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H.R. 5679, THE FORECLOSURE PREVENTION AND SOUND MORTGAGE SERVICING ACT OF 2008

HEARING

BEFORE THE

SUBCOMMITTEE ON
HOUSING AND COMMUNITY OPPORTUNITY

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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H.R. 5679, THE FORECLOSURE PREVENTION AND SOUND MORTGAGE SERVICING ACT OF 2008

Wednesday, April 16, 2008

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON HOUSING AND
COMMUNITY OPPORTUNITY,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Maxine Waters [chairwoman of the subcommittee] presiding.

Members present: Representatives Waters, Cleaver, Green, Ellison; Capito, Shays, Miller of California, and Neugebauer.

Also present: Representative Watt.

Chairwoman WATERS. This hearing of the Subcommittee on Housing and Community Opportunity will come to order. Good morning, ladies and gentlemen. I would like to thank Ranking Member Capito and the members of the Subcommittee on Housing and Community Opportunity for joining me for today's hearing on H.R. 5679, the Foreclosure Prevention and Sound Mortgage Servicing Act of 2008.

Yesterday, RealtyTrac released data on foreclosures for the month of March. The figures are sobering. Over 234,000 homeowners nationwide were hit with foreclosure filings, which include default notices, auction sale notices, and bank repossessions; this represents an increase of 5 percent since February, and 57 percent compared to March 2007. Of these filings, over 51,000 homes were actually repossessed by banks; in other words, actually foreclosed upon, a 10 percent increase over February. Year-to-date, such foreclosures have taken place at a rate that is a shocking 129 percent greater than during the same period last year. Clearly then we have not emerged from the biggest foreclosure wave to strike this country since the Great Depression.

Today's hearing is about strategies to prevent further increases in foreclosures. I took a careful and comprehensive look at the subprime mortgage and the subsequent foreclosure crisis before introducing H.R. 5679, the Foreclosure Prevention and Sound Mortgage Servicing Act of 2008. It became clear to me early in this debacle that mortgage servicers hold the key to any foreclosure prevention strategy. Simply put, they are the direct point of contact for nearly all borrowers in the contemporary mortgage market.

The vast majority of home mortgage loans do not remain on the books of the bank or the financial entity that originated them. Rather, they are typically bundled together and securitized, and then sold in the secondary market as a part of investment trusts in which the investors hold financial interest in particular bundles or tranches of the underlying mortgages. The trust then contracts them with the mortgage servicer, which takes payments and is responsible for taking all steps to address delinquency, including foreclosing on behalf of the investment trust. Loss mitigation refers to a range of activities that a mortgage servicer may offer a homeowner as an alternative to foreclosure, including repayment plans, loan modification, short sales, and deeds in lieu of foreclosure.

On November 30, 2007, this subcommittee convened a field hearing in Los Angeles entitled, "Foreclosure Prevention and Intervention: The Importance of Loss Mitigation Strategies in Keeping Families in Their Homes." There homeowners, homeownership counselors, legal aid attorneys, and local government officials testified as to difficulties they encountered in getting prompt, reasonable loss mitigation action by the mortgage servicers. Witnesses described challenges in finding and speaking directly to a person at the servicers who was empowered to engage in meaningful loss mitigation. Additionally, individual borrowers and even their trained advocates found it difficult to obtain accurate information on the status of their loans. Those that did receive loss mitigation offers were sometimes required to waive their legal rights or agree to pursue further complaints only through arbitration.

Unfortunately, since that hearing, I have not been satisfied with the progress made by the voluntary loss mitigation efforts undertaken by the industry. I think the rising foreclosure figures speak for themselves, although I look forward to hearing from our witness panels today on that issue.

Meanwhile, the data provided by industry to date has struck me as opaque at best, in terms of whether distressed borrowers are being offered sustainable repayment plans or loan modifications that will remain affordable over the long term. In my view, the fundamental problem is that the mortgage servicers have no legal obligation to engage in reasonable loss mitigation efforts to keep a borrower in delinquency in his or her home even where that borrower may have been the victim of a predatory or unaffordable loan. The only duty is to the investment trust that holds the bundle of mortgages they service. Simply put, absent a statutory duty of some kind, I am concerned that consumers have little leverage with mortgage servicers in the current crisis and will continue to lack it in the future.

H.R. 5679, the Foreclosure Prevention and Sound Mortgage Servicing Act, creates this enforceable legal duty. Specifically, the legislation amends the Real Estate Settlement Procedures Act, or RESPA, in the following ways:

First, it would permit foreclosures to proceed only after reasonable loss mitigation. Loss mitigation analysis would be required to consider the long-term affordability of the home loans using the standard employed by the VA Loan Guaranty Program, including analysis of junior liens and the borrower's other secured or unsecured debt.

Second, it would provide fair compensation for a servicer's loss mitigation activities. The bill ensures that mortgage servicers have a monetary incentive to engage in loss mitigation by authorizing reasonable fees for these activities.

Third, it would facilitate referrals to housing counselors. Servicers are required to refer homeowners who are late on their mortgage payments to HUD-certified housing counselors.

Fourth, it would institute comprehensive loss mitigation activity data reporting. Servicers are required to report various loss mitigation activities with specific geographical designations just as lenders must report data on loan originations under the Home Mortgage Foreclosure Act.

Fifth, it would strengthen the duty of servicers to respond to a homeowner's request for information. Servicers must provide timely responses to requests from homeowners and housing counselors for payment histories, loan documents, and loss mitigation documents. In addition, all servicers must provide a toll-free or collect-call phone number that provides the borrower with direct access to a person with the information and authority to fully resolve issues related to loss mitigation and undertake all loss mitigation activities in the United States.

Lastly, it would better protect borrowers' legal rights. Servicers may not condition a loan modification on a borrower's limitation or waiver of legal rights. The bill would also allow damage actions for individual violations and increases maximum damages.

In sum, I believe that H.R. 5679 is a prudent piece of legislation designed to balance the needs of lenders and servicers and borrowers in an effort to reduce foreclosures. I also see it as an important step in regulating what has been to date a largely below-the-radar-screen and underregulated sector of the mortgage industry.

With that, I will now recognize Ranking Member Capito for her opening statement.

Mrs. CAPITO. Thank you, Madam Chairwoman, for scheduling this hearing today on how to address the Nation's rising foreclosure rates and whether the lending industry has all the tools necessary to perform loss mitigation activities. As a result of plunging home prices, many borrowers now find themselves underwater, owing more on their home than it is actually worth. Economists have estimated that some 8.8 million mortgages are now underwater and expect that figure to rise as housing prices decline further.

Some analysts believe that even if a percentage of these borrowers can afford to make their mortgage payments, the difference between what they owe on their houses and the home's market value, a difference that has become known as negative equity, may encourage these borrowers to walk away from their homes. Some commentators have even gone so far as to say that in these circumstances, it is in fact economically rational for borrowers to purposefully default on these mortgages.

Investors have also found themselves affected by the decline in home prices. The values of the mortgage-backed securities they hold are not only threatened by greater risks of default and foreclosure, the collateral that secures these loans, these mortgages, is worthless, which in turn further increases the risk of loss. As a result, investors have found that the market for mortgage-based se-

curities has become increasingly illiquid with other investors reluctant to purchase these securities because of the increased risk of loss.

The climb in home prices has moved the discussion from ARM resets, which have not been as sizeable as initially feared, to discussions of negative equity and its relationship to defaults and foreclosures. While I understand and share Chairwoman Waters' goal of preventing foreclosures, it is important that we take care as we consider legislative remedies such as H.R. 5679 to not make the situation worse.

Many who are testifying here today have significant concerns about the unintended consequences of the provisions included in this legislation; specifically, that H.R. 5679 could have a negative impact on the availability of credit and the willingness of industry to enter into new mortgage contracts. With investor appetite for U.S. mortgages in flux, any legislative solution must not do additional harm and further disrupt market liquidity.

There is concern that the provisions in this bill are overly broad, burdensome, and could ultimately redefine existing mortgage contracts. There is certainly enough editorial comment on both sides of these issues, some urging quick action, others making the case that action would only further prolong the current mortgage crisis and exacerbate the problem. I realize it is difficult to know how best to proceed.

Several weeks ago, much of the attention relating to the mortgage crisis was focused on the pending resets and the ability of homeowners to make their payments after the reset. But recent reduction in rates have made the resets less of a problem, although they are still a problem for some.

Today, as I mentioned earlier, the focus is more on those homeowners who are underwater, families living in homes that are worth less due to declining markets than the current mortgage on their home. The change in focus serves to highlight the importance of being cautious before taking action that may only exacerbate the housing crisis and then weaken our economy.

I am anxious to hear from our witnesses today on the current condition of the mortgage markets and foreclosure statistics and how you are addressing these problems, what kind of progress is being made to improve market conditions and to help stem the tide of families facing foreclosure, and what action is being taken by advocacy agencies and industry to address this current mortgage crisis.

Again, I would like to thank Chairwoman Waters for her continued interest in this issue, and I look forward to the testimony of the witnesses. Thank you.

Chairwoman WATERS. Thank you very much. I will now recognize members of the subcommittee for opening statements. First, we will have Mr. Cleaver for 2 minutes.

Mr. CLEAVER. Thank you, Madam Chairwoman. I want to thank you and Ranking Member Capito for holding this hearing. The issues that are coming before us at this juncture are Herculean when you look at what is happening around the Nation. In particular, 20,000 foreclosures a week would suggest that we have more than a casual problem. I happen to be one who believes that

we have to take some dramatic and drastic actions to address a dramatic and drastic problem.

I listened to Ambassador Crocker this past week on NPR, and one of the questions he responded to dealt with whether or not al Qaeda was in Iraq before we arrived. He said, "No, they were not, but the reality is that they are there now; we have troops there now and so what can we do except address the problem that we find ourselves in now."

Chairman Frank has laid out, I think, a very ambitious but workable plan to deal with a major problem. There are a lot of reasons we can choose not to do it. I mean, there are people who actually lied about their incomes and purchased a home far bigger than they could afford, and some people with terrible credit who repeatedly missed their mortgage payments and found themselves in trouble. But the truth of the matter is we are in it now and we have to figure out a way to get out.

I think this happens to be the best way I have heard so far, and so I am anxious to engage in some dialogue with those of you who are testifying. Thank you for coming today, and I yield back the balance of my time.

Chairwoman WATERS. Thank you very much, Mr. Cleaver. Mr. Green for 2 minutes.

Mr. GREEN. Thank you, Madam Chairwoman, and thank you to the ranking member as well. I am pleased and honored to be here today. I was also pleased to be in California when the subcommittee met and we delved into these issues. It was quite revealing because we had persons who actually had experiences who were sharing with us their personal stories. I am looking forward to hearing some of the concerns that were raised at that hearing addressed at this hearing.

We heard concerns with reference to loss mitigation and the whole question of whether or not there is an incentive to perform loss mitigation or is there an inducement not to perform loss mitigation. That is a serious question that has to be addressed.

Also, we heard concerns about the HOPE NOW Alliance, and the clarion call from the persons that we talked to was an indication of a need for help now. And the question became whether HOPE NOW was going to become a cure or was it some sort of a lure, was it a long-term cure or was it a short-term lure that would get persons to sign certain documents that might cause them to find themselves in a position that would not be to their best benefit in the long term, but doing so because there was some short-term gain, meaning that they could stay in their homes for a little while longer.

I am also concerned about the whole question of tranche warfare. Apparently, there are some tranches that hold positions that are antithetical to allowing some sort of settlement, some sort of restructuring to take place, because they have these superior positions and foreclosure in effect can benefit some persons in certain tranches. So you have this tranche warfare; higher tranches having one position, lower tranches having another position.

These are the kinds of concerns that I think we have to address at the hearing, but we need a bill, we need some sort of act of Congress to ultimately propose solutions for the questions that we can

address at a hearing but we cannot resolve without an actual piece of legislation from Congress. I yield back the balance of my time.

Chairwoman WATERS. Thank you very much. Mr. Watt, do you have an opening statement for 2 minutes?

Mr. WATT. Thank you, Madam Chairwoman. I won't take 2 minutes. I just want to thank the Chair for allowing me to sit in on this hearing. The luck of the draw on our subcommittee assignments didn't allow me to get on the Housing Subcommittee, but what I have been doing—I am not on the Capital Markets Subcommittee either, but yesterday I attended a Capital Markets Subcommittee hearing. I am here this morning because I want to hear every idea that is out there to try to address this crisis that we are in and try to get us out of it and try to save homes in my congressional district, and particularly homes in vulnerable communities. And while we have seen some progress, we certainly haven't seen the kind of progress that we need to see.

I think the chairwoman's bill will push further in the direction that kind of impels all of the players to play a role in solving this crisis. And anything we can do to do that, I think, is advantageous. I thank the gentlelady for allowing me to be here. I won't try to ask questions, but I did want to hear the testimony of some of the witnesses. Thank you, and I yield back.

Chairwoman WATERS. Well, I thank you very much. And since I must follow procedures, I will ask unanimous consent to allow Mr. Watt to participate in today's hearing. Without objection, certainly as much as he ought to. Also Mr. Watt, I want you to know that I thought I heard you voluntarily removed yourself from my Housing Subcommittee, and I take that personally. However, I did sign up for your Committee on Oversight and Investigations.

Mr. WATT. If the gentlelady will yield, I will go out of my way to explain that.

Chairwoman WATERS. I will yield to the gentleman so he can defend himself.

Mr. WATT. I will defend myself. I think it was I had to either get off the subcommittee or go through another hour of rebidding the whole process, and I figured that I would come and participate in your subcommittee as often as I could anyway. You know I am your supporter and I will be here trying to protect your back even when some of your subcommittee members may not show up.

Chairwoman WATERS. Well, I appreciate that. Thank you, Mr. Watt. Mr. Shays for 2 minutes.

Mr. SHAYS. Thank you. I want to thank the chairwoman and our ranking member for conducting this hearing. This is a huge issue for the entire country and a very significant issue in my district. I have three urban communities. Bridgeport, where I live, is faced with the potential of many foreclosures. Subprime loans are basically loans that are extended to people whose credit may not be good or whose income may not be strong, and it was an effort to get more people into the marketplace as homeowners. So the general thrust of subprime loans is not the issue; the issue is how they were extended. I am deeply concerned that we do everything we can to minimize the number of foreclosures so that people who were truly never involved in this issue don't get pulled down with it.

We have, I think, a national interest, a regional interest, in dealing with this issue and I am very grateful, Madam Chairwoman, that you are conducting this hearing, and I don't think we should be afraid to go wherever the truth takes us. Thank you.

Chairwoman WATERS. Thank you very much, Mr. Shays. At this time, I will introduce our first witness panel: Ms. Laura A. Maggiano, Deputy Director, Office of Single Family Asset Management, U.S. Department of Housing and Urban Development; and Ms. Judy Caden, Director, Loan Guaranty Service, U.S. Department of Veterans Affairs. I thank both of you for appearing before the subcommittee today. Without objection, your written statements will be made a part of the record, and you will now be recognized for 5 minutes. I will start with Ms. Maggiano.

STATEMENT OF LAURIE MAGGIANO, DEPUTY DIRECTOR, OFFICE OF SINGLE FAMILY ASSET MANAGEMENT, FEDERAL HOUSING ADMINISTRATION, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Ms. MAGGIANO. Thank you, Chairwoman Waters, Ranking Member Capito, and members of the subcommittee. On behalf of Secretary Jackson and Commissioner Montgomery, thank you for allowing the Federal Housing Administration to participate in this hearing to discuss the critical difference that sound servicing practices can make in preventing mortgage foreclosures. This dynamic is well-illustrated by looking at the highly successful FHA loss mitigation program, which encompasses a series of flexible workout options for managing seriously delinquent loans, which we define as those that are 90 days or more past due. These workout options are administered not by government staff, but by FHA servicers. FHA, however, provides monetary incentives to encourage servicers to use the program and carefully monitors their performance. It is important to stress, however, that although loan servicers have delegated authority, participation is not optional.

Within 45 days of default, every delinquent borrower must be provided with comprehensive written information about workout options, including contact information for HUD-approved housing counselors. Each borrower must be evaluated for loss mitigation before the 90th day of default and servicers must consider loss mitigation right up until the day of the foreclosure sale if the borrower's financial circumstances have changed.

To ensure servicer compliance, FHA has developed a sophisticated ranking system. Top rank servicers are eligible to earn extra incentives. And servicing lenders that don't use loss mitigation seriously are subject to sanctions, including fines equal to triple the cost of a foreclosure claim.

FHA's home retention workout options are targeted at delinquent borrowers who want to keep their homes but who require more than just a short-term payment plan to help them regain financial footing. These include special forbearance, a long-term repayment plan that provides one or more special provisions such as a temporary reduction or suspension of payments.

Mortgage modification: This represents a permanent change in the mortgage that may include capitalization of delinquent payments, reamortization of the term, or a change in the interest rate.

And a partial claim: This is a loan provided by FHA in an amount necessary to reinstate the delinquent mortgage. The loan is interest free and is not due until the first mortgage is paid off. This option provides up to 12 months of mortgage payment assistance. Until recently this option was only available through FHA, but Fannie Mae has just introduced a home saver advance workout that is patterned on the FHA partial claim.

For borrowers who are financially unable to keep their homes, FHA provides pre-foreclosure and deed in lieu of foreclosure options. These workouts relieve the borrower of the mortgage debt without the emotional and social stigma of a foreclosure sale. Unlike most investors, however, FHA provides borrowers who utilize these disposition options with compensation of up to $2,000 to help them transition to more affordable housing.

The disposition options are important. FHA's commitment and focus is on home retention. In Fiscal Year 2007, for example, 95 percent of all loss mitigation workouts allowed borrowers to keep their homes.

The dual goals of the FHA loss mitigation program are to help FHA borrowers and to maximize losses to the insurance funds. The program is successfully achieving both goals. Last year alone, FHA helped 85,500 seriously delinquent borrowers retain homeownerships. And these are not temporary fixes. FHA has an 87 percent long-term success rate with loss mitigation. As foreclosure prevention has increased, there has been a corresponding reduction in foreclosure claims.

Contrary to the incorrect report in last Sunday's Washington Post, the percentage of FHA insured loans that terminated in foreclosure has decreased every year for the past 3 years, from 1.64 percent of all FHA loans in 2004 to 1.42 percent in 2007. And in terms of preserving the financial integrity of the funds, the $158 million paid in home retention claims last year resulted in $2 billion in loss avoidance.

The FHA loss mitigation program is a prime reason that FHA loans are considered safe and affordable. For too long, however, borrowers who would have benefited from an FHA loan were steered to higher risk subprime products. Fortunately, many of these borrowers now have the option of refinancing into FHA Secure. Under this program borrowers who became delinquent as a result of an interest rate reset have the option to refinance to FHA. And as of April 15th, 158,000 borrowers have closed on a fixed rate FHA Secure loan.

Just last week in this hearing room, Commissioner Montgomery announced additional mortgage assistance for subprime borrowers who are a few payments late or who have received a voluntary mortgage principle writedown. With this new flexibility, FHA Secure is expected to assist 500,000 at-risk borrowers by the end of December 2008.

In closing, I would like to again thank the committee for its thoughtful consideration of loss mitigation. The Administration is committed not only to helping American families achieve homeownership, but also to helping them preserve it.

[The prepared statement of Ms. Maggiano can be found on page 134 of the appendix.]

Chairwoman WATERS. Thank you very much. Ms. Judy Caden.

STATEMENT OF JUDITH CADEN, DIRECTOR, LOAN GUARANTY SERVICE, U.S. DEPARTMENT OF VETERANS AFFAIRS (VA)

Ms. CADEN. Good morning, Madam Chairwoman, and members of the subcommittee. I appreciate the opportunity to appear before you today to discuss the underwriting standards used by VA's Loan Guaranty Program, the loss mitigation tools available to our borrowers over the course of their loans, including guidance given to loan servicers, and performance data of loans guaranteed by VA over the past 10 years.

Lenders underwriting VA loans must ensure that the contemplated terms of repayment bear a proper relation to the veteran's present and anticipated income and expenses and that the veteran is a satisfactory credit risk. VA's credit standards employ the use of residual income deadlines and debt-to-income ratios in determining the adequacy of the veteran's income.

Residual income is the amount of net income remaining after deduction of debts and obligations and monthly shelter expenses, to cover family living expenses such as food, health care, clothing, and gasoline. VA considers minimum residual income as a guide. It does not automatically trigger approval or rejection of a loan, instead, underwriters should consider it in conjunction with all other credit factors. If residual income is marginal, underwriters should look to other indicators, such as the applicant's credit history and in particular whether and how the applicant has previously handled similar housing expenses. However, an obviously inadequate residual income alone can be a basis for disapproving a loan.

We also use a borrower's debt-to-income ratio to compare total monthly debt payments to gross monthly income. A ratio greater than 41 percent generally would require close scrutiny of the loan package. This is also a guide and lenders are to consider that in conjunction with all other credit factors. And in practice, it is a secondary underwriting factor to residual income.

The committee also requested that I describe VA's guidance given to mortgage servicers regarding loss mitigation for loans guaranteed under the VA Loan Guaranty Program. In 1994, we published a VA servicing guide which states that we expect every realistic alternative to foreclosure which may be appropriate in light of the facts in each case to be explored before a loan is terminated. The guide provides specific information on extended repayment plans, forbearance, loan modifications, short sales, and deeds in lieu of foreclosure.

Over the years, VA has also taken an active role in supplementing the servicing of private loan holders by attempting to contact veteran borrowers when their loans are reported as being seriously delinquent. We provide financial counseling and assistance in developing reasonable repayment plans which are then proposed to the private loan servicers. Our efforts in fiscal year 2007 resulted in foreclosure avoidance of more than 57 percent of the seriously delinquent loans. We helped arrange more than 8,000 repayment plans or other forbearance agreements in cases that otherwise would have gone to foreclosure and thereby avoided claim payments estimated at more than $181 million.

In February of this year, we published an extensive regulatory package that was a result of a business reengineering effort to assess the servicing of VA loans. The goal was to improve service to veterans by standardizing our internal operations while also recognizing best practices within the mortgage servicing industry. We have developed procedures to ensure that servicers will utilize the full range of alternatives previously considered by VA in its supplemental servicing in order to help veterans mitigate potential losses.

That new environment is called VALERI, which is VA Loan Electronic Reporting Interface. And under those regulations we have definitions for repayment plans, special forbearance assistance, and we have described the conditions for consideration of loan modifications, short sales, and deeds in lieu of foreclosure. We are also going to provide incentives to servicers who properly follow those guidelines and offer those alternatives.

Lastly, the committee asked that I describe the performance of loans guaranteed under the Loan Guaranty Program under recent standards, including the number and percentage of loans ending in foreclosure. The numbers are in my written statement, but I will summarize by just saying that the VA program has fared well in recent years with regard to foreclosure rates. According to data from the Mortgage Bankers Association, the quarterly delinquency rate for VA loans during the past 5 years has steadily declined while the rate for other loan programs has increased. And during that same period, the percentage of VA foreclosures has decreased while the rates for other programs has increased.

This concludes my testimony. I do appreciate the opportunity to speak before you today, and I would be pleased to answer any questions you may have.

[The prepared statement of Ms. Caden can be found on page 95 of the appendix.]

Chairwoman WATERS. Thank you very much. I will recognize myself for 5 minutes for questioning. Ms. Maggiano, I would like to make sure that I understand exactly who the servicers are, as well as their relationship to FHA. Who do you contract with to provide servicing activities?

Ms. MAGGIANO. FHA does not contract directly with anyone. FHA, unlike GSEs, doesn't actually own loans. We insure those loans against default. So an originator would either service their own loans or they may sell the servicing rights to their loans. There are currently 1,200 FHA approved servicers in the United States. However, 8 of them have 75 percent of the business.

Chairwoman WATERS. So if you are guaranteeing loans from Countrywide, for example, Countrywide would be responsible for servicing their own loans because they also provide servicing to other entities, is that right?

Ms. MAGGIANO. Countrywide may service some of their own loans, they may sell the servicing rights to some loans that they actually own, or they may service on behalf of other holders of the mortgage.

Chairwoman WATERS. Is Countrywide one of the big eight you just referred to?

Ms. MAGGIANO. Yes, ma'am.

Chairwoman WATERS. So they do a lot of servicing—

Ms. MAGGIANO. Yes, they do.

