code that would have allowed judges to modify mortgages on principal residences. When the bankruptcy reform failed to pass Congress, HAMP became an entirely voluntary system. As a result, any change to HAMP policy always had to be evaluated as to whether it would either deter servicers from signing up or cause them to withdraw from the program. In other words, not only did the HAMP carrot lack the bankruptcy stick with respect to individual borrowers, but it has had to pull punches with respect to overall program design to ensure continued participation.

Finally, as has become crystal clear to even the casual observer, the servicing system remains in complete disarray for a variety of reasons, including that the system's capacity is too strained to function correctly; the existence of crosscutting financial incentives that cause servicers and their contractors to act in their own best interest rather than in the best interest of either investors or homeowners; and the fact that the system may simply be too big to ever be manageable.

B. Recommendations to make HAMP fairer and more effective.

1. Aggressively enforce HAMP guidelines through serious penalties and sanctions for noncompliance.

Over its year and a half of operations, Treasury has improved the HAMP program in a number of ways in response to concerns expressed by homeowners, advocates, and servicers. Unfortunately, servicers do not always comply with all the HAMP guidelines. Although we are told that errors are corrected when they are found during the Freddie Mac compliance process, the continuous flow of HAMP horror stories from advocates and the press illustrates that many guidelines are being evaded or ignored.

We recommend that Treasury develop a clear, impartial system of penalties and sanctions for failure to comply with HAMP guidelines. Some HAMP guidelines are more crucial than others (see, for example, the section below on foreclosure stops), and violation of those guidelines should result in stiffer penalties. In addition, Treaury should release full information on the compliance records of each servicer, along with the number of corrective actions that have been taken, and develop a system for logging and investigating complaints from advocates about noncompliance with HAMP guidelines.

2. Create an independent, formal appeals process for homeowners who believe their HAMP denial was incorrect or who cannot get an answer from their servicer.

When a borrower is rejected for a HAMP modification, that borrower should have access to an independent appeals process where someone who does not work for the servicer can review and evaluate the situation. The existing HAMP escalation procedures are extremely inadequate. (Freddie Mac does conduct compliance reviews and will require a servicer to fix any errors it finds, but this process cannot be triggered by request of an individual homeowner.) Since HAMP changed its procedures in January 2010 to require that servicers send letters with reasons for denial, and even more so as HAMP implements the directive contained in the Dodd-Frank Act that servicers disclosure the inputs used to make those decisions, homeowners have increased access to information about their denial, but they still have no way to make a change if that information indicates their denial to be in error.

We recommend that the Treasury establish an Office of the Homeowner Advocate to serve an appeals and ombudsman role within the program, along the lines of the National Taxpayer Advocate. Senator Al Franken and several co-sponsors drafted an amendment to Senate legislation that would have established such an office; although the amendment passed the Senate floor with bipartisan support, the underlying legislation failed so it was never enacted.[57] For states or localities that have foreclosure mediation programs, those programs could also be used to handle this type of appeal.

3. Review all borrowers for HAMP, 2MP, and HAFA eligibility or other sustainable proprietary solutions before proceeding with foreclosure.

Prior to June 2010, servicers routinely pursued HAMP evaluations and foreclosures simultaneously. Homeowners trapped in those parallel tracks received a confusing mix of communications, including calls and letters concerning evaluation for a modification, and other formal notifications warning of an impending foreclosure sale. These mixed messages contributed to the failure of some borrowers to send in all their documentation, the early re-default of many trial modifications, and the difficulty servicers have reaching certain borrowers.

Although HAMP guidelines prohibited the actual foreclosure sale from taking place prior to a HAMP evaluation, sales were taking place anyway because the foreclosure proceedings are handled by outside law firms and communications between servicers and foreclosure attorneys regarding HAMP are extremely minimal.[58] Adding insult to injury, when continuing the foreclosure process during HAMP evaluation servicers' lawyers were billing thousands of dollars in attorneys fees that the homeowners were then expected to pay.

With Supplemental Directive 10-02, Treasury directed that for all new applicants, servicers were supposed to complete the HAMP review prior to referring the case to foreclosure. However, except for the very small group of borrowers whose trial modifications were fully verified,[59] borrowers whose foreclosures had already begun would remain in the foreclosure process even if their HAMP evaluation had not been completed.

Not surprisingly, despite Supp. Dir. 10-02, advocates are still routinely seeing homeowners placed into the foreclosure process even when they have not yet had their HAMP review. In some cases, this is because the homeowner did not qualify for the "foreclosure stop"; in other cases, servicers simply are not complying with the guidelines; in still other cases, the rules are ambiguous. For example, while servicers may not refer a case to a foreclosure attorney before the review, in a non-judicial state, it may not be clear that the foreclosure cannot actually be filed.

Foreclosures and foreclosure sales prior to HAMP evaluation are perhaps the biggest reason for the public's loss of confidence in the program. We recommend that when a borrower applies for HAMP,[60] the servicer should stop all foreclosure referrals, filings, or any actions to advance any goal other than HAMP review. As noted in Recommendation #1 above, when a servicer is found to proceed with a foreclosure prior to evaluation, strict penalties should ensue swiftly.

4. To ensure that loan modifications are sustainable, require servicers to reduce principal whenever the alternative waterfall yields a positive NPV or at least to disclose the positive NPV to investors, require servicers to reduce principal on second liens proportional to any reduction of principal undertaken with respect to the first lien, and require servicers to reduce principal appropriately when the underlying mortgage exhibits predatory characteristics.

Millions of Americans now owe more on their mortgages than their homes are worth. While the overall number of mortgages underwater is estimated to be almost one in four,[61] this ratio is far higher for homeowners who are having trouble affording their mortgage, and the average HAMP borrower owes $1.14 for ever $1.00 the house is worth.[62] Homeowners who are underwater have no cushion to absorb future financial shocks, and they have fewer incentives to sacrifice to stay in the home or to make ongoing investments in maintenance.[63] For these homeowners, even the reduction of monthly payments to an affordable level does not fully solve the problem. As a result, a homeowner's equity position has emerged as a key predictor of loan modification redefault, more so than unemployment or other factors.[64]

Many stakeholders believe that principal reduction is ultimately the only way to help the housing market reach equilibrium and begin to recover.[65] However, even as loan modification activity has ramped up in the overall market, principal reduction has remained relatively rare. One context in which it occurs is in portfolio loans with no second liens, which suggests that banks understand the usefulness of principal reduction but that for securitized loans, there is a conflict of interest between the banks that own the second liens (and who also own the servicers) and the investors who do not want to agree to a write-down on the first lien unless the second lienholder does the same.

In recognition of these realities, HAMP has initiated two programs: the "alternative waterfall" principal reduction program, and 2MP, the second lien program. Unfortunately, although HAMP offers generous financial incentives to cover the write-down, HAMP does not require servicers to engage in principal reduction even when it's in the best interests of the investor.[66]

Since the alternative waterfall program just began this month, we do not yet know how it will work. It is likely that the only way principal reduction is ever going to happen on a widespread basis is if it is required. Similarly, although 2MP has existed for over a year and although all four major banks have signed up, it is unclear why that program has only been used 21 times to date.[67] For this reason, HAMP should either require the write-downs or require the servicers to disclose the results of the positive NPV calculations to the investor.

Finally, HAMP should provide a commensurate reduction in principal for loans that exhibit predatory characteristics, such as 2/28s, 3/27s, and non-traditional loans such as interest-only or negatively amortizing loans not underwritten to the fully indexed rate or fully amortizing payment.

5. Increase the mandatory forbearance period for unemployed homeowners to six months and reinstitute the counting of unemployment benefits as income.

Another attempted improvement to HAMP this year was the establishment of a forbearance program for homeowners who lose their job (UP). Under UP, unemployed homeowners get at least three months (more if the servicer chooses) of reduced payments that will end when the homeowner becomes reemployed.

Unfortunately, this program does not adequately address the issue of unemployed homeowners. First, servicers were already doing a lot of three-month forbearances on their own. The problem is that most homeowners need longer than three months, as the average length of unemployment during this downturn is well over six months.[68] Second, when UP was announced, the HAMP guidelines changed so that unemployment income was no longer counted as "income" for a HAMP modification, even if it was guaranteed for at least nine months. Many families have sufficient income in addition to unemployment benefits to qualify for HAMP, and generally they would be better served by a HAMP modification than by a temporary forbearance.

Finally, HAMP should clarify the relationship between UP, HHF, and the new HUD bridge loan program.

6. Mandate automatic conversions of successful trial modifications and reimburse homeowners who pay their trial modifications but are not converted for any interest and fees paid during that period.

First, for borrowers who entered into verified income trial modifications, servicer delays in converting trial modifications to permanent modifications are simply unacceptable. They increase costs to homeowners and create significant periods of uncertainty. There is no reason why trial modifications should not automatically convert to permanent modifications if the borrower makes three timely trial modification payments.

Second, homeowners who received a stated income trial modification in good faith, made all their trial payments in a timely way, but are denied a permanent modification should not end up financially worse off than they were before the trial modification. Currently, however, they do end up worse off. Throughout the entire period, which is usually longer than three months since servicers are so backed up, these borrowers who are doing everything that is asked of them continue to be reported to credit bureaus as delinquent on their mortgage. Moreover, since the trial modification payments are by definition less than the full contract payment under the mortgage and the terms of the mortgage are not altered during the trial modification, homeowners finish a trial modification owing more on their homes than when they started. We have seen servicers use these arrears, accumulated during the trial modification, as the basis for initiating an immediate foreclosure against a homeowner, post-trial modification.

Homeowners who pay their trial modification payments but are not converted be given an opportunity to pay back the arrears through regular monthly installments rather than a lump sum payment. Furthermore, the borrower should have the choice to have the arrears capitalized into the loan and the term extended so that their participation in HAMP does not result in an increase in monthly payments (if the PSA prevents a term extension, the amortization period should be extended). Finally, many homeowners end up facing foreclosure solely on the basis of the arrears accumulated during a trial modification. Such foreclosures should be prohibited.

7. Make the NPV model transparent and available to homeowners and the public as required by the Dodd-Frank Act.

A homeowner's qualification for a loan modification under HAMP is determined primarily through an analysis of whether the investor profits more from a loan modification or a foreclosure. The outcome of this analysis depends on inputs that include the homeowner's income, FICO score, current default status, debt-to-income ratio, and property valuation, plus factors relating to future value of the property and likely price at resale. Servicers that participate in HAMP are required to apply a specific NPV analysis model to all homeowners who are 60 days delinquent and those at imminent risk of default.

Homeowners and their advocates need access to the HAMP program's NPV model so that they can determine whether servicers have actually and accurately used the program in evaluating the homeowner's qualifications for a HAMP modification. Without access to the NPV analysis, homeowners are entirely reliant on the servicer's competency and good faith.

In the Dodd-Frank Act, Congress required Treasury to make the NPV public and to provide the public with a web portal to access it. Although we understand this process is underway, we believe it should be expedited and be released by the end of the calendar year if not sooner.

Finally, the HAMP NPV model needs to be improved. The current model provides for two linear "waterfalls," which provide an easy path for servicers to discharge their duty to evaluate the NPV. However, these models are not designed with the goal of finding a positive NPV through different combinations of steps. A more dynamic and richer model would do a better job of saving as many homes as possible in a way that makes financial sense to the investors.

8. Require servicers to provide the homeowner with the relevant written documentation anytime a modification is denied to investor restrictions.

Servicers are required to provide a HAMP modification whenever the NPV is positive, unless the Pooling and Servicing Agreement with the investor prohibits such a modification and the servicer has sought a change in policy from the investor and the investor has not agreed. Yet servicers are not required to document the contract language

or the efforts made to otherwise obtain authority for the modification. It appears that many servicers are using "investor turndowns" as a reason not to do a modification in violation of HAMP rules, in most cases because the contract does not actually prohibit the modification and in some instances because the servicer has not requested a change in policy from the investor.

When a servicer believes a PSA prevents an NPV-positive modification, the servicer should contact the trustee and any other parties authorized under the terms of the PSA to grant a waiver, whether individual investors, credit rating agencies, bond insurers, or otherwise, in order to obtain permission to perform a HAMP modification. In cases where the servicer ultimately denies the modification due to investor restrictions, servicers should have to give the borrower or the borrower's representative a photocopy of the limiting language in the PSA, a copy of all correspondence with the lender and investors attempting to obtain authority to perform a modification, and electronic access to a complete and unaltered copy of the PSA.

9. Share loan-level data with the public to ensure that everyone has access to the most complete source of data on foreclosure prevention publicly available.

The Treasury Department is collecting a broad range of data from servicers participating in the HAMP program – more data than has ever been collected about the loan modification process by any other public entity. This data can shed great light into how the HAMP program is working: which borrowers are getting modifications and which are not; the geography of modification activity; the types of modifications that are being provided; and the patterns of re-defaults that are occurring. This data is crucial for those working to develop more and better tools to fight foreclosures and prevent a repeat of this crisis.

However, the Treasury Department has severely limited the data it has released. For over a year, it has promised to release the loan-level data to policymakers, researchers, and the public, but whenever asked, the promised date of release is pushed back. Treasury should release this data as soon as possible in a raw, disaggregated form so that independent researchers and other interested parties can analyze it themselves. If additional staffing is needed to scrub the data and turn it around quickly, we urge Treasury to assign more people to the task.

Finally, while this data must be purged of private information such as names and social security numbers, some have suggested that race and ethnicity data not be released on a servicer-by-servicer basis. Given the significant racial and ethnic inequities that have plagued the mortgage market, detailed demographic data for each servicer is of vital importance to all stakeholders.

10. Transfer servicing duties to companies that don't have conflicts of interest.

Since early 2007, mortgage loan servicers have been promising to help homeowners in trouble.[69] The Bush Administration believed that servicers would voluntarily provide this assistance because in so many cases, foreclosure made no economic sense for the lender or loan owner. Unfortunately, financial incentives for servicers often encourage outcomes that are not advantageous either for the loan owner or for the homeowner.[70] What's more, like other players in the financial services industry, much of their income comes from fee-generating tricks and traps for consumers.

It is fully understood now that helping homeowners avoid foreclosure is frequently in conflict with the financial interest of servicers. Thus, the HAMP program provides servicers with financial incentives for placing homeowners into permanent loan modifications if the benefit (net present value) of the modification is higher than that of foreclosure. Unfortunately, so far, these financial incentives have not proven sufficient for servicers to process loan modification requests in a timely, effective manner.

Moreover, most observers agree that most servicers in their current form lack the capacity to handle a foreclosure crisis of the size and scope we are seeing today.[71] Servicers have had to do a great deal of retooling. Their employees are no longer simply collection agents, but are serving essentially as both loan underwriters and housing counselors. In the early months of the program, a great deal of latitude was given to servicers to allow ramp-up time, but these capacity issues continue to persist. Homeowners still have terrible trouble reaching their servicers, and when they do, they often encounter employees who know little about HAMP, who try to steer them to other products or persuade them to leave their homes, and they are unable to get any firm decisions made in a timely manner.

The perceived shortcomings of the mainstream servicing industry has led to significant growth in the number and size of so-called specialty servicers – businesses that specialize in intensive, "high-touch" approaches to working with homeowners in trouble. These specialized servicers are often able to reach homeowners at many times the rate of a mainstream servicer and in many cases are more skilled in dealing with families in crisis. Recently, Fannie Mae and Freddie Mac began to require their servicers who are not producing sufficient results to use specialty servicers for the delinquent accounts.

We think it would be useful to explore how and under what circumstances the Treasury Department could require other HAMP-participating servicers to turn their accounts over to special servicers working for the government when the account becomes 60 days delinquent. However, it would be of the utmost importance to ensure that the specialty servicers are carefully monitored to ensure that a more aggressive approach does not violate consumer rights with respect to debt collection.

11. Permit homeowners who experience additional hardships to be eligible for additional HAMP modifications.

Even after a homeowner is paying the monthly payments due under a HAMP loan modification, life events may still occur that would once again disrupt these payments, such as job loss, disability, or the death of a spouse. These subsequent, unpredictable events, outside the control of the homeowner, should not result in foreclosure if a further loan modification would save investors money and preserve homeownership.

Foreclosing on homes where homeowners have suffered an involuntary drop in income without evaluating the feasibility of a further HAMP modification is punitive to homeowners already suffering a loss and does not serve the interests of investors. Some servicers provide some modifications upon redefault as part of their loss mitigation program; this approach should be standard and should include continued eligibility for HAMP modifications rather than only specific servicer or investor programs.

12. Mandate an additional 30 days after HAMP denial for the borrower to apply for assistance through a state Hardest Hit Program and then re-evaluate for HAMP if the application is approved.

Under Supplemental Directive 10-07, servicers may, but do not have to, provide borrowers with an additional 30 days after denial for the borrower to apply for HHF and see if the HHF program will get them to a HAMP-positive result. This additional time period should be mandatory. Allowing servicer discretion will lead to inconsistency in the program operation and denial of borrowers who could qualify for HAMP, and is at odds with HAMP's apparent intention that servicers not be allowed to condition HAMP application on HHF application.

Since borrowers can't know in advance if HHF funding will make the difference between HAMP denial or acceptance and won't know if the servicer will give them a chance to apply for HHF funding if they are denied for HAMP, borrowers will have to apply for HHF funds, even if HAMP alone would do the trick. This will result in the use of HHF funds to subsidize HAMP and diminish the impact of the additional HHF funds.

13. Clarify existing guidelines to streamline the process and carry out the intention of the program

These additional issues require some measure of clarification or minor tweaking to prevent abuses and problems:

- **All servicers should accept the standard HAMP application and corrected 4506-T forms.** Borrowers report that servicers reject HAMP applications if borrowers submit a standard application form (RMA) instead of the servicer's form, or return with corrections a 4506-T form completed by the servicer. Servicers need additional guidance that submission of standard tax and HAMP forms by borrowers is adequate for purposes of HAMP review and that servicers

may not deny review because a borrower has corrected misinformation on a servicer form.

- **Equity in a home should not preclude a HAMP modification.** Servicers routinely reject borrowers for HAMP who are in default because they have "too much equity," apparently relying on old guidelines to assess the availability of refinancing. Explicit guidance should be provided to servicers to disregard the amount of equity in a home when evaluating a borrower's HAMP eligibility, aside from its role in the NPV test.

- **Clarify that non-borrower surviving spouses and those awarded the home in a divorce decree are eligible for a HAMP modification**. In Sup. Dir. 09-01 and in FAQ 2200, HAMP appears to permit non-borrower surviving spouses or those who receive the property in a divorce decree although they are not borrowers to obtain a loan modification. Servicers, however, continue to insist that an estate be opened before dealing with the surviving spouse and often initiate foreclosure proceedings instead of reviewing the surviving spouse for a HAMP loan modification. Treasury should state directly that non-borrowers permitted under the Garn-St Germain Act to assume the note are to be treated as eligible borrowers for HAMP, provided they meet the other qualifications.

- **Wholly owned subsidiaries should be covered under the servicer contracts.** Many large servicers operate multiple companies and divisions, often with similar names, yet there is no easy way for homeowners to identify if these divisions are participating. For example, the only Wells Fargo entity listed on the "Contact Your Mortgage Servicer" page of the Making Home Affordable website is the national bank, but most mortgage customers of Wells Fargo will deal with Wells Fargo Home Mortgage, Wells Fargo Financial, or America's Servicing. Advocates continue to report confusion as to coverage, with subsidiaries frequently denying that they are covered by a contract signed by the parent.

- **Servicers should not be able to rescind permanent HAMP modifications.** Although HAMP trial modification contracts indicate that a homeowner can obtain a permanent modification by making three trial modification payments, servicers have been withdrawing trial modification offers, and, worse, cancelling existing permanent modifications, citing investor restrictions and other issues that should have been identified prior to these agreements. While servicers and others have sought to describe these cancellations as clerical errors, they are breaches of contract that epitomize the one-sided dynamic of HAMP modifications. For example, Ms. S. in Brooklyn, NY, an elderly homeowner, made five payments under a HAMP Trial Period Plan before obtaining a permanent modification in February 2010. After discussing the terms of the permanent modification in detail in a Settlement Conference in the New York State Court, she accepted the modification agreement and the foreclosure action was then discontinued. Inexplicably, although she was making payments under the modification agreement, Ms. S. then received a second permanent HAMP offer that lowered

her payment slightly but did not extend the term of her loan and therefore had a balloon payment of $280,000. After almost a year of negotiations and multiple court appearances, the servicer is claiming that an investor restriction prohibits a term extension and thus refuses to honor the first modification.

- **Servicers should pre-sign permanent modification documents.** After a borrower successfully completes a trial modification, the servicer is required to send permanent modification papers to the homeowner. Often, these papers are not pre-signed and such finalizing can often take months. Permanent modifications would increase and the timeline would be shortened if servicers were required to send pre-signed permanent modification agreements to the homeowner. Further efficiency would be derived from the establishment of a timeline for the sending and returning of permanent modification documents.

Conclusion

Today's foreclosure crisis is the worst housing downturn since the Great Depression. The stakes are high. Not only have millions of families lost their homes, but the crisis is responsible for close to two trillion dollars in additional lost wealth, cuts in municipal services, shortages of affordable housing, and reduction of homeowner disposable income. As foreclosures mount, these related costs will only grow worse.

Even under a best-case scenario, the current crisis will continue and fester if interventions remain on the current narrow course. There is no "silver bullet" strategy to fix every mortgage or repair every foreclosure-ravaged neighborhood. The breadth and depth of the housing crisis means that we must address it through multiple approaches and solutions. To make a real difference in preventing foreclosures and reducing associated losses, we need a multi-pronged strategy that strengthens the way current foreclosure prevention programs are implemented and also invests in new approaches.

As policymakers take actions to address the immediate crisis, it is our hope that they also will be mindful of policy failures that enabled the situation. Economic cycles and housing bubbles may always be with us, but the experience of recent years vividly shows the value of sensible lending rules and basic consumer protections, even during economic booms. It is critically important that policymakers translate the lessons of this crisis into sensible rules to prevent another disaster in the future.

We appreciate the chance to address the Congressional Oversight Panel and look forward to assisting you in your work in any way that we can.

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[1] Laurie Goodman, Roger Ashworth, Brian Landy, and Lidan Yang, "The Housing Crisis—Sizing the Problem, Proposing Solutions," Amherst Mortgage Insight (Oct. 1, 2010) [hereinafter "Amherst Study," on file with CRL.

[2] State Foreclosure Prevention Working Group, "Redefault Rates Improve for Recent Loan Modifications" (August 2010), p.1, *available at* http://www.csbs.org/regulatory/Documents/SFPWG/DataReportAug2010.pdf.

[3] The new report from the SIGTARP makes the same point about loss of public confidence in the program. *See* Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP), "Quarterly Report to Congress" (October 26, 2010).

[4] There were 468,058 permanent HAMP modifications and 3,213,594 proprietary modifications, although it is not clear whether these proprietary modifications were temporary or permanent. See Hope Now August 2010 Data Report, available at http://www.hopenow.com/industry-data/HOPE%20NOW%20Data%20Report%20(August)%2010-05-2010%20v2b.pdf.

[5] According to attorneys who are part of the Institute for Foreclosure Legal Assistance network, servicers often promise borrowers a speedier resolution if they choose a proprietary modification.

[6] Ironically, prior to the voluntary moratoria of recent weeks, a number of bloggers reported that Treasury Secretary Geithner suggested one of HAMP's successes was helping to delay foreclosures so servicers could collect a few more months of payment. See, e.g., David Dayen, "Treasury Admits HAMP Expectations Not Met, Thinks Extend and Pretend Is A Virtue" (Aug. 20, 2010), *available at* http://news.firedoglake.com/2010/08/20/treasury-admits-hamp-expectations-not-met-thinks-extend-and-pretend-is-a-virtue/.

[7] MBA National Delinquency Survey, August 2010 [hereinafter "MBA National Delinquency Survey"]. The combined percentage of loans in foreclosure or at least one payment past due was 13.7 percent on a non-seasonally adjusted basis.

[8] First American Core Logic Negative Equity Report Q22010, *available at* http://www.corelogic.com/uploadedFiles/Pages/About_Us/ResearchTrends/CL_Q2_2010_Negative_Equity_FINAL.pdf.

[9] Rod Dubitsky, Larry Yang, Stevan Stevanovic and Thomas Suehr, *Foreclosure Update: over 8 million foreclosures expected,* Credit Suisse (Dec. 4, 2008) (projecting 10 million foreclosures by 2012 depending on current unemployment rates); Jan Hatzius and Michael A. Marschoun, *Home Prices and Credit Losses: Projections and Policy Options*, Goldman Sachs Global Economics Paper (Jan. 13, 2009) (projecting 13 million foreclosures by 2014) at 16.

[10] Debbie Gruenstein Bocian, Wei Li and Keith S. Ernst, *Foreclosures by Race and Ethnicity: The Demographics of a Crisis,* Center for Responsible Lending (June 18, 2010).

[11] For methodology, *see* Center for Responsible Lending, "Soaring Spillover: Accelerating Foreclosures to Cost Neighbors $502 Billion in 2009 Alone; 69.5 Million Homes Lose $7,200 on Average; Over Next Four Years, 91.5 Million Families to Lose $1.9 Trillion in Home Value; $20,300 on Average" (May 2009), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/soaring-spillover-3-09.pdf.

[12] Center for Responsible Lending, *Continued Decay and Shaky Repairs: The State of Subprime Loans Today* (Jan. 8, 2009), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/continued_decay_and_shaky_repairs.pdf.