Chairwoman WATERS. —of their own loans that were originated by Countrywide, is that right?

Ms. MAGGIANO. That is correct.

Chairwoman WATERS. All right. Now, having said that, you have a responsibility to ensure that the loan originator whose loans you are guaranteeing and whose loans are being serviced by the same originator are doing a credible job?

Ms. MAGGIANO. Yes, ma'am.

Chairwoman WATERS. And if not, you have the ability to fine them, is that right?

Ms. MAGGIANO. That is correct.

Chairwoman WATERS. Now, tell me who you fined in the last 2 years and how much were those fines?

Ms. MAGGIANO. Madam Chairwoman, I don't have that information with me, but I can provide it.

Chairwoman WATERS. Ms. Maggiano, have you fined anybody? I don't want you to put me off.

Ms. MAGGIANO. Yes.

Chairwoman WATERS. You have had some fines?

Ms. MAGGIANO. There have been servicing violations.

Chairwoman WATERS. Just one second, because this is in the record.

Ms. MAGGIANO. Yes, ma'am.

Chairwoman WATERS. My question to you is, are you aware or do you know of any of your servicers who have been fined by you who were not in compliance with your rules and your guidelines?

Ms. MAGGIANO. I personally cannot give you any names. However, we do have an aggressive servicing audit program. We audit servicers every 18 months.

Chairwoman WATERS. Do you have anybody with you today who can help you with that information?

Ms. MAGGIANO. I am sorry, but I don't.

Chairwoman WATERS. Did you bring anybody with you who could help you with that information?

Ms. MAGGIANO. No, but I would be happy to provide it to the committee.

Chairwoman WATERS. Do you think there have been any fines?

Ms. MAGGIANO. Yes.

Chairwoman WATERS. About how many do you think there have been?

Ms. MAGGIANO. Madam Chairwoman, I can't answer that question.

Chairwoman WATERS. But you do think there have been some?

Ms. MAGGIANO. Yes, ma'am.

Chairwoman WATERS. All right. That is very good. Thank you. Let me ask you also, listening to Ms. Caden describe the servicing of veterans leads me to believe that they may have guidelines for their servicers that may be a little bit or much more directed and provided than you do. Let me ask Ms. Caden, who are your servicers?

Ms. CADEN. Well, like FHA, we don't contract. The loans are guaranteed, so it is whoever is holding the loans. Countrywide is

a large servicer. Wells Fargo has the most. They are our biggest servicers of VA loans.

Chairwoman WATERS. And do you have the ability to fine?

Ms. CADEN. I don't believe we fine. We do audit. We do look at what they are doing. What we are trying to do now is build a program of incentives and disincentives for doing proper servicing.

Chairwoman WATERS. So right now, while you are trying to build a program for incentives and disincentives, let us take Countrywide, for example, have your audits shown that they were not doing a good job or they could be doing a better job or did you caution them, did you do anything in working with Countrywide as a servicer to say something is wrong, we don't think that you are doing the kind of mitigation that we think can help keep people in their homes?

Ms. CADEN. I would have to go back and look and see, but I don't think we have taken them to task. In fact, I think Countrywide has been doing an adequate job on the VA loans that they service.

Chairwoman WATERS. That is why they have so many foreclosures?

Ms. CADEN. Well, I don't believe that so many foreclosures are on VA loans, on the VA guaranteed loans. It may be on other parts of their portfolio.

Chairwoman WATERS. All right. I am going to turn to the ranking member. But let me just say to both of you, you knew you were coming here today, and it seems to me you would have come armed with the kind of information that can help us to learn about how this business works. Unfortunately, our regulators don't have any responsibility to regulate the servicers, and we have to learn the best way that we can. We are picking information out of people to learn this servicing business, and I really don't like the idea that you can't tell me how you monitor and oversight your servicers.

Mrs. Capito.

Mrs. CAPITO. Thank you, Madam Chairwoman. I would like to make a bit of a distinction here the way I heard your testimony. Both FHA and VA, you both stated in your opening statements that the rate of foreclosure for both of your loans had actually gone down over the last, I think you both said, did you say 5 years? In light of the fact that many, and we heard earlier that 57 percent, you know nationwide 57 percent more mortgages are in foreclosure than were at this time than last year, am I correct to assume that these would not in a general way, not to say you don't have foreclosures, but FHA and VA guaranteed loans are not a part of that 57 percent increase?

Do either of you have a comment on that?

Ms. CADEN. I will go first. VA loans are not considered to be subprime, and that is where most of the problems are. We have always underwritten, as I described, using the credit underwriting standards that we have. So I don't believe that we are part of the big problem right now. In fact, our loans have performed very well.

Ms. MAGGIANO. FHA has a very standard loan product. And we don't have balloon loans, we don't do interest only, we don't do stated income, we don't allow many of the risk factors that were inherent in many of the subprime products that caused them to have the high default rates that they have.

Mrs. CAPITO. Are many of your loans then considered underwater? I think this may be a distinction here, because an FHA loan, a traditional one has been—what was the max on the property until we made it larger in the stimulus package?

Ms. MAGGIANO. The standard was about $230,000 and then it was higher, up to $340,000 in high-cost areas.

Mrs. CAPITO. But in consideration of, say, my area, that would certainly cover the grand majority of every home in my district. But I would say in a lot of places in California, that doesn't even scratch the surface.

Ms. MAGGIANO. We have a very small loan portfolio in California, so yes.

Mrs. CAPITO. And then, a final question. In looking at the chairwoman's bill and then in responding to what Ms. Maggiano had said about what you are moving forward with—and I hope we can get those statistics, maybe you can get them before the end of our hearing because we have two more panels on the servicers—would you say that the VA—oh, no, I wanted to ask about the VA loan guarantees, so I am going to switch over here. Would you say that the loan guarantee of 41 percent debt-to-value ratio—or what is it called, debt-to-loan ratio—

Ms. CADEN. Debt-to-income ratio.

Mrs. CAPITO. Yes, debt-to-income ratio. Has that worked well for you? Is that a little bit lower than what the VA has? What do you have to say about that, because I believe that is part of the chairwoman's bill as well?

Ms. CADEN. It is a little bit lower than what FHA—I think they have a 43 percent ratio. We think it has worked well. And I think in combination with that, with looking at the residual income guidelines that we use with the general underwriting standards that we use, as I said VA loans have performed very well so we think it has been working.

Mrs. CAPITO. My final question: I actually forgot the other question. You probably figured that out. When you talked about your responses that you had, you talked about making sure that people are being directed toward FHA counselors, you talked about making sure that the servicers are paying attention and sitting down before you get into the 90 days of delinquency. Does that match pretty much what is already in this bill? I mean, do you feel like those are—and have you stepped up those rates since the spotlight has been on the foreclosure situation?

Ms. MAGGIANO. There are many provisions in the bill that are extremely similar to written FHA policy with respect to loss mitigation, so yes, there is quite a bit of similarity. There are also some areas that are different. Have we stepped it up? We work very closely with our servicers to encourage them to continue to use loss mitigation, we do constant training of servicers and nonprofit housing counselors, and so we carefully monitor use of the program.

Mrs. CAPITO. Is this a joint effort? Do FHA and Fannie Mae and Freddie Mac all get together and talk with the servicers at the same time, do you do it individually or is this an industrywide effort?

Ms. MAGGIANO. There certainly is some amount of discussion between the GSEs and the agencies, but that tends to be not directly

related to the servicers. We talk together about various policies and where we are going and sharing best practices. But in terms of providing specific guidance, we have a very different program and we all have fairly unique loss mitigation characteristics. As I indicated earlier, we have a special program which has been incredibly effective for FHA borrowers where we will actually loan them the money to reinstate their loan and carry back a second note, but that note has no payments due.

Mrs. CAPITO. Until the first one is paid off?

Ms. MAGGIANO. Yes, until the first one is paid off. So it doesn't impact the ability to service the first mortgage.

Mrs. CAPITO. Thank you.

Chairwoman WATERS. Thank you very much. Mr. Cleaver.

Mr. CLEAVER. Thank you, Madam Chairwoman. The loss mitigation is, I think, very helpful to those who are trying to maintain their homes, and this is certainly a better option than foreclosure. I am becoming concerned as I read more about who is involved and the fact that there is no regulation of the servicers. And if there is no regulation of servicers, can you tell me what the fee schedule is like, what it is based on? When Countrywide, Bank of America, or Wells Fargo are engaged in loss mitigation, how do they develop their fee?

Ms. MAGGIANO. My remarks on loss mitigation were specific to loans insured by the FHA.

Mr. CLEAVER. I understand.

Ms. MAGGIANO. And we do have regulation.

Mr. CLEAVER. Let me ask it another way.

Ms. MAGGIANO. Certainly.

Mr. CLEAVER. Do you think we should have regulations over the servicers, those who are engaged in loss mitigation?

Ms. MAGGIANO. The Administration has not taken a formal position on this bill.

Mr. CLEAVER. Okay. Not the bill. Do you think we should have some kind of regulation? I mean, they are regulated because they are banks. But I am talking about for the particular services they provide, there are no regulations.

Ms. MAGGIANO. I think it is a worthwhile discussion. I don't think that we have an opinion on whether or not having a nationwide loss mitigation program of that magnitude is the appropriate course of action, but certainly it is a worthwhile discussion.

Mr. CLEAVER. I want to go to the seminar that government employees go to that teach you how to do that; you know, go all the way around the question. That is really great. I mean, I admire almost all of the people who do it. There are a couple who can't do it well, but you do it well. The loss mitigation program, which I support, and FHA's loss mitigation program is required?

Ms. MAGGIANO. Yes, sir.

Mr. CLEAVER. How do you think a loss mitigation program would impact the current crisis if it were a nationwide mandatory loss mitigation program for all existing loans, including those not guaranteed by FHA?

Ms. MAGGIANO. I believe very strongly in the importance of loss mitigation in keeping home buyers in their homes.

Mr. CLEAVER. Would it reduce foreclosures if we—this is the same question. Would it reduce foreclosures if we implemented it nationwide, including the existing loans and those not guaranteed by FHA?

Ms. MAGGIANO. It certainly has reduced foreclosures in the FHA portfolio, absolutely. What is very different in this particular marketplace is the huge impact of substantial amounts of negative equity and what to do with that negative equity. And that is not an issue that we have had a problem with in the FHA portfolio specifically.

Mr. CLEAVER. So, is that a "yes?"

Ms. MAGGIANO. I don't have a crystal ball. I can't tell you what the outcome would be.

Mr. CLEAVER. What do you think?

Ms. MAGGIANO. Loss mitigation is very important. And clearly, the more loss mitigation the more likely we are to see borrowers be able to retain homeownership.

Mr. CLEAVER. That is a yes. Thank you. I yield back the balance of my time.

Chairwoman WATERS. Thank you very much.

Mr. Shays.

Mr. SHAYS. I am still formulating my question. You have more Democratic members, so I will wait two more rounds. I am sorry, I didn't see you. I am going to pass. I am going to ask questions in a bit.

Chairwoman WATERS. Mr. Neugebauer.

Mr. NEUGEBAUER. Okay. Thank you. One of the things that I think is kind of interesting, that we have to kind of discriminate in terms of what the roles of servicers are in this process. And I think some people have been talking about certain companies that have higher foreclosure rates. That doesn't necessarily have anything to do with their servicing capability. Would you say that is a true statement?

Ms. MAGGIANO. Yes, I would say that.

Mr. NEUGEBAUER. Because people who service mortgages may be servicing mortgages that they didn't originate. And so a lot of the problems that are in our mortgage dilemma today really are more about origination than servicing. Would you say that is true?

Ms. MAGGIANO. I think certainly origination is a major factor. I think good servicing can ameliorate some of the mistakes of origination, but certainly not all of them.

Mr. NEUGEBAUER. But your relationship with a servicer generally only kicks in when they are beginning some process of loss mitigation at that particular point in time, is that right?

Ms. MAGGIANO. Primarily. FHA certainly has guidelines that servicers must follow for all performing loan servicing functions as well.

Mr. NEUGEBAUER. You have to be approved to be one of your servicers?

Ms. MAGGIANO. Absolutely.

Mr. NEUGEBAUER. So you have a certain criteria for them to follow?

Ms. MAGGIANO. That is correct.

Mr. NEUGEBAUER. One of the things—I think we have all kind of been on a witch hunt here, I think some of us, not me particularly, but others who are looking for who is to blame for all of this, and we kind of started looking around trying to find that person to blame. I think the thing about the industry is that I haven't heard of anybody saying that there is a huge problem with servicing in this country. In fact, over the break I sat down with a number of companies that say today, as far as loss mitigation goes that if someone, if a borrower will call their mortgage company today and make some effort to offer up some kind of a solution here, that most all of those companies are interested in working with the borrowers. But that primarily most of the people who are getting foreclosed on today, and this was a quote from a company that handles a lot of loss mitigation for some very big mortgage holders, that in most of the mortgages that they are foreclosing on, they never hear from the borrower, that the borrower just doesn't return their call. And so it is really hard to do loss mitigation with someone who won't—you know, that is a two-way street.

Would you agree with that?

Ms. MAGGIANO. I do agree with that. And in my remarks, when I said that servicers must evaluate a borrower for loss mitigation before they are 90 days past due, they can only do that if they have been able to reach the borrower. Most servicers, certainly FHA servicers, use a variety of techniques to attempt to reach borrowers including predictive dialers and unusual types of mailings. Most of our servicers, if not all, are members of the HOPE NOW Alliance—I believe you will hear from them later—and they have developed some really aggressive targeted mailings to delinquent borrowers to try to get them to contact the servicer, because without that contact you can't do a workout in a vacuum.

Mr. NEUGEBAUER. Are either one of you aware of, and maybe this question was asked a while ago, but I didn't hear the answer, have you ever removed someone's privileges to be a servicer while you have served in the capacity you are in?

Ms. CADEN. For VA, no, we have not.

Ms. MAGGIANO. I don't know the answer to that. I have not been involved in removing someone's privileges, although there have been a number of entities with FHA approval to originate and service that have been removed from our program. I haven't been personally involved in that activity.

Mr. NEUGEBAUER. What is the role that—maybe you can explain. In other words, you are the guarantor of these loans, but then other people hold and own these loans or made an investment in them. What latitude contractually do you have in working with the people who actually hold that note on being able to provide certain modifications or loss mitigation without violating the rights of the person who holds that note?

Ms. CADEN. For VA, we work with the servicer and we would work with the veteran; and, as I said in my statement, we have been fairly successful in working with a veteran and the servicer, the holder of the loan, to work out loss mitigation efforts, loan modifications, repayment plans, that type of thing. Basically, we just do it in tandem with them.

Mr. NEUGEBAUER. But it has to be in concurrence with a servicer.

Ms. CADEN. Yes.

Chairwoman WATERS. Thank you very much.

Ms. CADEN. I should say that there are some cases in which we evaluate the veteran and we will do what we call refund the loan, and we will buy the loan back, and then they will have a VA direct loan at that point. So we will do that in certain cases.

Mr. NEUGEBAUER. May I just have a quick follow-up?

Have you done that a lot here lately?

Chairwoman WATERS. Mr. Cleaver. Please, we have to move on. We have to be out at a certain time.

Mr. Green, I am sorry. Please go ahead.

Mr. GREEN. That is quite all right. Thank you, Madam Chairwoman.

Let me start by making a basic statement, and hopefully I will get some agreement on it. Is it true—and I am speaking to the representative from HUD, if you would kindly pronounce your last name for me, please?

Ms. MAGGIANO. "Maggiano."

Mr. GREEN. Ms. Maggiano, is it true that while you don't have a perfect paradigm, you have perfected a paradigm that produces lower foreclosures, in your opinion?

Ms. MAGGIANO. Yes, sir.

Mr. GREEN. And is it true that the reason you believe this paradigm works as effectively as it does is because the basic premise that it is built upon is one of home retention?

Ms. MAGGIANO. Yes.

Mr. GREEN. And is it true that you have a contractual agreement with your servicers, a codified agreement that requires certain things if a borrower falls into the class of possibly being foreclosed upon?

Ms. MAGGIANO. Yes.

Mr. GREEN. Would these things that are codified that must be done include special forbearance, mortgage modification, partial claim adjustments, pre-foreclosure sales, and deeds in lieu of foreclosure? Would these be the essence of what must be done when—or options that are available as opposed to foreclosure?

Ms. MAGGIANO. Those are certainly the options that are available. It is important to make a distinction that we delegate to servicers the responsibility to evaluate the borrower.

Mr. GREEN. Agreed, but let me intercede. You also have something else. Along with that delegation, you have the power to punish.

Ms. MAGGIANO. That is correct.

Mr. GREEN. Now, that is for an FHA loan.

Ms. MAGGIANO. Yes, sir.

Mr. GREEN. Let's talk about a loan that is not FHA. For our conversation, we will call it conventional. In the conventional market, do we have the same paradigm in place? I assume your answer would be no? Same paradigm as FHA?

Ms. MAGGIANO. FHA has no authority.

Mr. GREEN. I agree with you. I am not asking now whether FHA has authority. I am asking if the paradigm that FHA employs is

the same paradigm that is employed in the conventional market. Or maybe it should be reversed. Is the conventional markets paradigm the same as FHA's? I assume your answer is "no."

Ms. MAGGIANO. Actually, it is not "no." All of the loans that are—where Freddie Mac and Fannie Mae are an investor, those loans also are subject to very, very similar loss mitigation programs with oversight and monitoring by the GSEs. As a matter of fact, we—

Mr. GREEN. Is the power to punish there?

Ms. MAGGIANO. Yes.

Mr. GREEN. Is that power to punish employed?

Ms. MAGGIANO. You'll have to ask the representatives of the GSEs when they speak.

Mr. GREEN. So, in your opinion, the paradigm that includes special forbearance, mortgage modification, partial claim, pre-foreclosure sale, and deed in lieu of foreclosure is the same paradigm being employed in the conventional market?

Ms. MAGGIANO. Not exactly the same, but a similar paradigm.

As I mentioned in my remarks, partial claim is a rather unique workout structure that, until very recently, was really only employed by FHA; and Fannie Mae has adopted something not exactly the same but similar. But both of the GSEs have very strong and aggressive workout tool boxes, and they do monitor.

Mr. GREEN. Then the question becomes, if I may, if the paradigms are the same or similar, why are the results so vastly different?

Your contention might be that you received a product that is not the same as the product that the GSEs received. Is that a fair statement?

Ms. MAGGIANO. Yes.

Mr. GREEN. Meaning 3/27s, 2/28s, prepayment penalties, and no-doc loans, you did not receive these products? Is that your contention?

Ms. MAGGIANO. That is correct.

Mr. GREEN. And as a result of the lack of those products, your contention is that the results are different?

Ms. MAGGIANO. I believe that would be my conclusion, yes.

Mr. GREEN. Do the GSEs, by way of conventional loans, monitor the servicers to the same extent that you do? You have indicated clearly that you have a very close relationship with the servicers.

Ms. MAGGIANO. Yes.

Mr. GREEN. Do we have that same circumstance?

Ms. MAGGIANO. I don't wish to speak for the GSEs. They will be testifying later in the morning.

Mr. GREEN. Would that monitoring make a difference, in your opinion?

Ms. MAGGIANO. Monitoring always make a difference, yes.

Mr. GREEN. Finally, if I may, tell me quickly about your debt-to-income residual analysis, please.

Ms. MAGGIANO. We—were you referring to VA or—I didn't mention debt to income.

Mr. GREEN. My time is up, and I will yield back. Thank you.

Chairwoman WATERS. Thank you very much.

Mr. Shays, are you ready now?

Mr. SHAYS. Thank you.

Mr. Green, she is a tough chairman.

Mr. Neugebauer, you had a question.

Mr. NEUGEBAUER. I thank the gentleman.

I just wanted to follow up, because I think you made a very good point a while ago, that you were about to make, which is that the Veterans Administration has the ability to repurchase a loan. That the servicer doesn't agree to that, you think it is in the best interest of the veteran, and so that you can repurchase that.

Ms. CADEN. Right, and we do that after going through an evaluation of the veteran's financial picture, what is going on right now. If we think there is a chance for them to maintain that home and the loan payment, we can do that.

Mr. NEUGEBAUER. Do you do that a lot?

Ms. CADEN. I can provide for the record the numbers of what we have done. I wouldn't say it is a lot, but it is fairly significant.

Mr. NEUGEBAUER. Say that again?

Ms. CADEN. Significant.

Mr. NEUGEBAUER. I thank the gentleman. I yield back.

Mr. SHAYS. Thank you.

I want to get into this issue. I am deeply concerned, like the rest of us are, about the impact of foreclosures. I am deeply concerned that it strikes me the banks force you to go into foreclosure, to be delinquent before they negotiate with you, which seems nonsensical to me. So this is what I want to know first: If your loan is divided into three parts, the servicer has the right to negotiate loss mitigation. Is that correct, first?

Ms. MAGGIANO. Yes.

Mr. SHAYS. Leave your microphone on, thanks.

Secondly, does that right extend to writing down the interest rate or writing down the principal?

Ms. MAGGIANO. The servicer certainly is allowed to write down the interest rate, but FHA will not reimburse them for that interest rate, the cost of that interest rate reduction. They could also write down principal, but FHA does not have the authority to reimburse them for principal reduction.

Mr. SHAYS. Let me understand. So there is no motive for them to do that?

Ms. MAGGIANO. No, the motive for them to do that, and again—

Mr. SHAYS. Give me the short version.

Ms. MAGGIANO. There needs to be a real distinction between FHA and other products. Because FHA has nearly 100 percent loan guarantee.

Mr. SHAYS. So there is really no incentive for the servicer to negotiate?

Ms. MAGGIANO. Well, there is an incentive for the servicer to negotiate, because we provide them financial incentives, and we monitor their performance.

Mr. SHAYS. I don't know what "monitoring their performance" means, but let me ask you this: What right does the borrower have? Do I have the right to say that I want to negotiate before I am delinquent?

Ms. MAGGIANO. For FHA-insured loans, a servicer may not refer a loan to foreclosure until they have evaluated the borrower for loss mitigation.

Mr. SHAYS. I don't know what that means, but please answer my question.

Ms. MAGGIANO. I am sorry.

Mr. SHAYS. Does the borrower have the right to negotiate with the service provider before they go into default?

Ms. MAGGIANO. The borrower always has the right to discuss whatever they wish with their service provider.

Mr. SHAYS. Does the borrower have the right to demand that they negotiate with them before they go into default? Because we are hearing that they say, don't call us until you are in default.

Ms. MAGGIANO. Again, I am trying to relate this to an FHA insured—

Mr. SHAYS. No, I hear you.

Ms. MAGGIANO. And we don't tend to have the interest rate reset issue where payments are going to skyrocket next week and people are concerned about the impact of those increased payments on their ability to make their—

Mr. SHAYS. You have less potential foreclosures, right?

Ms. MAGGIANO. We have potential foreclosures for different reasons. Our borrowers tend to have more issues with unemployment, with health—

Mr. SHAYS. Someone is out of work. They can't pay. Do they have the right to call up and expect that they will be treated humanely?

Ms. MAGGIANO. Yes.

Mr. SHAYS. And that the service provider will say, well, let's talk about when we do about this, or do they say, we can't help you until you are in default?

Ms. MAGGIANO. I am sorry. I do understand your question, and they absolutely have the right to have the servicer treat them with respect.

Mr. SHAYS. What happens if the service provider doesn't? What if the service provider says, we are not talking to you until you are in default?

Ms. MAGGIANO. I haven't—that hasn't been raised.

Mr. SHAYS. I will tell you why it has been raised for me. It may not be your loans, but the bottom line is I had two forums on this in my district, and I have had people testify they wanted to not be in default, wanted to deal with this issue, and they were told, don't call us until you are in default. It may not be an FHA loan, but—

Ms. MAGGIANO. That is certainly not guidance we would ever give our servicers.

Mr. SHAYS. Madam Chairwoman, I know my time has run out, and I don't want you to treat me any nicer than anyone else. I hope that we really have a good discussion about this issue.

Chairwoman WATERS. Thank you very much, Mr. Shays.

Mr. Ellison.

Mr. ELLISON. Thank you, Madam Chairwoman, for having this important hearing.

Ms. Maggiano and Ms. Caden, one of the major goals of H.R. 5679 is to ensure that loss mitigation efforts by servicers result in offers to distressed borrowers, be they repayment plans, loan modifications, or some other options that are sustainable for the longer term. The key to such long-term sustainability, it seems to me, is whether the resulting payment plan is affordable to the borrower,

barring some other significant drop in income. Can you help me understand if and how HUD and VA make this evaluation for their servicers?

Ms. MAGGIANO. FHA has a financial evaluation requirement; and servicers, when they are evaluating a borrower for any of the options, even if it is a pre-foreclosure sale or a deed in lieu, must gather the borrower's income and expenses and use that in a formula that we have published in writing to calculate what we call surplus income, and that is the income over and above their household living expenses and their other debts like car payments that they need to make that they have available to support a repayment plan. It is not acceptable in FHA to put a borrower into a repayment plan if you cannot demonstrate that they have sufficient surplus income to make that plan.

Mr. ELLISON. I wonder if you could perhaps put a finer point on your response, and I am wondering if you could be very concrete in describing the debt-to-income and residual-income analysis your agencies undertake in determining whether a particular loss mitigation offer is workable.

For example, I have heard the VA requires at least $200 in residual income be left over after a borrower's household expenses, including payments on all secured and unsecured debt, are taken into account and that would be a good standard across the industry. So could both of you provide details of your agency's DTI and residual-income analysis for loss mitigation?

Ms. CADEN. I would be happy to provide that in more detail for the record.

But, basically, we don't have a standard such as the one you mentioned of the $200. There is no hard-and-fast rule, and residual income is looked at as a guide. It is mainly used, both residual income and the debt-to-income ratio, at the time of loan origination. That is part of the underwriting standards to make sure a veteran can afford the loan they are attempting to get for the house they are trying to buy.

We would expect servicers to use the same guidelines, but there is no hard-and-fast rule of the $200 over or under.

Mr. ELLISON. Thank you very much.

I had more questions right in front of me, and they just disappeared. I don't know what happened to them. I have too much stuff sitting here, I guess.

I do have a question that I didn't write out, and it is off the cuff. And that is, so FHA has a requirement to do mitigation services. That is FHA. But what about the rest of the industry? You guys only address about 40 percent of the industry, am I right about that? What other incentives are in place for the non-FHA mortgages, those trusts, those PSA trusts to do loss mitigation?

Ms. MAGGIANO. Again, FHA provides loss mitigation for FHA-insured loans only. The GSEs have very similar programs for all of the loans that they either own or securitize, that are securitized through them. And then I am not aware of any formal overarching loss mitigation program for loans that don't fall within those categories. However, most of the investors, also, it is clearly in their interest to keep borrowers in their homes. So there are loss mitigation requirements in many of the trusts.

Mr. ELLISON. One of the reasons I was kind of surprised when it sounded like there was the provision, the so-called cram-down provision—I am sure you guys know what I am talking about—when we were going to try to give bankruptcy judges the power to restructure debt going forward on a primary residence. There was a lot of resistance to that.

My thought would be, you know, why would there be resistance to that? I mean, we want people to stay in their homes, and most people will, out of their own incentives, try to do loss mitigation. But for those who don't, there is a social purpose in trying to make sure people can stay in their homes. Why then doesn't Congress—why wouldn't this be a good idea?

Could you help me understand some of the push-back? Not that it is your responsibility, but just in terms of your expertise in the field, would you mind sharing your ideas on that with me?

Ms. MAGGIANO. Well, I believe the primary objections that I have heard are that it would sort of undermine the sanctity of contracts and prevent mortgage originators from being willing to enter into contracts over which they thought other people then had control.

Mr. ELLISON. But we have always—I think I'm done.

Chairwoman WATERS. Thank you.

Mr. Miller.

Mr. MILLER. Thank you, Madam Chairwoman.

Welcome. I know it is hard answering questions based on somebody else's bill, but the bill requires the mortgagees of mortgages that are in default to basically do a number of things. These things are called "reasonable loss mitigation activities." These activities can be waiving of late fees, penalty charges, engaging in prepayment plans, or writing down the principal for the loan. Does a lender have to basically fulfill one or all of these things to be in compliance with "reasonable mitigation activities?"

Ms. MAGGIANO. Again, I can speak only to the FHA portfolio, and they absolutely must consider all of our options in a priority order in order to be considered to be doing—

Mr. MILLER. Let's say somebody bought a $300,000 home, and the rate was 6¼ percent, but now they can only afford a $250,000 home at 5¼ percent. What are your options?

Ms. MAGGIANO. I—

Mr. MILLER. That is a tough one. You have to engage in reasonable loss mitigation activities based on the criteria that is defined and that is part of the criteria, so what will you do when that situation arises?

Ms. MAGGIANO. FHA's loss mitigation program is based on keeping as many borrowers in their homes as possible.

Mr. MILLER. Based on this bill, as defined in this bill, the language, and that is the circumstance placed before you, what would you have to do? Not what you do currently, but what do you have to do based on this bill? That is what we are talking about.

Ms. MAGGIANO. I am sorry. I don't think I understand the question.

Mr. MILLER. Do you understand the language in this bill?

Ms. MAGGIANO. Yes, sir.

Mr. MILLER. That is considered reasonable loss mitigation activities, and you have to do these things.

Now let's say a person owns a $300,000 home. They bought it for $300,000, and they were paying 6¼ percent interest, and they are in default and 3 months behind in their payment. Now you are trying to deal with this. You look at their capability based on income, and they can only afford $250,000, and they can only afford to pay 5¼ percent interest. How would you deal with that?

Ms. MAGGIANO. The way I read the bill, it was not clear to me whether or not a servicer would be required to provide a repayment plan or a loan restructure based on the borrower's ability to pay, regardless of what that ability was.

Mr. MILLER. But the language says, such as waiving all late fees and their penalty charges, engaging in a repayment plan and writing down the principal for the borrower. That is in the language of the bill.

Ms. MAGGIANO. Yes.

Mr. MILLER. If you have to comply with that criteria, how will you do that? Because it says, writing down the principal for the borrower and engaging in a repayment plan. If they can only afford 5¼ percent interest and they can only afford that on a $250,000 loan, how do you accomplish that?

Ms. MAGGIANO. FHA does not have a—it is not our intention to keep every borrower in their home. We do a very aggressive job in home retention, but the reality is that there are borrowers who can't afford the home they have.

Mr. MILLER. I am not trying to argue with you. I am trying to understand the language and how you can apply it. It says "includes writing down the principal for the borrower." It includes that.

Ms. MAGGIANO. Right.

Chairwoman WATERS. Will the gentleman yield?

Mr. MILLER. Sure.

Chairwoman WATERS. Affordability is only one criteria that you have to consider. It does not mandate that you would have to write down that loan. It deals with reasonableness, business sense. That is what it deals with.

Mr. MILLER. That is what I am trying to figure out, what is considered reasonableness?

Chairwoman WATERS. I think to ask that in a vacuum without all of the information before you places the witness at a great disadvantage.

Mr. MILLER. I have great respect for you, and you know that. And I have read this bill, and I can't come to a reasonable conclusion of how we do it. And when I can't come to a conclusion on how we do it, I try to ask a professional who is a witness in the industry based on language that is in the bill. And when the language in the bill says, such as waiving all late fees, penalty charges, engaging in repayment plans, and writing down principal for the borrower, that is very specific. But when I can't determine how we do that—

Chairwoman WATERS. We will have some people on another panel who will help to show you how it is done. While the witnesses before us today talk about the standards that they have developed in order to instruct their services, they are not doing the workouts themselves.

Mr. MILLER. Yes, but the standards that currently exist are being changed.

Chairwoman WATERS. No, the standards are not being changed. You will find that the standards differ. We happen to have before us today FHA and VA, and we are hearing about their standards. You have servicers who are working with completely different standards, and we will hear some of that today.

Mr. MILLER. Is HUD currently writing down the loan amounts?

Ms. MAGGIANO. No, we do not have regulatory authority to do that.

Mr. MILLER. Do you currently write down interest rates?

Ms. MAGGIANO. FHA does not write down interest rates.

Mr. MILLER. So, Madam Chairwoman, that is the problem.

Chairwoman WATERS. No, it is not the problem.

Mr. MILLER. Well, let me finish. The language says that they should do these things.

Chairwoman WATERS. No, the language does not mandate that they do anything that is not reasonable.

Mr. MILLER. But it defines reasonable as—that is what we need to get to.

Chairwoman WATERS. All of those are different things that would be criteria that could be considered.

Mr. MILLER. Then they are reasonable.

Chairwoman WATERS. Your time is up.

Mr. MILLER. Okay.

Chairwoman WATERS. Thank you very much.

Mr. Watt.

Mr. WATT. Thank you, Madam Chairwoman.

Ms. Maggiano, you know, Representative Green used to be a judge, and I love the precision of his questions. But Representative Cleaver earlier stated that witnesses who come over here must take a lesson at answer avoidance, and perhaps the most adept at doing that are the folks from HUD. Even with the precision of Representative Green's questions, you managed to miss a category.

You have FHA and VA loans. You have conforming loans that the GSEs back. All of those categories have some form of mitigation arrangement. And most of them, at least VA and FHA, have some specific guidelines to get the loan. Most of the GSE conforming loans have some specific guidelines. You have to document income. You have to do all the things.

And then you have a third category—which is the one that you missed—which is the nonconforming loans that are not VA, not FHA, not GSE-backed at all. And those are the ones that have the highest rates of default in this crisis, isn't that right?

Ms. MAGGIANO. Yes.

Mr. WATT. Those are the ones that have the least amount of obligation to mitigate in this market, isn't that correct?

Ms. MAGGIANO. I can't speak to their obligation, because—

Mr. WATT. You know they are not under FHA's mitigation standards.

Ms. MAGGIANO. That is correct.

Mr. WATT. And you know they are not under the GSE mitigation standards, and we know that the loans were written outside—substantially outside any regulatory framework. They are the most

risky loans, and yet they have the least amount of obligation to mitigate, and that is the circumstance that we are in.

So I guess the question I am asking is, under those circumstances, if you assume all of that to be the case—and it is okay for you to assume that, because it is true—

Ms. MAGGIANO. Yes.

Mr. WATT. —would a reasonable approach be to apply this, some standards of mitigation, perhaps the ones in this bill, perhaps the ones that FHA applies, perhaps the ones that the GSEs apply to that third category of people who have no obligation to mitigation? Would that be a reasonable approach, do you think?

Ms. MAGGIANO. Yes.

Mr. WATT. Okay, all right.

With that, Madam Chairwoman, I am happy to yield back to the Chair.

Chairwoman WATERS. Thank you very much.

If there are no other members here to ask questions, we are going to thank our panel for being here today and thank them for helping us to learn more about how mitigation works, particularly in their own agencies, and helping us to understand the standards that you have set, and we certainly are going to use these as guidelines as we talk to some of the other persons responsible for servicing. Thank you very much.

Some members may have additional questions for the panel which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

Thank you. The first panel is dismissed.

I would like to call the second panel to the witness table.

I am pleased to welcome our distinguished second panel: Ms. Tara Twomey, senior counsel, National Consumer Law Center; Ms. Julia Gordon, policy counsel, Center for Responsible Lending; Mr. Kevin Stein, associate director, California Reinvestment Coalition; Mr. Kenneth Wade, president and chief executive officer, NeighborWorks; Mr. Jason Allnut, vice president for credit loss management, Fannie Mae; and Ms. Ingrid Beckles, senior vice president, Freddie Mac.

Thank you for coming today. We will ask you to keep your testimony to 5 minutes. You do not have to read the testimony if you do not wish. You can basically concise it.

Ms. Tara Twomey, senior counsel, would you begin our panel?

STATEMENT OF TARA TWOMEY, SENIOR COUNSEL, NATIONAL CONSUMER LAW CENTER (NCLC)

Ms. TWOMEY. Yes. Good morning, Chairwoman Waters, and members of the subcommittee. Thank you for inviting me to testify today.

My name is Tara Twomey and I am an attorney, currently of counsel at the National Consumer Law Center. On a daily basis, NCLC provides assistance on consumer law issues to legal services, government and private attorneys representing low-income clients. Prior to joining NCLC, I was a clinical instructor at Harvard Law School, where my practice focused on foreclosure prevention.

As we all know, we are facing the worst foreclosure crisis since the Great Depression. The statistics for 2007 are grim, and the outlook for 2008 is not any brighter. The consequences of the mortgage market meltdown have not only ripped through Wall Street, but they are taking a heavy toll or Main Street.

For nearly a year now, the financial services industry has been encouraged to meet this growing foreclosure crisis by scaling-up voluntary loan modification efforts. Unfortunately, the magnitude of the problem continues to dwarf the industry response. And we would suggest to you that the reason that voluntary measures have fallen short is because the mortgage servicing industry, that is, the servicers and the industry to which they belong, is fundamentally broken when it comes to the needs of borrowers.

Mortgage servicers have two primary goals: The first is to maximize their own profit; and the second is to maximize the return to the investors. In the name of cutting costs and maximizing profits, the needs of the borrowers are too often sacrificed.

And what recourse do the borrowers have? Very little. They do not get to choose their mortgage servicer. They do not get to choose the subcontractors that the mortgage servicers hire to deal with the borrowers. They cannot vote with their wallets or their pocketbooks. They cannot change the mortgage servicer if they are dissatisfied. Even refinancing will not necessarily protect a borrower from a bad or abusive servicer, because they may end up with the same servicer again.

For borrowers, the first hurdle in the loan modification process is finding a live person who can provide reliable and consistent information, a person who has the authority to make decisions about the homeowner's loan.

To date, industry efforts to staff loss mitigation departments have been woefully inadequate. We know that leaving homeowners to navigate a maze of voicemail is less expensive, that it cuts costs for the servicers and improves their bottom lines. But borrowers deserve better. We know that, under current regulations, mortgage servicers can ignore borrowers' requests for information, they can ignore borrowers' disputes about their accounts, and they can still proceed with collection activities, including foreclosure.

We know that pushing homeowners into repayment plans is cheaper and easier for mortgage servicers. A recent Mortgage Banker's Association report finds that repayment plans outnumber the loan modifications by an 8:1 ratio for subprime adjustable rate mortgages. Even recent numbers from HOPE NOW show little progress in long-term or life-of-loan modifications. We know the disparity and bargaining power between financially distressed homeowners and mortgage servicers present new opportunities for abuse.

We are pleased to support H.R. 5679, which recognizes these industry shortcomings and will align mortgage servicers' interest with those of borrowers trying to save their homes.

Industry may say that the burdens of this bill are too great. We believe that the industry claims that H.R. 5679 will reduce market liquidity are overstated. Providing clear guidance to mortgage servicers on how to determine how much a borrower can afford to

pay should give investors comfort that long-term modification will be successful.

H.R. 5679 requires servicers to provide borrowers with timely, competent, and consistent information about their loans. It requires that borrowers be permitted to speak to someone who has authority to modify their loan, if that is appropriate. Is it too much to ask that a borrower be able to obtain competent and consistent information about their loan? We say no.

H.R. 5679 requires servicers to resolve borrowers' disputes before foreclosing on them. We don't think that is too much to ask.

H.R. 5679 requires servicers to engage in reasonable loss mitigation, to focus on home savings options instead of home losing options. Is that really too much to ask? We don't think so.

We commend you, Chairwoman Waters, for introducing a bill that addresses some of the systemic problems in the mortgage servicing industry, for introducing a bill that will provide real benefits to homeowners, and for introducing a bill that can save millions of homes without costing the government a penny. We look forward to working with you and other members on the subcommittee on H.R. 5679 and other mortgage servicing issues. Thank you.

[The prepared statement of Ms. Twomey can be found on page 168 of the appendix.]

Chairwoman WATERS. Thank you very much.

Ms. Gordon.

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

Ms. GORDON. Good morning, Chairwoman Waters, Ranking Member Capito, and members of the subcommittee. Thank you for inviting me to speak about the Foreclosure Prevention and Sound Mortgage Servicing Act of 2008, a bill that my organization supports.

I am policy counsel at the Center for Responsible Lending, a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth. We are an affiliate of Self-Help, which consists of a credit union and nonprofit loan fund.

For the past 28 years, Self-Help has focused on creating ownership opportunities for low-wealth families, primarily through providing more than $5 billion of financing to 55,000 low-income and minority families who otherwise might not have been able to get loans.

Self-Help's experience suggests that the high rate of foreclosure in the subprime market cannot be explained solely by the slightly higher risk of lending to people with blemished credit. In our experience, while homeowners may fall behind temporarily on mortgage payments, they will make every effort to catch up and hold onto their home if the lender and servicer are committed to working with them.

While Self-Help's delinquency rate is similar to that of many other subprime lenders, its foreclosure rate is under 1 percent, far lower than other subprime lenders, in part because we only sell 30-year fixed-rate, fully amortizing loans, and in part due to our

strong corporate emphasis on loss mitigation aimed at keeping homeowners in their homes.

The foreclosure crisis continues to gather steam. We are now seeing 20,000 subprime foreclosures every single week. Each foreclosure represents an incalculable loss to the individual family, but the effects go far beyond that. For each foreclosure, lenders and investors lose money, property values in neighborhoods decline, crime increases, community tax bases are eroded, and millions of Americans who depend on the housing sector lose jobs and income. What is more, the worst is yet to come.

The rate of foreclosure on subprime hybrid ARMs will continue to rise throughout this year, but even after that rate begins to level out, we face a second and possibly even larger wave of problems.

Beginning in 2009, we will see a large spike in reset in a type of loan called a payment option ARM. These loans permit homeowners to opt for a monthly payment that does not cover either principal or interest. They can continue to pay these rates for a set number of years or until the loan reaches what is called a negative amortization cap, usually 110 or 115 percent of the original loan. At that point, the loan resets, and the homeowner suddenly has to pay a much larger monthly payment. These resets are not tied to interest rates in the way that subprime hybrid ARMs are, and the current decline in interest rates is not likely to change the shock of these resets very much.

The fact that these loan balances are growing while overall home prices are declining is a recipe for disaster. This wave of loans will be even harder to refinance than the current crop of hybrid ARMs, and most of these loans are the not confined to the subprime market.

While we applaud the voluntary loss mitigations now taking place, as Ms. Twomey noted, they are simply not reaching the critical mass necessary to extend the tide of foreclosures. A working group of State attorneys general and bank commissioners estimates that only 24 percent of seriously delinquent borrowers receive the assistance they would need to prevent foreclosure.

While the HOPE NOW Alliance reports that loss mitigation activity in the first quarter of this year has risen significantly from the first quarter of 2007, servicers have still not been able to get ahead of the escalating crisis. According to the numbers, although 1.8 million loans were delinquent by 60 days or more in the first 2 months of 2008, in that time, only 114,000 received permanent loan modifications, and just under 200,000 received a temporary repayment plan.

There are many reasons why servicers don't engage in loss mitigations. Many get paid more for doing foreclosures than for doing loss mitigation, some fear investor lawsuits and tranche warfare, and many simply face a staff's training and capacity issue. But no party right now has the leverage to push them to do better.

Homeowners have no choice in selecting a servicer. If the servicer doesn't provide them with the help they need, they are not able to take their business to a different servicer. Typical market incentives are absent here. That is why this is an appropriate area for the government to step in with legislation.

As a final note, I would like to mention that even if this bill passes, there are going to be loans that cannot be modified by the servicer even when the homeowner qualifies for an affordable solution. Most frequently, this will be when there is a conflict between senior and junior lien holders. In those cases, we believe it is crucial to permit bankruptcy courts to adjust the mortgage if the borrower can afford a market rate loan.

In conclusion, we believe that this legislation is a narrowly tailored proposal that will provide an effective tool for reversing the downward cycle of losses in the mortgage market. We commend the subcommittee for focusing on loss mitigation, and we urge the committee to include in this bill the broader foreclosure prevention package. Thank you.

[The prepared statement of Ms. Gordon can be found on page 114 of the appendix.]

Chairwoman WATERS. Thank you very much.

Mr. Kevin Stein.

STATEMENT OF KEVIN STEIN, ASSOCIATE DIRECTOR, CALIFORNIA REINVESTMENT COALITION

Mr. STEIN. Madam Chairwoman and members of the subcommittee, I want to thank you very much for holding this important hearing today and for inviting us to testify.

My name is Kevin Stein, and I am the associate director at the California Reinvestment Coalition. We are a statewide advocacy group comprised of 250 community-based organizations throughout California. We work to increase access to credit in underserved neighborhoods throughout the State and to fight predatory lending practices.

The main point I want to make today is that our current framework for preventing subprime foreclosures which relies on voluntary industry efforts is not working, and our working families and their communities are suffering as a result.

Today, one of the most important conversations that takes place day-to-day is between loan servicers and their borrowers or their representatives, and, amazingly, in the subprime market, there are virtually no rules and no oversight and no consistent data that relates to these critically important and life-changing conversations: Will a family be able to stay in their home or not?

In light of a large disconnect we were hearing between what the loan servicers were telling us and what we were hearing from borrowers and from counseling agencies, we conducted a survey to find out what exactly was happening on the ground. We were able to talk to 38 home loan counseling agencies who had served over 8,000 consumers in the month of December alone. The results of the survey were sobering, and I will share a few key findings:

First, servicers were not modifying loans for long-term affordability. Not one counseling agency reported that the industry was modifying loans for the long term. Agencies reported that where they were able to get loan modifications, they were for about 1 year, which merely postpones the problem.

Second, and I guess most compellingly, the outcomes for borrowers are poor and unacceptable. Foreclosure was the number one outcome cited by counseling agencies. And, again, these are folks

who have expertise, hopefully have some relationship with servicers, have borrowers who have the wherewithal to come find them, and a shocking 72 percent of these agencies reported foreclosure as a very common outcome. Fifty percent reported short sales, which was the second most common outcome and, in our view, not a good outcome. Loan modifications came in with only 17 percent of groups reporting that these were common outcomes.

Third, outreach to borrowers is poor, despite what lenders have said. A surprising 91 percent of groups said that, in their experience, servicers were not reaching out to borrowers before rates reset, to the Congressman's point. And when that happened, they were often told to call back when the borrower was in default.

Fourth, servicers are hard to work with. We listed in our report—we reproduced the comments from counseling agencies. I will read some:

One, they do not return calls;

Two, they take 30 to 60 days to give us a written answer;

Three, they require their own authorization to release information forms;

Four, they take too long to assign cases;

Five, they keep changing officers when cases are assigned;

Six, they give wrong information regarding the loan;

Seven, you always have to re-fax and explain the situation to different people;

Eight, customer service sends us to the wrong department;

Nine, they hang up; and

Ten, they are never willing to work any details.

In anticipation of this hearing, I tried to check back in with folks in the last few days to confirm, since the study was based on December experiences. Unfortunately, we hear a lot of the same problems repeating themselves.

A few things I will pull out. Counseling agencies and legal services offices are reporting seeing a lot of loans which are clearly unaffordable and never should have been made, including an increasing prevalence of spotted broker fraud—being told to call back by the servicers when the borrowers are in default, despite industry pronouncements to the contrary—and being strung along by servicers who say a borrower can get a loan modification, only to later decline the modification right before foreclosure.

And a growing concern in light of data that is being reported is that borrowers are being pushed into loan modifications and workouts that are, in the words of some of the counseling agencies, either ridiculous or make no sense. We are hearing more about this, of so-called loan modifications and workouts that are really not in the best interests of the borrower; and, unfortunately, we believe it would be reported as a loan modification by servicers.

This experiment with voluntary industry initiatives has failed, and hundreds of thousands of borrowers are falling through the cracks into foreclosure. H.R. 5679 will help borrowers remain in their homes by creating an obligation on the part of loan servicers to act reasonably and by requiring detailed reporting on loan servicing outcomes.

I appreciate the analogy to the Home Mortgage Disclosure Act. We think that when light is shed on industry practices, the effect will be better industry practices.

Madam Chairwoman, thank you for the opportunity to testify. We look forward to working with you to keep borrowers in their homes and to help communities.

[The prepared statement of Mr. Stein can be found on page 154 of the appendix.]

Chairwoman WATERS. Thank you very much.

Mr. Kenneth Wade.

STATEMENT OF KENNETH WADE, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NEIGHBORWORKS AMERICA

Mr. WADE. Thank you, Chairwoman Waters, and members of the subcommittee. Thank you for inviting us to be here to share with you some of the things we are doing and our perspective on this very challenging issue we are all facing on the foreclosure front.