[13] G. Thomas Kingsley, Robin Smith, & David Price, *The Impact of Foreclosures on Families and Communities*, The Urban Institute (May 2009), at 21, Fig. 3.

[14] D. Pelletiere, "Renters in Foreclosure: Defining the Problem, Identifying Solutions," National Low-Income Housing Coalition (Jan. 2010), *available at* http://dsl-router.nlihc.org/doc/renters-in-foreclosure.pdf.

[15] The "Helping Families Save Their Home Act of 2000," signed into law by President Obama in May 2009, provided that month-to-month tenants must receive 90 days' notice before having to move out and that tenants with leases may stay until the end of their lease (unless the owner plans to occupy the property, in which case tenants still must receive 90 days notice).

[16] Also, many tenants are not aware of their right to stay in their homes, and when they receive a notice from a bank lawyer naming their landlord and seeking eviction, they leave regardless of their legal rights. *See, e.g.,* Testimony of Deborah Cuevas Hill, The Legal Aid Society of the District of Columbia, before the Committee on Public Services and Consumer Affairs, Council of the District of Columbia (May 28, 2009), *available at* http://www.legalaiddc.org/issues/documents/TestimonyreTOPALegilsation.pdf.

[17] "Meeting Multifamily Finance Housing Needs During and After the Crisis: A Policy Brief," Joint Center for Housing Studies, Harvard University (Jan. 2009), *available at* http://www.jchs.harvard.edu/publications/finance/multifamily_housing_finance_needs.pdf.

[18] *Id.*

[19] It is popular, although incorrect, to blame the Community Reinvestment Act (CRA) and Fannie Mae and Freddie Mac (the GSEs) for the foreclosure crisis. For a complete discussion of why CRA and the GSEs did not cause the crisis, *see* Testimony of Eric Stein, Center for Responsible Lending, before the Senate Committee on Banking (Oct. 16, 2008), *available at* http://www.responsiblelending.org/mortgage-lending/policy-legislation/congress/senate-testimony-10-16-08-hearing-stein-final.pdf.

[20] These were loans with the following characteristics: debt-to-income ratios lower than 41%; fixed rate or loans with at least a 7 year fixed period; a term of 30 years or less; no balloon payments; no interest-only or negative amortization loans; full income documentation; and either an LTV under 80% or, if LTV above 80%, with mortgage insurance.

[21] Vertical Capital Solutions, Historical Performance of Qualified vs. Non-Qualified Mortgage Loans (February 2010) (on file with CRL).

[22] Rick Brooks and Ruth Simon, *Subprime Debacle Traps Even Very Credit-Worthy: As Housing Boomed, Industry Pushed Loans To a Broader Market,* Wall Street Journal at A1 (Dec. 3, 2007).

[23] Letter from Coalition for Fair & Affordable Lending to Ben S. Bernanke, Sheila C. Bair, John C. Dugan, John M. Reich, JoAnn Johnson, and Neil Milner (Jan. 25, 2007) at 3.

[24] *See e.g.,* Yuliya Demyanyk, "Ten Myths About Subprime Mortgages," Economic Commentary, Federal Reserve Bank of Cleveland (May 2009) *available at* http://www.clevelandfed.org/research/commentary/2009/0509.pdf; Karen Weaver, "The Sub-Prime Mortgage Crisis: A Synopsis," Deutsch Bank (2008) *available at* http://www.globalsecuritisation.com/08_GBP/GBP_GSSF08_022_031_DB_US_SubPrm.pdf (concluding that subprime mortgages "could only perform in an environment of continued easy credit and rising home prices).

[25] Lei Ding, Roberto G. Quercia, Janneke Ratcliff, and Wei Li, "Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Propensity Score Models," Center for Community Capital, University of North Carolina at Chapel Hill (Sept. 13, 2008), *available at* http://www.ccc.unc.edu/abstracts/091308_Risky.php.

[26] Center for Responsible Lending, *Steered Wrong: Brokers, Borrowers and Subprime Loans* (April 8, 2008), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/steered-wrong-brokers-borrowers-and-subprime-loans.pdf.

[27] *Id.*

[28] R.B. Avery, G.B. Canner, and R.E. Cook, Summer 2005. "New Information Reported under HMDA and Its Application in Fair Lending Enforcement," Federal Reserve Bulletin (available at http://www.federalreserve.gov/pubs/bulletin/2005/summer05_hmda.pdf); R.B. Avery, K.P. Brevoort, and G.B. Canner, September 2006. "Higher-Priced Home Lending and the 2005 HMDA Data," Federal Reserve Bulletin (available at http://www.federalreserve.gov/pubs/bulletin/2006/hmda/bull06hmda.pdf); R.B. Avery, K.P. Brevoort, and G.B. Canner, December 2007. "The 2006 HMDA Data" Federal Reserve Bulletin (available at http://www.federalreserve.gov/pubs/bulletin/2007/pdf/hmda06final.pdf); R.B. Avery, K.P. Brevoort, G.B. Canner, December 2008. "The 2007 HMDA Data", Federal Reserve Bulletin (available at http://www.federalreserve.gov/pubs/bulletin/2008/pdf/hmda07final.pdf); R.B. Avery, K.P. Brevoort, G.B. Canner, September 2009, "The 2008 HMDA Data", forthcoming in Federal Reserve Bulletin (available at http://www.federalreserve.gov/pubs/bulletin/2009/pdf/hmda08draft2.pdf). *See also* Debbie Gruenstein Bocian, Keith Ernst and Wei Lee, "Race, Ethnicity and Subprime Loan Pricing." Journal of Economics and Business, Vol. 60, Issues 1-2, January-February 2008, at 110-124; Debbie Gruenstein Bocian and Richard Zhai, "Borrowers in High Minority Areas More Likely to Receive Prepayment Penalties on Subprime Loans,"January 2005, available at http://www.responsiblelending.org/mediacenter/press-releases/archives/rr004-PPP_Minority_Neighborhoods-0105.pdf

[29] Debbie Gruenstein Bocian, Wei Li, and Keith S. Ernst, Center for Responsible Lending, *Foreclosures by Race and Ethnicity: The Demographics of a Crisis*, at 3 (June 18, 2010), available at http://www.responsiblelending.org/mortgage-lending/research-analysis/foreclosures-by-race-and-ethnicity.pdf.

[30] Debbie Gruenstein Bocian, Peter Smith, Ginna Green and Paul Leonard, Center for Responsible Lending, *Dreams Deferred: Impacts and Characteristics of the California Foreclosure Crisis* (Aug. 2010), *available at* http://www.responsiblelending.org/california/ca-mortgage/research-analysis/dreams-deferred-CA-foreclosure-report-August-2010.pdf.

[31] According to the 2007 Survey of Consumer Finance, the median net worth for white, non-Hispanic families in 2007 was $171,200, compared to $28,300 for families of color. *See* Table 4 of the Survey of Consumer Finance (Tables based on Internal Data, Estimates in Nominal Dollars), *available at* http://www.federalreserve.gov/PUBS/oss/oss2/2007/scf2007home.html.

[32] Similarly, the "cure" rate – the rate at which homeowners who are behind on their mortgages catch up rather than default – has plummeted to an astonishing 6.6 percent. *See* Fitch Ratings, Delinquency Cure Rates Worsening for U.S. Prime RMBS (Aug. 24, 2009).

[33] Laurie Goodman, Roger Ashworth, Brian Landy, Ke Yin, *Negative Equity Trumps Unemployment in Predicting Defaults*, Amherst Mortgage Insight, Amherst Securities Group (Nov. 23, 2009).

[34] Based on MBA Delinquency Survey for 2010 Q2, adjusted to reflect MBA's estimated 88% market coverage.

[35] See Hope Now August Data Report, *available at* http://www.hopenow.com/industry-data.php.

[36] State Foreclosure Prevention Working Group, "Redefault Rates Improve for Recent Loan Modifications" (August 2010), p.1, *available at* http://www.csbs.org/regulatory/Documents/SFPWG/DataReportAug2010.pdf.

[37] *See e.g. In re Ocwen Loan Servicing, LLC Mortg. Servicing Litigation,* 491 F.3d 638 (7th Cir. 2007) (allegations by a class of homeowners that Ocwen systematically charged late fees for payments that were sent on time); *Federal Trade Commission (FTC) Settlement* (2003) resulted in $40 million for consumers harmed by illegal loan servicing practices, *available at* http://www.ftc.gov/fairbanks (FTC alleged, among other things, that Fairbanks illegally charged homeowners for "forced placed insurance" and violated the

Fair Debt Collection Practices Act); and *FTC Settlement with Countrywide, available at* http://www.ftc.gov/countrywide (Countrywide agreed to pay $108 million dollars to homeowners in response to the FTC's allegations that Countrywide charged illegal fees to homeowners during Chapter 13 bankruptcy proceedings).

[38] The Center for Responsible Lending is serving as co-counsel in several cases relating to these issues, including a Maine class action filed against GMAC Mortgage, *Archibald et al v. GMAC Mortgage, LLC* (Civil Action, Docket CV-2010-494, Cumberland County Superior Court).

[39] As Lewis Ranieri, founder of Hyperion Equity Funds and generally considered "the father of the securitized mortgage market," has recently noted, such relief is the only way to break through the problem posed by second mortgages. Lewis S. Ranieri, "Revolution in Mortgage Finance," the 9th annual John T. Dunlop Lecture at Harvard Graduate School of Design, Oct. 1, 2008, *available at* http://www.jchs.harvard.edu/events/dunlop_lecture_ranieri_2008.mov (last visited Feb. 24, 2010).

[40] Mark Zandi, "Homeownership Vesting Plan," Moody's Economy.com (Dec. 2008), *available at* http://www.dismal.com/mark-zandi/documents/Homeownership_Vesting_Plan.pdf.

[41] Blackrock, the world's largest asset manager, supports using bankruptcy courts to address the need for principal reduction. Bloomberg News, *BlackRock Cramdown Plan,* American Banker (Jan. 22, 2010), *available at* http://www.americanbanker.com/syndication/blackrock-cramdown-plan-1006339-1.html. In April 2010, Bank of America joined Citi in support of this measure as well, so two of the four largest banks now support it. Barbara Desoer, President, Bank of America Home Loans, Hearing Before the Committee on Financial Services, U.S. House of Representatives, 111th Congress, Second Session, April 13, 2010, transcript *available at* http://financialservices.house.gov/Media/file/hearings/111/Printed%20Hearings/111-120.pdf. Citi reaffirmed its support at this same hearing.

[42] Thomas J. Fitzpatrick IV and James B. Thomson, "Stripdowns and Bankruptcy: Lessons from Agricultural Bankruptcy Reform" (8/3/10), *available at* http://www.clevelandfed.org/research/commentary/2010/2010-9.cfm.

[43] With a well developed system for making, tracking, and evaluating grants for foreclosure legal assistance, IFLA would be well positioned to assist HUD in administering this funding. IFLA is funded through the Center for Responsible Lending and administered by the National Association of Consumer Attorneys.

[44] National Taxpayer Advocate, *2008 Annual Report to Congress*, at 341, 391-96.

[45] The legislation defined "qualified mortgage debt" to include only that debt that was used to purchase a home or make major home improvements. In calculating the tax, any unqualified debt is first subtracted in its entirety from the amount of forgiven debt (not on a pro rata basis). In many cases, the amount of unqualified debt will equal or exceed the amount of debt forgiven, leaving the homeowner to pay tax on the entire forgiven debt – and even in those cases where the amount forgiven exceeds the amount of unqualified debt, the homeowner will still owe tax.

[46] To take advantage of the mortgage debt exclusion, a homeowner now has to file a long-form 1040 (not a 1040EZ) along with a Form 982. Unfortunately, most lower and middle income taxpayers are not accustomed to using these forms, and taxpayers filing long-form 1040s are not eligible to use the various tax clinics offered by the IRS and others for lower-income taxpayers.

[47] *Supra* Note 44 at 394.

[48] Pub. L. No. 111-203, Title X, §§ 1025(e); 1029A. Six of the top ten servicers, as ranked by Mortgage Servicing News, appear to be subject to the OCC's primary supervision.

[49] U.S. Department of Housing and Urban Development, Mortgagee Letter 2010-04, Loss Mitigation for Imminent Default (January 22, 2010), *available at* http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/10-04ml.pdf (Loss Mitigation is critical to both borrowers and FHA because it works to fulfill the goal of helping borrowers retain homeownership while protecting the FHA Insurance Fund from unnecessary losses. By establishing early contact with the borrower to discuss the reason for the default and the available reinstatement options, the servicer increases the likelihood that the default will be cured and the borrower will be able to retain homeownership.)

[50] Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP), "Factors Affecting Implementation of the Home Affordable Modification Program" (March 25, 2010), at 8 (According to Treasury, the NPV model increases investors' confidence that the modifications under HAMP are in their best financial interests and helps ensure that borrowers are treated consistently under the program by providing a transparent and externally derived objective standard for all loan servicers to follow.).

[51] *E.g.*, Maryland HB 472 (2010), *available at* http://mlis.state.md.us/2010rs/bills/hb/hb0472f.pdf (Maryland homeowners deemed ineligible for relief from their lender then have the option to participate in the court-administered foreclosure mediation program.).

[52] *See, e.g.*, NYS Banking Department, Part 419 of the Superintendent's Regulations, at 419.11 (effective October 1, 2010), *available at* http://www.banking.state.ny.us/legal/adptregu.htm (Servicers shall make reasonable and good faith efforts consistent with usual and customary industry standards and paragraph (b) of this section to engage in appropriate loss mitigation options, including loan modifications, to avoid foreclosure.).

[53] As of June 2010, HARP has refinanced fewer than 380,000 loans, a very disappointing performance given current mortgage interest rates. *See* "Historic Lows in Mortgage Rates Fail to Motivate Buyers, Owners" (September 29, 2010), *available at* http://www.usatoday.com/money/economy/housing/2010-09-29-mortgage-refinancing_N.htm?loc=interstitialskip. Commentators suggest that the reason for the low number is the high fees associated with the program, although there is no empirical evidence to demonstrate whether that hypothesis is correct. *See, e.g.*, Alyssa Katz," Mortgage Refinancing: Why Borrowers Aren't Playing HARP" (Aug. 24, 2010*), available at* http://www.housingwatch.com/2010/08/24/why-borrowers-arent-playing-harp/.

[54] HAMP Servicer Performance Report Through September 30, 2010, *available at* http://www.financialstability.gov/docs/SeptemberMHAPublic2010AugustMHAPublic2010.pdf. Although at one point more than a million homeowners had a trial modification under HAMP, the number of homeowners who have fallen out of trial mods (nearly 700,000) now far exceeds the number who have permanent modifications.

[55] There has been some back and forth among Treasury, SIGTARP, and Congress concerning the numerical goals of HAMP, and the current Treasury assertion is that they promised only to "offer assistance" to that many homeowners. While it is clear that language suggests that they do not anticipate 3-4 million borrowers actually obtaining a HAMP mod, it is not clear exactly what it does suggest.

[56] The HAMP report itself contains a chart indicating that as of August 31, only 1.3 million borrowers are even eligible for HAMP under its current guidelines and that number is only likely to decline as we see continued high unemployment. http://www.financialstability.gov/docs/AugustMHAPublic2010.pdf

[57] "Franken Homeowner Advocate Amendment Passes" (June 15, 2010), *available at* http://senatus.wordpress.com/2010/06/15/franken-homeowner-advocate-amendment-passes/

[58] One Pennsylvania bankruptcy judge has recently provided troubling details of how "communications" between servicers and their outside law firms take place almost entirely through automated systems without any human interaction. *In re Taylor*, 407 B.R. 618 (E.D. Pa. 2009). That judge concluded, "The thoughtless mechanical employment of computer-driven models and communications to inexpensively traverse the path to foreclosure offends the integrity of our American bankruptcy system."

[59] Advocates had thought this was a much larger group until discovering that many servicers had been classifying modifications as stated income before April 2010 even when the lawyer or counselor had submitted a full package.

[60] As of April 2010, all applications must now be fully documented.

[61] First American Core Logic, *supra* note 8.

[62] "Factors Affecting the Implementation of the Home Affordable Modification Program", SIGTARP (March 25, 2010), *available at* http://www.sigtarp.gov/reports/audit/2010/Factors_Affecting_Implementation_of_the_Home_Affordable_Modification_Program.pdf

[63] Although many decry the phenomenon of "walkaways," when people voluntarily default on their mortgages, there are actually far fewer such walkaways than economic theory might predict. *See, e.g.*, Roger Lowenstein, *Walk Away from your Mortgage!*, New York Times (Jan. 10, 2010) (noting that it would be economically rational for more people to walk away from their mortgages). However, it is clear that at some level, the disincentive of being underwater will have an impact on the homeowner's success in continuing with the mortgage.

[64] Andrew Haughwout, Ebiere Okah, and Joseph Tracy, *Second Chances: Subprime Mortgage Modification and Re-Default*, Federal Reserve Bank of New York Staff Report (Dec. 2009).

[65] *See, e.g.*, Amherst Study *supra* note 1; Shawn Tully, *Lewie Ranieri Wants to Fix the Mortgage Mess*, Fortune Magazine (Dec. 9, 2009); "Analysis of Mortgage Servicing Performance, Data Report No. 4, Jan. 2010, State Foreclosure Prevention Working Group, at 3.

[66] Most Pooling and Servicing Agreements require the servicer to act in the best interest of the investors as a whole, but those obligations have been honored mainly in the breach.

[67] SIGTARP, *supra* note 3.

[68] http://www.businessinsider.com/average-duration-of-unemployment-in-july-2010-8.
[69] Homeownership Preservation Summit Statement of Principles (May 2, 2007), http://dodd.senate.gov/index.php?q=node/3870/print (the Summit resulted in a statement of Homeownership Preservation Principles announced by Chairman Dodd and endorsed by the Mortgage Bankers Association, CitiGroup, Chase, Litton, HSBC, Countrywide, Wells, AFSA, Option One, Freddie Mac, and Fannie Mae).

[70] Diane E. Thompson, *Why Servicers Foreclose When They Should Modify and Other Puzzles of Servicer Behavior*, *supra* note 47.

[71] *See, e.g.*, Chris Arnold, *Are There More Foreclosures Than Necessary?* National Public Radio Planet Money (May 15, 2009), *available at* http://www.npr.org/templates/story/story.php?storyId=104177396

The CHAIRMAN. Thank you.
Professor Porter.

STATEMENT OF KATHERINE PORTER, PROFESSOR OF LAW, UNIVERSITY OF IOWA COLLEGE OF LAW

Ms. PORTER. My name is Katherine Porter. I'm a law professor who does research on consumer credit, consumer protection, regulation, and mortgage servicing.

In the last month, allegations about serious and widespread legal errors in the foreclosure process triggered moratoriums by a few of the nation's largest servicers. These moratoriums and the misbehavior that led to them are only the most recent and the most visible symptoms of a chronically sick industry. In 2007, almost exactly 3 years ago, I released an empirical study showing that 40 percent of the mortgage companies' paperwork in bankruptcy cases did not include a copy of the note, despite a clear legal requirement that it be included.

Sadly, the problems we are hearing about today are largely duplicative of those that I and others have described for several years now. To summarize, the key problems with the foreclosure process are: First, that the mortgage servicing industry is a high-volume, cost-cutting industry. It relies on staff with insufficient training. It provides weak oversight of that staff. It operates with inadequate quality control checks and it is not transparent about its profit structure and affiliations with related entities.

These problems are at the heart of the robo-signing scandal. That practice is entirely consistent with the industry's business model and standard of ethics. Robo-signing erodes confidence in the rule of law in this country.

Second, the paperwork on the troubled securitized loans often does not seem to comply with legal requirements. The primary concerns are: first, that some paperwork is missing, evidenced by the increasing use of lost note affidavits to try to remedy past mistakes; and two, that some transfers of loans simply did not occur or were not properly conducted. The proliferation of assignments in blank, the widespread use of MERS that eroded the public property records, and confusion about the location of the physical paper for these loans all expose the industry to attack from investors and from homeowners.

At the core is whether the securitization trust has the standing to foreclose and whether the investors have been defrauded. Contrary to what Ms. Caldwell suggested, I do think that good title is a requirement to do an effective loan modification. I think parties can't legally agree to override and alter the rights of a party that's not at the table.

The third problem is a sort of melange of miscellaneous problems we've seen in the servicing industry, including most primarily the bloating of homeowners' accounts with bogus or suspect default fees and the continuing difficulty that the servicers are having in sweeping under the rug the fact that the originations of these loans were themselves not documented correctly and did not meet the underwriting standards for the securitization.

If these practices are allowed to continue unchecked, I think we're going to see several kinds of harm. I think an increasing

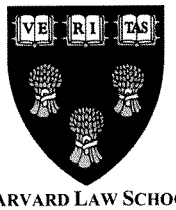
number of homeowners will challenge their foreclosures in court. I think there will be class actions by homeowners if problems are identified that exist across an entire pool of securitized loans. And I think in non-judicial foreclosure states we're going to see intense public frustration about the lack of access to a court to adjudicate these problems.

Second, I think investors will sue mortgage companies to force them, to try to force them to buy back the loans. One cannot easily put the genie back in the bottle with regard to litigation, notwithstanding the servicers' protestations that everything is basically all right.

The banks' argument that the foreclosures are not faulty because the homeowner is in default should be given zero weight. Regardless of whether a homeowner cannot pay, the mortgage company must comply with the relevant laws to exercise their rights. Due process does not bend in the wind. It is a fundamental principle that protects all Americans, consumers and businesses, as they invoke the law to their aid.

Finally, I think regulators will have to devote substantial resources to investigating problems with faulty foreclosures. I think it's crucial that the government investigation be transparent. American taxpayers need to be shown in concrete terms that the Dodd-Frank Act will change how regulators intend to carry out their promises about consumer protection.

[The prepared statement of Ms. Porter follows:]



HARVARD LAW SCHOOL
CAMBRIDGE, MASSACHUSETTS

Testimony of

Katherine Porter

Robert Braucher Visiting Professor of Law, Harvard Law School
Professor of Law, University of Iowa College of Law

Before the
Congressional Oversight Panel

Hearing on the TARP Foreclosure Mitigation Program

October 27, 2010

I appreciate the opportunity to address the Congressional Oversight Panel on foreclosure mitigation. I am a law professor with expertise in consumer credit, consumer protection regulation, and mortgage servicing. I have been conducting research on problems with mortgage servicing practices since 2005.

My testimony focuses on how the allegations of legal errors in the foreclosure process may impact the housing markets, the soundness of banks, and the overall financial markets. I describe the legal and economic issues involved in impermissible or flawed foreclosures and then set out the possible responses to such wrongdoing. Specifically, I consider the ways in which systemic foreclosure problems may set off extensive and complex litigation, destabilize the housing market, and result in regulatory interventions. I believe that the foreclosure process lacks integrity in an unacceptable number of ways and instances and that these problems undermine foreclosure mitigation efforts.

Foreclosure Moratoriums

On or shortly before September 20, 2010, GMAC Mortgage told its agents to halt foreclosure sales and evictions on foreclosed properties in 23 states.[1] GMAC Mortgage is a division of Ally Financial. Under the TARP program, the predecessor of Ally Financial, GMAC, estimated to have received $17 billion of government funds during the financial crisis. The announcement was apparently triggered by the public release of the deposition of a GMAC employee, Jeffrey Stephan. In questioning in a foreclosure defense case, Mr. Stephan explained his practices in completing affidavits to support motions for summary judgment in foreclosure. He stated that that he did not review the exhibits attached to the affidavit, that he did not review much of the information in the affidavit itself, and that he did not sign the affidavit in the presence of a notary. Because the affidavits stated that the affiant had verified the facts in the affidavit and bore a notarization seal, the affidavits were false. Courts and homeowners were misled by the affidavits to believe that GMAC had verified facts relevant to the foreclosure when in fact they had not done so. Mr. Stephan's admission exposed GMAC Mortgage to court sanctions, including fines or dismissal of pending foreclosure cases, for perjury. The practices of GMAC Mortgage employees, and other servicers, with regard to affidavit procedures have become known as "robo-signing." The term reflects the lack of human review in the submission of affidavits to courts.

Within days of the GMAC scandal, a number of concerns were aired about deficiencies in mortgage foreclosure that went well beyond the robo-signing of affidavits. Concerns about servicing misbehavior triggered the suspension of foreclosure sales by other several large servicers. JPMorgan Chase and PNC announced moratoriums similar to GMAC's in scope. Bank of America suspended foreclosures in all states. Together the four servicers comprise 37% of the loans serviced on 1-4 unit residential dwellings.[2] After GMAC and other servicers' announcement of moratoriums, the capital markets began to react. Fitch released an announcement that it was evaluating its ratings of servicers based on their foreclosure practices.[3] Bank stocks seemed driven down by concern about losses on foreclosure practices, either from litigation or loss severities from delays in the foreclosure process or abandonment of foreclosures.[4]

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[1] Denise Pellegrini, Ally's GMAC Mortgage Halts Home Foreclosures in 23 States, Bloomberg (Sept. 20, 2010).
[2] Amherst Mortgage Insight, *The Affidavit Fiasco—Implications for Investors in Private Label Securities*, (Oct. 12, 2010).
[3] Press Release of Fitch Ratings, *Foreclosure Probe to Weight on US RMBS Loss Severities, Servicer Ratings Vulnerable* (Sept. 29, 2010).
[4] Bloomberg, *U.S. Bank Stocks Slide on Concern Over Foreclosure Inquiry*, (Oct. 14, 2010).