We are involved in a broad variety of efforts out there. We are working with anybody and everybody, both nationally and locally, in order to address this very challenging problem. We are in partnership with the Housing Preservation Foundation to support the toll-free number that homeowners can call, and our network is one of the referral sources that they refer consumers to when they need a face-to-face counseling.

We are members of the HOPE NOW Alliance which has been convened by the Department of the Treasury, and you will hear more about their efforts as well, recognizing that working with the industry is obviously something we felt we had to do to get a handle on this issue.

We are encouraging borrowers to reach out through outreach efforts that we are conducting through our National Ad Council campaign, designed to reach those consumers who have been difficult to reach. And since the launch of that Ad Council effort in June of 2007, we have had more than 12,500 public service announcements. The estimated value of those ads are about $16 million, and they have been targeted in 126 of the 200 media markets that are hardest hit by foreclosure.

We also were named in the Fiscal Year 2008 Consolidated Appropriations Act to administer a national foreclosure mitigation counseling program. We are pleased to be able to say that, within 60 days of enactment, we were able to award $130 million to 130 organizations that were eligible through that legislation to support foreclosure prevention counseling. That is, basically, counseling that will be available all over the country.

And then, we are working on a new tool that we think will greatly aid the counselors in their ability to develop solutions that will help keep borrowers in their home. We have a secondary market organization of ours called Neighbor Housing Services of America. They have developed what we are calling a best-fit tool that we are rolling out today. That tool will allow counselors to assess a borrower's ability to pay in an automated way.

It will also be able to provide an automated valuation of the borrower's current property and allow the counselor to propose or to do a number of "what if" scenarios to help determine how you can

best create a loan solution that would keep that borrower in their home, including whether they qualify for any of the existing refinance products that might be out there, whether they be those offered by the FHA or local State housing finance agencies.

And it will allow the counselor to do "what if" scenarios, so that if you reduce the interest rate by "X," will that meet the borrower's ability to pay? Or if you reduce the principal by "Y," or do some combination thereof?

One of the challenges that the counseling community has is their ability to develop an automated way to interface with the servicers and do this in a more efficient manner.

Despite all that is going on, and the many things that we and others are doing, I would like to highlight five major challenges:

One, I would concur that there is still a challenge that we hear from our members about servicer responsiveness. I think the scale and scope of the challenge obviously has grown much beyond what any of us would have imagined, and I think the challenge to the servicing industry to keep pace with that seems to be a challenge.

Two, there does seem to be a language of standardization around approaches and rules to loan modifications that counselors will reasonably be able to expect that they can recommend to servicers and allow a consumer to stay in their home.

Three, we also have identified that the counseling community does not have a sustainable funding model to help support quality counseling. Thus far, most of the counseling has been supported by public funds and charitable contributions. The industry—we are working very closely to come up with a means by which the industry will share some of the cost of this counseling.

Four, we also are very concerned about the disparate impact that the foreclosure problem is having, and then we also recognize that there is a rising problem with foreclosure scams that are taking advantage of consumers while promising to try to keep them in their homes.

Five, we also think that, basically, the best remedy is good prepurchase counseling. Our own loan performance bears that out. Loans from our network performed 10 times better than subprime loans, 4 times better than VA and HUD loans, and slightly on par with prime loans.

Thank you for providing me the opportunity to say a few things today, and I look forward to answering any questions you might have in the course of this hearing.

[The prepared statement of Mr. Wade can be found on page 183 of the appendix.]

Chairwoman WATERS. Thank you very much.

We have two more witnesses to give their testimony, and then we are going to have to break for the vote, and we will return for the questions for this panel right after we take the votes on the Floor. I don't know exactly what the time is for each of those votes. I will ask my staff to inquire so that I can give you some reasonable speculation about exactly when we will return.

With that, we will go right to Mr. Jason Allnut. Thank you.

STATEMENT OF JASON ALLNUT, VICE PRESIDENT FOR CREDIT LOSS MANAGEMENT, FANNIE MAE

Mr. ALLNUT. Thank you, Chairwoman Waters, Ranking Member Capito, and members of the subcommittee. I appreciate the opportunity to be here today to describe Fannie Mae's foreclosure prevention practices. I will share with you our view on how our loan servicing practices can best be directed to reducing foreclosures that are damaging families, neighborhoods, and local communities across the country.

Fannie Mae has been investing in mortgage credit for 70 years, through many housing cycles, and the collective knowledge and expertise of those many decades are reflected in our loss mitigation practices. Underlying all of our efforts in that area is a simple principle: As a holder of mortgage credit risk, our interests are, in fact, closely aligned with those of the borrower.

Our loss mitigation efforts are undertaken in close partnership with our loan servicers, who have the most direct and meaningful contact with borrowers having trouble making monthly payments. I would like to outline the way in which our servicing relationships operate and how our policies and tactics around foreclosure prevention are working today.

First, Fannie Mae continuously monitors and measures servicer loss mitigation activity. For Fannie Mae, that means granting servicers as much leeway as possible to prevent foreclosure, while at the same time monitoring and rewarding their activities to make sure foreclosure prevention is occurring in accordance with our policies.

To accomplish this, we lay out the results we want and work with servicers to come up with the best possible tactics to achieve them. We do not require a standard one-size-fits-all workout. Rather, Fannie Mae leverages a combination of monthly servicer score cards and on-the-ground presence to ensure foreclosure prevention performance and compliance.

Our close monitoring of servicers, setting targets for their results and the regular feedback we receive from them has led to some important changes in our policies. For instance, since the market turmoil began last summer, servicers have requested 18 operational changes to resolve prior loans without prior approval from Fannie Mae. We have granted all 18. These changes have helped streamline the process and empowered servicers to resolve problems more quickly.

Second, we offer cash incentives to servicers to pursue alternatives to foreclosure, but we also pay foreclosure and bankruptcy attorneys to reach out directly to delinquent borrowers. As many have reported, borrowers don't necessarily respond to letters from a servicer, but may respond to a letter from an attorney, and we pay the attorney to prevent a foreclosure, not just to conduct it.

Third, we pursue a variety of ways to work with a delinquent borrower to prevent the foreclosure.

But, historically, our most effective method has been a renegotiation of the terms of the loan or a loan modification.

As noted in our annual report for 2007, Fannie Mae worked on more than 37,000 troubled loans last year. The majority, about 70 percent, were loan modifications.

The choices we make with our servicers and borrowers on the types of loan workout options we pursue are designed for the best long-term outcome. In other words, they are not designed to "kick the problem down the road." In fact, of the modifications, forbearances, and repayment plans we made between 2001 and 2005, only 9 percent of those workouts ultimately went to foreclosure.

The affordability standards we use when doing a loan workout is fairly straightforward. Our servicing guidance allows servicers to create an affordable plan whereby borrowers are required to have at least a $200 residual after monthly expenses are subtracted. The reworked loan needs to be sustainable, and it must allow for unexpected household expenses. A broken water heater is the rule of thumb. The final outcome must meet a basic test: Can the borrower sustain the payments over the long term?

As I said in my opening, these loss mitigation practices reflect the long experience we have in preventing foreclosure. But they also are a reflection of the long-standing underwriting practices of Fannie Mae and the basic safety and sustainability of our loans. The vast majority of our business—close to 90 percent of our entire single family mortgage book—is made up of fixed-rate mortgages with strong credit scores and plenty of borrower equity.

Before I close, I would like to offer a few points on the legislation currently under consideration by this committee, specifically H.R. 5679. We share Congress' concern that the tide of troubled loans has made it more difficult for servicers to address the growing need of borrowers who want foreclosure alternatives.

My view on legislation remedies to this problem is informed by my own experience at Fannie Mae. We have dedicated the time, people and resources needed to work through tens of thousands of problem loans since the market turmoil began last year. Loans are made one at a time, and loss mitigation happens one loan at a time. Creating a legislative standard for loss mitigation activities prior to a foreclosure may actually have unintended consequences by making solid loss mitigation activities, negotiated between a borrower and a servicer, less flexible. It could create an added cost to an already expensive process and ultimately, we believe, make home mortgages more expensive.

I want to thank the committee again for inviting me here today. With that, I would be happy to answer questions. Thank you very much.

[The prepared statement of Mr. Allnut can be found on page 72 of the appendix.]

Chairwoman WATERS. Thank you. Ms. Ingrid Beckles.

STATEMENT OF INGRID BECKLES, VICE PRESIDENT, SERVICING AND ASSET MANAGEMENT, FREDDIE MAC

Ms. BECKLES. Madam Chairwoman, Ranking Member Capito, and members of the subcommittee, good morning. My name is Ingrid Beckles, and I am the Vice President of Servicing and Asset Management for Freddie Mac. As you know, historically Freddie Mac's guarantee and securitization activities have centered around the conforming conventional prime market. Freddie Mac's mortgages continue to perform very well relative to other market sec-

tors despite the turmoil in the market. At year end 2007, only 1 in about every 150 Freddie Mac mortgages were seriously delinquent or in foreclosure compared to about 1 in 7 subprime mortgages; this is less than ⅔ of 1 percentage point, or about 65 basis points.

So while we may be experiencing relatively low delinquencies, Freddie Mac is not immune to the worsening conditions of the overall housing market. At Freddie Mac, we start from the proposition that a foreclosure is not in anyone's best interest, not the lender, not the investor, and certainly not the homeowner or the community. This is also the proposition underlying H.R. 5679. We know from experience that the earlier the servicer and the borrower begin to work out their delinquency, the more likely the borrower will be able to avoid foreclosure. For that reason, we emphasize early and frequent intervention with delinquent borrowers as early as the first missed payment. In 2007, we worked out ⅔ or 3½ times as many mortgages as we had to foreclose upon.

Under our seller servicer guide, which is our basic contract with our servicer, we require, not just recommend, that our servicers work with borrowers to try to resolve troubled loans prior to foreclosure. As a result, in 2007, we entered into approximately 50,000 workout situations last year, nearly 1,000 per week, where we prevented a family from losing their home. This is an exceptionally high proportion of our significantly delinquent portfolio which stood at 79,000 at the end of 2007. Our workouts fall into three categories: forbearances; repayment plans; and modifications.

In every case, we want the borrower to be able to sustain the workout based on the circumstances at the time the family enters into that workout. When we do a loan modification, for example, we not only assess the borrower's current income and other debts, but also whether the family's other living expenses, such as food and fuel, are such that the modified loan will be sustainable. We want to ensure that the family has a sufficient cushion. Our guideline is 20 percent of disposable income, to cover unanticipated expenses that might otherwise force a loan back into default. Since a workout must be sustained based on the borrower's present financial situation, we do not support H.R. 5679's requirement that the affordability be assessed on the income information derived at origination. Rather, our approach, which uses current financial information, has given us a very low redefault rate. And in fact, our loans have a success rate of 80 percent.

My staff and I work with our servicers every day to ensure that we can do the best job possible for our delinquent borrowers. We have found, however, that while mandates may provide clarity, the best way to encourage effective delinquency management is to combine carrots with sticks. We, therefore, reinforce good behavior by providing financial incentives on a per loan basis for completing repayment plans, modifications, and foreclosure alternatives. These incentives are in addition to the fees that we pay the servicers contractually for our mortgages. We also absorb these incentives rather than pass them on to our already distressed borrowers because we believe that they are cost effective in the long run.

In 2007, we paid approximately $12 million in incentives to the servicers for performing this good work. We concur with the objec-

tive of H.R. 5679 to ensure that every delinquent borrower has a reasonable opportunity to work out his or her loan prior to foreclosure. We do not, however, believe that it is necessary to create an affirmative statutory duty that imposes particular loss mitigation activities on the entire mortgage market. Such a measure could add unneeded costs and complexity to delinquency management.

And moreover, no matter what standard is chosen, be it Fannie Mae, Freddie Mac, FHA, or VA, the standard in the underlying principles may not be equally effective to all borrowers at a given point in time. In the long run, a Federal standard could chill innovation, discourage some investors from getting into the mortgage market, and ultimately raise costs for all borrowers. We are committed to working with Congress, the Administration, our customers, and other industry participants to find and implement effective solutions to this very difficult problem. Thank you for the opportunity to address the subcommittee and I look forward to questions.

[The prepared statement of Ms. Beckles can be found on page 87 of the appendix.]

Chairwoman WATERS. Thank you very much. The committee will stand in recess. We ask you to be patient; we should return in about 30 minutes.

[Recess]

Mr. CLEAVER. [presiding] I think, as you can see, the chairwoman is on the Floor. She is managing a bill. And we are going to proceed with questioning. And hopefully, you heard me earlier apologize, as you can see, Chairwoman Waters is on the Floor and should be back shortly. But we are going to proceed. Your time is valuable and we wanted to go ahead and try to minimize the time away from saving people. Let me begin the questioning. I raised questions earlier with the first panel about whether or not there was any value in spreading a program across the country that seems to be valuable to FHA so far. And so loss mitigation seems to have some great value. Let me ask you, Ms. Twomey, do you think there would be value in us having such a mandatory program all over the country?

Ms. TWOMEY. Yes.

Mr. CLEAVER. You know, I like that "yes," because we don't get those normally.

Ms. TWOMEY. I thought you might appreciate that.

Mr. CLEAVER. I do. I think everybody does, including the Judge, I think. The other issue that I raised that I am interested in getting all of your feedback on is the whole issue of regulation. Those who are involved with the loss mitigation are not normally regulated in what they do, except for the banking portion of their portfolio. Is there any downside to some form of regulation? Ms. Beckles?

Ms. BECKLES. I think that we have to be careful with how we go about applying regulation. We have practices at Freddie Mac that we find are doing a very good job at managing delinquencies and keeping people in their homes, which is the objective of your regulation. I do believe there are sectors of the market that would require further attention and possibly regulation. But I think that if

we spread a broad knife across all industry players, especially those who are performing the objective that you seek, it would be detrimental to those who are doing well.

Mr. CLEAVER. Let me amend my question about whether or not the servicers should be regulated. Do any of you have any idea, as you answer the first question, how the fee schedule is developed for the servicers?

Ms. TWOMEY. I might take a crack at that one. Servicers are generally compensated in three different ways through the pooling and servicing agreement, which is the agreement that governs the relationship between the servicer and the investors. And the three different ways that servicers are generally compensated are, one, a servicing fee. And the servicing fee is based on the outstanding principle balance of the loan pool. So they take a fractional interest in all the monies that they collect. And that is their primary source of income. Their second source of income is what is called float income, which is derived from short-term overnight investments of their deposits. And then they get fees; late charges, property inspection fees. All of these things servicers generally get to keep. I don't think that there is in most pooling and servicing agreements a specific fee allocated, unlike some of the FHA or Freddie, some kind of fee incentive for doing loan modifications.

There is not a line item in these pooling and servicing agreements that says if you do a modification, you get $500, or whatever it is. And so that has created a problem. There is no incentive for mortgage servicers, there is no financial incentive certainly in a majority of the market for them to do these types of work-out arrangements. They are focused on their servicing fee, their float income, and getting as much in these ancillary fees as they possibly can. I am not sure if that directly answers your question.

Mr. CLEAVER. It does answer the question. Yes, Mr. Allnut.

Mr. ALLNUT. I would only clarify by looking at the same revenues that were just outlined, the servicing fee is only paid on performing loans. The float is only paid when a borrower pays. And the late fees and other ancillary fees are only received when a borrower reinstates from a late status. If a borrower goes through to foreclosure there is a disincentive on servicing fees, a disincentive on float and a disincentive on ancillary fees. And on top of that Fannie Mae, as well as Freddie Mac, pay a servicer $200 if they do a repayment plan, $500 if they do a modification, and zero if they go to foreclosure. So from a revenue standpoint, I think the alignment is closer to what we all hope it is, which is keeping a borrower in their home, in their mortgage, versus taking that borrower to foreclosure.

Mr. CLEAVER. Anyone else?

Ms. BECKLES. I just want to agree with Mr. Allnut that our servicing structure is probably a little bit higher than that. But we do pay $250 for repayment plans. We pay $300 to $700 for our modifications. We even pay them to help a borrower in what H.R. 5679 would call secondary loss mitigation for deeds in lieu and short sales when the borrower cannot remain in the home upwards of $1,100. So our incentive to the servicer is really to work this situation out and not go to foreclosure. And on top of that, like Mr. Allnut, Freddie Mac also incents their foreclosure attorneys be-

cause many times that is the only person that a distressed borrower will contact because they really see that the rubber is meeting the road here despite the efforts of the servicer. So we actually incent our foreclosure attorneys, not just to proceed with foreclosure. So take that incentive away, work with the borrower on working out the product and getting them back in touch and in a performing state with their servicer.

Mr. CLEAVER. Yes, Mr. Stein.

Mr. STEIN. So if your question was broader, if it is the case that what they describe relates to the GSE purchase loans, most of the loans that were problematic to begin with and that are going into foreclosure are these private label securities. And so if it is the case that there is no clear incentive for servicers on those loans to do modifications or engage in loss mitigation, and there are basically no rules to say that it should happen, then I don't know that we should be surprised that it is not happening.

I think that is why this bill that is being put forth is so important. And on kind of the general concern about regulation and access to credit, this is kind of a frustrating argument to hear, because we have been hearing it over and over again for years from the industry, that if there is too much regulation, it is going to dry up access to credit. And I think they have been very successful in making that argument. So successful that we have had a basically unregulated insufficiently regulated mortgage market for years. That is why we have the problems we have today; the loans that were originated weren't sufficiently regulated.

Now they have all gone into default and foreclosure. The investors are scared. And that is why we have a liquidity crisis, because there is a crisis of confidence on the part of the investors because we didn't have sufficient regulation to begin with. So we think reasonable regulation around origination and reasonable regulation around servicing would bring back investors and bring back some sanity to the market.

Mr. CLEAVER. Following that line of thinking, the brokers are not regulated either, which are the first people who, I will try to say this diplomatically, the people who, in many instances, took advantage of financially illiterate home buyers. What is to prevent—my final question, what is to prevent less desirable companies from becoming servicers? I mean, we have some reputable companies involved, like Wells Fargo, Citibank, and Bank of America. What is to prevent "Joe's Home Company" from becoming involved?

Ms. TWOMEY. I think the question is less desirable from whose perspective; the investors or the borrowers? The investors really control this game. And the investors want to make sure that a servicer is going to maximize their return. And so they are not going to let "Joe's Servicing Agency," that has no experience servicing loans, sign up to be the servicer in a pooling and servicing agreement. They want to make sure that that investor or that servicer has the institutional capabilities to meet their needs. The problem is that doesn't necessarily help borrowers because borrowers don't choose at all.

Mr. CLEAVER. The paranoia exists today because of what has happened. And so I am just interested in, and I think our responsibility is not to do any damage to the lenders, but I think the ulti-

mate responsibility is just to protect the borrowers. That is why I am inclined to think that something related to regulation should occur. Every hearing we have, without exception, when we are dealing with this issue we hear recollections are a bad thing, that it will destroy the country, cause the Super Bowl to move to another continent.

I mean, it is the worst thing to happen when we listen to people. By now, the mantra has become one that irritates. Congressman Green.

Mr. GREEN. Thank you Mr. Chairman, and I commend you on how well you have acclimated to your new station in life. Let me ask questions to the panel as a whole, if I may. And if you would, you may respond by raising your hand. Does everyone agree that aside from FHA and the GSEs, we have other institutions that are involved in this market, what we are calling subprime, that are making loans and having homes foreclosed on and that these institutions—well, let us just find out if you agree that market exists. If you agree that it exists, would you raise your hand, please? Okay. Is there anybody who doesn't agree that it exists? I am asking you aside from conforming conventional loans, do you also have nonconventional conforming, conforming nonconventional?

Ms. TWOMEY. The answer is "yes." What is interesting is that Countrywide or Wells Fargo or any of these lenders that you have heard service for GSEs and service for Fannie and FHA also service the subprime loans.

Mr. GREEN. I understand. But we all agree that they exist. I just want to make sure that nobody assumes that they don't exist.

Ms. GORDON. Can I add one other comment?

Mr. GREEN. Well, let me just do this. For the record, all persons agree that they exist. Do you agree that there are a substantial number of foreclosures in this market? Everybody agree? Raise your hand if you would, please? Good. For the record, everybody has raised their hand. Do you agree that this market is, when compared to FHA and the GSEs, not nearly as regulated? Do you agree that they are not as regulated as FHA and GSEs? Do you agree that they are not regulated? Yes, Ms. Holmes, do you agree that they are not regulated? Excuse me, that is Ms. Beckles. Do you agree that they are not regulated to the extent that GSEs and FHA?

Ms. BECKLES. Based upon the outcome, they appear not to be.

Mr. GREEN. Well, do you have any empirical evidence of actual regulation?

Ms. BECKLES. I don't spend time studying the other markets.

Mr. GREEN. So your answer would be no, you don't have it, is that correct?

Ms. BECKLES. I do not have empirical evidence.

Mr. GREEN. All right. That will be sufficient. Thank you. I did not hear from Mr. Allnut. You did not respond.

Mr. ALLNUT. I have no empirical information one way or the other.

Mr. GREEN. As to whether they are regulated or not, okay now, given that you have no empirical evidence, Mr. Allnut, why do you defend that of which you have no empirical knowledge? And I would ask the same thing of you, Ms. Beckles. You have no empir-

ical knowledge of their regulations, but you defend the notion that they should be regulated, or am I incorrect and you do not defend that?

Ms. BECKLES. I am not making that assumption.

Mr. GREEN. Excellent. Okay. You do not defend. So then let me ask now of the entire panel, if they are substantially unregulated when compared to the others, would you agree that some regulation can be of help? If so, would you kindly raise your hand? Okay. I have three persons. Are you a yes or a no or a maybe? That would be Mr. Wade, is that right?

Mr. WADE. Yes. I just wanted to clarify that the way we experience it, there is no question the inconsistencies create a challenge for the consumer and those trying to help the consumer.

Mr. GREEN. I understand. But do you agree that if all markets were regulated to the extent that FHA was regulated that we would probably have fewer foreclosures?

Mr. WADE. Well, I do agree that if standards were in place—

Mr. GREEN. You know how FHA is regulated?

Mr. WADE. Absolutely.

Mr. GREEN. Would we have fewer foreclosures?

Mr. WADE. If the same products—

Mr. GREEN. If FHA requires the same products.

Mr. WADE. So, if—

Mr. GREEN. Assume whatever you like as it relates to FHA. But if they were regulated to the same extent that FHA is regulated, would we have fewer problems?

Mr. WADE. There would be fewer problems.

Mr. GREEN. So again, let me ask, do you think that some regulation would help these markets, this market that is apparently not regulated to the extent that FHA and their GSEs are regulated? If so, would you raise your hand please. Okay. Now we will get back to Mr. Allnut.

Mr. Allnut, you have no empirical evidence of what their standards are yet you conclude that no regulations should apply to them, is this correct?

Mr. ALLNUT. No that is not my conclusion.

Mr. GREEN. Well, if it is not your conclusion, and I say some regulations, and you don't agree with some, then some would include a scintilla to some large amount. But you don't—I have to conclude that you wouldn't even want a scintilla of regulation?

Mr. ALLNUT. That is not my conclusion.

Mr. GREEN. So you would want some?

Mr. ALLNUT. What I am suggesting is that the regulations that Fannie, Freddie, HUD, and VA abide by have to do with products that are available to the marketplace, and had those same regulations been applied to this other category that you are talking about, many of the products that are out there right now would not be out there and could have a positive impact on the rate of—

Mr. GREEN. Well, you are in agreement with me then?

Mr. ALLNUT. Yes.

Mr. GREEN. All right. For the record, Mr. Allnut is in agreement. Now let us go to Ms. Beckles. Is it your opinion that there should be no regulations with reference to this market?

Ms. BECKLES. Freddie Mac's opinion is probably that there should be some form of—

Mr. GREEN. Well, if you say "some," then your hand should have gone up with the others.

Ms. BECKLES. I think there is a difference between regulation, statutory requirements and oversight.

Mr. GREEN. In your mind, define it however you like. Should there be some regulation?

Ms. BECKLES. There should be something.

Mr. GREEN. Something. Can we call that thing "regulation?"

Ms. BECKLES. I am not sure how you are going to define regulation. There should be some things—

Mr. GREEN. You define regulation in your mind as it relates to your business and then apply it to this question. Some regulation of the market that has an overwhelming majority of problems, should there be some?