On October 18, 2010, Bank of America announced that it was lifting its moratorium and pursuing foreclosures again in the 23 judicial foreclosure states. It also announced that beginning on October 25, 2010, it would file 102,000 amended foreclosure affidavits.[5] GMAC also announced the restart of its foreclosure proceedings.[6] Citi and Wells Fargo have never announced a halt to their foreclosure proceedings.

Flawed foreclosures

Robo-signing is only one of a number of alleged deficiencies in foreclosure practices. Several courts have determined that there were serious deficiencies in the foreclosure process. At a website that I maintain with Tara Twomey, my co-investigator in the Mortgage Study, we make available a list of judicial decisions in which the court finds inappropriate foreclosure practices or misbehavior by mortgage servicers or their agents.[7] Although we stopped updating the document over a year ago, at that time there were already more than fifty such cases. The problems in such cases range from the imposition and collection of improper fees, a lack of standing to foreclose in judicial foreclosure states, the pursuit of foreclosure without rights in the note and mortgage, mortgage origination fraud, or liability to investors for poor underwriting or improper servicing. The key point is that the vast majority of the alleged problems cannot accurately be described as "technicalities." The flaws in the foreclosure systems go well beyond improper affidavits.

Mr. Stephan's deposition on robo-signing was not the first instance of an admission of abuse of the legal process by mortgage servicers and their agents, including their law firms, in the foreclosure process.[8] To give only one example, exactly two years ago, the U.S. Bankruptcy Court for the Southern District of Florida imposed sanctions on a law firm and a creditor for filing false affidavits to support motions to be permitted to pursue a foreclosure despite a

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[5] Reuters, *Bank of America to Partially Life Foreclosure Moratorium,* (Oct. 18, 2001) at http://www.cnbc.com/id/39726850.

[6] Jessica Silver-Greenberg et. al., *Banks Restart Foreclosures* (Oct. 19, 2010).

[7] The Mortgage Study website is at www.mortgagestudy.org. The Resources on Mortgage Servicing document is available at http://www.mortgagestudy.org/files/mortgage_resources.pdf. It should be noted that we stopped updating the document in July 2009. We did so because we were becoming overwhelmed with the number of cases affirming violations of foreclosure practices and servicing duties.

[8] For example, on September 10, 2010, the Florida Default Law Group filed a motion to withdraw an affidavit in foreclosure case in Palm Beach County, Florida. The motion stated that "[t]he undersigned law firm has recently been notified that the information in the Affidavit may not have been properly verified by the affiant; and accordingly, the Affidavit is hereby withdrawn." While courts may grant such motions, the withdrawal of the affidavit cannot eliminate the fact that the false affidavit was produced and entered in evidence in a court case. Put more simply, one can admit perjury but that does not negate its occurrence.

debtor's bankruptcy filing.[9] The lender conceded it had asserted in the affidavit that the debtor owed $2114 in "penalty interest" that was not owed and estimated that it may have wrongfully charged debtors an identical amount of penalty interest in about 50 other cases. The court imposed sanctions of $95,000.

Affidavits can be used in several legal contexts. In judicial foreclosure states, they are often filed to support a motion for summary judgment (a victory for the movant (here usually the party filing the foreclosure) without the need for a full trial). Affidavits also are frequently filed in bankruptcy cases of homeowners to support motions asking the bankruptcy court for permission to foreclosure on a debtor's home, despite the protection of the bankruptcy stay. Affidavits may also be filed improper fees, a lack of standing to foreclose in judicial foreclosure states, the pursuit of foreclosure without rights in the note and mortgage, mortgage origination fraud, or liability to investors for poor underwriting or improper servicing. Affidavits can also be used when a party has lost the mortgage note,[10] but as described below, the use of a lost note affidavit has important limitations.

The largest and most complex harm that may exist with the loans in default or foreclosure today is that the paperwork for the loans was not transferred correctly. I emphasize that what constitutes a correct transfer is a gray area; we need more direction from courts and legislatures on this subject. But there are plausible legal claims that the transfers of the notes and mortgages were not effective to give the trust full enforcement rights. These issues are complex but to summarize: First, what we commonly call a "mortgage" normally consists to two documents: a note and a mortgage or deed of trust.[11] The note creates a debt obligation, the borrower owes the lender a specified number of dollars payable in a specified way. If certain requirements are met, this note may be a negotiable instrument, a term of art under the Uniform Commercial Code. If the note is not a negotiable instrument, it is commercial paper, another term of art. Generally, the law governing notes is Article 3 of the Uniform Commercial Code and general contract law.[12] The mortgage or deed of trust is effectively a grant to the lender of a security interest in the property. Like the note, there are requirements that must be

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[9] *In re Haque*, 395 B.R. 799 (Bankr. S.D. Fla. Oct. 28, 2008); *see also In re Rivera*, 342 B.R. 435 (Bankr. D. N.J. 2006) (sanctioning law firm $125,000 for its practice of filing pre-signed "certifications" with the bankruptcy court in support of motions, without such completed certifications being reviewed by the signatory before they were filed by the court.).

[10] See Uniform Commercial Code 3-309.

[11] Loans will be secured either by a deed of trust or a mortgage, not both. Either document, if properly completed, creates a security interest in favor of the lender. The reasons for the differences between the two and why one type dominates in a given state are beyond the scope of this testimony, but may in fact have important implications for the legal resolution of paperwork documentation flaws.

[12] Some states have enacted a revision of Article 3 and other states have not, so Article 3 is less than "uniform" at the current time, with states having different versions in effect.

met to create a mortgage (for example, it must be in writing, and in some states, must be notarized). Generally, the law governing mortgages is non-uniform state real estate law, although when mortgages are securitized Article 9 of the Uniform Commercial Code, which is the law in every state, may also be relevant.[13]

The concern being raised is that during the securitization process that the transfers from originator to sponsor to depositor to trust (to generalize the parties in a typical process) were not performed or were not performed correctly. A related issue is whether the physical paperwork or electronic records can be located and are accurate. These records are needed to sort out whether the transfers were completed and valid.

I believe the law is somewhat unsettled on what actually must be done via a securitization to complete the transfers correctly. Some have argued that the traditional processes govern. This would mean the note must be negotiated (if a negotiable instrument) or endorsed (if bearer paper) and that the mortgage must be assigned to each party in the securitization process. The latter issue implicates MERS, the Mortgage Electronic Recording System and whether its efforts to declare itself the nominee for the mortgagee and not make public recordation of the assignments are valid. Others believe that the primary issue is whether the note was transferred correctly, on the theory that the "mortgage follows the note" (but it is not clear whether the same rules applies for a deed of trust). But even here, there is disagreement on whether the transfer of the notes needed to have occurred individually, by endorsement (negotiable instrument) or by transfer of possession (bearer paper), or whether the pooling and servicing agreement somehow suffices to effectuate the transfer of the notes to the trust.

The implications of problems with transfer are serious. If the trust does not have the loan, homeowners may have been making payments to the wrong party. If the trust does not have the note or mortgage, it may not have standing to foreclose or legal authority to negotiate a loan modification. To the extent that these transfers are being completed retroactively, it raises issues about honesty in creating and dating the assignments/transfers and about what parties can do, if anything, if an entity in the securitization chain, such as Lehman Brothers or New Century, is no longer in existence. Moreover, retroactive transfers may violate the terms of the trust, which often prohibit the addition of new assets, or may cause the trust to lose its REMIC status, a favorable treatment under the Internal Revenue Code. Chain of title problems have the potential to expose the banks to investor lawsuits and to hinder their legal authority to foreclose or even to do loss mitigation.

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[13] For example, 9-203(g) and 9- 109(a)(3).

For over 10 years, there have been allegations about violations of consumer protection laws and poor/nonexistent underwriting at loan origination. While the law gives great finality to completed foreclosure sales,[14] loans that are currently in default (which some estimate to be as many as 20 percent of mortgages underlying privately-backed securities) are at risk of being challenged for origination violations. These challenges could come in the form of investor suits trying to force banks to buy back loans that did not meet the representations of the securitization documents, e.g., they were not underwritten to the reported standard. Another type of lawsuit risk is that consumers are able to sue the current holder of their note for violations that occurred at origination. Normally, these complaints fail because the holder of the note is thought to be a "holder in due course," a person that receives protection from most of the claims that someone could bring against the originator of the note. However, if the notes do not meet the requirements of negotiable instruments, there cannot be a holder in due course. The person with the note merely is the possessor "bearer paper," and can be sued for all wrongs associated with that note contract.

How Serious and Widespread are the Deficiencies in Foreclosures?

The major unanswered question at this time is the extent and severity of any foreclosure deficiencies. Despite the proclamation of James Dimon, President of JP Morgan Chase that no one has been "evicted out a home who shouldn't have been," there seems to be near universal agreement that at least some homeowners have lost their homes without adherence to legal procedures, that the validity of many pending foreclosures is in question, and that servicers may face much more extensive examination of their grounds for future foreclosures.

The banks have repeatedly tried to minimize perceptions about the materiality of their foreclosure deficiencies. JP Morgan Chase has tried to narrow the characterization of the allegations, describing them as "process-oriented problems that can be fixed."[15] The general thrust of the banks' defense has been that because the homeowners did take on a mortgage obligation, and have in fact missed payments, then the foreclosure is proper. For example, Brian Moynihan, the CEO of Bank of America, said on October 14, shortly before Bank of America reinitiate foreclosures in some states, that about a third of the homes Bank of America seizes are vacant, and that borrowers in foreclosed homes typically haven't made payments for 15 to 24 months.[16] Mr. Moynihan's statement is likely correct; there are thousands of

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[14] Posting to *Credit Slips* blog of Robert Lawless, *The Finality of Foreclosure Sales,* Oct. 9, 2010, at http://www.creditslips.org/creditslips/2010/10/the-finality-of-foreclosure-sales.html.
[15] Kate Kelly, *JP Morgan: Foreclosure Process Can be Fixed*, CNBC, (Oct. 18, 2010), http://www.cnbc.com/id/39721009/JPMorgan_Foreclosure_Process_Can_Be_Fixed.
[16] Bloomberg, *BofA Posts $7.3 Billion Loss on New U.S. Rules* (Oct. 19, 2010).

homeowners in America who cannot pay their mortgages and for whom the foreclosure mitigation options are failing. But Mr. Moynihan's facts are also completely irrelevant to the concerns about foreclosure process. As I have explained recently:

> "Just because the homeowner hasn't paid his mortgage doesn't mean anybody in the world can kick him out," said Katherine Porter, a visiting law professor at Harvard. "The bank has to have the standing to do that." She added that the bank's argument was a little like saying that someone who committed a crime shouldn't receive a trial because he's so obviously guilty.[17]

Due process does not disappear merely upon the assertion by one party that the other is clearly liable. The allegations of problems in mortgage servicing should, if anything, only heighten the due process requirements on consumers. For example, in light of the lack of verification procedures for affidavits to support requests for judgments in judicial foreclosures, it may be reasonable to be concerned that there is absolutely no verification of the facts in the non-judicial foreclosure context. Thus, we might argue that states or the federal government ought to increase the legal requirements for foreclosures across the board, at least for loans initiated in the last five to ten years when widespread allegations of paperwork and procedural problems have existed. The banks' arguments that we can ignore possible systemic wrongdoing by the banks because as a systemic matter, homeowners are in default on their loans, is unpersuasive. Indeed, it seems to reflect a fundamental misunderstanding of the obligations of any party wishing to invoke the aid of the law in enforcing its rights.

The most pressing issue is to assess the extent of the wrongful or problematic foreclosures. This assessment needs to have two fundamental parts. First, how many loans or foreclosures have any defect? Second, what kinds of defects do the troubled loans or foreclosures have? Without an answer to these questions, it is nearly impossible for anyone to do more than speculate about the key questions before this panel about the impact of these troubled loans or foreclosures on the government's foreclosure mitigation efforts and the well-being of financial institutions.

The immediate need is to know the extent to which the problems in mortgage servicing occur sporadically or are endemic. As a preliminary matter, I note that it is simply not credible to believe that the lenders have made no errors in their foreclosure procedure. Because they are being allowed to control the definition of error and are being allowed to audit themselves, we cannot have confidence in such reports. The

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[17] Joe Nocera, *Big Problem for Banks: Due Process*, NY Times (Oct. 22, 2010).

question is then is whether the rate of troubled loans is nearly 100% as some have alleged, or rather is a smaller fraction of loans, such as 5%.

Regardless of the size of the problem, lenders have an obligation to address it and to comply with legal rules. But the ways in which a lender may need to address the problem, and the responses to the problem from regulators and markets, will change depending on whether the problems are sporadic or endemic. It may be, for example, that there are entire pools of loans that were improperly documented and serviced; other pools may be entirely clean. In such a situation, issues concerning the authority of the trust to act despite its passive structure and the ability to do wholesale loan modifications under the pooling and servicing agreement should be front and center. On the other hand, if the problems occur with less frequency but are spread throughout the mortgage market, the solution may be individualized approaches that leave resolution to the courts or mediators.

The other key question is to determine what kinds of problems exist with the loans. Robo-signing is a relatively easy matter to fix, at least in theory, although the culture of servicing practices may cause compliance to erode again in the future. Problems with chain of title, on other hand, are quite complex. Fixing these problems requires grappling with legal issues that are uncertain and complex. For example, what is the legal effect of an assignment in blank of a mortgage? Most scholars think this is an invalid document that cannot serve as a conveyance of real estate. How should that conclusion be harmonized with case law that emphasizes that the "mortgage follows the note," suggesting that it is ownership of the note, not the mortgage that is crucial for transfer? How does the revision of Uniform Commercial Code Article 9 affect this analysis? To take another example, if a trust cannot show a proper transfer of the note and mortgage, can it mediate with the homeowner to reach an agreement that the homeowner will agree to release liability on these issues in return for a loan modification? The answer seems to be "no," on the grounds that only the party with title to the property and with the right to enforce the note has the authority to alter its interest in the property. Put more simply, two parties that do not have good title (the trust via its servicer agent and the homeowner) probably cannot confer good title on the trust by agreement among themselves. Doing so would inhibit the rights of the non-present party and may leave an unenforceable agreement that clouds title for years to come.

The Panel asked in its written invitation to me that I address the question of whether I believe the problems with foreclosures processes and loan paperwork are endemic in the industry. I have no definitive evidence to support my answer to that question. Indeed, as I say above, I think it is lack of knowledge of how widespread the problems may be that is turning the allegations into a crisis. Lack of knowledge feeds speculation and worst case scenarios. It

also permits implausible denials of responsibility and a lack of accountability. None of these reactions are going to aid the housing market in its recovery or assist homeowners in keeping their homes. At best, they are causing uncertainty and delay, which I do not see as providing a net overall benefit, even from the consumer/homeowner perspective. The Congressional Oversight Panel should urge regulators and financial institutions to immediately outline a plan for auditing a sample of loans at each servicer, including analysis of loans that were part of private mortgage-backed securities as well as GSE or FHA loans, as the type and extent of problems may vary by class of loans.

I do think that the structure of the mortgage servicing industry and the lack of accountability by financial institutions in the securitization process make it a fair inference that the problems from flawed foreclosure are not isolated incidents. The robo-signing scandal should not have been a surprise to anyone; these problems were being raised in litigation for years now. Similarly, I released a study in 2007—three years ago—that showed that mortgage companies who filed claims to be paid in bankruptcy cases of homeowners did not attach a copy of the note to 40% of their claims.[18] This behavior occurred in the face of court supervision of the bankruptcy process, review of the claims by a bankruptcy trustee, the debtor in nearly all instances having obtained a lawyer to represent her interests, and a clear rule requiring a copy of the note to be attached. My study does not prove, and could not prove with the data that I used, whether the mortgage companies have a copy of the note and refused to produce it to stymie the consumers' rights or to cut costs, whether the mortgage companies or their predecessors in a securitization lost the note, or whether someone other than the mortgage company is the holder/bearer of the note. The depth of the problem—more than four in ten loans—provides some support for concerns expressed by consumer advocates that the deficiencies in paperwork and inappropriate foreclosure processes are widespread and systematic. In addition, as I discuss in my study, mortgage servicing is a high-volume industry. Its personnel have relatively little training, weak supervision, and are under pressure to cut costs and boost profits. These structural qualities of mortgage servicing make it likely that procedural problems need to be treated as part of a pattern or practice of illegal behavior and not as isolated incidents.

Finally, I want to share with the Panel that the lawyers that I have met over years of my research on mortgage servicing—both creditor lawyers and debtor lawyers—have nearly universally expressed that they believe a very large number (perhaps virtually all) securitized loans made in the boom period in the mid-2000s contain serious paperwork flaws, did not meet underwriting or other requirements of the trust, and have not been serviced properly as to default and foreclosure. I trust and respect these individuals; they are in the trenches,

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[18] Katherine M. Porter, *Misbehavior and Mistake in Bankruptcy Mortgage Claims*, 87 Tex. L. Rev. 121(2008).

reviewing paperwork and litigating these cases. I trust and respect the courts around the country that have devoted time and resources to identifying such problems and preparing published opinions to explain the legal consequences of such problems. In the wake of these parties' longstanding allegations and findings of inappropriate and illegal practices, I am unable to give weight to recent statements by banks such as Bank of America that only 10 to 25 of the first several hundred loans that it has reviewed have problems.[19] As Professor Adam Levitin has noted, what exactly does this mean?[20] Are there 10 problem loans or 25 problem loans? What is the nature of the problems? And, most crucially, how is a problem being defined? Given statements by industry that suggest their interpretation of "problem" is limited to outright lying to a court (which the announcement of the moratoriums seems to have acknowledged was an actual problem that needed remedying) or taking the house of someone who has made all their payments, industry numbers of the scope of the problem should be given no weight. The need for outside audit and verification of loans and foreclosure procedures remains urgent.

Responses to Flawed Foreclosures

Litigation: The defects in foreclosure and the servicing errors suggest two possible types of lawsuits that banks are likely to face. Each type of lawsuit has the potential to expose the nation's largest banks, because they own servicing arms, to serious risk of damages or injunctive relief. Without legislative that retroactively changes the law for foreclosures for mortgages made in the past, it is difficult for the government to discourage or prevent homeowners or investors from exercising their rights through litigation.

Most obviously, homeowners can contest the right of a plaintiff to foreclose. The homeowner may allege that the foreclosure paperwork is incorrect (e.g., invalid affidavit), or that the foreclosing party is not entitled to enforce the mortgage or note (e.g., they lack title to the mortgage or are neither the holder nor bearer of the note), or that the servicer has bloated its fees and charges beyond what is legally permitted (e.g., force-placed insurance applied inappropriately.) Each of these lawsuits would require a certain amount of discovery, such as depositions or document production, to resolve. In addition, absent settlement by the bank, the court would have to hold an evidentiary hearing to determine whether the homeowners' challenge to the foreclosure should prevail. Each of these processes will take time, increasing the loss severities on the foreclosure. FBR Capital Markets estimated that direct litigation costs for cases filed by homeowners could reach $4 billion, while the delay in foreclosure in such contested cases could add an additional $6 billion in costs. While it is also important to consider the substantial burden on the court system to resolve such matters on a case-by-case basis, the

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[19] Dan Fitzpatrick, *BofA Finds Foreclosure Document Errors*, Wall Street Journal, Oct. 24, 2010.
[20] Posting to *Credit Slips* blog by Adam J. Levitin, *Faulty Foreclosures*, Oct. 25, 2010, at http://www.creditslips.org/creditslips/2010/10/faulty-foreclosures.html.

costs to the bank of litigating with each homeowner may encourage servicers to be more willing and generous to modify loans. In this way, the foreclosure process crisis may actually improve loss mitigation outcomes.

Any such effect, however, will be tempered by the fact that it is very difficult as a procedural matter for homeowners in non-judicial states (where the filing of a lawsuit is not required to foreclose) to get their claims of foreclosure wrongdoing before a court. In general, to do so, a homeowner would have to file for a temporary restraining order; procedurally this is like making the homeowner the plaintiff, in terms of filing fees and the burden to go forward on the evidence and arguments. For many consumers, the lack of a judicial forum in a non-judicial state will mean that no official decision-maker will be involved in resolving the alleged wrongdoings.

The extensive media coverage of the moratoriums, combined with the confirmed regulatory response by the states Attorney Generals, will almost certainly embolden more homeowners to challenge their foreclosure. At the margin, the belief that they might win in litigation could diminish a homeowners' pursuit of a HAMP loan modification. My own view, however, is that most homeowners would prefer to avoid the stress of a court case and receive a loan modification, and that we will largely see homeowners using the foreclosure wrongdoing as a shield when the homeowner is in foreclosure.

The second type of lawsuit that seems certain to follow the exposure of the flawed foreclosure procedure is a claim by investors that problems at loan origination, including a lack of paperwork to support a valid foreclosure, or mortgage servicing mishaps have increased their losses. These suits most obviously will seek to force the banks to "buy back" or "repurchase" loans that were improperly placed into a particular trust for securitization or were improperly originated. Investors could also argue for money damages for lost revenue stream or breach of fiduciary duty by the trust or the servicer to exercise good judgment in favor of in investors' interests. These suits could be incredibly expensive for banks, requiring the payments of large claims to make investors whole and to satisfy the plaintiffs' attorneys who will bring such cases.

Regulation: At present, the servicers face new regulations or enforcement actions to require compliance with the applicable law. The most aggressive, and seemingly well-coordinated, response to date is from the 50 states' Attorney Generals. This makes sense as several Attorneys General formed an organization called the State Foreclosure Prevention Working Group back in early 2008 or 2007.[21] The Attorneys General have expertise in mortgage

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[21] Press Release, Office of Martha Coakley, *Multi-state Foreclosure Prevent Group Release Third Report* (Sept. 29, 2008),

servicing. Also the Dodd-Frank Financial Reform Bill clarified that the Attorneys General have the power to enforce federal consumer laws and repealed some Supreme Court precedent that held that state authorities were preempted from bringing actions against national financial institutions. I expect the Attorneys General to be aggressive; they are elected officials and the public's tolerance for financial institutions making sloppy or socially-harmful decisions seems very low. The most likely outcome from such a lawsuit is that the Attorneys General gain concessions from servicers about their willingness to do mediation before foreclosure or to relax their rules about who may receive a loan modification.

The federal regulatory landscape is unsettled. While the Consumer Financial Protection Bureau may have jurisdiction to regulate to address many of the homeowners' concerns, it is patently obvious that the Bureau remains too understaffed and too engaged in its set-up functions to tackle the allegations of foreclosure wrongdoing in a major way. I do think, however, that the Bureau could begin its function of consumer financial education by offering videos or printed material to help homeowners understand the current situation with regard to foreclosure defects. This type of educational outreach is relatively simple to put into place, and importantly has a large pay off for the Bureau in terms of being seen as visible and "on the job" during the fallout from the foreclosure moratorium—the first big event since its creation.

The Treasury and HUD have both made announcements about their responses to the allegations of wrongdoing. Mr. Donovan has announced that HUD began a review of the five largest mortgage companies it deals with on government-backed securities through the Federal Home Administration. Importantly, the worst problems are likely to be in private-label securitizations, rather than government-backed bond offerings. Thus, it may be hard to generalize from HUD's finding to the worst hit segment of the housing market. It appears that the HUD review is primarily focused on keeping borrowers in their homes or transitioning homeowners out of ownership. While this may produce evidence of widespread servicer disparity in efforts at foreclosure mitigation and may help police servicers' commitments under the HAMP program, this focus is unlikely to provide any measure of the depth of the most serious problem in the flawed foreclosure laundry list, which is lack of title and the difficulties in obtaining proper transfers.

It is unclear if the Treasury is pursuing an independent investigation, although Deputy Secretary Michael Barr has answered questions about the wrongful behavior of the servicers. Arguably, however, his comments reflect a continued mindset that the banks and servicers could and just should fix procedures, and that it "is not a problem for Secretary Donovan to

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athttp://www.mass.gov/?pageID=cagopressrelease&L=1&L0=Home&sid=Cago&b=pressrelease&f=2008_09_29reclosure_report&csid=Cago.

fix."[22] The difficulty with this statement is that it reflects a continued trust in the banks and servicers to self-correct and self-police. Yet, in light of both the allegation of poor procedural adherence and limited authority to deviate from standards, the public's confidence in allowing banks and servicers to check their own misbehavior is extremely (and perhaps understandably) low.

A transparent government response that assessed the veracity of the allegations of wrongdoing would be reassuring to the housing market and the capital markets. Until the government does so, the specter of such action will create a drag on the housing markets and the financial institutions' well-being. Without the launch of such a research project, I fear that people will conclude that their government is not positioned to know the depth of the problems with foreclosure procedures.

Housing Markets: The problems with foreclosures—both whatever they actually are and what they are perceived to be—are having a deleterious effect on the recovery of the housing market. While the slowdown in foreclosure may provide a short-term benefit to homeowners, it does not offer a permanent solution. It may, in some instances, be offering false hope to homeowners who may assume that their loan or foreclosure is flawed and that they will be able to stay in their houses, perhaps without having to make any payments or with all prior defaults forgiven. Homeowners who have such beliefs may be less committed to pursuing loan modifications. They may also be overwhelming strained housing counselors, legal aid offices, and courts with requests to raise paperwork or foreclosure process arguments. Those helping homeowners on the front line cannot afford to ignore such requests given the likelihood that problems are systemic and do affect many of their clients loans. But piece-meal litigation of such issues will be expensive, and I am deeply concerned about the knowledge capacity of existing organizations to address these complex legal claims, particularly on the issues about proper assignment.