Ms. BECKLES. I believe that there should be oversight and consequences.

Mr. GREEN. Okay. Does oversight entail regulation and consequences? Isn't that a form of regulation? Let me ask you this: Is it hard to say regulation as it applies to this market?

Ms. BECKLES. It is hard to say regulation when at times regulation is taken with a broad brush and does impede practical business.

Mr. GREEN. Okay. But let us not talk about impeding practical business. Let us just talk about a market that we conclude has not been regulated to the extent that FHA has and whether there should be some regulation given that this is the market where we have the problem? Should there be some?

Ms. BECKLES. There should be some form of oversight and consequences in management.

Mr. GREEN. Okay. I am going to define oversight and consequences as regulations. With that definition, should there be some regulation?

Ms. BECKLES. Yes, there should.

Mr. GREEN. Thank you. And I yield back, Madam Chairwoman.

Chairwoman WATERS. Thank you very much. I would like to yield myself some time to raise some questions. Before I get into some of the questions that I prepared to ask you, I need to be educated some more about this business. Let me ask Fannie and Freddie. You have underwriting standards, is that right?

Ms. BECKLES. Yes, ma'am.

Chairwoman WATERS. And you have loan originators such as Countrywide, is that correct?

Ms. BECKLES. Yes, ma'am.

Chairwoman WATERS. And you buy the products, you buy the loans from Countrywide on the secondary market?

Ms. BECKLES. Yes, ma'am. Those that meet our standards, yes, ma'am.

Chairwoman WATERS. Those that meet your standards?

Ms. BECKLES. Yes, ma'am.

Chairwoman WATERS. And some of those loans—well, all of your loans are serviced by Countrywide and others, is that right?

Ms. BECKLES. By Countrywide and others, yes, ma'am.

Chairwoman WATERS. So Countrywide is servicing some of the loans that you picked up from them?

Ms. BECKLES. That we purchased from them.

Chairwoman WATERS. That you purchased from them; they are servicing some of those?

Ms. BECKLES. Yes, ma'am.

Chairwoman WATERS. All right. They meet your standard for the loan origination?

Ms. BECKLES. And for the loan servicing, ma'am.

Chairwoman WATERS. How does the loan servicing that they do for you compare with loan servicing they do on loans that they would keep in their portfolio? Is there a difference?

Ms. BECKLES. Well, I cannot comment as to what they do on the loans that they keep in their portfolio or that they sell to other people. But they are required to follow our strict standards. We monitor their performance. We actually model our loans loan-by-loan to determine their probability of default. We put those into their call campaigns. They use our models to drive their call campaigns to make sure that we are reaching out to borrowers. And then we compensate them when they do successful workouts to keep borrowers and loans.

Chairwoman WATERS. Describe to me how the loans that you have picked up from Countrywide perform in relationship to foreclosure, what is the percentages?

Ms. BECKLES. One moment, I do not have specific lender percentages. I have some State information. But on the whole, they are performing at par with their peer groups, I can tell you that. Because they are one of our largest customers and we do look at our larger customer performance. So our loans are performing on par with our peer groups.

Chairwoman WATERS. Well, that is not good enough. Let me just say this.

Ms. BECKLES. Our overall foreclosure rate is—

Chairwoman WATERS. For Countrywide loans.

Ms. BECKLES. If they are performing on par?

Chairwoman WATERS. For Countrywide loans, that is all I want to know.

Ms. BECKLES. Countrywide loans are performing on par, which is less than 100 basis points.

Chairwoman WATERS. I want the exact information. And I guess I will have to write and ask you for it, because you obviously don't have it with you today.

Ms. BECKLES. I did not bring lender specific information, ma'am, but I can certainly get it.

Chairwoman WATERS. This is important. We have a crisis out there in America. I have been to areas not only in my own city, but in Cleveland, Ohio, and Detroit, Michigan, where whole blocks are boarded-up, and other people who are living on those blocks, their values are being driven down, the homes are not being taken care of, they are being vandalized. We have a really serious problem.

Ms. BECKLES. Yes, ma'am.

Chairwoman WATERS. Obviously, Countrywide emerges big in this problem. Do you understand that?

Ms. BECKLES. I do understand that, ma'am.

Chairwoman WATERS. Okay. So it is reasonable that when you are coming here, you would know that we would want to ask you about your relationship with Countrywide and the performance level of Countrywide.

Ms. BECKLES. Our relationship with Countrywide is very strong. They perform on par with their peers, and that is a very good group of folks. As they are a large customer, you would think that they would drive down our overall performance rate and they are not. So when I say that they are performing on par, they are not aberrant to our average or 90-plus foreclosure rate.

Chairwoman WATERS. I am going to ask you some specific information that obviously you don't have today. But let me ask you this, do you know whether or not the loans that were originated by Countrywide are originated by a combination of individuals who either are hired or contracted with by Countrywide in California? For example, we have licensed and unlicensed brokers. Were your loans, any of your loans, originated by unlicensed brokers with Countrywide?

Ms. BECKLES. I will have to get that information for you, ma'am. I am focusing on the servicing side, so I will get that information to you.

Chairwoman WATERS. Let us get to servicing.

Ms. BECKLES. Okay.

Chairwoman WATERS. You have standards?

Ms. BECKLES. Yes, we do, ma'am.

Chairwoman WATERS. And they are monitored?

Ms. BECKLES. Yes, ma'am.

Chairwoman WATERS. And they are audited?

Ms. BECKLES. Yes, ma'am.

Chairwoman WATERS. And you have written documentation on the auditing of the servicing that Countrywide is doing for you?

Ms. BECKLES. Yes, ma'am.

Chairwoman WATERS. And you can make that available to this committee?

Ms. BECKLES. Yes ma'am.

Chairwoman WATERS. We shall require of you, we will ask of Freddie and Fannie, to give us that information. We want to take a look at what you do. Now, how many times have you determined that Countrywide was not in compliance with your servicing standards?

Ms. BECKLES. We haven't found that—okay. How many times have we determined? They have an acceptable rate of performance on our audit. That means that they do have some outliers, just like any other mortgage servicer. And when we find outliers in the performance of the servicing duties, we develop work plans with them, we give them correspondence, and we go onsite and actually train them on how to improve or remediate that performance. Their inability to service properly for us also affects their ability to receive the incented compensation because they will not perform well on their workout status if any of our servicers are not following our standard.

Chairwoman WATERS. Do they subcontract any of the servicing they do for you?

Ms. BECKLES. I beg your pardon, ma'am?

Chairwoman WATERS. Do they subcontract any of the servicing they do for you? They service for you. Do they hire other people, do they have contractual relationships with others who are doing servicing for you?

Ms. BECKLES. To my knowledge, Countrywide uses Countrywide's employees on the Freddie Mac portfolio.

Chairwoman WATERS. Fannie Mae?

Mr. ALLNUT. Same question?

Chairwoman WATERS. Same question. Do they subcontract, does Countrywide subcontract its servicing?

Mr. ALLNUT. I focus on the borrower contact aspect of who Countrywide uses for servicing and those are Countrywide employees.

Chairwoman WATERS. So your answer is either you don't know or no they do not subcontract out their servicing?

Mr. ALLNUT. The portions of the work that they do that I oversee are not subcontracted out.

Chairwoman WATERS. Okay. Well, let us talk about the work that maybe you don't oversee directly, but because you are a smart employee, you know what goes on around you. Do you know or have you heard that they subcontract out any of their servicing? Have you heard any of that from anybody, maybe from somebody who sits next to you, works in the same area that you work in, who is doing what maybe you don't do, but it is connected to servicing?

Mr. ALLNUT. No, I have not.

Chairwoman WATERS. So you don't know, is that it?

Mr. ALLNUT. No. No, I have not heard through conversations or elsewhere that Countrywide subcontracts out the servicing portion of their responsibilities.

Chairwoman WATERS. Okay. For either of you, whether it is Countrywide or any of your other servicers, have you heard that they utilize foreign operations to do some of the servicing? Have you heard that some of the servicing that is done by Countrywide or any of your other services is actually being done from India or anyplace else?

Mr. ALLNUT. I have had conversations with servicing management at Countrywide relative to their desire to use offshore call centers.

Chairwoman WATERS. Not their desire. I don't care about their desire. I want to know whether or not they are doing it and whether or not you know about it?

Mr. ALLNUT. I am not familiar with them doing it today, and I have voiced my perspective that they not do so.

Chairwoman WATERS. So you had a conversation with them because you heard they were interested in doing it?

Mr. ALLNUT. I heard that there was a possibility that Countrywide was looking into offshoring early borrower contact and voiced my concern and opinion that was not in the best interest of our borrowers.

Chairwoman WATERS. Okay. So you know that they don't do that for Fannie Mae; they are not doing offshore contracting for services?

Mr. ALLNUT. That is correct.

Chairwoman WATERS. And the same thing for Freddie Mac?

Ms. BECKLES. Freddie Mac, yes, ma'am.

Mr. ALLNUT. That is my understanding.

Chairwoman WATERS. Now, I want to hear about the incentives.

Ms. BECKLES. Okay.

Chairwoman WATERS. You have alluded to incentives, and this is one reason why you know they are doing the best job that they could do. Would you explain those incentives to us?

Ms. BECKLES. Certainly, ma'am. We measure our loans and model our loans based upon their probability of default. Those models are used to drive call campaigns. So since we have access to all of our loan data and can track the progression of a loan we can determine how well or how the loans are moving through their performing cycle, as well as their default cycle. We measure our servicers based upon their ability to mitigate losses to the borrower and to the organization.

Servicers are ranked according to their effectiveness at doing this. So on a loan-by-loan basis we watch the population of loans that become early stage default such as, you know, day one after 30 and watch its movement through the pipeline. And based upon our models, we give them benchmarks that say you should not be exceeding these thresholds, and when you do you get disincented for exceeding thresholds at each of the major categories.

Chairwoman WATERS. How do you get disincented?

Ms. BECKLES. The first way they get disincented is that they don't get as many points. I know that sounds pretty mundane, but the points add up to their tier ranking. If you maintain a Tier 1 or Tier 2 standard, which is basically an industry standard, you are able to get delegations of authority, which means that you can respond to borrower situations more quickly.

Chairwoman WATERS. Let us back up. Now, hold it for one second. I think it is very important, because like I said, since we have no regulation of mitigation services, we don't know this stuff.

Ms. BECKLES. That is fine. I am sorry. I did not mean to go so fast. I apologize.

Chairwoman WATERS. When you talk about Tier 1 or whatever else you just said, you are basically explaining to us that if you do a good job, you get more flexibility—

Ms. BECKLES. You get more flexibility.

Chairwoman WATERS. —to work out—

Ms. BECKLES. To work out product.

Chairwoman WATERS. —and to do modifications?

Ms. BECKLES. And to do other foreclosure alternatives, yes, ma'am.

Chairwoman WATERS. So that if they are not in the top tier, as you alluded to, they are doing servicing and doing modifications with less flexibility and less authority, and some of those people whom they are servicing don't have the advantage of the flexibility because this servicer is not in the right tier, is that correct?

Ms. BECKLES. What happens, unfortunately, is that if they are in a lower tier, that means that they are not effective at mitigating losses and doing workouts for the borrowers. And in those cases, we work with them to bring them back up. So we look at case files to understand why they are missing hand-offs. In many cases, the reason that a servicer is not able to catch a borrower before foreclosure is because sometimes they miss the hand-off between the

collection call and the loss mitigation activity. So we go through all of that with a fine tooth comb to help them see where they can harvest more borrowers who want to stay in their homes and have the potential to stay in their homes through a workout of some kind of foreclosure alternative.

Chairwoman WATERS. Okay. I get it. You don't have to go any further. And I am going to—Mrs. Capito, I was out. Have you not had an opportunity? I am understanding more than I thought I was going to get out of understanding, of trying to understand how mitigation works. I have a lot more questions. I will ask some of the financial institutions that are here today. But I am more convinced than ever that mitigation needs regulation. Mrs. Capito.

Mrs. CAPITO. Thank you, Madam Chairwoman. I would like to ask Mr. Wade a question about NeighborWorks America. This came up in a hearing we had last week when we were—you know, a lot of the emphasis is on good sound home counseling, financial counseling to keep people in their home, to get them into a mortgage, on the beginning, the end, the middle, the whole deal, and I know that you are very involved with this. The money that we put into the economic stimulus package, I believe, had financial counseling money.

Mr. WADE. Yes.

Mrs. CAPITO. Can you give me the amount of that? I can't remember.

Mr. WADE. $180 million.

Mrs. CAPITO. $180 million. What has been the result of that? I will tell you what kind of disturbed me was the gentleman from Ohio said that NeighborWorks had gotten the money, then he applied on the benefit of 18 housing counseling agencies in Ohio for the money. And all I am thinking is administrative fee, administrative fee and what is going down to the actual person who needs the help. Can you explain to me how that works?

Mr. WADE. Absolutely. That is a good question. The legislation was pretty specific about how the money could be allocated. Of the $180 million, we were required to only use 4 percent, up to 4 percent to administer the program.

Mrs. CAPITO. That is just NeighborWorks, though?

Mr. WADE. That is just NeighborWorks America. There were three classes of eligible applicants: State housing finance agencies; HUD-approved national intermediaries that do housing counseling; and then NeighborWorks organizations. We were required to set up an application process. Those folks applied. And we awarded within the 60 days that we were required to make at least $60 million worth of awards, we awarded a little more than $130 million of the $180 million.

Mrs. CAPITO. And what was that deadline date?

Mr. WADE. Well, it was 60 days from enactment, so it is 60 days from December 26th. We announced the awards within that timeframe. We were only required to get a minimum of $50 million awarded. We awarded $130 million. Of the awards that we made, the groups could only use a—well, let me just clarify. The amount that groups could use to administer the program was capped.

So there were limitations on what any of the national organizations could use to administer the program. And then the funding

that went to the NeighborWorks organizations, there was no allowance for any administrative costs in that case.

Mrs. CAPITO. Okay. Thank you. You mentioned in your, I think it was you who mentioned in your testimony, foreclosure scams?

Mr. WADE. Yes.

Mrs. CAPITO. Could you just give me a short—what should people be watching out for; things in the mail, on the telephone?

Mr. WADE. It is always that people are being approached. Many times people go to the registry of deeds, the people who are perpetrating the scams, find out what people have been, where there have been foreclosure filings. They approach those folks. And there are two main things that end up happening at the end of the day on the negative. They either end up taking possession of the home from the borrower without their knowledge, usually with the premise that they can help save them from foreclosure, sometimes disclosing that they have to take short-term possession of the property in order to cure the foreclosure, oftentimes the consumer being asked to sign a paper not being clear that they are signing the home over to someone else.

And then the other general circumstance that we see are people whose equity is taken from them in the context of the notion that they are going to help cure the foreclosure. So those are the two major things that we see.

Mrs. CAPITO. A question for Ms. Gordon.

Ms. GORDON. Yes.

Mrs. CAPITO. I wasn't here for your testimony. At least I didn't hear all of it. In it, you mention a self-help organization where you actually do lend money separate and apart from your research?

Ms. GORDON. Correct.

Mrs. CAPITO. What is your foreclosure rate and delinquency rate on those loans?

Ms. GORDON. The foreclosure rate on our loans, which are all to what you would consider a prime population, is under 1 percent.

Mrs. CAPITO. Under 1 percent. And do you have a—does somebody service your loans for you?

Ms. GORDON. Yes. We do have a company that does servicing for us. We work very closely with them. And in a situation where the servicing company is having trouble for whatever reason in helping the homeowner come to a resolution that will help them remain in the home, we will often step back in as the lender and try to help work it out as well.

Mrs. CAPITO. Now, is that a servicing organization that is affiliated with you, or is it separate and apart? Is it one of the 1,200 that are FHA approved? What is the name of it?

Ms. GORDON. You know, I don't know the name of that. I can get that to you. But they are a separate organization, although not one of the large servicers that we have been talking about.

Mrs. CAPITO. Okay. I think that is it for me. Thank you.

Chairwoman WATERS. Thank you very much. All members having—Mr. Cleaver, you had your chance too. Thank you very much, panel. Thank you for being patient and waiting for us to return after having gone to the Floor. Actually, we could do this for hours because there is so much information that we need to learn. I am pleased to have some of our consumer advocates here who are con-

cerned about this area of servicing and who have gathered a lot of information. We will continue to work with you and get advice from you about what we can do to assist our homeowners in staying out of foreclosure.

To our friends here who do not think we need to do anything, let me just say that we have to pursue this. We have to pursue this because servicing is unregulated. And it appears that the complaints are overwhelming about the lack of being able to reach anybody on the telephone, the lack of being able to talk with anybody before a foreclosure actually takes place, and also what appears to be in some cases, we have to continue to investigate, that servicers are actually making a profit on foreclosures. So we have to continue to investigate this and see what we can do to provide some assistance to our homeowners. Thank you all very much for coming.

The Chair notes that some members may have additional questions for this panel that they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses, and to place their responses in the record. The panel is dismissed.

I now welcome our third panel: Ms. Faith Schwartz, executive director, HOPE NOW Alliance; Mr. David G. Kittle, CMB, president and chief executive officer, Principle Wholesale Lending, Incorporated, in Louisville, Kentucky, and chairman-elect, Mortgage Bankers Association; Mr. Tom Deutsch, deputy director, American Securitization Forum; and Mr. Steve Bailey, senior managing director, Countrywide Financial. I would like to thank you all for being here today. I would like to ask you to present your testimony. You don't have to read all of your testimony; you can condense it and concise it. You will have 5 minutes.

We will start with Ms. Faith Schwartz.

STATEMENT OF FAITH SCHWARTZ, EXECUTIVE DIRECTOR, HOPE NOW ALLIANCE

Ms. SCHWARTZ. Chairwoman Waters, and Ranking Member Capito, thank you for the opportunity to testify today. My name is Faith Schwartz, and I want to tell you about the HOPE NOW Alliance's real progress to reach out to at-risk borrowers and find solutions to prevent foreclosures. The HOPE NOW Alliance is an unprecedented broad-based collaboration among homeownership counselors, lenders, investors, mortgage market participants, and trade associations that is achieving real results. From July 2007 through February 2008, nearly 1.2 million homeowners have avoided foreclosure through the efforts of HOPE NOW members.

HOPE NOW has also brought more of the industry together in this effort. And as of April 10th, the Alliance's 27 loan servicers represent over 90 percent of the subprime market, a vast majority of the prime market. We have strong participation from respected nonprofits led by NeighborWorks America, the Homeownership Preservation Foundation, and HUD counseling intermediaries. HOPE NOW has a three-pronged approach to preventing foreclosure, and it is reaching homeowners in need, counseling homeowners in need, and assisting homeowners in need.

Under reaching homeowners in need, a major challenge is that borrowers in trouble are reluctant to ask for help; 50 percent of the borrowers who go into foreclosure never contacted their servicers for help. We are working to drastically reduce those numbers and help as many troubled homeowners as possible to avoid foreclosure. HOPE NOW has an aggressive monthly direct mail outreach campaign to at-risk borrowers. This effort is in addition to the thousands of letters already underway from individual companies to their customers.

Since November, HOPE NOW has mailed out 1.2 million letters in an attempt to reach the most at-risk borrowers. On average, 20 percent of those receiving the HOPE NOW letters do contact their servicer, and there was zero contact before these letters. In addition, the Homeownership Preservation Foundation reports that in the first quarter of 2008, over 11 percent of the people calling the hotline heard about it from a HOPE NOW letter. HOPE NOW has launched homeownership preservation workshops in a series of public outreach events across the country to reach more at-risk borrowers and provide them with an opportunity to meet in person with their loan servicer or a HUD-certified counselor to develop a workout solution. We have held three events in California, as well as forums in Ohio and Pennsylvania, reaching over 1,400 borrowers in person. In Philadelphia, HOPE NOW reached 328 homeowners at risk for foreclosure.

Present were 14 mortgage servicers who participated and local counseling organizations, such as the Philadelphia Unemployment Project, the Urban League, Advocates for Financial Independence, and ACORN Housing. We have had very positive feedback from the homeowners who attended these events. Homeowners have shared the following: "It gave me hope that I will survive; we received a reduction in our payment and were not meant to be belittled or intimidated; without your help, we would have lost our home; and I am too choked up to talk." This month, we are continuing the outreach in Atlantic, Milwaukee, Indianapolis, and Chicago, and we are working with Members of Congress and other officials from those areas to promote those events and will continue to do so.

For counseling homeowners in need, HOPE NOW is actively providing nonprofit counseling to homeowners through the Homeownership Preservation Foundation's HOPE Hotline, which connects the homeowners with 450 trained counselors at HUD-certified nonprofit counseling agencies. Counseling is free, and it is offered in English and Spanish 24 hours a day, 7 days a week.

To date, the HOPE Hotline has received 632,000 calls, with over 250,000 calls in the first quarter of 2008. We greatly appreciate the Dear Colleague letter that Chairwoman Waters, Ranking Member Capito, Chairman Frank, and Congressman Bachus sent to the House Members to remind them of the HOPE Hotline and the dedicated service or phone numbers for consumers.

Assisting homeowners in need—HOPE NOW members are providing help to at-risk homeowners through loan modifications and repayment plans and targeted efforts such as Project Lifeline to freeze forecloses in a method for fast track modifications based on the American securitization framework.

From July 2007 through February 2008, again, nearly 1.2 million homeowners avoided foreclosure through these efforts of HOPE NOW members. Subprime workouts totaled 717,500 workouts, including 485,000 repayment plans and 232 loan modifications. HOPE NOW members do understand that workouts must be viable, more than a short period of time, workouts including loan modifications and repayments help borrowers avoid foreclosure and stay in their homes and servicers are rapidly increasing their efforts and were modifying subprime loans during the fourth quarter at triple the rate of that of the third quarter.

The increase in the number of loan modifications shows that this effort is real and it is seeking the best solutions for borrowers. HOPE NOW is measuring and reporting on our results and helping homeowners. We are continuing to gather data on these results, and this is an enormous undertaking, but we are confident that we will be able to systematically inform you and that will help measure what servicers are doing to support homeowners.

In conclusion, the members of HOPE NOW are committed to producing results. Loan servicers joining HOPE NOW agree to a statement of principles on reaching out and helping distressed homeowners remain in their homes. My written statements contains those principles which include contacting borrowers early, and having a dedicated hotline, e-mail address and fax number available to all HUD-approved counselors.

In February, we released a list of loan numbers on HOPE NOW servicers that consumers can call to receive assistance. This is a serious effort and it will continue until the problems in the housing market and the mortgage market abate. It is neither a silver bullet nor a magic solution, but HOPE NOW is helping homeowners, and we will continue to report on that progress to assist homeowners in distress and to prevent foreclosures whenever possible. Thank you for inviting the HOPE NOW Alliance to testify today and I am happy to answer any questions.

[The prepared statement of Ms. Schwartz can be found on page 139 of the appendix.]

Chairwoman WATERS. Thank you very much.

Mr. Kittle.

STATEMENT OF DAVID G. KITTLE, CMB, PRESIDENT AND CHIEF EXECUTIVE OFFICER, PRINCIPLE WHOLESALE LENDING, INCORPORATED, AND CHAIRMAN-ELECT, MORTGAGE BANKERS ASSOCIATION (MBA)

Mr. KITTLE. Good afternoon, Chairwoman Waters, Ranking Member Capito, and members of the subcommittee. Thank you for the opportunity to discuss the loss mitigation process. The bill before us, H.R. 5679, seeks to specify and require certain procedures to reduce the level of foreclosures. All of us are focused on the same goal; keeping people in their homes. Such a goal serves the interest not only of borrowers, but also of our own members and the communities where they do business. That is why MBA is a founding member of the HOPE NOW Alliance. And as of the end of February, we have helped nearly 1.2 million troubled borrowers establish affordable mortgage payments. Mortgage servicers have done

this through informal forbearance, repayment plans, and loan modifications; all forms of loss mitigation.

As we seek to do more to help ease this crisis, MBA is eager to partner with Congress to finish work on FHA modernization, GSE reform, housing tax incentives, and expanding the use of tax advantaged mortgage revenue bonds to include refinancing. When Congress completes work on these important initiatives, it should avoid taking action that would inadvertently increase interest rates or borrowing costs, constrain the availability of legitimate offers of credit, or that would encourage borrowers not to make mortgage payments.