On the other hand, it is true that the negative press and litigation and regulation risks may be increasing the industries' willingness to modify loans. But such an outcome is positive only if we are confident that the loan modifications being made are sustainable and that they are not continuing to mask paperwork defects that must ultimately be addressed. The negative press and litigation and regulation risks are undoubtedly deterring some people from purchasing foreclosed homes. If such concerns are not abated, the banks that are resuming foreclosures may ultimately end up with increased REO stock that must be addressed.

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[22] Shahien Nasiripour, *Obama Team on Furor Over Foreclosures: 'Problem for Banks and Servicer to Fix'* (Oct. 20, 2010) at http://www.mass.gov/?pageID=cagopressrelease&L=1&L0=Home&sid=Cago&b=pressrelease&f=2008_09_29_foreclosure_report&csid=Cago,

Finally, the housing market faces a grave risk of near complete shutdown if the concerns about correct transfer of loans should cause title insurers to refuse to write new policies on foreclosed homes. This would leave banks saddled with REO properties and would not permit the housing market to find its bottom by processing the pending foreclosures and returning the properties to the market.

Conclusion

For at least three years (and probably closer to five years), there have been well-publicized and repeated allegations that mortgage servicers, trusts, and others in the securitization process have engaged in misbehavior or committed mistakes. The concerns about shortcomings in documentation, procedure, and substantive rights are not new. In fact, the current "crisis" has existed for years, as homeowners' and investors' rights have been ignored in the foreclosure process. It is very likely that there are thousands, and possibly hundreds of thousands, of families who already have lost their homes were deprived of procedural or substantive rights.

But America does not have to continue in a "crisis." We do not have to tolerate abuse of the legal system, systematic errors, bloated fees, and chaos in the housing and financial sector. As a society, we have the tools to guard against wrongful foreclosure going forward. These tools include legal reforms and regulatory intervention. The fixes are not simple or cheap fixes, but they are possible. The banks and servicing industry designed and implemented the practices that allow inaccurate and unfair foreclosure procedures to flourish, and it is entirely right that they should have to shoulder the cost, in both time and money, of designing and implementing improved procedures.

Permitting the current situation to continue threatens to undermine the fragile recovery in the financial sector and to further erode the weakness in the housing market. The key task going forward is to provide transparent measures of the depth of deficient paperwork and to provide reliable monitoring of foreclosure processes. Without additional information and reassurance, prospective homebuyers and prospective investors in financial institutions are likely to be reluctant to join together in rebuilding the damage of the housing economy created by the failure of foreclosure mitigation.

The CHAIRMAN. Thank you.
Mr. Evers.

STATEMENT OF JOSEPH EVERS, DEPUTY COMPTROLLER FOR LARGE BANK SUPERVISION, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Mr. EVERS. Chairman Kaufman and members of the Congressional Oversight Panel: My name is Joe Evers. I'm a Deputy Comptroller and National Bank Examiner in the Large Bank Supervision Division of the Office of the Comptroller of the Currency. In this role, I oversee the collection, analysis, and reporting of data we collect from national banks relating to the performance of first lien residential mortgages.

I appreciate the opportunity to share insights that this data provides us on mortgage modification activities. Consistent with the Panel's letter of invitation, my written testimony includes data and charts from the most recent mortgage metrics report that demonstrate the trends we are seeing pertaining to loan modifications and delinquencies on loan modifications for mortgages serviced by the largest national banks and Federally regulated thrifts.

Beginning in 2008, the OCC began collecting mortgage loan-level data from the largest banks it supervises and publishing this information in quarterly metrics reports. The most recent report, published last month, reflects data at the end of June 2010 and represents almost 34 million first lien mortgage loans or 65 percent of all first lien mortgages outstanding in the country, totaling nearly $6 trillion in outstanding balances.

Early in the mortgage crisis, servicers were generally relying on traditional methods to assist borrowers who were facing financial hardship, typically various informal payment plans that allowed a borrower to defer his or her mortgage payment for a period of time. These types of plans, which were previously successful in normal economic times, gave delinquent borrowers experiencing temporary financial problems a chance to catch up on making their loan payments.

However, as the mortgage crisis deepened and the number of delinquent borrowers increased to unprecedented levels, it became clear that more formal and permanent modifications would be needed. The OCC's mortgage metrics data provided factual evidence that loan modifications completed in 2008 were experiencing high redefault rates. As a result of those high redefault rates, the OCC directed the largest national banks to implement programs designed to achieve more sustainable modifications.

Today servicers are using a combination of actions to achieve more affordable and sustainable modifications. When taking these actions, mortgage servicers are taking into account both the needs of borrowers and the rights and interests of investors.

Our mortgage metrics report provides data on how modification actions affect the borrower's monthly payment and how the modifications perform over time. This allows us to evaluate the effects that certain modifications may have on long-term sustainability.

Over the past several quarters, we have seen the servicers offering more sustainable modifications. Modifications that lower monthly principal and interest payments now represent over 90

percent of all modifications provided. Modifications made during the second quarter of 2010 reduced monthly payments by an average of $427. This resulted in a 62 percent reduction in the average monthly payment from a year ago.

Further, 56 percent of the modifications made during the second quarter reduced the borrower's monthly payment by 20 percent or more, representing an average saving to the borrower of $698 a month.

Our data also illustrates the rate at which previously modified loans become delinquent or redefault. This is a useful metric to gauge the payment sustainability of loan modifications, identify unsafe and unsound loan mitigation practices such as loss deferral, and determine loan loss reserves.

Our data show that, while all modifications experience redefaults, more recent modifications have performed better than early modifications. As well, modifications that result in lower monthly payments consistently perform better over time than those that increase payments or leave payments unchanged, and that better performance directly correlates to the amount of payment reduction.

In conclusion, following our directive to large national bank servicers to make more sustainable modifications, our data show that servicers have adjusted their programs to provide meaningful reductions in borrowers' monthly mortgage payments. These actions are resulting in more sustainable modifications and fewer redefaults.

Thank you for the opportunity to appear today. I will be happy to answer questions.

[The prepared statement of Mr. Evers follows:]

For Release Upon Delivery
10 a.m., October 27, 2010

TESTIMONY OF

JOSEPH H. EVERS

DEPUTY COMPTROLLER FOR LARGE BANK SUPERVISION

OFFICE OF THE COMPTROLLER OF THE CURRENCY

BEFORE THE

CONGRESSIONAL OVERSIGHT PANEL

OCTOBER 27, 2010

Statement Required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

Introduction

Chairman Kaufman and members of the Congressional Oversight Panel (Panel), my name is Joe Evers and I am a Deputy Comptroller and national bank examiner in the Large Bank Supervision division at the Office of the Comptroller of the Currency (OCC). In this role I oversee the collection, analysis, and reporting of data the OCC collects from national banks relating to the performance of first-lien residential mortgages. I appreciate the opportunity to share with the Panel insights that this data provides on mortgage modification activities.

The OCC instituted loan-level mortgage data collection from the banks it supervises in 2008 and published this information in quarterly Mortgage Metrics Reports. Later that year, we expanded our reporting and joined with the Office of Thrift Supervision (OTS) to publish data on the performance of loans and loan modifications, and to highlight trends in loss mitigation activities, foreclosures, and re-defaults occurring on mortgages held by national banks and federally regulated thrifts. Our efforts to report on this very large portfolio of mortgage loans, using validated, loan-level data based on standardized definitions and data elements, has allowed us to develop what we believe to be one of the most accurate and comprehensive data sets available on first-lien mortgages in the country.

The Mortgage Metrics Reports are dynamic documents that continue to evolve to address areas of supervisory interest, better inform policy makers, and contribute to the public discussion. The scope of our data requests from servicers is large, and the effort to validate the data is extensive. The data included in the Mortgage Metrics Reports today represent 65 percent of all first-lien residential mortgages outstanding in the country. In our most recent report, which reflects data at the end of June 2010, the reporting institutions serviced almost 34 million first-lien mortgage loans, totaling nearly $6 trillion

in outstanding balances. More than 90 percent of the mortgages in the portfolio are serviced for third parties because of loan sales and securitization.

In order to best address the areas of interest described in the Panel's letter of invitation, my testimony will first provide general background about our Mortgage Metrics Reports. My statement will then discuss the evolution of mortgage modification efforts and address trends the OCC has observed pertaining to loan modifications and delinquencies on loan modifications including:

- Home retention actions (number of payment plans and loan modifications);
- Types of modification actions;
- Changes to monthly payments resulting from modifications; and
- Post modification performance (re-defaults).

Background of the OCC and OTS Mortgage Metrics Reports

In late 2007, the OCC recognized the supervisory need for more comprehensive data on the performance of mortgages and loss mitigation activities of the largest national bank servicers regulated by the OCC. We realized that the mortgage data being reported to the banking agencies were not giving us a sufficiently granular look at mortgage performance and loss mitigation activities. At the same time, the lack of standardized loan modification data and reporting within the industry made it difficult to obtain accurate, reliable and timely information on loan modifications including post loan modification performance. Given this combination of a lack of information and inconsistent standards for reporting the information that was available, the OCC undertook a comprehensive initiative to improve the way that mortgage performance could be measured, thus producing better information for our particular supervisory purposes, and better information for policymakers. To accomplish this, the OCC made a formal information

request to the Chief Executive Officers of the largest national banks to submit monthly loan-level mortgage data to the OCC. The results of this first data call were published in June 2008, as the *OCC Mortgage Metrics Report, October 2007-March 2008.*[1] Before even completing this first report, the OCC began to work with the OTS[2] to issue a joint report in September 2008.[3]

Evolution of Mortgage Modification Efforts

Early in the mortgage crisis, servicers' informal payment plans and loan modifications were done in low volume and often resulted in mortgage payments that increased or did not change. This traditional approach to loss mitigation, which was previously successful in normal economic times, gave delinquent borrowers experiencing temporary financial problems a chance to catch-up on making their loan payments. However, as the mortgage crisis unfolded and the number of delinquent borrowers increased to unprecedented levels, servicers increasingly shifted from traditional loss mitigation activities to loan modification programs designed to achieve affordable and sustainable loan payments. This shift was aided by implementation of the Home Affordable Modification Program (HAMP) and OCC's mortgage metrics data that put a bright spotlight on high re-default rates for loan modifications completed in 2008. As a result of those high re-default rates, the OCC in March 2009 directed the largest national banks to implement programs designed to achieve more sustainable modifications.

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[1] See *OCC Mortgage Metrics Report, October 2007-March 2008*, released on June 11, 2008.
[2] The OTS separately issued its first report on mortgage metrics on July 3, 2008.
[3] See OCC and OTS News Release, "Agencies Release Joint Mortgage Metrics Report For the Second Quarter of 2008," September 12, 2008.

September 2010 Mortgage Metrics Report[4]

On September 24, 2010, the OCC and OTS released the most recent Mortgage Metrics Report on data through the second quarter 2010 which provides current information and trends in loan modification activity and performance.

Home Retention Actions

The report shows that during the second quarter 2010, servicers implemented 504,292 home retention actions, which include loan modifications, trial performance plans, and payment plans. During the quarter, servicers implemented 273,419 permanent loan modifications, including modifications made through HAMP and other modification programs, which is an increase of 18.1 percent from the first quarter of 2010. While the number of permanent modifications increased, the number of trial modifications and other payment plans declined as servicers worked through their portfolio of seriously delinquent mortgages to determine borrower eligibility under HAMP and each servicer's own proprietary loan modification programs.

Table 1. **Number of New Home Retention Actions**

	6/30/09	9/30/09	12/31/09	3/31/10	6/30/10	1Q %Change	1Y % Change
Other Modifications	142,362	130,464	103,617	131,207	164,473	25.4%	15.5%
HAMP Modifications	--	783	20,679	100,269	108,946	8.7%	--
Other Trial Period Plans	64,201	127,902	96,048	101,764	73,673	-27.6%	14.8%
HAMP Trial Period Plans	79,994	272,709	259,015	188,503	64,666	-65.7%	-19.2%
Payment Plans	131,974	163,551	121,722	120,587	92,534	-23.3%	-29.9%
Total	418,531	695,409	601,081	642,330	504,292	-21.5%	20.5%

[4] The *OCC and OTS Mortgage Metrics Report, Second Quarter 2010* can be accessed at http://www.occ.gov/news-issuances/news-releases/2010/nr-ia-2010-112.html

Types of Modification Actions

Servicers generally use a combination of actions when modifying mortgages. The types of modification actions have different effects on borrowers' mortgage structures and payments. Over time, these differences may have varied effects on the long-term sustainability of mortgages. Consistent with the sequence of loss mitigation actions established by HAMP and generally followed for other modifications as well, servicers added past due interest and fees to the outstanding loan balance in 94 percent of all modifications during the second quarter, and reduced interest rates in 87 percent of modifications. As detailed in Table 2 below, term extensions were used in 51 percent of all modifications, principal deferrals were used in 11 percent, and principal reductions were used in two percent of the modifications.

In determining the appropriate mix of modification actions to take, mortgage servicers strive to balance the need of borrowers for affordable and sustainable payments with the rights and interests of investors. To balance these objectives, servicers are increasingly relying on modifications that emphasize payment affordability and sustainability through lower monthly payments, verification of income, and underwriting based on an affordable housing debt to income ratio. In such programs, payment affordability and sustainability is primarily achieved through some combination of rate reduction and term extension. The decline in the percentage of modifications involving principal reduction over the past year reflects servicers' emphasis on achieving affordable and sustainable payments for homeowners by a combination of reduced interest rates and other actions. The resulting outcome has been a substantial increase in modifications that provide borrowers with significantly lower monthly mortgage payments.

Table 2. Changes in Loan Terms for Modifications Made Through the Second Quarter of 2010 (Percentage of Total Modifications)							
	6/30/09	9/30/09	12/31/09	3/31/10	6/30/10	1Q %Change	1Y %Change
Capitalization	65.8%	68.2%	82.8%	91.4%	94.1%	2.9%	42.9%
Rate Reduction	72.2%	81.1%	84.5%	82.6%	87.0%	5.2%	20.4%
Rate Freeze	8.0%	2.7%	1.9%	1.3%	4.2%	237.2%	-47.0%
Term Extension	45.8%	47.4%	45.3%	45.8%	51.4%	12.3%	12.2%
Principal Reduction	10.0%	13.0%	6.8%	1.9%	2.1%	11.2%	-78.5%
Principal Deferral	2.5%	3.1%	5.8%	10.2%	11.0%	8.1%	347.2%
Unknown*	5.8%	1.9%	1.2%	1.0%	0.5%	-53.0%	-91.6%
Total Number of Changes in Each Category							
Capitalization	93,677	89,553	102,885	211,630	257,183	21.5%	174.5%
Rate Reduction	102,811	106,443	105,060	191,281	237,801	24.3%	131.3%
Rate Freeze	11,341	3,512	2,407	2,901	11,554	298.3%	1.9%
Term Extension	65,218	62,156	56,321	105,957	140,568	32.7%	115.5%
Principal Reduction	14,194	17,090	8,435	4,464	5,865	31.4%	-58.7%
Principal Deferral	3,496	4,040	7,205	23,518	30,027	27.7%	758.9%
Unknown*	8,326	2,447	1,516	2,413	1,339	-44.5%	-83.9%

*Processing constraints at some servicers prevented them from aggregating and reporting specific modified term(s).

Changes to Monthly Payments Resulting from Modifications

In addition to providing data on the types of loan modifications, the Mortgage Metrics Reports include information on the changes to monthly principal and interest payments resulting from the modifications.

Mortgage modifications that lowered monthly principal and interest payments increased to over 90 percent of all modifications during the second quarter 2010. Modifications that reduced payments by more than 20 percent continued to increase, to 56 percent, up from 55 percent the previous quarter. This increase in modifications that reduce the borrowers' monthly mortgage payments continued over the last several quarters as servicers focused on more sustainable modifications.

Table 3. Changes in Monthly Principal and Interest Payments Resulting from Modifications (Percentage of Modifications)*							
	6/30/09	9/30/09	12/31/09	3/31/10	6/30/10	1Q %Change	1Y %Change
Decreased by 20% or More	38.8%	37.0%	41.8%	54.9%	56.4%	2.9%	45.5%
Decreased by 10% to Less than 20%	19.6%	18.3%	19.1%	17.7%	17.6%	-0.4%	-10.2%
Decreased Less than 10%	19.9%	24.4%	21.1%	14.9%	16.1%	8.1%	-19.3%
Subtotal for Decreased	**78.3%**	**79.7%**	**82.0%**	**87.4%**	**90.1%**	**3.1%**	**15.1%**
Unchanged	4.3%	3.6%	4.8%	2.7%	1.9%	-30.8%	-55.8%
Increased	17.4%	16.8%	13.2%	9.9%	8.0%	-18.9%	-54.0%
Subtotal for Unchanged and Increased	**21.7%**	**20.3%**	**18.0%**	**12.6%**	**9.9%**	**-21.4%**	**-54.4%**
Total	100.0%	100.0%	100.0%	100.0%	100.0%		
(Number of Modifications)							
Decreased by 20% or More	54,860	48,151	51,036	126,379	153,730	21.6%	180.2%
Decreased by 10% to Less than 20%	27,691	23,786	23,338	40,663	47,875	17.7%	72.9%
Decreased Less than 10%	28,213	31,707	25,748	34,271	43,827	27.9%	55.3%
Subtotal for Decreased	110,764	**103,644**	100,122	201,313	245,432	21.9%	121.6%
Unchanged	6,038	4,630	5,822	6,273	5,136	-18.1%	-14.9%
Increased	24,665	21,829	16,142	22,750	21,831	-4.0%	-11.5%
Subtotal for Unchanged and Increased	30,703	**26,459**	21,964	29,023	26,967	-7.1%	-12.2%
Total	141,467	130,103	122,086	230,336	272,399	18.3%	92.6%

*Payment change information was not reported on 895 modifications in the second quarter of 2009; 1,144 in the third quarter of 2009; 2,210 in the fourth quarter of 2009; 1,140 in the first quarter of 2010 and 1,020 in the second quarter of 2010.

Modifications made during the second quarter of 2010 reduced monthly payments by an average of $427. HAMP modifications made during the quarter reduced payments by an average of $608, compared with other modifications that reduced average monthly payments by $307 overall. The emphasis on payment affordability and sustainability has resulted in a 62 percent reduction in the average monthly payment from a year ago.

Status of Mortgages Modified in 2008-2010

Since the beginning of 2008, servicers have modified 1,239,896 loans. At the end of the second quarter of 2010, 46 percent of these modifications remained current or were paid off and another 10 percent were 30 to 59 days delinquent. More than 26 percent of

the modifications were seriously delinquent, nine percent were in the process of foreclosure, and four percent had completed the foreclosure process.

Table 4. Status of Mortgages Modified in 2008-2010								
	Total	Current	30–59 Days Delinquent	Seriously Delinquent	Foreclosures in Process	Completed Foreclosures	Paid Off	No Longer in the Portfolio*
2008	421,322	26.8%	7.8%	32.2%	13.6%	8.8%	2.3%	8.4%
2009	587,098	46.8%	10.6%	28.2%	8.9%	2.1%	0.7%	2.7%
First Quarter 2010	231,476	73.7%	12.7%	11.6%	1.4%	0.1%	0.1%	0.5%
Total	1,239,896	45.0%	10.0%	26.5%	9.1%	4.0%	1.1%	4.2%
Modifications that Reduced Payments by 10 Percent or More								
	Total	Current	30-59 Days Delinquent	Seriously Delinquent	Foreclosures in Process	Completed Foreclosures	Paid Off	No Longer in the Portfolio
Modifications that Reduced Payments by 10% or More	596,796	57.8%	10.3%	19.2%	6.3%	2.0%	0.6%	3.8%
Modifications that Reduced Payments by Less than 10 Percent								
	Total	Current	30–59 Days Delinquent	Seriously Delinquent	Foreclosures in Process	Completed Foreclosures	Paid Off	No Longer in the Portfolio
Modifications that Reduced Payments by Less than 10%	643,100	33.3%	9.8%	33.2%	11.6%	5.9%	1.6%	4.6%

*Processing constraints at some servicers prevented them from reporting the reason for removal from the portfolio.

OCC Re-default Reporting Methodology

A re-default occurs when a modified loan becomes delinquent on contractually required payments subsequent to the modification. Re-default is a useful metric to gauge payment sustainability of loan modifications, identify unsafe and unsound loan mitigation practice such as loss deferral, and determine loan loss reserves.

Our reports show re-defaults in a variety of ways to more comprehensively reflect the severity of the delinquency and the amount of time that has elapsed after the modification. Among the measures we report are the number and percentage of modified loans that are 30, 60, or 90 days delinquent or in process of foreclosure at several time periods after the modification, including three, six, nine, and twelve months post-

modification. These measures enable us to assess the sustainability of a modification over time. We also report on the comparative performance of modifications implemented during specific calendar quarters to gauge the effectiveness of changes in modification actions or criteria.

The re-default rate refers to the percentage of modified loans that subsequently re-default relative to the total number of modified loans. Our Mortgage Metrics Reports show re-default rates based on the number of modified loans that remain in effect at the measurement date (e.g., the number of modified loans that are 60 or more days delinquent or in the process of foreclosure at six months after the modification as a percentage of all modified loans still in effect six months after the modification).[5]

Performance of Modified Loans

More recent modifications have performed better than earlier modifications every quarter since the end of the first quarter of 2009. At six months after modification, nearly 21 percent of the modifications made in the fourth quarter of 2009 were seriously delinquent, compared with 43 percent of the modifications made during the first quarter of 2009. This trend of lower delinquency rates following modification corresponds with the increasing emphasis on repayment sustainability through reduction of the borrower's monthly payment.

[5] All modified loans that have been repaid in full, refinanced, sold, or have completed the foreclosure process after the modification are removed from the calculation. Re-default rates reported by other sources may be based on the total, unadjusted number of modified loans.

Table 5. Modified Loans 60 or More Days Delinquent				
Modification Date	3 Months after Modification	6 Months after Modification	9 Months after Modification	12 Months after Modification*
First Quarter 2009	30.8%	42.8%	51.5%	55.0%
Second Quarter 2009	18.7%	33.5%	40.9%	43.2%
Third Quarter 2009	14.7%	27.7%	32.7%	--
Fourth Quarter 2009	11.4%	20.7%	--	--
First Quarter 2010	11.1%	--	--	--

*All re-default data are based on modified loans that remain in effect at the specified amount of time after the modification. All loans that have been repaid in full, refinanced, sold, or completed the foreclosure process are removed from the calculation. Data include only modifications that have had time to age the indicated number of months.

Re-Default Rates by Change in Payment

Modifications that reduced payments by 10 percent or more performed better than modifications that reduced payments by less than 10 percent, increased, or left the payment unchanged. At the end of the second quarter, 58 percent of modifications that reduced payments by 10 percent or more were current and performing, compared with the 33 percent of modifications that reduced payments by less than 10 percent.

Our data also show that modifications that result in lower monthly payments consistently perform better over time than those that increase payments or leave payments unchanged, with better performance directly correlating to the amount of payment reduction.

The following tables present re-default rates, measured as 60 or more days delinquent, for modifications made since January 1, 2008. Data show re-default rates decreased as reduction in monthly principal and interest payments increased, and the re-default rates were lower among modifications made in 2009 and 2010, compared with 2008 modifications.

The better performance of more recent modifications corresponds with the on-going emphasis on lowering monthly payments and improving payment sustainability.

HAMP, as well as an increasing number of other modification programs, also attempt to increase sustainability by not only reducing payments, but also targeting monthly payments relative to the borrowers' income and ability to repay the loan.

Table 6. **Re-Default Rates of Loans Modified in 2008 by Change in Payment** (60 or More Days Delinquent)*				
	3 Months after Modification	6 Months after Modification	9 Months after Modification	12 Months after Modification
Decreased by 20% or More	15.8%	26.0%	33.3%	39.4%
Decreased by 10% to Less than 20%	20.7%	33.0%	41.4%	48.1%
Decreased by Less than 10%	23.9%	40.0%	49.4%	55.1%
Unchanged	48.3%	57.9%	63.7%	67.0%
Increased	35.2%	54.3%	63.3%	68.5%
Total	31.6%	45.2%	53.0%	58.1%

Table 7. **Re-Default Rates of Loans Modified in 2009 by Change in Payment** (60 or More Days Delinquent)*				
	3 Months after Modification	6 Months after Modification	9 Months after Modification	12 Months after Modification
Decreased by 20% or More	11.1%	19.6%	28.4%	34.7%
Decreased by 10% to Less than 20%	16.1%	29.8%	40.2%	46.0%
Decreased by Less than 10%	17.8%	34.2%	44.6%	51.7%
Unchanged	46.7%	51.5%	60.2%	63.9%
Increased	26.7%	46.7%	57.9%	65.4%
Total	19.9%	32.3%	42.7%	49.7%

Table 8 **Re-Default Rates of Loans Modified in 2010 by Change in Payment** (60 or More Days Delinquent)*				
	3 Months after Modification	6 Months after Modification	9 Months after Modification	12 Months after Modification
Decreased by 20% or More	8.2%	--	--	--
Decreased by 10% to Less than 20%	10.2%	--	--	--
Decreased by Less than 10%	13.5%	--	--	--
Unchanged	31.2%	--	--	--
Increased	20.0%	--	--	--
Total	11.1%	--	--	--

*Data include all modifications implemented during 2010 that have aged the indicated number of months. Data do not include modifications for which payment change data was not reported.