While a considerable effort is being made by lenders, borrowers, and public officials to avoid foreclosures, we all recognize there will be cases where the goal cannot be achieved.

Ultimately, the mortgage contract rests on two pillars: First, the promise of the borrower to pay; and second, the ability of the lender to rely as a last resort on the value of the house the borrower has pledged as security for the loan. It is the pledging of the house as security that makes mortgage credit considerably less expensive than unsecured consumer debt. The rate of interest on mortgage loans is significantly lower than the rate on unsecured consumer loans. If borrowers are deprived by legislation of the ability to reliably pledge their homes as security for mortgage loans, it is probable that rates they pay for mortgage credit will approach the rates paid for unsecured credit. In evaluating the legislation, we believe that Congress should ensure it enhances borrowers' chances to remain in their homes; does not deprive investors of the value of their investments; and preserves for all consumers the benefits of reasonably priced mortgage credit by maintaining the essential elements of the mortgage contract.

Our review of H.R. 5679 revealed that there are a number of elements of the bill that fail one or more of these criteria. First, the bill would authorize borrowers' counsel to use qualified written requests to block foreclosure indefinitely. Second, the bill's overly prescriptive loss mitigation provisions could increase the cost of mortgage credit for future borrowers. Third, mandating debt-to-income ratios on first loans would require holders of first liens to subordinate their economic interest to the interest of junior lien holders and unsecured creditors, which may be the source of the borrower's inability to stay current on the mortgage payments in the first place. Fourth, prescribed and detailed mitigation procedures would deprive lenders of the flexibility required to negotiate effectively with borrowers to achieve a manageable debt payment schedule. And finally, the bill would impose expensive and time consuming paperwork requirements on lenders without any corresponding benefit to the borrower.

Though we are committed to working with you to improve H.R. 5679, the harmful provisions in this bill currently outweigh its potential benefits. Thank you for the opportunity to appear before you, and I look forward to your questions.

[The prepared statement of Mr. Kittle can be found on page 124 of the appendix.]

Chairwoman WATERS. Thank you very much.

Mr. Tom Deutsch.

STATEMENT OF TOM DEUTSCH, DEPUTY EXECUTIVE DIRECTOR, AMERICAN SECURITIZATION FORUM (ASF)

Mr. DEUTSCH. Thank you, Madam Chairwoman, Ranking Member Capito, and distinguished members of the subcommittee. My name is Tom Deutsch, and I am the deputy executive director of the American Securitization Forum. I very much appreciate the opportunity to testify before this subcommittee again on behalf of the 370 member institutions of the ASF and the 650 member institutions of the SIFMA. These members include all of the major lenders, servicers, underwriters, and institutional investors and all forms of mortgage and asset-backed securitization throughout the country.

Since I last testified before this subcommittee on November 30, 2007, in Los Angeles, California, a significant amount of progress has been made by the industry to help struggling homeowners stay in their homes. One very significant initiative was launched on December 6, 2007, less than a week after your hearing, Madam Chairwoman. On that day, the ASF announced, and President Bush and Secretary Paulson supported and endorsed, the ASF streamlined loan modification framework for industry servicers to fast track subprime ARM borrowers into interest rate loan modifications in certain circumstances. The ASF framework uses objective criteria to determine the continued affordability of subprime loans based on such factors as the borrower's payment history, credit standing, owner occupancy, and amount of home equity. The primary purpose of the ASF framework was to address the rising tide of subprime ARM borrowers who may not have been able to meet their higher payments at their initial reset.

Most subprime 2/28s and 3/27 borrowers pay a fixed introductory rate for say 2 or 3 years and then adjust to a floating rate, based on 6-month LIBOR thereafter. Importantly, since the ASF framework was announced, 6-month LIBOR has dropped precipitously from 5 percent on December 6, 2007, to 2.6 percent as of today, April 16, 2008. What has really changed then for subprime ARM borrowers since December 6th is that every single resetting subprime ARM borrower in America has experienced the equivalent of a 2.5 percent loan modification through the normal contractual functioning of their mortgage note.

As a result, the average subprime ARM borrower has had little or no rate increase at their reset. Falling rates, then, have obviated the need to make systematic contractual rate modifications for these subprime ARM borrowers which largely explains why an even more significant increase in industry contractual rate modification activity hasn't been observed over the past few months. But let me turn, Madam Chairwoman, to some of our views and perspectives on your proposed bill, H.R. 5679.

We fully agree that all servicers should engage in reasonable loss mitigation activities, which is described above. Servicers are already contractually obligated to engage in these activities for the benefit of security holders. But the new Federal duty that the bill would propose is unreasonably compelling, all servicers nationwide to rewrite existing mortgage and pooling and servicing agreed contracts solely to benefit borrowers in default rather than to act in the best interest of security holders as the mortgage and PSA con-

tract specify. By analogy, it would suggest that all forms of repayment on consumer credit should be measured not by what the borrower has agreed to pay, but instead ultimately, by what the borrower can pay at any time during the life of the loan. This bill then, we believe, disregards the original loan terms to which the borrower agreed as well as the servicer's obligations under the pooling and servicing agreements to institutional investors.

Now as a general matter, we have very strong concerns with any legislation that would retroactively abrogate or interfere with previously established private contractual obligations. We believe the bill would do just that, and that it would fundamentally alter the contractual obligations of pooling and servicing agreements to require servicers to be the agent of the borrower, rather than the MBS institutional investors or loan portfolio manager.

Changing the standard would alter the commercial expectations of investors and would seriously undermine the confidence of investors and the sanctity of contracts, which are the bedrock to extension of consumer credit in the process of securitization. Any legislative intervention into otherwise valid legal contracts threatens the stability and predictable operation of contractual legal framework supporting our capital markets system.

While we fully support and encourage servicers to meet their contractual obligations to engage in reasonable loss mitigation, we have very significant concerns about this bill from the very premise that it starts from, that is, that mortgage contracts should be modified to serve solely the borrower's interests rather than the interests of the original contractual obligations that the borrower has agreed to fulfill.

A shared goal of participants in the mortgage financing markets is to keep people in their homes. Unfortunately, there is no comprehensive solution that will fix all the current problems in the mortgage market today and the current home price correction. Market participants have and continue to collaborate and work towards developing coordinated solutions to the current issues in the mortgage financing market. Recognize it is essential to balance the interests of borrowers and investors while preserving the significant benefit of the continued availability of mortgage and consumer credit. I thank you very much for the opportunity to testify here on behalf of our members, and we look forward to working with you, Madam Chairwoman, and this committee to develop even more solutions.

[The prepared statement of Mr. Deutsch can be found on page 101 of the appendix.]

Chairwoman WATERS. Thank you.

Mr. Steve Bailey.

STATEMENT OF STEVE BAILEY, CHIEF EXECUTIVE FOR LOAN ADMINISTRATION, COUNTRYWIDE FINANCIAL

Mr. BAILEY. Good morning, Madam Chairwoman, Ranking Member Capito, and subcommittee members. Thank you for the opportunity to appear here today to discuss the efforts of servicers like Countrywide to help families prevent avoidable foreclosures. Countrywide has long been a leader in providing home retention solutions to our borrowers.

Today's market conditions have created unprecedented challenges for servicers and mortgage investors, in developing new approaches to mitigating losses for security holders while keeping as many borrowers in their homes as possible. We know that foreclosures are financially and emotionally damaging to our customers and very costly to us and the security holders. Because of the high financial costs of foreclosures, we cannot emphasize enough that as a matter of basic mortgage servicing economics, foreclosure is always and absolutely the last resort. The home retention personnel who report to me at Countrywide fully comprehend the human implications of foreclosure.

They are committed to doing all they can to help keep families in their homes whenever possible. We don't have a loss mitigation division. We have a home retention division. We don't have a workout department. We have a hope department. There is a campaign in our home retention division called the Life Behind the Loan that focuses on connecting and humanizing conversations and circumstances, such as learning the names of the children. I know from personal experience that it is euphoric to tell a customer that you have a plan for them to save their home. It is equally heartbreaking to tell a borrower that they may lose their home. Last November, we testified before the House Financial Services Committee and before a housing subcommittee field hearing. At that time, they had just announced a number of new ground-breaking home retention programs. Today, I want to update you on the impact of those initiatives and what effect they have had on our efforts to keep families in their homes.

During the last 6 months, we have completed more than 91,000 home retention workouts, saving an average of more than 15,000 homes each month from foreclosure. That compares to an average of 6,700 home retention workouts during the first 9 months of 2007. In short, the pace of activity in the past 6 months is more than twice the pace of the first 3/4 of 2007. Just last month, we completed 16,500 home retention plans, a nearly 150 percent increase compared to March a year ago. Moreover, that increase was driven by an almost 600 percent jump in loan modification plans from 1,800 in March of 2007 to almost 13,000 last month.

Clearly, the efforts of our home retention team are paying off. Let me explain. Through October of last year, the average number of completed foreclosures each month had been steadily increasing over an extended period. However, since October, when we announced our new programs, the number of completed foreclosures has actually leveled off and has slightly declined. While it is too soon to tell if this 5-month period will become a long-term trend, we will continue to do all we can to help every borrower we can. We directly associate the dramatic increases in workouts with the leveling and declining of the foreclosure completions in our portfolio.

In addition to sharply increasing the pace of workout completions, we have also become more aggressive in the types of workout plans completed. During the last 6 months, loan modifications have become the predominant form of workout assistance at Countrywide, accounting for nearly 70 percent of all home retention workouts, while repayment plans accounted for less than 20 percent.

While previously rare, rate relief modifications now account for almost 43 percent of all loan modifications. The majority of these rate relief modifications have a duration of at least 5 years. They are targeted to borrowers experiencing payment difficulties caused by disruption of income or other financial stress as well as a result of rate resets.

We have also continued to expand our outreach initiatives and partnerships in order to ensure that every customer who needs help is reached. In addition to our NACA partnership, which we discussed with the committee last fall, we have strengthened our relations with NeighborWorks America, the Home Ownership Preservation Foundation, and the National Foundation for Credit Counseling. And in February 2008, Countrywide signed a national counseling partnership and best practices agreement with ACORN. Countrywide remains committed to helping our borrowers avoid foreclosure whenever they have a reasonable source of income and a desire to remain in the property. Foreclosure is always a last resort for Countrywide and the investors in the mortgage securities we service. I am happy to respond to your questions at the appropriate time.

[The prepared statement of Mr. Bailey can be found on page 77 of the appendix.]

Chairwoman WATERS. Thank you very much.

I thank you, Ms. Capito, for allowing Mr. Cleaver to ask his questions first. He has to leave for another meeting. Mr. Cleaver.

Mr. CLEAVER. Let me thank you, Madam Chairwoman, and the ranking member. I have another committee hearing. I apologize.

Mr. Deutsch, this is a general question. What is objectionable about the Chair's legislation? And say it in as few words as possible.

Mr. DEUTSCH. Sure. I think the bill has been characterized as servicers being required to engage in reasonable loan modification activity. I think we share that goal. There is no question about that.

Mr. CLEAVER. Okay. I have another committee hearing. Just tell me—

Mr. DEUTSCH. Sure. But what the bill does is define what is reasonable loan modification activity and then it goes into great specificity.

Mr. CLEAVER. Who should define that?

Mr. DEUTSCH. I think what is defined currently under the contractual arrangements is that either the holders of those mortgage notes, whether that is in a loan portfolio or whether that is in a securitization trust, is those servicers are acting on behalf of the holders of those mortgage notes.

Mr. CLEAVER. So you are saying, leave it like it is.

Mr. DEUTSCH. Correct.

Mr. CLEAVER. In spite of the fact that we have 20,000 foreclosures a week.

Mr. DEUTSCH. I believe there is a lot of—

Mr. CLEAVER. And we are having a negative impact on the world economy. And we are just going to continue the way things are going?

Mr. DEUTSCH. I believe there are a lot of solutions out there, and I believe the industry is working very hard on a number of different solutions. But this solution will restrict significantly the availability of credit on an ongoing forward basis.

Mr. CLEAVER. Just give me one of your solutions.

Mr. DEUTSCH. Well, I think the first one, as I mentioned in my testimony—

Mr. CLEAVER. That is the Chair's solution. That was the Chair's solution that you were getting ready to mention.

Mr. DEUTSCH. No. I was going to mention the solution that the ASF put out on December 6th, that would address any adjustable rate mortgages and any higher interest rate resets that those would address to be able to fast track or streamline those into loan modifications. Other areas that I might suggest would be FHA modernization, for Congress to complete the modernization of that Act. I would also suggest mortgage revenue bonds, that those be allowed to push through to allow more borrowers to be able to access affordable credit for refinancing.

Mr. CLEAVER. Okay. Some people suggest that we may end up with as many as 8 million foreclosures. What about those 8 million people?

Mr. DEUTSCH. Well, I think that is a very high estimate on the number of foreclosures.

Mr. CLEAVER. Okay, let's say there are 200. That means there are 200 human beings, families who no longer possess a home—200 humans.

Mr. DEUTSCH. Right.

Mr. CLEAVER. I would say we are actively pursuing as many—to prevent as many foreclosures as possible. But I would be remiss if I didn't say that not every foreclosure is preventable.

Mr. CLEAVER. You said—I am sorry?

Mr. DEUTSCH. I would be remiss in saying I didn't believe every foreclosure was preventible.

Mr. CLEAVER. Okay. I think everyone—well, I agree that they are not. Some people bought homes who shouldn't. But I don't know if you were here earlier when I talked about the fact that we are forced to deal with things the way they are.

Mr. DEUTSCH. Correct.

Mr. CLEAVER. And the way things are, we have millions of people who are going to lose their homes. Don't you agree?

Mr. DEUTSCH. I think there will be a significant number, as there historically has been a significant number of people who go through the foreclosure process.

Mr. CLEAVER. And what do we do about those people?

Mr. DEUTSCH. I think we continue working—to work with every one of those borrowers to be able to try to find a home—a sustainable solution for those homeowners to stay in their homes. But again, as we—

Mr. CLEAVER. Okay. Because time is running out, what do we do? If you are suggesting to me that I shouldn't support the Chair's bill, what should I do?

Mr. DEUTSCH. Right, well I just walked through a—

Mr. CLEAVER. I know you did. And I am asking you about the people whose homes are being foreclosed even as we speak. What do we do about them?

Mr. DEUTSCH. I think if a number of those initiatives were passed through the Congress, that many of those borrowers would be helped.

Mr. CLEAVER. If this bill is approved?

Mr. DEUTSCH. If many of the other things that I discussed were to pass, many of those borrowers would receive assistance.

Mr. CLEAVER. Have you made any attempt to work with the Chair and her staff about your recommendations?

Mr. DEUTSCH. Absolutely. I think there has been a lot of activity by the industry to work with the House Financial Services Committee generally on a number of these—on all of these issues.

Mr. CLEAVER. Yes. I have to go. You know, the frustration for me is that there does appear to be an absence of intentionality about dealing with people who are hurting. I mean, it seems as though many in your industry are interested in nothing that would regulate anything or anybody, which means that it can happen again. And it troubles me that we don't seem to have the anxiousness to help people who are losing their homes every day. I mean, we did not receive much outrage from the financial services industry when Bear Stearns was bailed out. The objection comes when we begin to deal with human beings, those human beings who live down the street from me on Gregory Boulevard in Kansas City. What about them? What do I tell them in my neighborhood meetings?

Mr. DEUTSCH. Well, Mr. Cleaver, my folks live in Kansas City, and I would be very concerned about any foreclosures in my folks' neighborhood in Kansas City. I believe it is very important that any and all foreclosures be addressed by servicers in the best way they can and to do—to engage in a reasonable loss mitigation. But I don't believe that those should be created and new standards and Federal duties of care should be created after the fact that would allow borrowers to potentially stay in their homes when they can't simply afford at any payment to stay in those homes.

Mr. CLEAVER. I am sorry. I have to go. Thank you.

Chairwoman WATERS. Mrs. Capito.

Mrs. CAPITO. Thank you, Madam Chairwoman. I thank the panel. I have a couple of questions. First, Mr. Bailey, in the panel before this one, there was quite a bit of conversation about servicers. And Countrywide is a major servicer of mortgages, yours and others, correct?

Mr. BAILEY. That is correct.

Mrs. CAPITO. The chairwoman made a statement or question that possibly servicers could make a profit from a foreclosure or profit by people going under. Could you respond to that statement and clarify that? Or your opinion on it?

Mr. BAILEY. Sure. I will make two points. The first one, I think Mr. Allnut touched on pretty clearly. The way that servicers make money, it starts with borrowers making payments. So if you don't have a borrower who makes a payment, you don't obtain any service fee. And as they went through, you don't obtain any income that continues through any sustainable time. If you just look at the general finances of foreclosure, whether it is your own loan and

portfolio or one that you are servicing for another, just the raw numbers, the credit loss that will be suffered through a foreclosure that is avoidable dramatically outweighs any kind of income that might come through a foreclosure, revenue of any kind. But in general, the fees and the compensation to a servicer and when payments are not flowing from a customer. So there is no general incentive to do that.

Mrs. CAPITO. Thank you. So it would be an accurate statement to say that that if a person is delinquent or if a loan is going bad or a mortgage is going bad, that is really not to anybody's advantage, certainly not to families and the individuals that we are all trying to keep in their homes. But you don't see that as a profit-making venture?

Mr. BAILEY. Well, again first, it leads to a credit loss for someone, either if you hold it in your portfolio or whoever you are servicing for. That credit loss will be significant. Any short-term thinking that there would be some kind of desire or incentive to pursue a foreclosure when a workout was available, there isn't any income from that. So you don't get any payments, you don't get any reimbursement. But you do build costs and those costs then are not reimbursed. You also are advancing payments to the investor generally. If you make significant errors in loss mitigation, you risk having your servicing pulled, your risk not being reimbursed for your advances. You risk punitive damages, depending on what the contract says. There is no incentive to stop the stream of income.

Mrs. CAPITO. Okay. Thank you. Ms. Schwartz, quickly, on wonderful statistics on what you are all doing with the HOPE NOW Alliance, I have referred a lot of people and try to talk about it publicly quite a bit. When you are working on a workout or trying to help somebody, how do you get to the point that, this is a person who has lost a job or is having a tough time or they are in an adjustable mortgage and they can no longer make the payments, how can you differentiate that person from the person who maybe bought a house knowing that they weren't ever going to be able to fulfill their commitment, but were relying on the real estate going up, or this was their second home, or they got a higher appraisal, took the money, and bought a boat.

Well, these are the kind of people that I think taxpayers don't want to see—well, there are two different types of folks there. How do you differentiate that?

Ms. SCHWARTZ. Well, first of all, the HOPE NOW Alliance is just an aggregation of all these servicers and the contracts are with the servicers and the borrowers. And between them one by one.

Mrs. CAPITO. How would you help them differentiate?

Ms. SCHWARTZ. Typically, and why we are tracking repayment plans and modifications is that repayment plans might be for a temporary or short-term disruption, whether it is 3 months, 1 year, something has happened or changed in the borrower's circumstance versus when a modification occurs, it could be at a higher rate. They can't afford the higher rate, and it is clear. That is an affordability issue. That is more than a short-term disruption. And you may see some appropriate modifications happening in those circumstances. So the workouts, as Tom Deutsch spoke to, are on behalf of investors. And everyone's interests are quite aligned right

now in that the best thing to do is work through avoiding foreclosure and keeping people in their homes. And we are outpacing foreclosures through these workouts, whether they are repayment plans or modifications. And it is loan level and I don't speak for all the servicers, and that is very individual with the contracts.

Mrs. CAPITO. Right. Okay. Thank you. And Mr. Kittle, next week, the committee will be considering legislation that provides a mechanism for lenders to write down problem loans and refinance and do a FHA loan. Are you familiar with that proposal? And could you make a comment on that?

Mr. KITTLE. Excuse me. FHA Secure, FHA modernization?

Mrs. CAPITO. Yes.

Mr. KITTLE. We think it is an excellent program. We actually have—to go just slightly on a tangent—we have over 200 individual members in Washington, D.C., today and tomorrow who will be on Capitol Hill promoting Chairwoman Waters' FHA modernization bill. So we have something here that we can agree on, something that we can support. And we think FHA modernization, GSE reform, FHA Secure, all of those programs will go a long way toward helping us. But it will help long term, not provide a quick short fix.

Mrs. CAPITO. All right. Thank you.

Chairwoman WATERS. Thank you very much. Let me just take a few minutes here to raise some questions.

I think it was Mr. Kittle who just said—are you supporting the Barney Frank draft bill that would do a couple of things, it would support FHA being able to refinance when there has been a write-down on a mortgage? I think it is about 85 percent and it would also appropriate maybe up to $15 billion that would go to cities and maybe counties and States in order to assist in purchasing foreclosed properties, rehabbing them and putting them back on the market. Have you taken a look at that?

Mr. KITTLE. Yes, ma'am. And we are still considering that. We have not come out with a position on it but we worked very closely with Congressman Frank over the years and have a great relationship with him.

Chairwoman WATERS. So you are not supporting the bill as of now?

Mr. KITTLE. We have not come to an opinion either pro or con for it.

Chairwoman WATERS. Ms. Schwartz.

Ms. SCHWARTZ. Yes.

Chairwoman WATERS. Did I hear you in your testimony say you sent out 1.2 million notices or alerts of some kind?

Ms. SCHWARTZ. The servicers agreed under HOPE NOW letterhead to send out to at-risk borrowers whom they have not been able to contact, 60 days or later in delinquency, the no-contact borrowers, and we sent in 4 months 1.2 million letters to those borrowers at risk of foreclosure, yes.

Chairwoman WATERS. And that is the same number of borrowers that you have been able to help, 1.2 million?

Ms. SCHWARTZ. Yes. In aggregate. And what we are measuring that is from July through February, just to get a snapshot of where the market was and where it is today and what is moving through

the loss mitigation. So those are additional at-risk borrowers who could be going into foreclosure.

Chairwoman WATERS. Let me see if I understand how you work. We have an alliance of the financial services industry, which includes some nonprofits, banks, securitizers, everybody. And do you think you are doing an adequate job without any government support or intervention?

Ms. SCHWARTZ. I think for an industry alliance that has come together—

Chairwoman WATERS. No, no, no. Do you?

Ms. SCHWARTZ. Yes. I think we are doing adequately. Can we do better? Sure, we can.

Chairwoman WATERS. You don't think the government needs to do more? Like Mr. Frank's bill that would get these properties rehabbed and back on the market, helping to stabilize the market with the support of government, you don't think you need that?

Ms. SCHWARTZ. You know what, I actually don't comment on any of the legislation because I represent a very broad variety of people. And what I do, my job is to keep HOPE NOW focused on what we can do today with today's laws.

Chairwoman WATERS. Well, every day—I don't know what the numbers are. I wish someone would tell me. Every day we are getting information about increased numbers of foreclosures. It seems there is no end in sight. And you think you are handling that well enough and the American people should be appreciative and understanding of that because you are doing a great job?

Ms. SCHWARTZ. Actually, in our testimony, I was quite clear that this is not a silver bullet. This is about people coming together and seeing what we can do to do better and to raise standards and bring more focus on the contacting borrowers who are not calling the servicers, working with housing counselors who will help—

Chairwoman WATERS. Where do you get your numbers from about how many people you have served? Some of the organizations that you have worked with, you have asked them, some of the nonprofits, others you have asked them, how many, what did you do? How do you compile that?

Ms. SCHWARTZ. The actual loss mitigation data is from the HOPE NOW servicers, which comprises the majority of the mortgage market. This is the most comprehensive set of mortgage industry data in loss mitigation that is available. And it is a voluntary alliance and I see it in aggregate. It is released monthly, and we will have State and national data. I am happy to walk through that any time with you.

Chairwoman WATERS. Well, I am not so sure I want to do that because it is not audited information. I mean, I have asked some of our regulators: How do you know what HOPE NOW is doing? How do you document that? How do you audit that? Nobody is able to tell me how it is done. And I am getting some disjointed information about how you collect the information. First of all, you are telling me that you basically get it from the servicers—

Ms. SCHWARTZ. Yes.

Chairwoman WATERS. —who tell you what they are doing, and from others?

Ms. SCHWARTZ. From their servicing system.

Chairwoman WATERS. A combination of the counseling and the modifications that have been done by some of the nonprofits and the workouts and modifications that are being done by the servicers.

Ms. SCHWARTZ. Right.

Chairwoman WATERS. This is where you are compiling this information.