Conclusion

Since the mortgage crisis began, mortgage servicers have been confronted with an unprecedented number of borrowers facing difficulties in meeting their mortgage obligations. This has required servicers to make substantial investments in their operations and fundamental changes in the types of modifications being offered. While much has been done, much more still needs to be accomplished. The OCC and OTS Mortgage Metrics Reports have helped to fill a critical void in monitoring and measuring loan modification activities and post modification loan performance.

Our data show that servicers are adjusting their programs to use a combination of factors to provide meaningful reductions in borrowers' monthly mortgage payments, resulting in more sustainable modifications. The result of these efforts is demonstrated in the improved longer-term performance that we are seeing in more recent mortgage modifications that have emphasized lower and more sustainable monthly payments for borrowers.

The CHAIRMAN. Thank you.
Ms. Schwartz.

STATEMENT OF FAITH SCHWARTZ, SENIOR ADVISOR, HOPE NOW ALLIANCE

Ms. SCHWARTZ. Chairman Kaufman and member of the Panel, members of the Panel: Thank you for having me here today. My name is Faith Schwartz and I'm currently a Senior Advisor to the HOPE NOW Alliance and HOPE LoanPort.

HOPE NOW was formed in 2007 to expand and coordinate the industry response in the private sector and nonprofit counseling sector to reach borrowers at risk, counsel borrowers at risk, and work toward alternatives to foreclosure. We've supported the Homeowner's HOPE Hotline, 888–995–HOPE, which has to date manned over 4 million calls, which operates 24 hours a day, 7 days a week, and is supported by over 600 housing counselors, HUD-approved counseling agencies.

The HOPE NOW outreach events for homeowners have held over 90 events across the country in at-risk markets, with up to 75,000 families who've come through. While it doesn't mirror the hundreds of thousands through other outreach events that they've attracted, it's very targeted outreach and doesn't just offer help to anyone who wants to talk to their servicer. So they're 60 days or later past due or non-contact borrowers. In fact, 30 to 40 percent of the borrowers who still come to these events have never contacted their servicer.

We also support HOPE LoanPort, a neutral and independent web-based system that addresses the issue of loan documentation and allows for uniform intake of an application for all types of loan modifications, which allows the stakeholders to see the same information in a secure manner. This portal delivers a completed loan application package to the servicer which is actionable, with the ability to message back and forth until a final decision has been made.

Currently, 14 nationwide servicers have adopted and signed onto the portal, one mortgage insurer, a few state housing agencies, and 320 housing counseling agencies across the country in 48 states. We welcome more endorsement and use of this portal.

HOPE NOW also, as you know, has collected data across the industry for 3 years every month to report on loss mitigation results. In August, we know that year to date we have 874,000 non-HAMP mods that were made. We know year to date that HAMP modifications are 429,000, and we know that year to date foreclosure sales are 775,000 sales.

The points and takeaways from some of the data points are as follows. Loan modifications combined far exceed that of loan sales to foreclosure. It's important to note the interventions are working and should continue.

The vast majority of the non-HAMP modifications, much like Mr. Evers has spoken to, in August 91 percent of them had a lower principal and interest payment, and we know that that's far better than it was a year or 2 ago.

I was asked to speak to the merits of HAMP and some of the detraction from it. Let me say I quite agree, it's very integral and im-

portant that the government step forward to put a protocol in place for modifications, and that this protocol would have been very difficult to get into place otherwise. I am here to tell you, I've been 3 years on this project and it's been a good step forward.

The first most important contribution of HAMP is that all servicers that signed up for HAMP must review all homeowners for eligibility. The HAMP process offers homeowners a first line of defense to avoid foreclosure.

Second is the importance of the HAMP waterfall. Investors, servicers, lenders, nonprofits, and homeowners have a uniform map of activity that is necessary to ensure delinquent homeowners who seek help are being considered for a solution prior to foreclosure. HAMP offers uniformity of approach which is fair and systematic, and it's an approach for all homeowners at risk. That's important for fair lending and other attributes.

There are many challenges around HAMP and I'll cite just a few of them that have been addressed by Treasury. But these challenges have impacted some of the uptake from the program. Clearly, there are a lot of changes as it was being rolled out. This is a complex effort and those changes had to require retraining, hiring of staff, changing of legacy systems that are outdated, and so execution made it difficult quickly.

It's a complex program. Definitions are unclear investor to investor. GSEs don't agree with Treasury or FHA on what imminent default would be. There are differences on principal writedown attributions. Back-end consumer debt—while we are addressing the first lien and made it an easier process to go through, there's a broader debt issue in the country, not just first liens, second liens, and consumer debt, and that's been cited today.

Honestly, just lack of uniformity for all the mod processes. If you wanted a cookie-cutter approach, it would be a lot easier if everyone would accept the same processes, documents, etcetera. Again, the servicers have legacy systems. They have to train and get things in process.

Also, affordability and eligibility. Everyone thought that 31 percent was an awfully good and aggressive start, because after years of looking at the front-end debt ratio, some of which were very high, 31 percent seemed aggressive. Yet, many of these borrowers come in under 31 percent; they don't qualify, and in theory they'd go to foreclosure. So lots of people don't qualify because they're under 31 percent, but yet they're having trouble staying in their home.

High vacancy rate. 30 percent of the market, vacant homes, investor properties. Those don't qualify and it's hard to get people to contact if they're not in their homes. So when you look at the uptake of HAMP, you need to accommodate for some of the foreclosures going through that people aren't on the other side of the conversation.

I do think all of us can do a better job to communicate to the public, to policymakers, to stakeholders, about what the process is and what the options are for all borrowers, whether it's HAMP or non-HAMP. I believe a lot of the non-HAMP activity is very positive and huge progress has been made versus a couple of years ago.

You've asked me to speak a little bit about the current documentation issues in the market. First of all, remember——

The CHAIRMAN. Can you finish, please?

Ms. SCHWARTZ. Pardon me?

The CHAIRMAN. Can you bring it to a close shortly?

Ms. SCHWARTZ. Pardon me?

The CHAIRMAN. Bring it to a close shortly?

Ms. SCHWARTZ. Yes.

The CHAIRMAN. Thank you.

Ms. SCHWARTZ. So the market issues are such that HOPE NOW works on the pre-foreclosure process, and I think all the stakeholders do agree no borrower should go to foreclosure without due process and a thorough review of all alternatives to foreclosure. That said, I'm confident the companies are working through their documentation issues to execute that.

Thank you.

[The prepared statement of Ms. Schwartz follows:]

Statement of Faith Schwartz

Senior Advisor, HOPE NOW Alliance

Before the

Congressional Oversight Panel on the

Troubled Asset Relief Program

Hearing on

"TARP Foreclosure Mitigation Programs"

October 27, 2010

I am Faith Schwartz, and I currently serve as Senior Adviser to the HOPE NOW Alliance, a voluntary foreclosure prevention effort among lenders, servicers, non-profit housing counselors, trade associations and government agencies. My involvement with the HOPE NOW Alliance began in September 2007 at its inception, and I served as its Executive Director through June 2010. I work closely with mortgage servicers, non-profit partners and government agencies and regulators to help homeowners avoid foreclosure. I am also involved as a founding principal in HOPE LoanPort™, a non-profit entity making a positive contribution in improving communications among homeowners, counselors and servicers by ensuring secure processing of loss mitigation solutions and helping borrowers avoid foreclosure.

I appreciate the opportunity to participate in this hearing of the Congressional Oversight Panel. First, I will explain the development and role of the HOPE NOW Alliance, and then I will attempt to respond to the specific questions on loan modifications and other issues raised in the Panel's invitation letter of October 19th.

The HOPE NOW Alliance was formed in 2007 to expand and better coordinate the private sector and non-profit counseling community reach borrowers at risk, counsel borrowers at risk and prevent as many foreclosures as possible through loan modifications and other alternatives to foreclosure. The formation of the Alliance was strongly supported by the Treasury Department and HUD. HOPE NOW participants have expanded and strengthened foreclosure prevention measures through coordinated outreach efforts, providing information and education, and facilitating numerous options for at-risk homeowners that avoid foreclosures.

CONTACTING BORROWERS AT RISK

Early on, the goal of the Alliance was simple: reach at-risk borrowers that had no contact with their servicer. Research showed that over 50% of all foreclosures involved homeowners who were not in contact with their servicer. We focused on outreach efforts by collectively supporting the following:

1) The Homeowner's HOPE Hotline™, 888-995-HOPE™: The hotline is managed by the non-profit Homeownership Preservation Foundation, operates 24 hours a day, 7 days a week in several languages, and connects homeowners to counselors at reputable HUD-certified non-profit agencies around the country. There have been more than 4 million consumer calls into the hotline. Today mortgage investors fund this hotline through current ASF guidance, Fannie Mae and Freddie Mac reimbursement and banks who own the loans on their balance sheet. The hotline has worked with both the Bush and Obama Administrations as the nation's primary foreclosure prevention hotline, and it continues to provide a valuable service for homeowners in every state and the industry.

2) HOPE NOW Outreach events for homeowners: HOPE NOW has hosted over 90 in-person outreach events across the country since 2008. We partner with the Making Home Affordable government program, non-profit homeownership counselors, NeighborWorks America, Fannie Mae and Freddie Mac, and HOPE NOW servicers and mortgage insurers. The events enable homeowners to meet in person with their servicer or a non-profit counselor. We are proud of these events which have served more than 75,000 homeowners who desired to meet with servicers and counselors to work face-to-face on foreclosure prevention solutions. It is important to note the personnel and resource dedication that mortgage servicers have made to the HOPE NOW and other outreach events. Servicers have dedicated teams of loss-mitigation personnel who often work seven days a week to participate in these events and spend hours working with individual distressed homeowners.

3) HOPE NOW Letter Campaign: Since HOPE NOW was formed in late 2007, participating servicers have sent HOPE NOW letters to all 60-day past due borrowers on a monthly basis to encourage them to call their servicer or the Homeowner's HOPE Hotline™. This effort has resulted in an increased contact rate of 18% on average with borrowers who otherwise have not contacted their loan servicer.

4) HOPE NOW Website: www.HOPENOW.com is the website which helps educate consumers and provides links to counselors and servicers for direct help, as well as provides links and information on home preservation resources. Homeowners can go to this website to understand possible solutions and find ways to reach their servicer or a non-profit homeownership counselor. Homeowners also can submit a basic intake document which alerts the servicer to their current situation.

5) HOPE LoanPort™ is an independent non-profit entity that was developed by HOPE NOW after many meetings with non-profits and the government on the issue of lost or incomplete documentation and other communication gaps among counselors, borrowers and loan servicers. Lost or incomplete document submissions have been one of the obstacles that cause frustration among borrowers, policymakers, counselors and servicers. Troubled borrowers do not always submit complete information; servicers are sometimes overburdened by the number of borrowers seeking basic information or assistance, and counselors need a method to help bridge gaps between homeowners and servicers. The new HOPE LoanPort web based system allows a uniform intake of an application for a modification, both HAMP and proprietary solutions, allows for the stakeholders to all see the same information in a secure manner, and delivers a completed loan package to the servicer which is actionable. The pilot is live now, and those involved include 14 major mortgage servicers, representing a majority share of the market, as well as 320 housing counseling offices in 48 states, the District of Columbia and Puerto Rico, with 1700 counselors using this portal. Additionally, the portal is supported by a large nationwide mortgage insurer and various State Housing Finance agencies. This neutral web-portal allows for accountability, stability, security, and confidence that the information from the borrower will not be lost and a decision will be made in a timely manner. Most important, the servicer and counselor steering teams made the decisions on how best to execute and implement changes to enhance this

system. In time, this model is anticipated to help ensure that homeowners seeking help are able to submit complete applications for help and to ensure that these applications do not fall through the cracks and that their packages are safely delivered to loan servicers. It is progress on an important issue. Consumers can visit www.hopeloanportal.org for more information.

HOPE NOW'S ROLE AS POLICY REVIEW FORUM

Since its inception HOPE NOW has been able to provide a forum for servicers and other participants to exchange views with government on foreclosure prevention efforts. It is a candid forum for all participants to discuss what is working or what could be changed for enhanced performance. These in-person meetings take place on a quarterly basis and there are many interim calls among the stakeholders to discuss key issues. Our goal is to keep the members and stakeholders apprised of new information and activity around foreclosure prevention. The HOPE NOW servicing forum helped contribute to the first uniform standards developed by servicers for reviewing loan modifications prior to HAMP and have provided input to government officials on suggestions to improve and make HAMP more efficient

HOPE NOW DATA ON INDUSTRY PERFORMANCE

HOPE NOW has long recognized that data collection would be critical to measuring results of activity in the market. We agreed to publish data each month to measure performance in loss mitigation and recognize strengths and challenges of the many efforts underway. Our data may be found at www.HOPENOW.com and a recent data release and data summary charts are attached to this testimony. We focus on "Non-HAMP" modifications and add to it the formal government-reported HAMP data in order to complement the government activity around modification efforts. The Department of Housing and Urban Development now uses the HOPE NOW data to broaden the snapshot of activity happening overall in the housing market.

August 2010 HOPE NOW Servicer Data Results

This is a summary of the most recent monthly data on loan modifications collected by HOPE NOW from its servicer members, as well as Treasury's data on HAMP:

- 2010 through August, non-HAMP proprietary loan modifications: 874,000 permanent
- 2010 through September, HAMP loan modifications: 429,000 permanent, 413,000 trial modifications
- August Delinquencies (60 days past due): 3.3 million
- 2010 through August, foreclosure starts: 1,720,000
- 2010 through August, foreclosure sales: 775,000
- Life to date modifications: 3.63 million, of which 429,000 are HAMP

permanent modifications and 3.2 million are proprietary modifications.

I would like to note several key points in the data:

- First, in August, non-HAMP loan modifications continued to outpace HAMP modifications by almost a three-to-one margin. When evaluating loan modification efforts, it is important to consider both the number of HAMP modifications and non-HAMP or proprietary modifications. A very significant number of troubled homeowners are getting help in avoiding foreclosure. This includes deed in lieu or short sale option.

- Loan modifications continue to outpace foreclosure sales. In other words, many more homeowners are getting help and staying in their homes than are losing them to foreclosure sale. This is encouraging news in a very difficult environment when unemployment is more than 9 percent in most areas of the country and homeowners are facing very difficult economic circumstances.

- The vast majority of non-HAMP modifications – more than 80 percent year to date now reduce the homeowner's monthly payment, principal and interest, making the modification more affordable and sustainable for the homeowner. The HAMP program helped establish a waterfall for helping homeowners that lead to these reduced payments and many proprietary modifications are following this process.

MERITS AND DEFICIENCIES OF HAMP

The Home Affordable Modification Program (HAMP) has received criticism, in part, because it did not immediately produce certain projected numbers of permanent loan modifications. This criticism is not entirely accurate. HAMP has played an important role by helping to organize the participants and process in the loan modification effort and instituted a loan modification protocol that would have been difficult to mandate in any other way. HOPE NOW and government agencies attempted this in 2008 through the streamlined modification program (SMP) but it did not reflect all investors and primarily focused on GSE-owned loans. That was a start, but the HAMP program expanded and formalized those initial standards for loan modifications.

Treasury made significant strides in 2009 by signing up the vast majority of the mortgage servicers – approximately 100 – for HAMP and having a HAMP-like process for all GSE servicers. This mandate provided a clear method (or "waterfall") for evaluating borrowers who were at risk of default. By instituting rules, HAMP established a consistent process for pre-HAMP (trial modification periods) through modifications and short sale and deed in lieu options to prevent foreclosures.

This process provided stakeholders clear guidance to review homeowner's eligibility to receive a Making Home Affordable solution. All constituents – Treasury, servicers, and

HOPE NOW members – worked countless hours reviewing and offering feedback to ensure guidance was actionable and meaningful.

Importance of the HAMP "Waterfall": The HAMP process offers homeowners a first line of defense to avoid a foreclosure. The most important achievement of the HAMP government program is that investors, servicers, lenders, non-profits and homeowners have a better road map of the activity necessary to ensure delinquent homeowners (who seek help) are being considered for a solution prior to foreclosure. The HAMP roadmap set the stage for servicers to better apply solutions for distressed borrowers who failed to meet the HAMP requirements. All servicers who signed up for the Government Making Home Affordable MUST review all homeowners for eligibility.

By introducing clear guidance for the HAMP waterfall, Treasury instituted standard protocols on structuring an affordable payment for borrowers. These include:

a) Forbearance (3-6 months) for unemployed borrowers;
b) 31% housing DTI split by investors and Government dollars;
c) Use of lower rate, extended term and principal deferral and or principal write down, to get to the affordable 31% DTI;
d) If ineligible, servicers must review for proprietary solutions (GSE, other), and if ineligible;
e) Servicers must consider HAFA (Making Home affordable short sale and deed in lieu) or proprietary programs;
f) In some instances, follow state mediation requirement to review all solutions outside of foreclosure; and
g) Foreclosure sale as the final option.

Timelines for homeowners have been extended throughout the process to ensure homeowners have every possible solution offered to them prior to a foreclosure.

Servicers needed to organize reporting systems, report to the government and their own investors, and ensure they had adequate staff and training and systems support to execute this process. In addition, they needed to communicate effectively to the homeowners all of their options and Treasury instituted clear communication requirements including denial requirements of servicers to homeowners.

Challenges of the HAMP program: The HAMP program was rolled out in 2009 with the support of taxpayer dollars to incentivize modifications, short sales and deed in lieu programs to be executed by loan servicers. The program is complex and requires key documentation to ensure there is no fraud in the process due to the use of taxpayers' dollars. Early on, servicers spent many months re-tooling systems to accommodate Making Home Affordable. This cannot be overstated. Servicers must devote significant time, personnel and technology resources to implement every change or even slight modification in HAMP requirements. Those initial revisions helped slow the conversion from HAMP trial modifications to permanent modifications. The challenges of the

HAMP program include:

- Several changes to the Program which entailed re-training staff and re-tooling systems at the servicer's shops. Over 80 changes to the initial Program occurred.

- Program parameters are complex. HAMP is overly complex and throughout the effort, many processes were left to interpretation.
    - Imminent default: How do you treat a current borrower who is at risk and how do you define hardship? This had several options and iterations among investors and HAMP.
    - Trial modifications required limited documentation which has been adjusted to verifying income early on. Since no documentation was required for trial modifications, as servicers and borrowers attempted to fully document the loans, many did not meet the HAMP criteria.
    - Consumer debt load: As indicated in the HAMP report, many borrowers have excessive consumer debt loads and the HAMP activity focuses on first lien debt, with counseling recommended for high back end ratios.
    - Lack of uniformity for all processes with GSEs: Due to different securities, Fannie Mae and Freddie Mac have some different processes to follow, HAMP-like, but unique to their requirements.
    - Affordability: This program is focused on affordability. Other refinance programs introduced attempted to focus on negative equity such as the GSE refinance programs for up to 125% LTV.

- Eligibility: When the HAMP program evolved, a 31% DTI seemed like an aggressive and good target for homeowners to have an affordable option. But a majority of the defaults are prime mortgages and many are already below the 31% DTI so they do not qualify. In addition, full documentation is required for a permanent modification and many borrowers are not meeting the full documentation requirements. In many cases, houses are abandoned and there is no one to communicate with. Finally, investor properties continue to be part of the defaulting population so that many loans fall outside of HAMP, thus the continued growth in the non-HAMP solutions.

- **Public communication of HAMP and non-HAMP activity:** One clear challenge remains. Loan workouts, modifications and foreclosure prevention are complex processes and difficult to communicate. Treasury, the industry and the government need to improve the message for homeowners on clearly stating the options when considering foreclosure prevention. With so many government programs and many industry programs, clarity around this message should be developed and used through public service announcements and by working with our non-profit counselors. These efforts should dovetail on basic messages around fraudulent scam activities which will deplete cash reserves and leave homeowners more vulnerable.

CURRENT DOCUMENTATION ISSUES ON FORECLOSURE

HOPE NOW is focused on pre-foreclosure activity, and I want to emphasize that working with servicers and counselors to review all options prior to foreclosure should not be impacted given the new issues being reported about foreclosure document review. In fact, it is a reminder to make sure we are all sending that message to homeowners who are confused with this issue.

My opinion (not that of HOPE NOW) is that mortgage servicers will work through these challenges – including mortgage documentation issues. Each company has slightly different process review issues to evaluate and no one process or company is exactly alike. However, as the companies involved have stated and key government officials have stressed, this appears to be a process issue and does not appear to mean the underlying facts of the foreclosure filing – the homeowner's financial situation and loan delinquency – are incorrect.

At the end of the day, if homeowners are current or in the process of working through a solution, they should not be impacted and sent to foreclosure. If a borrower is in significant arrears, has made no payments for many months, or has abandoned the home, these situations will likely result in a foreclosure. But, if a borrower demonstrates the willingness and capacity to support reasonable payment – or is willing to work with their servicer to relinquish the home in an efficient (least costly) manner – then these borrowers should be supported in those efforts to stabilize their lives. The industry will endure this crisis and continue to work diligently toward helping homeowners, stabilizing housing, and restoring confidence in the U.S. housing markets.

CONCLUSION

HOPE NOW, the mortgage industry, and non-profit counseling agencies continue to work hard to assist at-risk homeowners in avoiding foreclosure. Increasingly, there are more and more resources being utilized in foreclosure prevention. The Homeowner's HOPE Hotline™ handles millions of calls, and HUD-approved counseling agencies and NFMC recipients counsel hundreds of thousands of people each year. Servicers have many tools to use such as government HAMP modifications, proprietary modifications as options, with short sales and deed-in-lieu as alternatives. These are the key alternatives for homeowners and servicers who are trying to avoid foreclosure.

HAMP modifications offer a well-defined safety net for borrowers as a first line of defense. As evidenced by HOPE NOW data, servicers are implementing significant modifications after reviewing for HAMP eligibility by offering alternative modifications in lieu of foreclosure. Servicers report proprietary non-HAMP solutions run almost 3 times greater than HAMP modifications due to eligibility challenges. We should see this as a positive alternative to foreclosure if they fail to meet the Government required HAMP modification. These are modifications that do not require taxpayer dollars and they are meant to benefit the homeowner and investor in lieu of foreclosure.

This year we are seeing that more than 80% of proprietary modifications have a lower principal and interest payment for the borrower than pre-modification, thus pointing to better affordability. Depending on the economy, we would expect better performance on these modifications versus modifications which may have had higher payments in the past.

We will continue to work with at-risk homeowners to explore all possible solutions in avoiding foreclosure. Thank you for this opportunity to testify on the work of the HOPE NOW Alliance, and I look forward to the panel's questions.

Support & Guidance For Homeowners

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Media Contacts:
Brad Dwin
(202) 589-1938
brad@hopenow.com

Faith Schwartz
(202) 589-2406
faith@hopenow.com

HOPE NOW: Nine out of Ten Proprietary Loan Mods in August Included Principal & Interest Payment Reduction

Almost 150,000 Permanent Loan Mods for Homeowners for the Month

(WASHINGTON, DC) – HOPE NOW, the private sector alliance of mortgage servicers, investors, mortgage insurers and non-profit counselors released its August 2010 survey data today, which estimates the industry completed almost 150,000 permanent loan modifications for the month.

The reported data for August shows that mortgage servicers completed approximately 116,000 proprietary loan modifications for homeowners and 33,000 Home Affordable Modification Program (HAMP) modifications (as reported by US Treasury Department), for an estimated total of 149,000.

Of particular note in the August data, is that 91% of all proprietary loan modifications for the month (105K) included a reduction of the monthly principal and interest payments for homeowners. This statistic indicates that the vast majority of loan modifications are being structured to make mortgages more sustainable for homeowners.

According to these latest estimates, mortgage servicers have completed 1.3 million loan modifications so far in 2010, and almost 3.7 million since 2007.

Additionally, HOPE NOW's data continues to see declines in 60-day plus mortgage delinquencies which has been a positive trend since January 2010.

Here are the notable highlights of the August 2010 data:

- Proprietary loan modifications completed decreased slightly - 120,351 in July compared to 115,756 in August
- Principal and interest reduction modifications completed continued at a consistent pace - 103,029 in July to 104,988 in August and represented 91% of all proprietary loan modifications
- 60+ days delinquencies decreased from 3,298,236 in July to 3,256,682 in August
- Foreclosure starts increased from 226,664 in July to 245,015 in August
- Completed foreclosure sales increased from 97,951 in July to 101,780 in August

Faith Schwartz, Senior Advisor for HOPE NOW, issued the following statement:

"HOPE NOW is encouraged by the ongoing efforts of its servicing members to seek and provide workout solutions for distressed homeowners. Homeowners and loan servicers are using all available avenues for preventing foreclosures, including utilizing a combination of forbearance, HAMP modifications, proprietary modifications and even short sales and deed in lieu efforts.

Despite significant strides in foreclosure prevention efforts, it is clear that long term job creation will be an important driver for recovery and sustainable homeownership.

Mortgage servicers are the first responders to foreclosure prevention, loss mitigation and resolution, and they are taking the lead in reviewing, resolving and repairing an industry in crisis.

HOPE NOW will continue to support distressed homeowners through face to face outreach events nationwide and by encouraging them to call 888-995-HOPE™ to connect with a non-profit housing counselor in their area.

Additionally, the industry is leveraging HOPE LoanPort™ in its mission to promote technology as the path to increased efficiency and effectiveness in handling loan modification applications. Currently, this web-based loan modification solution is being used by 12 major mortgage servicers and a network of more than 1,600 non-profit housing counselors in 48 states.

For the balance of the year and into 2011 and beyond, the industry will be committed to using all of the tools at its disposal to achieve viable and sustainable mortgage solutions for homeowners nationwide."

"Year to Date" Snapshot

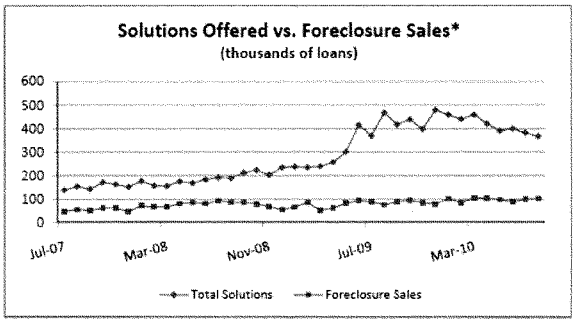
Industry Extrapolations and HAMP Metrics (January 2010 - August 2010)

	Q1-2010	Q2-2010	Jul-2010	Aug 2010	**Year to Date Total or Average**
Total Completed Modifications	469,381	499,103	157,046	149,098	**1,274,629**
HAMP Permanent Modifications[1]	163,863	167,220	36,695	33,342	**401,120**
Proprietary Modifications Completed[2]	305,518	331,883	120,351	115,756	**873,509**
Proprietary Reduced P&I Modifications	234,796	262,958	103,029	104,988	**705,770**
Proprietary P&I Modifications / Proprietary Modifications	77%	79%	86%	91%	**81%**
Foreclosure Starts	684,874	566,012	226,664	245,015	**1,722,566**
Foreclosure Sales	288,526	286,712	97,951	101,780	**774,969**
60+ Days Delinquency[3]	3,944,479	3,605,377	3,298,236	3,256,682	**3,650,561**

[1]Source - Making Home Affordable.

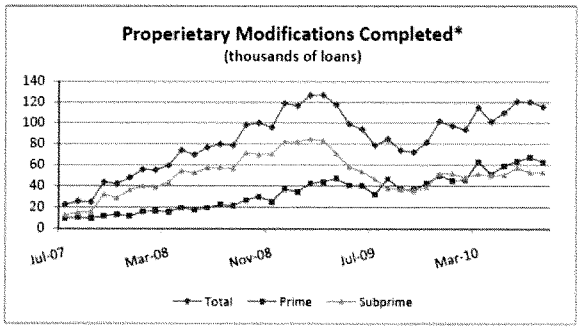
[2]Extrapolated. Modifications Completed was revised in December 2009 to include Current Modifications and specifically exclude HAMP.

[3]Monthly average.



Source: Making Home Affordable and HOPE NOW

*Total Solutions is comprised of HAMP Permanent and Trial Loans, Proprietary Modifications Completed, Repayment Plans Initiated, Other Retention Plans Completed, Short Sales and Deed-in-Lieu



*Non-HAMP

HOPE NOW is the industry-created alliance of mortgage servicers, investors, counselors, and other mortgage market participants, brought together by the Financial Services Roundtable, Housing Policy Council and Mortgage Bankers Association, that has developed and is implementing a coordinated plan to help as many homeowners as possible prevent foreclosure and stay in their homes. For more information go to www.HopeNow.com or call the free Homeowner's HOPE™ Hotline at (888) 995-HOPE™.

The following companies are members of the HOPE NOW Alliance:

Acqura Loan Services
American Home Mortgage Servicing, Inc.
Assurant, Inc.
Aurora Loan Services
Bank of America
Bayview Financial
Carrington Mortgage Services, LLC
Citigroup, Inc.
Fannie Mae
Freddie Mac
First Horizon Home Loans
Genworth Mortgage Insurance Corporation
GMAC
HomEq Servicing
HSBC USA
JPMorgan Chase
Lender Business Process Services, Inc.
Litton Loan Servicing
LoanCare
Marathon Asset Management
MetLife Home Loans
MGIC
Mortgage Electronic Registration System
Nationstar Mortgage LLC
Ocwen Loan Servicing
OneWest Bank
PMI Mortgage Insurance Company
PNC Mortgage
Quicken Loans
Radian
Residential Credit Solutions
RoundPoint Financial Group
Saxon Mortgage Services/ Morgan Stanley
Select Portfolio Servicing, Inc.
State Farm Insurance
SunTrust Mortgage, Inc.

Vericrest Financial
Wells Fargo and Company

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The CHAIRMAN. Thank you very much. I thank the panel.

I'd like to ask a question to all the panel members. That is, based on the fact the President said 3 to 4 million homes saved from foreclosure was a realistic objective for HAMP, what do you think the realistic objectives are for HAMP? I start with Ms. Schwartz.

Ms. SCHWARTZ. Well, I think if you look at HAMP and then non-HAMP solutions you're already at about 1.3 million modifications to date this year. That's combined. So if you look at an annual rate, you can hit that if you give the Treasury some credit for the protocols someplace.

The CHAIRMAN. At the end of the program—we're just getting started with the program—what do you think? Is it a realistic objective at the end of the program, after we're finished?

Ms. SCHWARTZ. For the mod program?

The CHAIRMAN. Yes, for the mod program, the modification program, number of homes protected from foreclosure.

Ms. SCHWARTZ. Well, I think we do have systems and protocols in place and NPV tests that now are used across the market to look at foreclosure versus a modification that were not in place probably 4 years ago in any systematic way. So hopefully the systems in place will stay and the regulators will I'm sure work with the banks and the investor community to keep things moving.

The CHAIRMAN. Mr. Evers.

Mr. EVERS. That's really a policy question I don't have a real clear view on. All I can tell you is that over the last five quarters there have been 902,000 mods completed, both HAMP and proprietary. That compares to about 670,000 completed foreclosures. So yes, I agree with Faith that you have to look at what's happening with HAMP and the proprietary mods to get a better sense of how many borrowers are being helped.

The CHAIRMAN. Professor Porter.

Ms. PORTER. I apologize in advance, but I'm going to turn your question a little bit and say that what concerns me is that what I'm hearing is that we've gotten up to speed with HAMP slowly, we're making progress. It took 3 years, it took 2 years, it took—what does that timeframe and that gigantic learning curve mean for whether the servicers are going to be able to address the kinds of procedural defects that we're hearing about now in anything remotely approaching a timely and effective fashion.

The CHAIRMAN. Ms. Gordon.

Ms. GORDON. Realistic objectives for HAMP. First of all, what we need to do is fix HAMP, not end it. HAMP's the only thing we've got out there right now and if we take that away we go backward in time to a very dark place.

The concept of the NPV test has been a very useful one to get out and it serves as a great benchmark for Federal legislation or for states to work on incorporating it into the requirements for foreclosure. There is lots of use for this. I've provided in my written testimony what one might charitably call an exhaustive list of ways in which we could fix HAMP and make it work better. But until we've got something better in place, let's fix it and not get rid of it. We need much better programs in place. We need mandatory programs, and to the extent possible we need third party involvement to make sure everything is going as it should.

The CHAIRMAN. Mr. Cecala.

Mr. CECALA. The simple answer is I think the HAMP goals are unrealistic, given the program restrictions and the types of troubled borrowers we're dealing with. If there's any good news, I think it's extremely unlikely that TARP or your Panel will see anywhere near $30 billion spent on this program. My understanding is in the first year and a half about $400 million has been spent in terms of incentives paid out. I think that gives you a realistic expectation on, if we continue on the current path, what we're going to spend.

The CHAIRMAN. Thank you.

The next question is, can you comment on the impact you think these foreclosure problems will have on the mortgage market?

Mr. CECALA. Obviously, that's a real tough question to answer. There are a couple different areas we're looking at, you have to look at the foreclosure problem. One of them is just the issue of what is the liability in terms of servicers improperly foreclosing on a property. The mortgage industry's response is that these are paperwork problems, we can clean it up, worst case we just refile the paperwork and we get to the same point, maybe in 2 or 3 months.

Obviously, the states attorneys general and other regulators are looking at whether laws were actually violated. That brings up the question of legal action for criminal behavior or whatever else. That's kind of hard to quantify, too.

The other issue, of course, is the lawsuits that are surfacing now regarding mortgage securities and mortgage securities investments. Those are kind of interesting to monitor because those lawsuits have been pending out there just on different reasons in the past. The latest reason is to go after them because of foreclosure paperwork.

I've been covering this industry and the mortgage security industry for 25 years. I'm not aware of any successful litigation involving procedures, foreclosure procedures that have been violated, that would require a lender to buy back a loan.

The CHAIRMAN. Thank you. I'm going to hold the rest of them until my next set of questions.

Mr. McWatters.

Mr. MCWATTERS. Thank you, Senator.

Mr. Cecala, in your opening statement you said there were $8.5 trillion of new residential mortgages made between 2005 and 2007, and that about a third of those were subprime, with documentation problems, around 2.8 or so. There are a lot of lawsuits out there that are beginning and they're not based solely upon foreclosure issues. They're based upon straight-up misrepresentations and warranties, underwriting that was misrepresented when the securitization trust bought those, and the securitization trusts and their investors are undertaking to put those back.

What is your estimate, do you have an estimate, of what of that $2.8 trillion will be put back to the loan originators?

Mr. CECALA. I think it's important to identify what the size of the universe we're really talking about now.

Mr. MCWATTERS. Okay.

Mr. CECALA. There's approximately $6 trillion worth of mortgage securities outstanding. $1.5 trillion is what we call non-agency mortgage securities. The rest are basically guaranteed or insured

by Ginnie Mae, Fannie Mae, or Freddie Mac. So that really means we're talking about a universe of $1.5 trillion.

You're right, there's been litigation from day one. A disproportionate amount of that volume has involved subprime, Alt-A mortgages, mortgages with a lot of default characteristics, and clearly they've performed a lot worse than anyone expected. The normal recourse that the mortgage industry uses is to require buybacks on those loans, and they go right at the mortgage originator. If a mortgage originator originates a loan that goes bad in 6 months, they're required to buy back the loans.

What we saw is that process actually began in 2006. By 2008, basically all the major subprime mortgage originators in this country were put out of business. What we've got left are major banks that acquired subprime loans, either through servicing or through some other capacity.

Bank of America was one of the few major mortgage lenders out there that steered away from the subprime market. Nevertheless, it's the target of all the litigation out there? Why is that? First of all, they're the largest bank and they've got a lot of money, so that helps.

But also the reason is they, for better or for worse, acquired Countrywide Financial, which was the largest subprime lender, and basically inherited the largest subprime mortgage portfolio that they are trying to deal with now.

Mr. MCWATTERS. Right. And as those loans moved into securitization pools, BofA or Countrywide may have re-upped the representations and warranties that were made by the subprime lenders, because someone's going to have to do that or you wouldn't take it.

Also, I'm not sure why you excluded Freddie and Fannie. I mean, they were huge securitizers. If they took loans, mortgage loans, under misrepresentation, why shouldn't Freddie and Fannie—in fact, I think they are beginning to exercise their rights to put back their loans to the mortgage originators.

Mr. CECALA. They are. Currently Fannie and Freddie are requiring mortgage repurchases by the major banks and mortgage servicers to the tune of about $2 billion a quarter. They clearly have the most clout because they're still in business and if you don't play ball with Fannie and Freddie they'll cut you out of new business. So that is where most of the action is going on in terms of repurchases, and Fannie and Freddie have been very aggressive at pursuing it. But they're getting pushback from the mortgage industry, too.

The most pushback you see is in the non-agency area, because the parties are not around anymore who originally committed the crime, such as it is, and you have no leverage over the lenders other than legal action.

Mr. MCWATTERS. Will, in your view, this present a systemic problem, meaning a lot of TARP recipients that are going to have to buy back loans?

Mr. CECALA. That's been a problem that's been going on for 2 or 3 years. Is the amount of buybacks going to increase significantly? My personal opinion is not. It'll be managed and spread out over time. However, if these non-agency security litigation claims, par-

ticularly the more recent ones involving foreclosures, gain traction, that's certainly going to increase the liability and that's something really we haven't factored into the system.

Mr. MCWATTERS. Well, one new development is that the investors in RMBS are beginning to recognize one another and work in concert, and they are suing the securitization sponsors and the securitization trusts and the servicers to force them to put back loans, which they've been unwilling to do so far, perhaps because of conflict of interest issues and otherwise.

How do you see that changing it?

Mr. CECALA. Well, as I pointed out, it's been very unsuccessful to date. There are a lot of people who are requiring mortgage repurchases, but they're not non-agency security investors. Mortgage insurance companies, Fannie Mae and Freddie Mac, they've been very successful. The investors in non-agency securities haven't been, for a variety of reasons, as I indicated. One, the original offending party is no longer around. They're going after people who acquired other ones, and it's hard to make a legal claim that Bank of America is really liable for the quality of loans someone made 3 years earlier.

Mr. MCWATTERS. Yes, but if Bank of America put those loans into a securitization trust and re-upped the representations and warranties, they're on the hook the same.

Also, I've read that there's an increased use of statistical sampling, as opposed to having to prove each individual loan was misrepresented, to do a statistical analysis of the pool and if it's significant then put the whole pool back.

Okay, my time is up.

The CHAIRMAN. Thank you.

Mr. Silvers.

Mr. SILVERS. Thank you.

Mr. Cecala or anyone, any other member of the panel: In view of the exchange, Mr. Cecala, you just had with Mr. McWatters, I remain just deeply puzzled by what the Federal Reserve Bank of New York is up to. Do you have a theory, or do any other members of the panel have a theory as to why, in view of—if I take your remarks of a few moments ago, why the Federal Reserve Bank of New York is asserting the sorts of claims that we were just discussing?

Mr. CECALA. I'll take a quick shot at that. The Federal Reserve Board of New York inherited a bunch of non-agency mortgage security investments as a result of the merger of JPMorgan Chase, Bear Stearns is the most obvious one. Part of the agreement required the Federal Reserve Board of New York, or effectively the government, to take over the worst assets, because no bank wanted to acquire those bad ones.

So basically the Federal Reserve Board of New York's in the position of having acquired a sizable amount of these bad assets and, in representing the government's interests, would like to get any possible money they can get out of anybody who does—so they basically helped lead that effort to reclaim losses that those investors—that doesn't mean they've got a great claim, but that's the motivation behind it.

Mr. SILVERS. Well, they appear to have a good enough claim to put their name behind it, which is a nontrivial thing in terms of the Fed.

Other members of the panel have a theory about what's going on here?

[No response.]

Mr. SILVERS. Okay. Secondly, I just want to—Mr. Evers, I know that your testimony is limited to matters of data. If you were in the room when I was discussing with Ms. Caldwell Bank of America's finances, did I make any mistakes in that analysis?

Mr. EVERS. I heard parts of it. What we're doing is we're working with our banks to assess that put-back risk and basically make sure it's properly dimensioned, and that the banks have the reserves for that. We're making sure that they do a very full, complete analysis of that.

Mr. SILVERS. How many $47 billion buybacks of 50 cents on the dollar securities could Bank of America do before it blows through its capital?

Mr. EVERS. Well——

Mr. SILVERS. Isn't that a mathematical question, not a policy question?

Mr. EVERS. Yes, you could do the numbers.

Mr. SILVERS. You could run the numbers. It's not ten, right?

Mr. EVERS. Right.

Mr. SILVERS. It's less than ten.

Mr. EVERS. Right.

Mr. SILVERS. It's probably less than five before you guys would be pulling the fire alarms.

Mr. EVERS. Like I said, the banks have to assess, fully assess and dimension the risk here. We're making sure that they do that. I don't know whether the estimates thrown out there in terms of exposure——

Mr. SILVERS. I understand that. I just wanted to make sure I wasn't making any mathematical mistakes.

Now, we have heard in this hearing I think from different members of our panel and from different witnesses two kinds of stories about what is in the public interest here broadly with respect to what to do about the very large number, somewhere between, I've heard, 7 million and 13 million homes and families, homeowners, that are facing foreclosure, what outcome we want.

I think there are two stories that have been put out there. One is kind of the thing that Andrew Mellon said early in the Great Depression, which is liquidate everything, let's get these homes out of the hands of the homeowners and into the hands of the banks and sold onto the markets as fast as we possibly can. The second theory is—and one can look back at how Andrew Mellon's advice worked out for him and Mr. Hoover.

But then we can look at the other sort of basic inclination, which is to try to keep as many people as possible in their homes and keep those homes off the market.

Those are the two sort of basic ideas in play here. In view of what we know about housing prices, housing prices' effect on consumer demand, basic supply and demand dynamics, which of these

ideas is right? Which is in the national interest? I ask any member of the panel to respond.

Mr. CECALA. I'll start out responding. There's no question that to resolve the housing crisis, such as it is, you have to eliminate or reduce the number of distressed properties out there. The question is just the timeframe of doing it. It would be painful, there is no question, to try to burn through all the foreclosures as quickly as possible, get over the foreclosure mess in 2 or 3 years, but recover. Worst case is you take action that drags it out for 5, 10 years.

Mr. SILVERS. You didn't listen to my question. My question is, is it a better idea to throw people out of their homes and put the homes on the market or is it a better idea to try to keep them in the homes paying something? Which is better for the economy? Which is better for housing prices? Which is better for the viability of the financial system? Which course is better for the country, not if we're going to take one course should we do it slow or fast, but which course is better?

Ms. GORDON. I'm happy to provide a straight answer to that. It is better to save the homes. We're talking—let's not conflate two things. What we want to do is keep homes from being sold in foreclosure. Once the homes are sold in foreclosure and the family is gone, you want a family living back in them. I in many cases would like to see the original family get to buy that home right back at the same price that they kicked them out for, that they wouldn't reduce their principal to to prevent the costs of foreclosure in the first place.

But before you get to the foreclosure sale, we should be doing every single thing we can do to keep people in their homes. Once that sale is over, putting Humpty Dumpty back together again is very, very difficult. But before the foreclosure starts, we've got lots of options to prevent it.

Mr. SILVERS. My time has expired. Thank you.

The CHAIRMAN. Dr. Troske.

Dr. TROSKE. Thank you.

I have a question for I guess several of you, and maybe I'll start with you, Mr. Cecala. Several of you in your written statements indicated that you felt that the rules under HAMP were sort of inappropriate, that they were overly onerous and didn't address the problem directly, and also indicated that HAMP rules may be pushing servicers to modify mortgages outside of HAMP.

Could you sort of respond, do you think the rules of HAMP are appropriate, and if not what do you think we should do to be modifying them?

Mr. CECALA. Well, one of the significant things we've seen with the HAMP program—particularly it was an unintentional test of it—was when the program was launched you saw a lot of people who were put in trial modifications without having their paperwork checked or whatever else. One of the most significant, I think, results of that is a lot of the borrowers were able to make the payments at the reduced amount, but later were kicked out of the program because they couldn't meet the paperwork requirements.

Keep in mind, going back to what I said before, we've got a huge number of borrowers who've got loans out there with no paperwork, no documentation of income, and now we're asking them to produce

tax returns and other things to qualify for a HAMP modification. I think that makes it very, very hard.

There are some other things. Talk about the present value test; I think that's a good idea, but it basically favors people who are under water on their mortgage. There are a number of borrowers that I know who've come to me and said they had equity in their home and that immediately almost disqualifies them for HAMP, because you can certainly get a lot more out of them with a foreclosure than you can with a loan modification.

There are some basic flaws in the program that I think discourage a lot of people and end up in rejections.

Dr. TROSKE. Ms. Gordon, would you like to—care to address the question?

Ms. GORDON. Complexity is never our friend, and with the kind of business model that the servicers have, having relied on them alone to take on the task of reunderwriting all of these mortgages, we didn't do the necessary things to make sure they staffed up and increased capacity in a way to make that happen right.

Now, I do want to point out that actually, particularly for people who used nonprofit housing counselors or attorneys, many of those borrowers in fact submitted all of their documentation at the beginning of their trial modification, but the servicer just didn't necessarily want to bother to look at it or wasn't quite sure what to do with it.

So in my written testimony I give a lot of reasons why I think there have been problems with HAMP. But ultimately the problem is we're offering carrots and apples and oranges, but we've got no stick. And there are so many different cross-cutting incentives in the system right now, so many entities are wearing two or three different hats. It's just very difficult to untangle without involving neutral third parties in some way.

Dr. TROSKE. Ms. Schwartz, I'd like to hear your response.

Ms. SCHWARTZ. Sure. Well, it's my view that, while onerous, these are taxpayer dollars and if they don't qualify, and if there's a like solution outside of HAMP, which is happening, we shouldn't necessarily say that's a bad thing. People that don't qualify for HAMP could go to foreclosure.

If the person wants to stay in their home, has the capacity to stay in their home, the servicer can accommodate that and the investor. Modifications outside of HAMP are a good thing and they are not with the use of taxpayer dollars.

So I think it's a complicated issue and I would say the lost documentation, we also recognized that and that's why we developed a safe and secure way for counselors to be involved in the process. I really like the third party help for that borrower, to have a trusted solution and an adviser to work with as they submit things, and you know they won't get lost through an electronic system.

Dr. TROSKE. Mr. Evers, I have a question for you. You talk about mortgages that involve a larger reduction in payment. Do you know, for those modifications, what the average increase in payments is going to be when the permanent modification ends in a 5-year period? Are they going to look—so the payment goes down by $500 or $600. How much is it going to go up?

You've looked at these numbers. Can you speculate a little, what you think is going to happen at that point?

Mr. EVERS. Well, the mods are a permanent change in contractual terms. So those reductions in payment are permanent. So you're expecting the borrower to have lower payments.

So when you look at HAMP, you're seeing a greater reduction in payment——

Dr. TROSKE. But the reduction is only for—at some point it resets. It may not reset all the way, but those payments are going to go up. A previous witness did testify that at the end of that period the interest rate is going to reset to whatever the Fannie Mae interest rate at the time is. Presumably, they're making higher payments at that time. Is that not true?

Mr. EVERS. What we're tracking right now is basically the contractual change in payment and we're basically saying at the time of the mod that it's being done, we're comparing what the payment was before and after the mod, and we're doing that for HAMP mods and we're doing it for proprietary mods.

What we haven't done is looked out further, 5, 7 years, or 10 years.

Dr. TROSKE. Is it possible? That seems like something worth doing to me. I guess I would encourage you to do that.

Mr. EVERS. It's something we could look at.

Dr. TROSKE. Thanks.

The CHAIRMAN. Thank you.

Superintendent Neiman.

Mr. NEIMAN. Thank you.

I'd like to direct my first questions to our national bank regulator, Mr. Evers, and to our industry representative, Ms. Schwartz. You probably heard my dialogue with Ms. Caldwell around the sustainability of proprietary mods. I also want to point out that Ms. Caldwell has remained for this portion of the panel, and I want to commend her for that, because we've often asked Treasury representatives to stay for the second panel and it has not been a practice in the past. So I think it is very helpful for her, and we appreciate that, listening to this round of dialogues.

You may also have heard Ms. Gordon, who shared my concerns that borrowers in proprietary mods may be worse off than they were before. So my question really goes to the data, and do you share our frustrations in being able to assess the actual sustainability of the proprietary mods? Though you point in certain sections that proprietary mods, we understand the reduction in payments may be half of what they are for HAMP mods, we still don't even know the terms of those modifications.

In a HAMP mod, we know that those reduced payments will be for the existence of the trial mod, 5 years. We don't know the reduction in the HAMP mod and for what term.

How comfortable are you and how can we improve these reports so that we really can get our arms around the sustainability of these proprietary mods? Mr. Evers.

Mr. EVERS. That's a great question. It's something we've looked at, so we've been trying to track that for the HAMP as well as the proprietary. In the second quarter report, where we're at right now is we know the change in payment for a HAMP mod versus a pro-

prietary. We also reported the redefault rate for a HAMP mod versus a non-HAMP mod, and the HAMP mod redefault rate is half of what it is for a proprietary mod.

Mr. NEIMAN. Ms. Schwartz.

Ms. SCHWARTZ. Yes. I think it's an excellent question and one that we need to address. We've been attempting to track, in addition to how many loans have a lower principal and interest payment, which is a good step forward. We've asked for, are they at 5 years duration and at 10 percent or more a reduced payment, so that you feel that affordability, and you can measure that as well. We're looking at redefaults. We've been working for a couple of months to collect that, and it's probably this month or next we'll be able to start reporting that.

All the government agencies have looked to us to try to collect that, and I've worked with the servicers to do so.

Mr. NEIMAN. Mr. Evers, could you share our interest in getting that performance data by servicer, so that we can actually compare performance among servicers as well as, I assume, provide a more effective supervisory tool for regulators?

Mr. EVERS. We can cut the data just about any way possible. We can do it by——

Mr. NEIMAN. Is there a reason that you are not sharing that information by servicer in the public reports?

Mr. EVERS. It's confidential supervisory information.

Mr. NEIMAN. Why do you feel that that is supervisory information, where the information of simply factual data included in the Treasury's monthly reports do not present similar issues?

Mr. EVERS. Well, we're collecting our data directly from our institutions. We're collecting loan-level data and we're using that data as part of the supervisory process. So under our legal authority, we deem it to be confidential supervisory information, and our policy approach has been to disclose aggregate data, but not individual bank-specific data.