Ms. SCHWARTZ. That is right.

Chairwoman WATERS. All right. Let me go over something. You state that 5,607 of 80,652 subprime ARMs rescheduled to reset in January or February are not paid in full through refinancing or sale received loan modifications, and 60 percent or 3,334 of them received modifications for 5 years or longer. And I guess I have two questions. First, do you think that a rate of long-term—of long-term loan modifications of subprime ARMs of 4 percent, 3,334 out of 80,652 is sufficient to stem the tide of foreclosures?

Ms. SCHWARTZ. Well, those numbers, Chairwoman Waters, are because the rate environment has decreased, and that was based on the streamlined modifications that Tom Deutsch has testified to. We can do more, and we want to do more. But we are trying to report every month no matter what the data says. So whether we will be disappointed or not disappointed, we are going to report the actual data. So we inform the public and inform Congress and everyone what is going on in the market. I think that is additive. I think 5,000 borrowers who get a modification is better than no borrowers getting one under those circumstances. And more importantly, we showed in January and February that modifications and repayment plans exceeded 300,000 loans for prime and nonprime borrowers.

Chairwoman WATERS. Let me stick with the ARMs that I am talking about. What evidence do you have that the remaining 77,318 resetting ARMs, which presumably are subject to repayment plans, some other loss mitigation offer, or nothing at all, are affordable for the short and long term for the borrowers?

Ms. SCHWARTZ. Well, all of the repayment plans or the modifications are presumed to be affordable because it is between the borrower and the servicer and they are reworking loans so that they are sustainable. It is in no one's interest to have a redefaulting modified loan or a short-term repayment plan for servicers. It is a high cost to keep going back time and time again, and they will go back if it redefaults to look at another solution. But it is in no one's interest to the first time have no one get it right.

Chairwoman WATERS. Let me go to Countrywide and ask you, you heard a description from Freddie Mac about its servicing arrangements that they have with you. And they talked about the tiered system. Are you familiar with that?

Mr. BAILEY. Yes.

Chairwoman WATERS. And how many tiers are there in the contract?

Mr. BAILEY. There are four possible tier rankings.

Chairwoman WATERS. Describe those tier arrangements for us.

Mr. BAILEY. Well, they are generally set off of points that you receive for different levels of effectiveness within a range of different servicing functions. So you receive points for or points against,

based on your performance in those different categories. And then depending on how many points you receive, it stacks up to which tier you would achieve.

Chairwoman WATERS. Okay. What do you receive points for?

Mr. BAILEY. Things like doing effective workouts, staying effective in the foreclosure process, reporting, things of that nature.

Chairwoman WATERS. What you have is a tiered system. And I can't tell from talking with you right now what the incentives or disincentives really are. But you get some points. And if you are high up in the system, the tiered system, you get points. You get a certain number of points. But if you are low in the system and you are not getting the points, let's say, that means you are not doing a good job, whatever a good job is, but the people whom you service don't know whether or not you are good, bad, or indifferent. But those people just get bad services. Those people don't get fired, they don't get the contract separated. You just go and work with them and try and make them better. Is that what you do?

Mr. BAILEY. What Freddie Mac would do with us or any servicer, first the incentive reimbursement that you would get, for example, for doing workouts, if you were the top tier, you would get the full reimbursement—

Chairwoman WATERS. Are you getting paid because you have stopped the foreclosure?

Mr. BAILEY. Yes. Essentially if you do effective servicing, Freddie Mac, you are entitled to those incentives.

Chairwoman WATERS. No. No. That is not my question. My question is, are you getting paid because you have stopped a foreclosure? Or are you getting paid because the criteria that is evaluated shows that you did a good job, whether you stopped the foreclosure or not?

Mr. BAILEY. No. One of the key measurements in stopping foreclosures is performing loan workouts compared to the foreclosures that proceed.

Chairwoman WATERS. Are these tiers spelled out in the contract?

Mr. BAILEY. Yes. They are clear.

Chairwoman WATERS. Okay. I would like to request from you copies of the contracts that you do with Freddie and Fannie.

Mr. BAILEY. Sure.

Chairwoman WATERS. And they should be one and the same. I think I have one more question that I would like to—well, I won't raise a question at this time. We have other members who need to ask questions. Mr. Green.

Mr. GREEN. Thank you, Madam Chairwoman. Let me go quickly to Mr. Deutsch. Am I pronouncing that correctly, sir?

Mr. DEUTSCH. Correct.

Mr. GREEN. It is good to see you again. We were together in California. You talked about the 3/27s and 2/28s, and you mentioned LIBOR and how under the current conditions with LIBOR having declined to the extent that it has, this means that when the ARMs adjust, people will be paying something lower than they actually are paying currently. And you seem to indicate that this will act as a means by which the mitigation that we are looking for will take place and hence, things are getting better and there is no need to do more.

My concern with your perception is this—the 3/27s and 2/28s don't end right away. We are talking about 27 additional years of adjustable rates or 28 additional years of adjustable rates. And as a result, if we don't do something now when these loans can adjust and have them refinanced into a fixed rate, all we do is say, you are really doing well now, but 2 years from now, you could very well be paying twice the rate that you are paying currently. Do you agree?

Mr. DEUTSCH. I agree. And that is why I would say that right now, the American Securitization Forum is working feverishly to put together a proposal where our framework would be extended to where not only would existing rates but if LIBOR rates were to rise again on subsequent rates—

Mr. GREEN. Well, I am glad you said that because you left the impression with me and I suspect many others that because of the current conditions, the 3/27s and 2/28s were going to be okay. They are really not okay. And we agree that they are not okay. There is still a problem there. All right. You and I are familiar with the term tranche warfare, aren't we?

Mr. DEUTSCH. Correct.

Mr. GREEN. And you and I agree that in tranche warfare, we have some people who have positions that are superior to others.

Mr. DEUTSCH. Correct.

Mr. GREEN. And those people who have positions that are superior to others, there are some who literally don't take the same—to use some highly technical terminology, the same hit that others will take if foreclosure takes place.

Mr. DEUTSCH. Correct.

Mr. GREEN. And when this occurs, then you have the tranche warfare which means you have people in different tranches who are at odds with each other.

Mr. DEUTSCH. Correct.

Mr. GREEN. And some will say, I am really not eager to see you do anything to adjust the loan such that it impacts my position because I paid more money to have a superior position. And if it goes to foreclosure, I really don't want to see that happen. I love everybody. But I have already taken care of that by locating myself in a superior tranche. True?

Mr. DEUTSCH. Is that a question?

Mr. GREEN. Yes. Isn't that true? Because you are in a superior tranche, you may not be—you can withstand foreclosure to a greater extent than a person in an inferior tranche.

Mr. DEUTSCH. I think the general characterization is accurate. I would say there are two things that are different from that characterization, though. I think one is that a servicer who is acting on behalf of all of the security holders is making that decision, and they are doing that in the best interest of all the security holders. I think secondly, most of the loss triggers have been breached at this point. So it is irrelevant as to whether you would foreclose or not. The people in the lower tranches effectively will have nothing.

Mr. GREEN. Exactly. But the people in the superior tranches still have a vested interest.

Mr. DEUTSCH. I would disagree.

Mr. GREEN. You are saying people in the superior tranches don't have a vested interest?

Mr. DEUTSCH. I would say the lower-rate tranches—

Mr. GREEN. Vested interest is the operative phrase.

Mr. DEUTSCH. The lowered rate of tranches at this point has been extinguished. So there is no tranche warfare between somebody whose interest has been extinguished—

Mr. GREEN. You are saying that there is no tranche warfare because you don't have two—

Mr. DEUTSCH. You don't have two people fighting. You have one person left.

Mr. GREEN. I agree. Let me go on quickly. And in that sense, yes. But in the sense that the person who still remains has an interest. Do you agree with that?

Mr. DEUTSCH. The person who remains has a very strong interest at avoiding foreclosure.

Mr. GREEN. Strong interest at avoiding foreclosure. But if that foreclosure takes place, that person still has some benefit from the foreclosure, some benefit not 100 percent of what the person may have had invested.

Mr. DEUTSCH. They will still receive some proceeds but they are a lot lower proceeds than the loan would perform.

Mr. GREEN. Okay. Let me go quickly now to another point. With reference to ex post facto regulation, Mr.—is it Bailey?

Mr. BAILEY. Yes.

Mr. GREEN. Mr. Bailey, you oppose ex post facto regulation, right? Ex post facto, meaning after the fact regulation.

Mr. BAILEY. Yes.

Mr. GREEN. Okay. Just for edification purposes, would you oppose—you opposed it because you don't want to infringe on contracts that are already made, right?

Mr. BAILEY. It would make it difficult to enforce.

Mr. GREEN. Well, just for edification purposes, what about regulation that is not ex post facto? Do you oppose that as well?

Mr. BAILEY. I don't mean to run on. I will say no, I don't. But I would back up. Regulation—

Mr. GREEN. I only have a little bit of time. Ex post facto, you oppose. But if it is not ex post facto, you may be able to live with some kind of regulation if it is not ex post facto.

Mr. BAILEY. Yes, absolutely.

Mr. GREEN. Mr. Deutsch, you would be able to live with some kind of regulation that is not ex post facto?

Mr. DEUTSCH. I would agree if, on a going forward basis, you look at something and it makes sense.

Mr. GREEN. Madam Chairwoman, may I ask one more question?

Chairwoman WATERS. Quickly.

Mr. GREEN. To Countrywide, quickly, I want to ask you, in your servicing portfolio, what percentage of it emanates from GSEs?

Mr. BAILEY. If I combine GSEs, FHA, VA, and prime—

Mr. GREEN. I want GSE segregated along with the FHA and put them in one lump in the VA and then the others.

Mr. BAILEY. Okay. Well, are you trying to get after what is subprime?

Mr. GREEN. Yes.

Mr. BAILEY. Okay. Subprime makes up about 8 percent of our portfolio.

Mr. GREEN. 8 percent. That 8 percent is not performing as well as the FHA and those that are through the GSEs, is that correct?

Mr. BAILEY. Correct.

Mr. GREEN. Okay. And sometimes when we talk about these things, we tend to confuse these with our questions and our answers, which causes us to have a convoluted opinion as to what is really happening in your portfolio. True?

Mr. BAILEY. True.

Mr. GREEN. Okay. Thank you.

Chairwoman WATERS. Thank you very much.

Mr. GREEN. I yield back.

Chairwoman WATERS. Mr. Ellison.

Mr. ELLISON. We are under a time constraint, so I am just going to go quickly.

Ms. Schwartz, a few questions about HOPE NOW. HOPE NOW data reveals that about 1.8 million loans were delinquent by about 60 days or more during the first 2 months of 2008, and about 346,000 went into foreclosure. However, only about 114,000 received modifications. That means that more than 3 times as many borrowers entered foreclosure as received loan modifications. Further, HOPE NOW projects that more than 2 million loans are estimated to enter foreclosure in 2008, up 37 percent from 2007. Does this not suggest to you that the Administration's programs designed to address this crisis are just dwarfed by the sheer magnitude of it?

Ms. SCHWARTZ. We are clearly in a crisis, and there is a magnitude of housing issues to address. I would like to clarify two things. I think you are confusing foreclosure starts with actual foreclosures. Less than 50 percent of loans that go to foreclosure starts go into foreclosure and foreclosure sale, so actual workouts exceed foreclosures monthly. And certainly, year-to-date, that is the case.

While the Administration, Secretary Paulson, and the Secretary of HUD strongly urged the industry to get together, I would like to comment that this is—there is no money from the government in this. This is everyone coming together. We do have industry trade groups coming together. We have disparate interests who seemingly didn't always talk, talking together. We have workshops with nonprofit counselors.

Mr. ELLISON. On that score, can you share data or provide data on who is paying for the services provided by HOPE NOW? Is that published data?

Ms. SCHWARTZ. No. The only collections for HOPE NOW is from the servicers, and it is a very lean overhead. There are only three of us on payroll. This is all a voluntary effort.

Mr. ELLISON. I know that. So who are the three servicers?

Ms. SCHWARTZ. No. All servicers pay a nominal fee really to make sure that we have someone who is helping coordinate the effort. All of the committee work, all of the heavy-duty resources comes from the industry, across the industry to chair the committees, et cetera, to keep us moving in the same direction. It is not a—

Mr. ELLISON. I guess my question is that, so—

Ms. SCHWARTZ. I would like to add, servicers also do pay for counseling sessions, and we are working with the investor market to also invent a new model to pay for servicing in the market in addition to the government funding that is coming.

Mr. ELLISON. I am just asking, do you have a list of which servicers and how much they contribute?

Ms. SCHWARTZ. I have a list of servicers, and the—

Mr. ELLISON. That is fine. Could you share that with us?

Ms. SCHWARTZ. 27 servicers.

Mr. ELLISON. We will get together and get that then.

Ms. SCHWARTZ. Okay.

Mr. ELLISON. And then my last question before we have to run is, in your recent press release, you indicated that 1.2 million loan workouts have been completed by HOPE NOW servicers since July 2007.

Ms. SCHWARTZ. Right.

Mr. ELLISON. How many of these workouts were permanent loan modifications?

Ms. SCHWARTZ. You know, I don't have that data. But of a recent survey on the 2/28, 3/27 ARMs from February backwards, we requested that servicers tell us how many of those were 5 years or greater, and we did get over 60 percent in that number. But just a point to make on that, whether it is 2 years, 3 years, or 5 years, if that has taken a pause in foreclosure, has adjusted somewhere someone has been in foreclosure and now is in a modification, a servicer can go back and will go back if circumstances need to, to go and work with that borrower 2 years later if need be.

Mr. ELLISON. Are you willing to provide me with the information on how many were permanent loan modifications?

Ms. SCHWARTZ. As I said, the answer I have is 60 percent or greater of the survey I took where I have no loan level data on that.

Mr. ELLISON. Okay, well, we have 3 minutes to go vote, so I am going to submit some written questions to you. And Madam Chairwoman, can I count on some responses?

Chairwoman WATERS. Oh, yes. We have questions that certainly are going to submitted, and we will get those responses.

Mr. ELLISON. All right. I thank all the panelists. I had questions for everybody, but time ran short.

Chairwoman WATERS. Thank you very much. I have just one question: Is there a fee for modification or workout to the borrower? From anybody? Servicers?

Mr. BAILEY. No. Especially in subprime, there is no modification—

Chairwoman WATERS. No. Don't parse it. Is there a fee for modification to workout?

Mr. BAILEY. There can be a fee in some investors, yes.

Chairwoman WATERS. Thank you very much. Let me just thank all of you for your testimony. We are learning a lot. We have a lot more questions, so we will continue to have more hearings.

The Chair notes that some Members may have additional questions for this panel which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days

for members to submit written questions to these witnesses and to place their responses in the record.

I thank you. The panel is dismissed.

But before we adjourn, without objection, the following written submissions will be made a part of the record of this hearing: A letter of support for H.R. 5679 from various consumer law, civil law, and other organizations; a statement from the American Bankers Association; a statement from Professor Kate Porter, University of Iowa; and a statement from the National Alliance of Community Economic Development Associations.

We will have staff provide those submissions. Thank you very much. The hearing is adjourned.

[Whereupon, at 2:28 p.m., the hearing was adjourned.]

A P P E N D I X

April 16, 2008

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Financial Services Committee
Hearing "H.R. 5679, The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008"
Opening Statement for Congressman André Carson
April 16, 2008

Thank you, Chairwoman Waters and Ranking Member Capito for holding this hearing today on loss mitigation efforts. I would like to commend the work of this subcommittee in trying to help Americans maintain and secure affordable, safe and stable housing. The legislation at hand today continues that crucial effort by helping at risk borrowers connect with their servicers to reach a mutually beneficial agreement when a loan is in danger of foreclosure.

The Foreclosure Prevention and Sound Mortgage Servicing Act bill addresses the lack of constructive communication between servicers and borrowers; a major problem for my constituents in the 7th Congressional District of Indiana. The bill requires servicers to provide borrowers with timely, accurate information when requested. Further, it prohibits the initiation of a foreclosure if a servicer has not engaged in reasonable loss mitigation efforts.

As you know, Indiana consistently ranks among the top ten states in foreclosure starts. There are about 17,000 foreclosed properties in Indianapolis and over 7,300 in the preforeclosure phase.

I am encouraged that this committee has chosen to move forward H.R. 5679 which would help many in the preforeclosure phase by requiring servicers to forward borrowers contact information to a HUD certified housing counselor if a loan payment is 60 days overdue. That counselor could then help those individuals at risk of foreclosure refinance to safer loans with far stronger underwriting standards.

I would also like to highlight the success of Fannie Mae's HomeStay program which seeks to help borrowers work out their loans or refinance into more stable loan agreements. In my district alone, the program has helped work out 114 loans which totals more than $13 million. Fannie Mae has done a model job of loss mitigation loan workouts through refinancing, and by increasing incentive fees to work out loans and refer borrowers to counseling.

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I look forward to the hearing the testimony today and to continue working with this committee on responsible and thoughtful housing legislation.

Testimony of Jason Allnutt
Vice President for Credit Loss Management, Fannie Mae

Before the House Subcommittee on Housing and Community Opportunity
Hearing on "H.R. 5679, The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008"

April 16, 2008
Washington, D.C.

Chairwoman Waters, Ranking Member Capito and members of the committee, I appreciate the opportunity to be here today to describe Fannie Mae's foreclosure prevention practices. I will also share with you our view on how loan servicing practices can best be directed to reducing foreclosures that are damaging families, neighborhoods and local economies across the country.

I will begin my testimony with a somewhat detailed discussion of Fannie Mae's loss mitigation and foreclosure prevention practices. As I do, I will address the specific issues you've asked me to testify about, and hopefully explain the underlying business philosophy behind our loss mitigation strategies.

Fannie Mae has been investing in mortgage credit for 70 years, through multiple up and down housing cycles, and the collective knowledge and expertise from those many decades are reflected in our loss mitigation practices. Underlying all our efforts in this area is a simple principle: As a holder of mortgage credit risk, our interests are in fact closely aligned with the borrower's.

When a borrower runs into a period of financial difficulty, allowing the borrower to keep their home while they work through the difficulty is, in almost all cases, the best possible outcome — both for the borrower and for Fannie Mae. When that outcome is not achievable, our goal remains to prevent a formal foreclosure, which is usually the worst outcome for the borrower and for the well-being of the surrounding community. Our foreclosure prevention practices are not only good business practice, but we believe they align very closely with the mission embodied in our Congressional Charter to be a stabilizing force for housing.

Our loss mitigation efforts are undertaken in close partnership with our loan servicers, who have the most direct and meaningful contact with borrowers having difficulty making their monthly payments. I'd like to outline the way in which our servicing relationships operate, and how our policies and tactics around foreclosure prevention are working today.

First, Fannie Mae continuously monitors and measures servicer loss mitigation activity. For Fannie Mae, that means granting servicers as much leeway as possible to prevent a foreclosure, while at the same time monitoring and rewarding their activities to make sure foreclosure prevention is occurring in accordance with our policies.

To accomplish this, we lay out the results we want and then work with servicers to come up with the best possible tactics to achieve them. For our purposes, we do not require a standard software solution for workout. Rather, Fannie Mae leverages a combination of monthly servicer score cards and on-the-ground presence to ensure foreclosure prevention performance and compliance.

Fannie Mae staff routinely visits the offices of our largest servicers, who together handle more than 80 percent of our loan portfolio, to be on site to make sure they are following best practices in foreclosure prevention. When they don't, we require changes. For instance, in nearly all cases our servicers have added staff and increased service levels in response to our requests. When servicers are not performing at the level Fannie Mae expects, we will remove their delegated foreclosure authority until their loss mitigation practices improve.

Our policies are broadly outlined in our Servicing Guide, which delegates a large portion of the decision-making to servicers themselves. But the Guide is only part of the story. We can and do work with servicers every day to work through problem loans that fall outside our guidelines. Results are what we are after, not just following a guidebook. And we measure results, not just compliance with the guide.

Our close monitoring of servicers, setting targets for their results, and the regular feedback we receive from them, has led to some important changes in our policies. For instance, since the market turmoil began last summer, servicers have requested 18 operational changes, including enhanced authorities, to resolve problem loans without prior approval from Fannie Mae. We have granted all 18. These changes have helped streamline the process and empowered servicers to resolve problems more quickly.

Second, we offer cash incentives to servicers to pursue alternatives to foreclosure. We also pay foreclosure and bankruptcy attorneys to reach out directly to delinquent borrowers. As many have reported, borrowers don't necessarily respond to letters from a servicer, but may respond to a letter from an attorney. And we pay the attorney to prevent foreclosures, not just conduct them.

Third, we pursue a variety of ways to work with a delinquent borrower to prevent a foreclosure. Broadly, they are:

1. A loan modification, where terms of the loan are renegotiated to lower the interest rate, convert an adjustable rate into a fixed rate, or extend the life of the loan, for example.
2. A repayment plan, where a borrower makes up the past-due payments over time, usually less than 12 months.
3. A forbearance, in which we agree to reduce or suspend loan payments for a period of time.
4. A pre-foreclosure or "short" sale. Here, a servicer works with a borrower to sell the home and use the proceeds to pay off the loan, even if the proceeds are not

enough to settle the entire balance. We have begun revamping our delegations to servicers that will allow them to conduct more short-sales.

5. A deed-in-lieu of foreclosure, where a borrower signs over title to the property to Fannie Mae without the expense of a foreclosure.

At Fannie Mae, we have recently introduced a sixth option, which we call HomeSaver Advance™. It offers borrowers experiencing a temporary financial hardship an advance of past-due mortgage payments in exchange for a separate, unsecured loan.

Each one of these options has advantages and disadvantages. All are analyzed against individual borrower willingness and ability to pay.

As noted in our annual report for 2007, Fannie Mae worked out more than 37,000 troubled loans last year. The majority, or about 70 percent, was loan modifications. Of these loan modifications, five-and-a-half percent consisted of changes that reduced an interest rate for a period of time that typically expires when a borrower can resume paying market-rate interest.

About 21 percent of our loan workouts were repayment plans, about 7 percent were short sales, and about 2 percent were deeds-in-lieu of foreclosure. As you can see from these statistics, our most widely used and effective means of loss mitigation is an actual modification of the terms of the loan.

The choices we make with our servicers and borrowers on the types of loan workout options we pursue are designed for the best long-term outcome. In other words, they are not designed to "kick the problem down the road." In fact, of the modifications, forbearances and repayment plans we made between 2001 and 2005, about 60 percent remained current or were repaid two years after they were done. Historically, only 9 percent of our workouts ultimately go into foreclosure.

The affordability standard we use when doing a loan workout is fairly straightforward. Our servicing guidance allow servicers to create an affordable plan whereby a borrower is required to have at least a $200 residual after projected monthly expenses are subtracted from projected income. The reworked loan needs to be sustainable, and it must allow for unexpected household expenses — a broken water heater is generally the term we use. The final outcome must meet a basic test: Can the borrower sustain the payments over the long term.

We believe our affordability standard provides the best framework for underwriting newly reworked loans. As I said, only 9 percent of loans that we work out go to foreclosure after two years. The Veterans Administration loan standards in this area are indeed different from Fannie Mae's. For instance, we believe the VA's debt-to-income test, while an acceptable underwriting standard, is unnecessarily restrictive for a loss mitigation framework. And its residual income requirement is too broad to allow for flexible loss mitigation, in that it does not allow a servicer to craft individual solutions for individual borrowers.

As I said in my opening, these loss mitigation practices reflect the long experience we have in preventing foreclosure. But they also are a reflection of the long-standing underwriting practices of Fannie Mae and the basic safety and sustainability of our loans. The vast majority of our business — close to 90 percent of our entire single-family mortgage book — is made up of prime, fixed-rate mortgages with strong credit scores and plenty of borrower equity.

Overwhelmingly, when our borrowers run into trouble, it is not a function of the loan they received. It is instead a temporary life event or hardship, such as a divorce, the loss of a job or a medical condition. Our loss mitigation practices are designed to help borrowers with those temporary hardships, and our experience has proven very effective.