Mr. NEIMAN. And you are using that information with respect to supervisory responsibilities?

Mr. EVERS. Right. So for example, in my testimony, when we saw high redefault rates, we calculated that for each of the reporting institutions and we criticized each of them using their data and said: Here's your redefault rate, fix these redefault rates, put in mod programs.

Mr. NEIMAN. Thank you.

Picking up on this, we in New York have for the first time registering mortgage loan servicers. We now have oversight responsibilities. We've adopted duties of care, business conduct rules that are enforceable, including the requirement, the authority, to receive quarterly data regarding not only the mandatory modification efforts, but also performance data.

Our ability is limited because of the visitorial powers, that we would be restricted in receiving data from national banks. I also assume the industry would not necessarily like to see different reporting structures among 50 states, even though we do believe that this is a model that can be adopted either nationally or at the CFPB level.

Would the industry support a national reporting requirement for mortgage performance data?

Ms. SCHWARTZ. I have not spoken to—for that specific question, I couldn't comment on it. But I do believe there is some call in the Dodd-Frank bill to have a loss mitigation database created. So I thought that might be happening.

Mr. NEIMAN. Thank you.

The CHAIRMAN. Thank you.

Ms. Gordon, to continue on my other question, what do you think the present foreclosure problems—the present foreclosure problems have on HAMP? I mean, the problems with the robo-letters and the rest?

Ms. GORDON. The problems with the robo-signing and whatever title problems they are, these aren't a technical problem. Also, just to set the record straight, these are not allegations. This is stuff we now know.

But what it is, it's symptomatic of problems throughout the servicing industry. What's interesting, Mr. Silvers before used the term "pull the fire alarms." The fire alarms only seem to get pulled around here when the bank solvency is threatened, when it's that kind of systemic threat. When it's the systemic threat to the American people, when we could have a quarter of homeowners with mortgages lose their homes, that seems to me to be worth a few fire alarms.

The problems we're seeing now just demonstrate how broken the system. These problems I don't think—they're not a cause. They're a symptom of a broken system.

The CHAIRMAN. Professor Porter.

Ms. PORTER. I echo that, the symptom of a broken system. I think any foreclosure relief program that permits servicers to craft the system around their choices, their preferences for how to deal with homeowners, is going to fail largely. So I think the leading problem—one of the leading problems with HAMP from the very beginning that we've seen Treasury try to peel back is putting the servicers front and center in charge and saying, you steer the ship and we'll just sit, we'll be the coxswain in the boat and every once in a while we'll shout something at you.

I think that's a real problem. The other thing I'm concerned about is in the talk from Mr. Silvers about how do we get people to these events, how do we do outreach. I'm very concerned that homeowners are terribly discouraged by HAMP. There's this whole pool of people who've tried and failed, or who had the lost paperwork, friends and neighbors who've had that experience. There's sort of a community contagion effect here.

Even as things improve, there's a big lag in getting the word back out. So I'm a little concerned that the result of that is we have people who are not coming into a HAMP program that might be improved and instead their new plan is that they're going to sue in court and they're going to prove the chain of title, and they don't have the legal capacity to do that and, with all due respect to our court system, they don't have the legal capacity, without a lot of struggle, to litigate those things.

So I'm concerned that people are clinging to a life raft. There's sort of no good life raft, so they're looking from one to the other and they're falling and they're drowning in between.

The CHAIRMAN. Thank you.

Mr. McWatters.

Mr. MCWATTERS. Thank you.

You know, I come at this problem as a corporate lawyer, M and A lawyer, tax lawyer. When I look at it, I'm sort of mystified, because if someone came in my office and—to take off our foreclosure mitigation hat and just think about a workout deal, someone comes in and says, yeah, I paid $250,000 for something, it's worth $150,000 today, there's a second lien on it of 50 and a first lien of 200. What do I do?

The first thing I'd ask them: Is it non-recourse debt? And if it's non-recourse debt, I have an answer. If they say—then I would ask them, if it's recourse debt and they say yes, it's recourse, but I'm broke. Okay, now we have the facts.

In a commercial setting, what you would do is you would write the loan down to 150. You wouldn't fool around. You would just write it down to 150, because, guess what, that's what the property is worth if you foreclose and nobody's going to pay a dime over 150. So you go to economic reality, 150.

Now, first lien, first and second lienholders are not chumps. They're going to say: Well, what if the market turns? Okay, I'll give you an equity kicker. You give them an equity kicker. And the second lien mortgage, what you should do is write them down to zero. You can't write them down to zero. They're going to extort something out of you, right? They have a seat at the table. You give them 10 cents on the dollar, you give them 20 cents on the dollar, you make them happy, you give them an equity kicker, you write it down.

The second thing you do is you refinance the loan to a market rate of interest, not 7 percent, not one of these ridiculous adjustable rate things which people can't pay. You take it down to a 3.75, 4 percent, risk-adjusted, 30-year fixed rate.

Okay, what am I missing? Why doesn't that work in this environment? Yes, Ms. Schwartz.

Ms. SCHWARTZ. Well, you have investor contracts that won't let you write down mortgages. You have Fannie Mae, Freddie Mac, and FHA who won't allow for a writedown like that.

Mr. MCWATTERS. Well, those rules need to be changed. Someone needs to talk to them.

Ms. SCHWARTZ. The NPV test requires something north of what it's worth, and those workouts then take that into consideration. One thing this program has done through HAMP and others is target affordability. It's not negative equity per se. So 2 percent, 40 years, gets you that $500 payment, versus just writing off the full amount.

Mr. MCWATTERS. So you're saying there are rules that would inhibit a commonsense market-oriented response?

Ms. SCHWARTZ. Of course.

Mr. MCWATTERS. Oh, that's encouraging.

Anyone else?

Ms. PORTER. I would say that what you described—I'm a bankruptcy lawyer, so what you described——

Mr. MCWATTERS. I'm trying to keep everyone out of bankruptcy here. I'm trying to cut a deal.

Ms. PORTER. Right. But the idea is, what you described is exactly right and exactly consistent with where parties get to when they don't want to go into bankruptcy court because they know that's exactly the deal the judge is going to get them.

Mr. MCWATTERS. Of course.

Ms. PORTER. So the point here is that if you like what you described and you think it makes sense, and I do, and the servicers aren't doing it, because they're the intermediary—in your negotiation, you weren't negotiating with someone that hung up on you, that you had to call—I don't know what your calling is like at your law firm, but——

Mr. MCWATTERS. I've been hung up on a few times, yes.

Ms. PORTER. But the basic idea is that it wasn't this intermediary that had a profit center and had misaligned incentives and was inept, frankly.

Mr. MCWATTERS. I would tell them that's a personal problem. They cut that deal back in 2004. I'm sorry they cut a bad deal. But guess what, if that deal had turned out to be a really good deal, do you think they would be calling Secretary Geithner and saying, hey, we made a whole bunch of dough, we want to give you some more? No, they would keep every dime of it. So they should live with the downside, too.

Ms. PORTER. I agree, and I think this is one of the reasons that we have pushed and pushed for cramdown, is our sense is that servicers will not reach the rational conclusion that you're talking about, and that negative equity—while affordability is important, so is negative equity. And because they won't get there on their own, we need this system to force them. And bankruptcy courts in my view are not the perfect system for this. I have concerns about putting more families into bankruptcy, but the point that Ms. Gordon raised about we need a stick—these people have gorged themselves on a buffet of carrots and they're still not doing what we want them to do, and so we need something stronger, I think.

Mr. MCWATTERS. I'm way over my time. Thank you.

The CHAIRMAN. Mr. Silvers.

Mr. SILVERS. I just want to get a couple relevant pieces of data on the table.

Mr. Evers or other panel members: The prior testimony today was that there have been 600,000 actual foreclosures this year. Do we know what portion of those were on homes whose mortgages were held by Fannie, Freddie, or another agency, as opposed to what percentage were in the private label market?

Mr. EVERS. I don't have that data available. I may be able to follow up with you.

Mr. SILVERS. If you could please follow up with us.

Does anyone have a guess roughly, I mean in orders of magnitude?

Mr. CECALA. Sure. It's got to be close to half, and particularly if you thrown in FHA and VA, or the whole government.

Mr. SILVERS. The whole government.

Mr. CECALA. The whole government share of the market is 60 percent. Even assuming the mortgages perform better than, let's say, non-agency mortgages, it's got to be close to half. So the answer is Fannie Mae, Freddie Mac, FHA, VA have a large role in terms of controlling those foreclosures.

Mr. SILVERS. Ms. Gordon, you think that's correct, that it's close to half? I would have thought, given what we've heard about the relative balance of quality, that it would not be.

Ms. GORDON. You know, I don't know, but I'm pretty sure someone in my office does, and I can get back to you. But I think there's no doubt that some of the foreclosures happening are agency loans.

Mr. SILVERS. Oh, yes. Just the percentages.

Mr. Evers, I think you probably have the definitive information on this. If you could provide the Panel with it, that would be very helpful.

Secondly, Mr. Evers, in your testimony, in your written testimony, I believe you said that approximately 2 percent of mods both under HAMP and private mods—and Ms. Schwartz can comment—2 percent involved principal reductions; is that correct?

Mr. EVERS. Correct.

Mr. SILVERS. Ms. Schwartz, does that make sense to you? Does that sound right, in thinking about, say, the press release that's in your testimony——

Ms. SCHWARTZ. Yes.

Mr. SILVERS [continuing]. And the breadth of what your members are doing?

Ms. Schwartz. Well, I think I don't have distinct knowledge of the 2 percent, but early indications show that we know investor roles—and of course, the HAMP waterfall is rates, term, and then principal forbearance or deferral as the three tools, until the market has a standard NPV test that includes the principal writedown first, which is coming, I believe, through Treasury. We can then see a little more activity under that, where applicable.

Mr. SILVERS. If there's any more data on that, I'd appreciate it.

I have a final question for the panel. I think one could characterize the testimony and the remarks of my fellow Panel members, particularly Mr. McWatters' remarks, which I fully agree with, just a few moments ago, that we are faced with a choice here. We can either have a rational resolution to the foreclosure crisis or we can preserve the capital structure of the banks. We can't do both.

Which should we do?

Ms. SCHWARTZ. I think we can do both.

Mr. SILVERS. I'm not surprised.

Any other panel members?

Ms. GORDON. I'm not sure. I think that we can—I think either way, down the road we can't—these homes are worth what they're worth. No matter what anybody's carrying them on their books at, we can't—we're not going to change that, and in fact the best hope we have of changing that is fixing the foreclosure crisis and stopping this death spiral that the housing sector is in.

So if we do that right, maybe we can help make the banks' books hew closer to reality. If we do neither, everybody can lose their home and then the banks are going to lose all the money anyway.

Mr. SILVERS. My time is up. But, not surprisingly, you appear to favor keeping people in homes and perhaps having to deal with the bank balance sheets as a result.

Ms. GORDON. Yes.

Ms. PORTER. Can I just say one more thing? If the banks got their deleveraging—we had too much leverage.

Everybody was overleveraged, families and the banks. They got their chance to dump some of their bad stuff on the Fed of New York, and they got their chance to get an infusion of cash.

Mr. SILVERS. But the Fed wants it back.

Ms. PORTER. Yes, I know.

But the point is, the American family is still very highly leveraged. We're still at a point of debt for most families that is unprecedented in the history of America. Even with their making a little more saving, their not using as much credit card, they're still really vulnerable going forward. That long-term affects the ability of the financial sector to be stable and be profitable.

So there's some benefit to getting the homeowners' positions. There's pain in the short term for the banks, but if your whole base or pool to lend to is highly risky and highly unstable, you'll just keep running the risk of more blowups, of more very poor lending.

Mr. SILVERS. Thank you.

The CHAIRMAN. Thank you.

Dr. Troske.

Dr. TROSKE. So I'd like to sort of preface my question a little, and I'm actually going to answer the question that my fellow panelist Mr. Silvers asked before, since I'm always happy to answer his questions, to the previous witness, because I'm actually an economist and I understand a little bit about supply and demand, and I also understand a little bit about dynamics and the growth of the economy over time.

Mr. Silvers is exactly correct. If we push a lot of homes on the market, prices will go down, unequivocally. Now, why would that be a rational policy for a government to do? Because, of course, there are tradeoffs. As people have noted, we are at a point where—we're at a point. We're at a point where house prices are worth less than they were. Banks need to write that off, and of course people need to write that off as well.

But again, the point I made before is, well, is that there are lots of actors in this economy, many of whom were hurt and any of whom will only recover when the economy begins to grow again. And there is a tradeoff. There is a tradeoff between the short-term growth, taking losses in the short term, for the potential of a quicker long-term growth in the long run. Part of what we're looking for is what's the best way to get to the long-term solution, a solution in which we have people in affordable housing situations.

So, Ms. Gordon, you seem to be the one that was willing to address this question before, so I guess I'll ask you again, or I'll ask you to expand on what you thought. Should we not take any of the rest of the actors in the economy's well-being into consideration when thinking about this tradeoff? Because we are where we are, and the question is—part of the question should be how we got here and we need to address the issues that got us here. But the

other question is how do we move forward in a way that gets us back to a growing economy as quickly as possible.

Ms. GORDON. I don't want us to be posing false choices here. There are foreclosures that are unavoidable. What we need to do is figure out a reliable way to separate out the ones that are avoidable from the ones that are not avoidable. We do not have that reliable way right now. That is the system in which the public has lost confidence and now the buyers have lost confidence, and we are in a pickle as a result.

Foreclosures that are unavoidable, I completely agree, let's do them. Let's get that home resold, hopefully to someone in the community and get some of these communities rebuilt. For the ones that are unavoidable, where, as Mr. McWatters has pointed out, it just makes no sense to go through these very costly foreclosures when both the investor and the homeowner end up worse off.

I mean, I'm not an economist, but I'm pretty sure that's not an optimal scenario there.

Dr. TROSKE. As an economist, I'll agree with you 100 percent. What Mr. McWatters said is entirely correct. If it's in the interests of the borrower and the lender to modify the mortgage, that should be done, and we shouldn't have rules that prevent that from occurring.

Ms. SCHWARTZ. And that is what we—we want that to happen in all of those situations.

Dr. TROSKE. Thank you.

The CHAIRMAN. Superintendent Neiman.

Mr. NEIMAN. Thank you.

One of the main frustrations with HAMP has been regarding issues around lost documents and delays in decisioning. That's why I've been so strongly interested in a web portal, the Hope LoanPort that Ms. Schwartz is an executive on. What is the level of usage? When are we going to begin seeing data regarding access and volumes of mortgages and counselors and borrowers who are using the system?

Ms. SCHWARTZ. It's a great question. We just left our pilot phase in June of this year and signed on some of the nation's largest servicers over the summer, which is what you need to get the volume. And of course, you need housing counselors to help direct that volume, and we've worked with NeighborWorks America and HUD to help endorse the system for counselors across the country.

We have thousands of loans now on it that have entered the system.

Mr. NEIMAN. Thousands meaning?

Ms. SCHWARTZ. Up to 6,000.

Mr. NEIMAN. 6,000.

Ms. SCHWARTZ. What's most important is that we tested it thoroughly, and you should know that it was banks and counselors that developed it together and that accommodated each other's requests on how it could work for statusing of loans. We have good agreement among the banks and the counselors on how to operate and tell each other what's going on in a more timely manner and kind of guidelines of that sort.

So we're working very closely with the community groups, counseling groups, as well as the banks and servicers.

Mr. NEIMAN. Plans for direct access by borrowers?

Ms. SCHWARTZ. We'd like to see that happen. We do have—one of the state housing agencies already has direct access through the tool to borrowers and we'd like to see that more broadly offered, and we'll offer it to counselors directly, to have direct borrower access.

We think third parties should be helpful to the borrower in that document retrieval and scanning to make sure it all works well. But we believe it's a fine way to go.

Mr. NEIMAN. So my last question is also directed to you. You heard Mr. Evers talk about the limitations on sharing data regarding proprietary mods based on supervisory considerations, something I certainly know something about. However, the same restraints would not apply to the industry itself to voluntarily share that information to the public on performance data by servicer.

Ms. SCHWARTZ. You know, we went through a long process to get all the servicers to agree to share data. One of the constraints I have is I don't see anyone's individual data. I just have the aggregate information. I would leave it up to the regulators and the supervisors to work with you on bank by bank and servicer by servicer. We're here to kind of tell you the results otherwise.

Mr. NEIMAN. Well, ideally, Treasury and HOPE NOW and the regulators, if they can find a way to share the servicers—I see Ms. Gordon. How important do you think getting that data out is?

Ms. GORDON. You know, our goal is to make evidence-based policy, and when you can't see the evidence that makes it harder. We've been particularly frustrated by the fact that we have yet to see the public release of the loan-level HAMP data, which has been promised for months and months and months. The people at my organization who do the research using this data really, really need it.

Mr. NEIMAN. Thank you.

My time has expired.

The CHAIRMAN. Well, thank you very much. Thank the panel very much. The record will be open for a week for any further questions the Panel members want to raise.

I also want to thank Ms. Caldwell for staying behind. I thought this was an excellent panel and I think we all learned a lot from it.

So thank you, and with that the hearing is adjourned.

[Whereupon, at 12:53 p.m., the hearing was adjourned.]

OCC/OTS Mortgage Metrics Completed Foreclosures Second Quarter 2010						
	6/30/09	9/30/09	12/31/09	3/31/10	6/30/10	Total
Fannie Mae	20,564	28,056	29,745	41,677	46,653	166,695
Freddie Mac	8,908	12,927	15,760	20,134	27,118	84,847
Government- Guaranteed	18,742	16,609	20,926	25,270	29,175	110,722
Subtotal – Foreclosures by Government Investors	**48,214**	**57,592**	**66,431**	**87,081**	**102,946**	**362,264**
Private	46,658	46,768	42,526	45,361	40,148	221,461
Portfolio Loans	11,132	14,246	19,902	20,212	19,718	85,210
Subtotal – Foreclosures by Other Investors	**57,790**	**61,014**	**62,428**	**65,573**	**59,866**	**306,671**
Overall	106,004	118,606	128,859	152,654	162,812	668,935

OCC/OTS Mortgage Metrics Completed Foreclosures (Percent of Total) Second Quarter 2010						
	6/30/09	9/30/09	12/31/09	3/31/10	6/30/10	Total
Fannie Mae	19.40%	23.65%	23.08%	27.30%	28.65%	24.92%
Freddie Mac	8.40%	10.90%	12.23%	13.19%	16.66%	12.68%
Government- Guaranteed	17.68%	14.00%	16.24%	16.55%	17.92%	16.55%
Subtotal – Foreclosures by Government Investors	45.48%	48.56%	51.55%	57.04%	63.23%	54.16%
Private	44.02%	39.43%	33.00%	29.71%	24.66%	33.11%
Portfolio Loans	10.50%	12.01%	15.44%	13.24%	12.11%	12.74%
Subtotal – Foreclosures by Other Investors	54.52%	51.44%	48.45%	42.96%	36.77%	45.84%
Overall	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

Questions for the Record for Phyllis Caldwell
From the Congressional Oversight Panel

Questions for the Record from Panelist Damon Silvers

1. Can you describe the program for auditing servicer compliance with HAMP agreements?

   - How many auditors do you have?

     Treasury's Compliance Agent, Making Home Affordable—Compliance (MHA-C), which is an independent division of Freddie Mac, has 180 employees and contractors directly engaged in conducting various compliance activities, including but not limited to audits, on behalf of the Making Home Affordable (MHA) program. Additionally, there are 70 employees and contractors at MHA-C in support roles such as risk analytics and reporting (providing the basis for the areas of focus for MHA-C compliance activities), information technology (primarily focused on enhancing off-site loan file reviews and general user-technology support), and administrative functions (including vendor management). Information technology and risk analytics account for 36 of those positions.

   - Have all servicers compliance with HAMP agreements been audited at some point during the program? If not, which have not been audited?

     MHA-C conducts nearly continuous compliance activities including but not limited to audits in the ten largest mortgage servicers, given the size and complexity of the organizations. Additionally, MHA-C's overall compliance activities, to date, account for 75 of 117 participating servicers, or approximately 99% of the expected volume for MHA. Generally the servicers that have not been subject to compliance reviews are the smallest of participating servicers.

     While we have established minimum frequencies for which MHA-C would perform each compliance activity at servicers, we employ a risk-based approach which may adjust the scope, nature and frequency of compliance activities conducted based on the assessed risk in each servicer. Some factors in determining the risk at servicers are: number and nature of complaints, results of compliance activities, and servicer program performance.

   - Can you produce any data from the audits on percentages of HAMP applicants that were improperly denied modifications?

     Second Look loan file reviews are conducted using statistical samples to help ensure that borrowers are solicited and properly evaluated for MHA, and are designed to minimize the likelihood that borrower applications are overlooked or that applicants are inadvertently denied a modification. Second Look loan file reviews are conducted monthly for the largest servicers in MHA, and smaller servicers are also statistically sampled on a quarterly or semi-annual cycle. MHA-C evaluates the content of loan files

to determine whether there is documented evidence of appropriate HAMP consideration. For loans where MHA-C is not able to agree with the servicer's disposition, that servicer is directed to suspend any foreclosure activities until questions regarding the related loan's disposition can be resolved.

In general, more than 95% of the time, MHA-C agrees with the related servicer's decision during its Second Look reviews. In cases dating between October 2009 and June 2010 where MHA-C has initially disagreed with servicers' decisions, once provided with additional supporting information from the servicers, the overall number of agreed-with decisions rose to [97%] with only [3%] of the overall decisions found to be incorrect.

2. What is your response to the concern that we have a double standard under HAMP—that homeowners are required to meet strict document requirements to get HAMP relief, but that lenders and servicers are not required to prove that they have a valid lien in order to receive HAMP incentive payments?

   Treasury believes the documentation standards for borrowers are appropriate in light of the need to ensure that the program is available to eligible homeowners and that taxpayer funds are used wisely. Treasury notes that these documentation standards have been designed with extensive input from the oversight agencies.

   Treasury recognizes that some may feel that borrowers are being treated with stricter documentation requirements than servicers, but we do not believe this is the case when one considers the totality of the obligations of a servicer. Treasury has always required that each servicer represent and warrant to Treasury that it has the ability to perform the modifications required under MHA's guidelines, which includes servicing the loan, evaluating each eligible loan for a modification and paying the correct owner of the loan (the "investor"). In addition, Treasury requires each servicer to provide an annual certification to that effect. A final level of review is that servicers are subject to compliance reviews and audits from Treasury, Treasury's agents, and the GAO and SIGTARP. While it is therefore the servicers' responsibility to ensure they are paying the correct owner of the loan, Treasury has implemented mechanisms such as the certification required to help make sure that MHA servicers pay the correct investors/owner of the loan.

3. Can you comment on very recent trends in HAMP modifications? What do you project as the trends in HAMP modifications over the next few months?

   Since the conversion to verified documentation in June, servicers have reported an average of 23,000 trials per month. It is difficult to predict the level of activity in the near term, though it will reflect the overall economic environment and the number of eligible loans entering delinquency.

Questions for the Record from Panelist Richard Neiman

1. Your responses to the Panel's inquiries at our hearing were appreciated, particularly our discussion of the need for more disclosure of the terms of non-HAMP modifications in order to understand how sustainable and beneficial these modifications are. Another important area of disclosure pertains to the Hope Now web portal. The utilization of the portal by housing counselors and servicer participation may be the most effective way of surmounting homeowners' claims of lost documentation by servicers.

   - When will the monthly HAMP reports include information about how many borrowers, housing counselors, and servicers are participating in the portal?

     Neither LoanPort, the borrower portal developed by HopeNow,nor any other borrower portal services are affiliated with the Department of the Treasury. Due in part to the inability of Treasury to authenticate this data, HAMP monthly reports will not report the volumes of these independent initiatives.

   - How concerned is Treasury that only about 6,000 loans are currently in the system, as stated by Hope Now's representative during our hearing's second panel, given that about 25,000 new active trials are starting each month?

     LoanPort, the borrower portal developed by HopeNow, is one of a number of document portals now in the marketplace. As noted above, LoanPort is not affiliated with Treasury. However, we have observed that LoanPort has made significant progress signing up counselors to work with borrowers in the completion of modification documents, and with signing up servicers, who can accept these documents, and provide status of applications. We applaud their efforts, and are hopeful that volumes will continue to grow.

2. We also discussed oversight of the Hope Now web portal by Treasury in order to assess servicer compliance and identify areas of concern.

   - How will Treasury utilize the online data in order to provide meaningful oversight?
   - When do you believe borrowers themselves might be able to access the web portal, even if at a minimum to check on their status and confirm receipt of submitted documents?

     As noted above, LoanPort is an independent initiative. Treasury will not have access to the data in this portal, nor is it privy to further development plans.

3. As a follow up to Senator Kaufman's question asking how many modifications have occurred under Treasury's Second Lien Modification Program (2MP), thank you for agreeing to provide the latest data to the Panel as soon as you can. In the mean time, your assessment would be appreciated as to why only 21 second line modifications have allegedly occurred so far under 2MP, as stated on page 69 and 76 of SIGTARP's third quarter 2010 report, and what has so far been learned about this program that can serve as basis for improved utilization of this program?

Seventeen servicers have signed agreements to participate in the second lien modification program (2MP). For each first lien HAMP modification, where any of these servicers hold a corresponding second lien, that second lien will be modified according to a fixed protocol and without any additional documentation or action required by the borrower, except to make the trial period payments and sign the final modification agreement.

A significant implementation issue for 2MP has been to develop the ability to identify when a servicer holds a second lien on a home as to which the first lien mortgage has been modified under HAMP. No system existed for doing this. Lender Processing Services, acting as a Fannie Mae contractor, has developed a process to match all first lien HAMP modifications (retroactive to the beginning of the program) against all second liens held by participating 2MP servicers. Five of the seventeen servicers are now fully integrated into the LPS matching system and have begun modifying second liens starting with those cases where the servicer holds both the first and second lien. Because 2MP trial plans are not reported into the system of record, Treasury does not have official confirmation of 2MP modifications until they become permanent. As of November 30, 2010, 1,467 non-GSE 2MP permanent modifications have been reported, with many more in trial periods. October was the first month that servicers had the ability to report this data to us. We have not begun to publish this data publically yet, but fully intend to do so, following a reasonable period of validation.

All other participating servicers are in some phase of configuring their systems to communicate with LPS. These servicers have 120 days from the date from when they are able to receiving matching information from LPS, to begin to modify second liens. We expect to see a steady increase in 2MP modifications in coming months as servicers become technologically ready to do this work and begin working through the backlog of existing first lien matches.

Questions for the Record from Panelist Mark McWatters

1. When you consider the foreclosure documentation irregularities (i.e., robo-signing issues), the failure of some securitization trusts and others to obtain properly endorsed mortgage loan notes and properly assigned mortgages and deeds of trusts as required by local law, as well as the exercise of "put" or repurchase rights by securitization trusts and others, is Treasury concerned that any of the too-big-to-fail financial institutions may experience a solvency, liquidity or capital crisis over the next few years?

   At the present time, the various issues you have mentioned concerning foreclosure documentation irregularities and related matters are being investigated by a number of federal agencies. Treasury is very concerned about these issues and is an active participant in the interagency task force coordinating the work of those agencies, which include the federal banking regulators, the SEC, HUD, FTC and DOJ. The main objectives of the task force are to determine the scope of the foreclosure problems, hold banks accountable for fixing these problems, protect homeowners, and mitigate any long-term effects this misconduct could have on the housing market. The interagency task force is closely coordinating with state Attorneys General as well.

Regulators are conducting onsite investigations to assess each servicer's foreclosure policies and procedures, organizational structure and staffing, vendor management, quality control and audit, loan documentation including custodial management, and foreclosure prevention processes. The task force also is closely reviewing related issues that include loss mitigation, origination put backs, securitization trusts, and disclosure putbacks. These examinations are extensive and resource intensive. For example, the Office of Thrift Supervision has approximately 80 examiners on-site at their four servicers, and Office of Comptroller of the Currency has 100 examiners at the top eight national bank servicers. Many members of the task force are also members of the Financial Stability Oversight Council (FSOC), which is receiving briefings and updates on the status of the task force's efforts. The federal agencies involved in these efforts will report their findings upon completing of the investigations and will take appropriate action to remediate any abuses.

Although these issues have not thus far resulted in a solvency, liquidity or capital crisis for any institution, it would be inappropriate for us to speculate as to whether there could be such a situation in the future. .

- What are the systemic consequences to the economy of these events?

  Please see above answer.

- In making this assessment have you considered the exposure of the too-big-to-fail financial institutions to CDOs and synthetic CDOs?

  Please see above answer.

2. Most American homeowners have a mortgage on their home. When they pull out their checkbook every month to pay their mortgage installment how do they know they are paying the correct lender?

   Treasury understands that the foreclosure irregularity issue has raised significant concerns for homeowners about the mortgage and foreclosure process. Treasury is participating in the Administration's interagency efforts to determine what the problems are in these processes. Depending on the results of those efforts, financial institution regulators and state attorneys general may implement improvements to protect against incorrect actions and incomplete or erroneous process issues to help ensure that there are no questions for borrowers as to which servicer and/or lender is responsible for their loans.

   For loans in the MHA program, under the servicing participation agreements, each servicer represents and warrants to Treasury that it has the ability to perform the modifications required under MHA's guidelines, which includes servicing the loan, evaluating each eligible loan for a modification and paying the correct owner of the loan (the "investor"). It is therefore the servicers' responsibility to ensure they are paying the correct owner of the loan. The servicers also provide to Treasury each year an annual certification to that effect. Finally, the servicers are subject to compliance and audits from Treasury, Treasury's agents, and the GAO and SIGTARP; these auditors can inspect the servicers' payments to investors.

If it later emerges that a borrower was paying the correct servicer, but the servicer was remitting that borrower's monthly mortgage payments to the wrong investor, the matter should be resolved between the parties that made the mistake – specifically, the servicer and the investors. If it were not resolved, it could proceed to litigation. Although legal outcomes cannot be predicted, it should be noted that if Treasury's compliance office found that the servicer deliberately paid the wrong investor, the servicer would be in breach of their obligations under the servicer participation agreement as described above.

3. How will a potential purchaser know if a securitization trust or a special servicer retained by a securitization trust may deliver clear legal title to a residence purchased out of a foreclosure?

   Transfer of legal title of mortgage loans is governed by the state law where the property is located. The recent issues and questions on transfer of legal title, particularly into or out of securitization trusts, are important issues that the state courts must adjudicate on a case-by-case basis, or must be handled legislatively by state legislatures. Treasury does not have the ability to adjudicate these cases.

4. Are title insurance companies issuing clean mortgagor (borrower) and mortgagee (lender) title insurance policies with respect to residential real property purchased out of foreclosure?

   Treasury does not regulate title insurance companies, and at present, does not have this information. Title insurance companies are typically regulated by state insurance or banking regulators.

   - Will title insurance companies insure title to residential real property where the mortgage lien was "recorded" and "assigned" under MERS (Mortgage Electronic Registration Systems, Inc.)?

     Please see the above response.

   - Have any financial institutions agreed to indemnify any title insurance companies with respect their issuance of title insurance policies based upon MERS?

     Please see the above response.

   - Has the United States government in any manner undertaken to backstop any such indemnifications?

     Treasury has not insured, guaranteed or indemnified any title insurance policies, and Treasury is not aware of any federal agencies that have done so.

5. It is my understanding that the Fannie Mae and Freddie Mac – who are controlled by the United States government – are part owners of MERS. It is also my understanding that the two GSEs purchased billions of dollars of residential mortgage loans and bundled those loans

into securitization pools in reliance upon the mortgage lien recordation system maintained by MERS.

- Do the securitization trusts formed by the GSEs own clear legal title to each of the mortgage notes and liens acquired by the trusts?

  Treasury does not regulate the GSEs nor does Treasury participate in the GSEs' securitization process. Therefore, we defer to the GSEs to provide commentary on this question. In addition, the GSEs are regulated by the Federal Housing Finance Agency (FHFA), which may be able to comment on this matter.

- Were the mortgage notes duly endorsed to the order of the securitization trusts?

  Please see the above response.

- Were the mortgage liens properly assigned to the securitization trusts?

  Please see the first response.

- Will Treasury deliver a legal opinion to the Panel to such effect?

  Please see the first response.

- If the response to any of the above questions is "no," why do Fannie and Freddie use MERS?

  Please see the first response.

- What is Treasury's estimate of the additional costs and expenses the taxpayers will incur to remedy the non-compliance of the GSE-sponsored securitization trusts with applicable local recording, transfer and commercial law?

  Please see the first response.

- What about penalties for non-payment of such fees?

  Please see the first response.

- Does MERS claim to act as both a mortgage lender and as a nominee of the mortgage lender? If so, how can MERS act as both the agent and the principal?

  Treasury does not regulate MERS, and is not in a position to respond on its behalf. However, according to publicly available materials on MERS, they do not characterize themselves as a mortgage lender. They describe themselves as an agent for the beneficial holder of the related mortgage. We also note that a part of the work being coordinated

by the interagency task force described above is a review of certain issues that have been raised concerning MERS.

- Must a party seeking to foreclose on collateral securing a loan hold the mortgage loan note as well as the mortgage or deed of trust? Does MERS actually hold each properly endorsed note?

  These are legal questions regarding state foreclosure laws and MERS and are not determined by Treasury.

- Are the GSE-sponsored securitization trusts "holders in due course" of the mortgage notes so they may enforce the notes without being subject to defenses which the original maker (borrower) of the note may be able to assert against the original payee (lender)?

  As described above, Treasury does not regulate the GSEs nor does Treasury participate in the GSEs' securitization process. Therefore we defer to the GSEs (or FHFA) to provide commentary on this question.

- What diligence did the two GSEs perform in order to determine that MERS works as advertised? Did the GSEs obtain one or more legal opinions? If not, why not? If so, would you please provide the Panel with a copy of the legal opinions?

  Please see the above response.

6. Since legitimate questions of law and fact continue to emerge regarding the true ownership of the residential mortgage loans that collateralize RMBS (residential mortgage-backed securities), does Treasury believe it is likely that a material number of borrowers who are otherwise current on – or in the process of modifying or refinancing – their mortgage loan obligations may unilaterally elect to stop making their mortgage payments?

There is no way of quantifying the impact that the claims and counter claims about true ownership of securitized mortgages may have on borrower behavior, including on the likelihood of "strategic default". However, borrowers could be irreparably harmed if they stop making mortgage payments based on either their own assessment of the ownership issue, or under the influence of unscrupulous agents that, for a fee, promise to invalidate the mortgage debt because an assignment was not executed or a trust is not able to hold title. Individuals who borrowed money owe a debt to someone. The mortgage obligation will not go away because the chain of ownership is unclear.

- What would be the consequences of a nationwide mortgage payment moratorium by disgruntled homeowners?

  Borrowers who fail to make payments that they are contractually obligated to make, regardless of their reasons for doing so, will become delinquent and, absent intervention by state or federal courts or other legislation protecting borrowers, will eventually be referred to foreclosure. It is likely that the most of these foreclosure cases would proceed

and in the meantime, delinquent borrowers would experience a significant impact to their credit score and be responsible for late fees and foreclosure expenses in addition to their mortgage debt.

If this happened on a wide-scale basis, the impact on those financial institutions and other investments with concentrated mortgage exposure on their balance sheets could, over time, be severe, as the investors and owners of mortgage assets experience a drop in income. In addition, if the number of foreclosures increased dramatically as a result of strategic defaults, it could increase the supply of housing at a faster-than-expected pace and result in further house price declines. However, at this time, it is difficult to predict how state and federal courts, financial institutions, and investors would react in such a scenario.

7. Does Treasury anticipate that individual mortgage loan borrowers – or a class of such borrowers – may initiate wrongful foreclosure and other actions against their mortgage loan originators and RMBS sponsors, securitization trusts and mortgage servicers as a result of the failure to hold clear legal title to the property prior to foreclosure?

   Treasury expects the number of borrowers challenging lack of legal title as a defense to foreclosure to increase, at least for so long as the issue remains prominent. However, the impact or the use of this defense is difficult to predict at this time, and it will depend on its success as a defense in state courts.

   Since TARP recipients and other financial institutions have acted in all three capacities, could TARP recipients suffer substantial losses and capital impairment if the mortgage loan borrowers prevail in the exercise of their legal rights and remedies?

   It is possible that if large numbers of borrowers prevail in their challenges of a lack of clear legal title by the related investor, then banks and other financial institutions with concentrated mortgage assets on their balance sheets could experience losses, which might possibly be severe. At this time, the outcome of these legal challenges is difficult to predict and will primarily depend on the holdings from state courts in foreclosure cases.

8. Since Fannie Mae and Freddie Mac have also acted as RMBS sponsors and given Treasury's unlimited support for the GSEs, does Treasury anticipate that Fannie and Freddie may also serve as targets for aggrieved RMBS investors and mortgage loan borrowers?

   As described above, Treasury does not regulate the GSEs nor does Treasury participate in the GSEs' securitization process. The GSEs (or FHFA) should each be able to provide commentary on this question. However, it is likely that foreclosures of GSE-guaranteed mortgage loans will generally experience the same legal challenges that non-GSE loans face in state courts.

   - What consequences may follow from such action?

The outcome to the GSEs could potentially be similar as the outcome to any other mortgage investor – a loss of income on the mortgage loan or an inability to foreclose on the property. However, it is difficult to predict the outcome at this time.

- Does Treasury anticipate that the GSEs may accelerate their efforts to "put" individual residential mortgage loans back to the originators, or, perhaps, cancel the guarantees issued for the benefit of the RMBS holders?

  We defer to the GSEs (and FHFA to provide commentary on this question.
- What consequences may follow from such action?

  The GSEs (or FHFA) should each be able to provide commentary on this question. As described above, Treasury cannot answer this question.

- Could the broad-based enforcement of these rights and remedies adversely affect any RMBS-based quantitative easing program undertaken by the Fed if the GSEs walk away from some of their RMBS guarantees?

  If the GSEs were to cease to pay on their guarantees on the GSE RMBS, it would adversely affect the value of those GSE RMBS securities, regardless of whether the investor is the Federal Reserve or any other entity.

9. Securitization trusts organized with respect to some RMBS have undertaken to "put" individual mortgage loans back to the loan originators due to the breach of representations or warranties made by the originators. Since many mortgage loan originators are also TARP recipients, what consequences may follow from the exercise of such rights?

   It is possible that if there is a large amount of successful mortgage loan putbacks, then the banks or other financial institutions that had to repurchase the loans would experience losses, which could be severe. On the other hand, it should be noted that most mortgage assets and RMBS are held by other financial institutions, so these institutions (many of whom were TARP recipients) would benefit. At this time, the expected amount and timing of successful putbacks is difficult to predict.

   - Since some securitization trusts have been reluctant to exercise their put rights, RMBS investors have pooled their interests so as to force securitization trusts to exercise their put rights. Since many mortgage loan originators are also TARP recipients, what consequences may follow from the exercise of such rights?

     Please see the above response.

   - What is Treasury's estimate of the total face amount of residential mortgage loans that securitization trusts and others may put back to TARP recipients?

Treasury cannot predict the outcome of mortgage loan putbacks due to the fact that these depend on the facts and circumstances of individual situations, default rates on the mortgage loans, investor and originator behavior, and court decisions.

- Has Treasury considered how the claims of parties to CDOs and synthetic CDOs may exacerbate the problem?

  CDOs and other synthetic structured vehicles certainly make the outcomes more difficult to predict. The issues regarding CDOs have primarily been regarding the asset quality selected for the CDOs by the manager or sponsor, or regarding conduct by affiliated parties in betting against the selected asset pool through derivative instruments, such as swaps. These products are difficult to unravel and to understand by many, including by many of the related purchasers. Consequently the degree of their impact is difficult to predict as well.

10. Why specifically have servicers, securitization trusts and residential mortgage loan holders been reluctant to modify or refinance distressed mortgage loans?

- Why have holders of mortgage loans been reluctant to write down mortgage loan principal where the outstanding principal balance of the mortgage clearly exceeds the foreclosure sales price of the residence? Why ignore economic reality?

  While this question relates to the broader mortgage market and may be more appropriately responded to by institutions and their regulators, servicers in MHA were required to comply with the procedures in Treasury's principal reduction program as of October 1, 2010. All participating servicers are now required to consider every loan with an LTV of 115% or more for principal reduction and must provide a plan that describes the circumstances under which they will actually offer principal reduction in conjunction with a HAMP loan. The largest four servicers have provided plans indicating that they do intend to offer principal reduction. This is a major policy shift for these servicers. We should begin to see the results of these actions in December.

- Are mortgage lenders afraid of booking losses and taking a hit to capital?

  The losses from principal reduction flow to the ultimate holder of the note and losses and capital requirements vary depending on the entity and the investor agreement. As it relates to mortgage loans held by regulated financial institutions, the agencies with direct supervisory authority can provide commentary on booking losses and capital requirements. With regard to the HAMP PRA program, we note that there has been a significant level of interest by servicers in the program.

- Are they concerned about a ratings downgrade?

  Please see previous response.

11. The TARP-funded HAMP program carries a 100-percent subsidy rate according to the Congressional Budget Office. This means that the U.S. government expects to recover none of the $50 billion of taxpayer-sourced TARP funds invested in the HAMP foreclosure mitigation program. It is my understanding that an equity sharing feature has been incorporated in the Supplemental Directive to the Principal Reduction Alternative (PRA). Please describe how the equity sharing arrangement works.

    Equity sharing is an agreement between an investor and a borrower to forgive principal in exchange for the potential for the investor to recoup some or all of the amount forgiven if the property increases in value over time. Treasury is not a party to an equity sharing agreement and would not recoup any funds from such an agreement. The reference to equity sharing in our guidance just serves as notice that should a borrower and investor enter into such an agreement, they would still be entitled to incentives, however the investor could not recover from the borrower more than the amount of the principal forgiveness, less any amount of incentive paid by Treasury, thus they could not double dip.

    - Since Treasury is charged with protecting the interests of the taxpayers, why doesn't Treasury participate in the equity sharing arrangement as a means to recoup the "financial incentives" offered by the taxpayers to the investors/lenders under the PRA?

      Treasury declined to implement an equity share feature for a number of reasons. Two of the primary reasons were that (1) an equity share feature would present many operational hurdles that would delay bringing the feature to live status until some time in 2011; and (2) it would require a larger capital investment by Treasury in order to secure the "equity share" and would likely burn through too much of the approximately $29 billion for MHA, leaving too little for loan modifications and other MHA programs.

    - Why should investors/lenders receive any "financial incentives" from the government to write off principal under the PRA or otherwise?

      Without financial incentives, fewer modifications that include principal reduction would be NPV positive.

    - If an investor/lender made a bad deal, why should the government—yet again—bail out the investor/lender under the PRA or otherwise?

      The same question could be asked about a standard HAMP modification. The intent of the program is not to bail out investors, but to strategically use financial incentives to create an NPV positive transaction so as to facilitate a modification that an investor might not otherwise be willing to enter into. Those modifications consequently help many homeowners stay in their homes. Preventing avoidable foreclosures through mortgage modifications and other alternatives helps fulfill the goals of Emergency Economic Stabilization Act of 2008(EESA) and is necessary to stabilize the housing market.

12. While many homeowners have recently lost equity value in their residences, others have suffered substantial losses in their investment portfolios including their 401(k) and IRA

retirement plans. Why should the taxpayers bail out a homeowner who has lost $100,000 of home equity value and neglect another taxpayer who has suffered a $100,000 loss of 401(k) and IRA retirement savings?

This is particularly true if the homeowner was able to cash out of some or all of the homeowner's equity appreciation. That is, what public policy goal is served by bailing out a homeowner who received a ski boat, trailer and all wheel drive SUV as proceeds from a $100,000 home equity loan while neglecting the taxpayer who suffered a $100,000 investment loss in her 401(k) and IRA accounts?

Since it is neither possible nor prudent for the government to subsidize the taxpayers for the trillions of dollars of economic losses that have arisen over the past two years, why should the government undertake to allocate its limited resources to one group of taxpayers while ignoring the equally (or more) legitimate economic losses incurred by other groups?

The Obama Administration took office at a time of an unprecedented crisis in the housing market. Stabilizing the housing market was needed to help stabilize the overall financial system and fulfill the purposes of EESA. As part of the Homeowner Affordability and Stability Plan, pursuant to the authority granted in EESA, the Treasury Department began work on a program that would improve the affordability of mortgages for responsible homeowners, consistent with the mandate of EESA to promote financial stability while protecting taxpayers. Legal and other constraints required Treasury to develop a voluntary program that would support servicers' efforts to modify mortgages.

Protecting taxpayers required that the new program not aim to prevent all foreclosures. The Administration determined the target group was middle-class working homeowners in owner-occupied homes who are at risk of losing their homes but for whom government assistance would significantly improve the odds they would avoid foreclosures. Helping these homeowners would prevent unnecessary pain and suffering and would help to stabilize housing markets.

HAMP was built around four core principles, designed to help the large segment of at-risk homeowners for whom foreclosure is avoidable and who want to stay in their homes. First, the program focused on affordability, in an effort to ensure that borrowers who hope to remain in their homes would be able to afford the modified mortgage payment.

Second, HAMP would protect the taxpayer by employing an innovative pay-for-success structure and requiring the investor in the mortgage to retain the risk of future re-default. This structure aligned the interests of servicers, investors, borrowers and taxpayers and encouraged loan modifications that would be both affordable for borrowers over the long term and cost-effective for taxpayers.

Third, any servicer that signed up for the program would be required to evaluate every eligible loan using a standard net present value (NPV) test. If the test was positive, the servicer would be required to modify the loan.

Fourth, unemployed borrowers would be allowed to participate in the program.

By focusing on those homeowners who are most likely to benefit from government assistance, the program was designed to help stabilize the housing market, the financial system, and prevent further negative impact of foreclosures on communities.

13. What about:

(i) the retired homeowner whose residence drops in value by $100,000 after she has diligently paid each installment on her $300,000 mortgage over 30 years;
(ii) the taxpayer who rents her primary residence and purchases (with a $300,000 mortgage loan) real property for investment purposes that subsequently drops in value by $100,000; and
(iii) the homeowner suffering from a protracted illness or disability who loses $100,000 of equity value upon the foreclosure of her residence for failure to pay property taxes?

HAMP and the other foreclosure mitigation programs supported by the Administration offer no assistance to these taxpayers. Why should the government undertake to allocate its limited resources to one group of taxpayers while ignoring the equally (or more) legitimate economic losses incurred by other groups?

In the specific cases mentioned above, case (i) might be eligible for a modification if the homeowner is at risk of imminent default. In case (ii), the homeowner would not be eligible because the MHA program is limited to owner occupied residences. In case (iii), a home that already went through a foreclosure sale would not be eligible for MHA as title has already been transferred to a new owner – and there is no longer a possibility of keeping that homeowner in the home.

The Administration has undertaken comprehensive financial stability and housing stability initiatives over the past two years, including the Making Home Affordable program. The impact of government initiatives is not perfectly distributed across the population. However, the impact across the country has been positive – we are seeing signs of an economic and housing recovery and that benefits all of us.

Along these lines, the Administration's housing programs are not designed to prevent every foreclosure. MHA, HFA Hardest Hit Fund, and FHA Refinance target responsible, middle class borrowers and enables them to modify or refinance their mortgages in a way that will allow them to avoid losing their homes.

Reducing the number of foreclosures will help stabilize home values or reduce their fall even for those who do not participate in MHA. When there is a foreclosure, the damage isn't limited to just the house that is lost. Foreclosures have dragged down entire neighborhoods and threaten to ignite a vicious cycle of foreclosure and loss in housing values. Foreclosures reduce the value of neighboring properties and lead to increased crime and property abandonment.

In addition, the standards for better servicing and loss mitigation established by the MHA program have had a significant impact even for those who are unable to qualify for the program – or to afford even a modified loan. According to OCC/OTS mortgage metrics, the quality and frequency of modifications across the industry has improved following the introduction of the MHA standards.

14. Suppose, instead, two taxpayers purchased condominiums in the same building for $200,000 each (with 100 percent financing) and, after the condominiums appreciated to $300,000 each, the first homeowner secured a $100,000 home equity loan the proceeds of which were used to pay the college tuition of the first homeowner's son, but the second homeowner declined to accept a home equity loan (expressing a "this is too good to believe" skepticism) and the second homeowner's daughter financed her college tuition with a $100,000 student loan.

    If the condominiums subsequently drop in value to $200,000 each, why should the taxpayers undertake to subsidize the write-off of the first homeowner's home equity loan and in effect finance the college tuition of the first homeowner's son while the second homeowner's daughter remains committed on her $100,000 student loan?

    - What message is sent by bailing out the imprudent homeowner while neglecting the prudent and fiscally responsible homeowner who elected not to over-leverage her residence?

      We share the goal of reaching responsible homeowners who have played by the rules. The Home Affordable Refinance Program and FHA Refinance option are available to current borrowers and only current borrowers, respectively, giving responsible borrowers who have made their payments on time an opportunity to refinance into lower rates and more affordable payments. In addition, MHA provides extra incentives to reach borrowers before they go delinquent.

      Given the significant negative impact of widespread foreclosures on communities, neighborhoods and the market, the Administration's housing programs are working to strike an appropriate balance by enabling lenders and borrowers to agree to affordability modifications but steering them to responsible homeowners.

      MHA targets borrowers who have played by the rules in the following ways:

      - *it only applies to owner-occupied properties and does not apply to investors or speculators.*
      - *it targets greater resources at people that have played by the rules and paid their bills on time.*
      - *it targets people who got into difficult situations because prices fell through no fault of their own.*
      - *it does not require people to become delinquent before it provides support.*
      - *it aligns incentives of homeowners, servicers and investors – and provides financial incentives only for successful modifications.*
      - *it does not apply to millionaire homes and only GSE conforming loans are eligible.*

15. In many instances it is unlikely that holders of second lien mortgage loans are truly out-of-the-money since today's fire-sale valuations are not representative of the actual intermediate to long-term fair market value of the residential collateral securing the underlying loans. As such, why should a lender write-off a second lien loan particularly if an across-the-board write-off of second-lien loans will require the lender to recognize significant accounting losses and impair regulatory capital?

    The MHA program is not asking for an across the board write off of second liens.

    - Why not offer the second-lien lender an equity appreciation right as incentive to write off the loan?

      In the MHA programs, nothing prohibits the investor in a junior lien from entering into equity share agreements with the holder of the related senior lien (or other junior liens on the same property).