However, as you know and as has been widely reported, foreclosures are a growing problem in regions of the country experiencing job losses and economic downturn. Fannie Mae is not immune from these trends. The number of properties acquired through foreclosure increased 34 percent in 2007 to more than 49,000. The properties were concentrated in the upper Midwest, particularly Michigan, Indiana and Ohio. We also saw a significant increase in foreclosures in regions where home prices are declining substantially, especially in California, Florida, Nevada and Arizona. Given the delinquency trends in our book, which are rising, we expect foreclosures to increase again this year. These foreclosures were not only a terrible outcome for borrowers in these states; they were a major driver of Fannie Mae's $2.1 billion net loss in 2007.

It is a key priority for Fannie Mae to reduce foreclosures, which is one reason why we have given more than $9 million to not-for-profit, independent counseling agencies to assist at-risk borrowers. It's also why last year we funded more than $13 billion in prime loans to refinance subprime loans to nearly 68,000 borrowers under our HomeStay™ initiative.

Before I close, I'd like to offer a few points on the legislation currently under consideration by this committee, specifically H.R. 5679. We share Congress's concern that the tide of troubled loans has made it more difficult for servicers to address the growing need of borrowers who want foreclosure alternatives.

My view on legislative remedies to this problem is informed by my own experience at Fannie Mae. We have dedicated the time, people and resources needed to work through tens of thousands of problem loans since the market turmoil began last year. As I said, we have an incentive to achieve the best possible outcome for a borrower in as little time as possible, and we enforce servicing practices geared toward that outcome. This involves active outreach to borrowers, making sure they have independent counselors available to them, and then making sure our servicers have all the tools necessary to prevent a foreclosure if a borrower is willing and able to stay in the home.

Loans are made one at a time, and loss mitigation happens one loan at a time. Creating a legislative standard for loss mitigation activities prior to a foreclosure may actually have

the unwanted side effect of making solid loss mitigation activities, negotiated between a borrower and a servicer, less flexible. It would create an added cost on an already expensive process, and ultimately, we believe, make home mortgages more expensive.

I want to thank the committee again for inviting me here today. Foreclosure prevention is a key focus of our company, and we continue to seek out and implement new ways to keep troubled borrowers in their homes while the housing downturn plays out. I look forward to working with this committee and Congress as it seeks long-term solutions to prevent more foreclosures, stabilize the housing market, and promote sustainable homeownership. With that, I'd be happy to answer any questions the committee has about our loss mitigation activities and practices.

Thank you.

TESTIMONY OF

STEVE BAILEY

CHIEF EXECUTIVE FOR LOAN ADMINISTRATION

COUNTRYWIDE FINANCIAL CORPORATION

Before the

HOUSE FINANCIAL SERVICES COMMITTEE

SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

UNITED STATES HOUSE OF REPRESENTATIVES

APRIL 16, 2008

Good morning, Madam Chairman, Ranking Member Capito and Subcommittee Members. Thank you for the opportunity to appear here today to discuss the efforts of servicers like Countrywide to help families prevent avoidable foreclosures. Countrywide has long been a leader in providing loss mitigation services to investors and home retention solutions to our borrowers. Last November, we testified before the House Financial Services Committee and before a Housing Subcommittee field hearing. At that time we had just announced our $16 billion home retention commitment – a strategy designed to help 82,000 subprime hybrid ARM borrowers find refinance and loan modification options. We had also recently announced our groundbreaking agreement with NACA, and the work of the HOPE NOW alliance had just begun in earnest. Not quite five months later, I can report that – as a result of these initiatives and other new ones – the number of families receiving loan modifications and home retention workouts has picked up dramatically.

As the oversight work of this Committee has demonstrated over the past several months, today's market conditions have created unprecedented challenges for servicers and mortgage investors to develop new approaches to mitigating losses for security holders, while keeping as many borrowers in their homes as possible. This is a delicate balancing act. Servicers have contractual, fiduciary obligations to take actions which will maximize the return to the security holders. Sometimes, that requires a servicer to pursue a foreclosure action. At the same time, we recognize that foreclosures are financially and emotionally damaging to our customers and very costly to us and the security holders. Because of the high financial costs of foreclosure to security holders and servicers, we cannot emphasize enough that – as a matter of basic mortgage servicing economics – foreclosure is always and absolutely the last resort.

But I would be remiss if I did not also emphasize that the 3700 home retention personnel that report to me fully comprehend the human implications of foreclosure, and are committed to doing all they can to help families keep their homes whenever possible. I know from personal experience that it is euphoric to tell a customer that you have a plan for them to save their home. It is equally heartbreaking to tell a borrower that they may lose their home. While it is human nature to want to find a way to say "yes," especially when it means keeping a family in their

home, we also provide our employees the training and the tools needed to be successful as often as possible.

The recent sharp rise in mortgage delinquencies and foreclosures is challenging mortgage servicers and investors as never before. By August 2007, as credit markets collapsed and home price depreciation accelerated, the pace of delinquencies and foreclosures increased beyond expectations. It became clear that new tools were needed to help borrowers avoid foreclosure and to help investors mitigate losses.

What began with the Dodd Summit in May 2007 became a concerted industry, investor and governmental effort to develop new approaches, clarify legal standards, and remove barriers to more effective home retention strategies. The work of this Committee, the Senate Banking Committee, the federal banking agencies and the servicer and investor members of the HOPE NOW alliance has created the conditions that have allowed Countrywide and the industry to sharply increase the volume and the pace of home retention activities.

Recap of Prior Initiatives

When we testified before the House Financial Services Committee in early November, 2007, Countrywide had just announced a $16 billion home retention initiative to help subprime hybrid ARM borrowers refinance into fixed-rate loans or obtain a loan modification. For that campaign, we deployed dedicated teams to contact by mail and by phone subprime customers who are approaching or have just had a rate reset to determine their financial circumstances and to inform them about refinancing and other home preservation options.

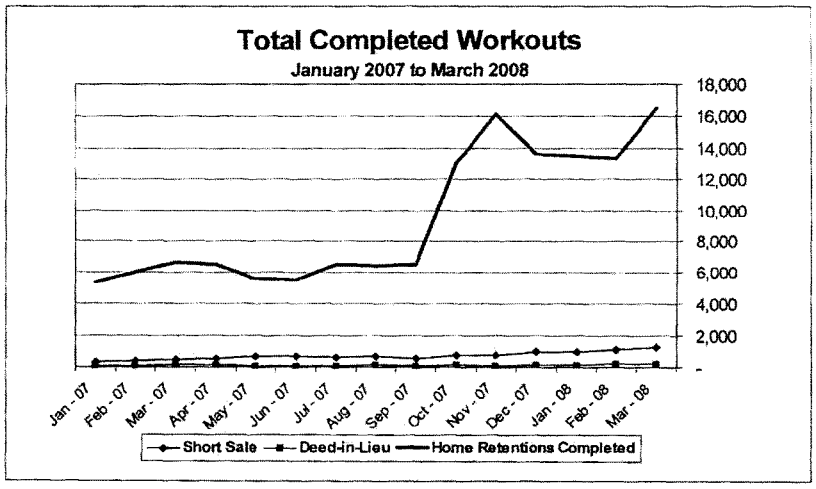
We had also recently announced our groundbreaking partnership with the Neighborhood Assistance Corporation of America. As we testified then, the NACA program provides a borrower-centric approach to home retention, starting with a detailed assessment of a borrower's household budget to determine what level of payment the borrower can afford. That payment is then evaluated against a progressive set of loan workout options, starting with repayment plans and ending with more aggressive loan modification options. Once a workout option meeting the borrower's affordability payment is identified, a solution has been found that balances the

borrower's need for affordability with the servicer's obligation to maximize returns for the investors.

Finally, we noted that we had grown our Home Retention Division staff from 2000 employees in January to more than 2700 employees. We reported that, through September 2007, we had completed nearly 40,000 workout solutions that resulted in borrowers keeping their homes, and had refinanced more than 31,000 subprime borrowers into fixed rate loans. Again, that was the Fall of 2007, and the initiatives announced by Countrywide, and the work of the HOPE NOW Alliance and the American Securitization Forum had just begun in earnest. What has been the progress since then?

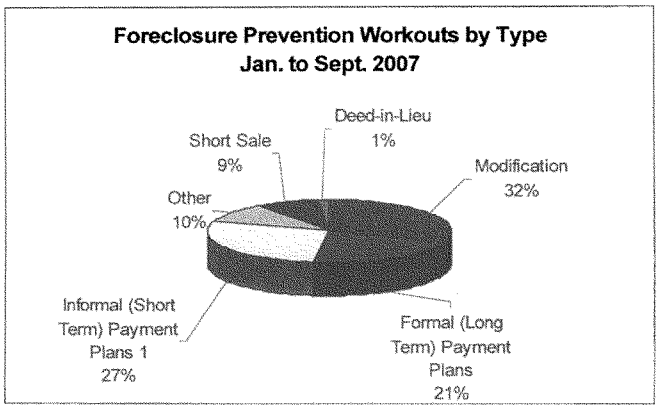
Prior Efforts Pay Off as Home Retentions Increase Sharply

In the last 6 months, we have redoubled our commitment, growing our home retention staff by another 1000 employees from 2700 last Fall to almost 3700 today. Over that same time period – media reports to the contrary – the pace of home retention efforts by Countrywide and the rest of the industry has picked up sharply. And just as important, the types of workouts implemented have become dramatically more aggressive.



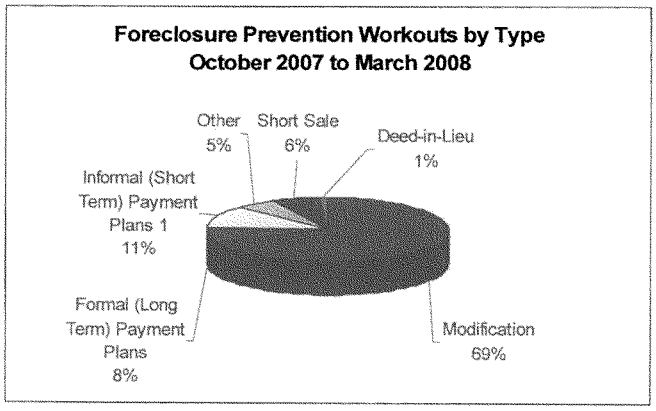
Through the first 9 months of 2007, Countrywide completed an average of 6,700 home retention workouts per month. This includes loan modifications, forbearance, repayment plans and other solutions that keep families in their homes. By contrast, in the last 6 months (through March 31) we completed more than 91,000 home retention workouts, saving an average of more than 15,000 homes from foreclosure each month. In short, the pace of activity in the past 6 months is more than twice the pace during the first three quarters of 2007.

As noted, the types of home retention workouts provided to borrowers have also changed dramatically. During the first 9 months of 2007, short or long term repayment plans were the most common solution provided to borrowers, accounting for nearly half of all workouts. Loan modifications accounted for only 32% percent of workouts, but virtually all of these were traditional modifications involving re-amortizing missed payments over the remaining term of the loan. Rate reduction modifications were extremely rare at that time.



Note: Rate relief modifications account for a negligible percentage of all loan modifications

By contrast, in the past 6 months (ending March 31), loan modifications have become the predominant form of workout assistance at Countrywide. Nearly 70% of all home retentions during the time period involved loan modifications, while repayment plans accounted for less than 20%. Moreover, previously rare rate relief modifications now account for almost 43% of all loan modifications. The majority of these rate relief modifications has a duration of at least 5 years and are targeted to borrowers experiencing payment difficulties caused by disruption to income or other financial stress, as well as a result of rate resets.



Note: Rate relief modifications accounted for 43% of all loan modifications

In short, the growth in the number of home retention workouts completed – particularly loan modifications – is increasing dramatically faster than the number of foreclosure completions. As shown in the table below, in March 2007, we completed about 6,700 home retentions, of which about 1,800 were loan modifications.

Growth in Loan Modifications Far Outpaces Growth in Foreclosures

	Mar-07	Mar-08	% Change
Home Retentions Completed	6,651	16,514	148%
Loan Modifications	1,843	12,807	595%
Loan Mods as % of Home Retentions	28%	78%	n.a.
Foreclosures Completed	5,206	8,266	59%

By March, 2008, we completed 16,500 home retention plans – nearly a 150% increase over the prior year. Moreover, that increase was driven by an almost 600% jump in loan modification plans. By comparison, completed foreclosures in March 2008 increased by 59% over the March 2007 pace. An increase in foreclosures is a trend no servicer likes to see. However, the effort of our home retention team is paying off. In October 2007, we completed just over 9000 foreclosures – however, in the five months since October, the average number of completed foreclosures declined to 8200.

Partnerships and Outreach Remain Critical

We have also continued to expand our outreach initiatives and partnerships in order to ensure that every customer that needs help is reached. In addition to our NACA partnership, we have strengthened our relationships with NeighborWorks, the Homeownership Preservation Foundation and the National Foundation for Credit Counseling. And in February 2008, Countrywide signed a national counseling partnership and best practices agreement with ACORN. This agreement accomplishes two important objectives. First, it leverages ACORN's national reach and counseling expertise in a fee-for-service arrangement that will allow us to reach and provide assistance to more of our borrowers. Secondly, the agreement contains a set of detailed home retention best practices between Countrywide and ACORN that will apply to all of Countrywide subprime servicing portfolio (not just hybrid ARMs). The scope of the agreement includes:

- ✓ notification standards for subprime ARM borrowers,
- ✓ proactive portfolio reviews to identify candidates for rate freezes or rate rollbacks,
- ✓ specific guidelines to identify the appropriate workout options for borrowers whose problems are more severe than basic rate reset issues,
- ✓ guidelines requiring the impounding of taxes and insurance and second reviews for any loan not determined to be initially eligible, and
- ✓ ongoing training of Countrywide staff and monitoring of the agreement by senior Countrywide executives and ACORN leadership.

A detailed summary of the ACORN Agreement is attached as Exhibit A.

We have also have continued to develop new local partnerships with non-profit housing groups in key markets around the country. In addition to our We now have more than 50 counseling groups working with the Countrywide advocacy team on case resolutions. In the past 6 months, Countrywide participated in 130 homeownership preservation seminars in local communities around the country. We have also hosted numerous "train-the-trainer" sessions around the country to help improve the ability of non-profit agencies to connect and communicate with loan servicers. The effectiveness of these events is validated by the seemingly insatiable demand for them in local markets around the country. Countrywide is making every effort to attend as many such events as possible in 2008.

Looking Forward

While there is no single solution to address current conditions, the incremental initiatives of the HOPE NOW Alliance and the clarifications of accounting and tax rules facilitated by Congress and the banking regulators over the past several months have made a significant impact in servicers' ability to increase home retention. Foreclosure is always the last resort for servicers and investors. Additional initiatives, such as using the FHA program to facilitate so-called "short refinance" transactions, could provide servicers another layer in the progression of workout options to help borrowers who may not be able to sustain a loan modification one more alternative to foreclosure. We look forward to working with Congress on such programs to ensure that they will be attractive enough to investors to effectively reach the targeted audience, but do so without unduly burdening taxpayers or providing financial windfalls for investors, borrowers or servicers.

We have not had time to fully analyze H.R. 5679, the Foreclosure Prevention and Sound Mortgage Servicing Act. Our initial review indicates that there are a handful of provisions that we could, with modest changes, support, including:

- ✓ Enhanced notice provisions to borrowers about upcoming adjustable rate mortgage resets (this should codify the existing banking agency guidance that applies to federally-regulated lenders like Countrywide, but not others),
- ✓ Enhancing the ability of borrowers to access quality foreclosure prevention counseling resources, and
- ✓ Uniform reporting requirements of certain loss mitigation activities to our primary regulator (Countrywide currently participates in the HOPE NOW and the Conference of State Bank Supervisors data collection efforts. A uniform reporting process with an institution's primary regulator would be preferable).

However, we have serious concerns with provisions of the bill that could force servicers to violate their contractual and fiduciary obligations to investors and we welcome the opportunity to discuss our concerns with members of this subcommittee. Many provisions, while well intentioned, would make it more difficult to find workable solutions tailored to individual borrower circumstances. Others would limit the ability of servicers to "triage" loss mitigation activities in order to improve service and turnaround times.

As Congress evaluates this and other legislation to stabilize the housing market, it is important that care be taken not to undermine the legal certainty that investors depend on when providing much needed liquidity to the mortgage. Such actions could impose higher costs on

new borrowers just as they are preparing to re-enter a fragile market. Efforts to stabilize the housing market should also focus on the demand side of the equation in order to encourage reluctant buyers – especially first-time buyers – to return to the market.

Conclusion

In conclusion, Countrywide remains committed to helping our borrowers avoid foreclosure whenever they have a reasonable source of income and a desire to remain in the property. Foreclosure is always a last resort for Countrywide and for the investors in the mortgage securities we service. While we cannot, at this time, address any specifics regarding the Bank of America-Countrywide merger, the Subcommittee can be assured that both organizations are fully committed to meeting the challenges of today's housing market with leading-edge foreclosure prevention technology, training, programs and partnerships.

TESTIMONY OF INGRID BECKLES

VICE PRESIDENT
SERVICING AND ASSET MANAGEMENT
FREDDIE MAC

before the

SUBCOMMITTEE ON HOUSING AND ECONOMIC OPPORTUNITY
COMMITTEE ON FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES

THE FORECLOSURE PREVENTION AND SOUND MORTGAGE
SERVICING ACT OF 2008
APRIL 16, 2008

TESTIMONY OF INGRID BECKLES
Vice President, Servicing & Asset Management
Freddie Mac
Before the Subcommittee on Housing and Economic Opportunity
Committee on Financial Services
United States House of Representatives
April 16, 2008

Chairwoman Waters, Ranking Member Capito, members of the subcommittee:

Good morning, and thank you for the opportunity to address the Subcommittee today. My name is Ingrid Beckles, and I am Vice President of Servicing and Asset Management at Freddie Mac. In this capacity, I oversee the servicing of Freddie Mac's single-family mortgages, which includes management of mortgage delinquencies, foreclosure actions, and the disposition of foreclosed properties. In my testimony, I'd like to briefly describe how Freddie Mac approaches mortgage delinquencies and foreclosure prevention, and offer some thoughts on how our experience might inform the Subcommittee's work on H.R. 5679, "The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008."

Freddie Mac's Role In the Mortgage Market

Freddie Mac is a government-sponsored enterprise, or GSE, created by Congress to bring liquidity, stability and affordability to the nation's residential mortgage markets. We do this by providing the primary market with a reliable secondary market for mortgages in all economic conditions. We are a shareholder-owned corporation, capitalized entirely by private-sector money.

Historically, Freddie Mac's guarantee and securitization activities have concentrated on the "prime" conventional conforming segment of the mortgage market, not the subprime mortgages that are at the center of the current crisis. At year-end 2007, we guaranteed more than $1.7 trillion of mortgage-backed securities, representing approximately 12 million mortgages.

Freddie Mac's mortgages continue to perform very well relative to other market sectors, despite the turmoil in the market. At year-end 2007, for mortgages we guarantee only about one mortgage out of 150 was seriously delinquent (90 days plus) or in foreclosure, compared to about one out of seven subprime mortgages, according to statistics from the Mortgage Banker's Association. Our serious delinquency rate is less than two-thirds of one percent (65 basis points). It is actually lower than it was five years ago, but also represents a 55 percent increase over the 2006 rate of 42 basis points. We expect that the rate will rise further in 2008. So while to date we may have experienced comparatively low delinquencies, Freddie Mac is not immune from the worsening conditions in the overall housing market.

We pool the mortgages we buy into mortgage-backed securities called Participation Certificates (PCs), which give the holder an undivided interest in the cash flows from the underlying mortgages. The guarantee we provide ensures investors that they will receive timely payment of principal and interest from these mortgages. Because we continue to own the underlying mortgages, however, we can proactively assist troubled borrowers. In the private-label subprime market, by contrast, ownership of the underlying mortgages

is diffused through the securitization structure, and servicing is governed by the terms of the Pooling and Servicing Agreement (PSA) entered into at the time the securities were issued. These contractual arrangements, as well as technical tax and accounting issues, make foreclosure prevention efforts for mortgages in subprime securities more challenging.

Freddie Mac's Delinquency Management Practices

Helping Delinquent Borrowers

At Freddie Mac, our interest in a mortgage, the home securing the mortgage, and the family whose home the mortgage finances starts when we purchase the mortgage. When a borrower becomes delinquent, our focus intensifies. We start from the proposition that foreclosure is not in anyone's interest – not the investor, the lender, and certainly not the homeowner. This is also the proposition underlying H.R. 5679. We are constantly reviewing our systems and processes for dealing with delinquent mortgages, and experimenting with new ones, all with the aim of keeping families in their homes, even when house prices are falling as they currently are some markets.

We know from experience that the earlier the servicer and borrower start to work out a delinquency, the more likely the borrower is to avoid foreclosure. We want every workout to be sustainable over the long term. For that reason, we emphasize early and frequent intervention with delinquent borrowers, as early as the first missed payment. We try to work out every delinquent mortgage, not just principal residences, because any foreclosure damages neighborhoods where other homeowners live, as well as causing losses to investors.

In 2007, we worked out three and a half times as many mortgages as we had to foreclose upon. Under our Seller/Servicer Guide, our basic contract with our servicers, we require, not just recommend, that our servicers work with borrowers to try to resolve troubled loans short of foreclosure. As a result, with the help of our servicers we entered into about 50,000 workouts – nearly 1,000 a week – that helped families stay in their homes. This level of workouts is an exceptionally high proportion of our seriously delinquent mortgages, which stood at about 79,500 at the end of 2007. By contrast, we foreclosed on only about 14,000 homes.

These workouts fall into three categories:

- Forbearances, under which mortgage payments are reduced or suspended for a defined period of time. Forbearances may be used to give troubled borrowers time to arrange other foreclosure alternatives, or to provide temporary relief to victims of natural disasters like Hurricane Katrina. In the wake of Gulf

hurricanes, we entered into more than 24,000 forbearance agreements in 2005 and 2006, but that number fell to 3,100 in 2007;

- Repayment plans, that allow borrowers to make up past due amounts over a period of months and return to compliance with the original terms of their mortgage. We entered into nearly 39,000 repayment plans in 2007; and

- Modifications, which typically involve changing the terms of the original mortgage in a way that allows the borrower to return his mortgage to good standing. Modifications may involve capitalizing any delinquency into the total mortgage amount, extending the term of the mortgage, and/or reducing the interest rate. When we modify an ARM, we generally convert it into a fixed-rate mortgage. We entered into more than 8,000 loan modifications in 2007, and expect 2008 volume to be even higher.

In every case, we want borrowers to be able to sustain the workout based on the circumstances at the time the family enters into it. When we do a loan modification, for example, we not only assess the borrowers' current income and other debts, but also whether the family's other living expenses, like food and fuel, are such that the modified loan will be sustainable. Reliance on outdated and less comprehensive information might simply set the borrower up for another failure. We also want to be sure that the family has sufficient cushion – about 20 percent of net disposable income – to cover unanticipated expenses that might otherwise force them back into default.

Since any workout must be sustained based on the borrowers' *present* financial situation, we do not support H.R. 5679's requirement that the affordability assessment be based on income information furnished by the borrower at the time of origination (unless the borrower volunteers current information). Our approach, which uses current information, has given us a very low re-default rate; our overall success rate is about 80 percent.

Unfortunately, some families experience circumstances in which they will not be able to keep their homes. In some of these cases, we may be able to help families avoid some of the short- and long-term effects of foreclosure through deeds-in-lieu of foreclosure or short sales, in which the borrower, working with the servicer, sells the home and pays a part of the outstanding loan, accrued interest and other expenses from the sale proceeds. H.R. 5679 aptly terms these "secondary loss mitigation activities." We engaged in more than 2,000 such transactions in 2007.

In the final analysis, most borrowers try to pay their mortgage as originally agreed, even if home values have fallen or personal circumstances make it harder than anticipated. Homeownership is a long-term investment. Freddie Mac and it servicers work diligently to accommodate borrowers in financial distress who have the capacity and desire to avoid

foreclosure. Foreclosures remain an important tool to protect investors' rights and recirculate properties that the borrower can no longer afford or does not desire to keep.

Working with our Servicers

My staff and I work with our servicers every day to ensure that together we can do the best job possible for delinquent borrowers. In our Seller/Servicer Guide, we spell out our loss mitigation expectations for our servicers. We measure our servicers' performance under the Guide against monthly performance benchmarks, which include minimizing credit losses and helping delinquent borrowers avoid foreclosure. If a servicer is performing poorly, we work with them to improve so that they may in turn better serve borrowers and their communities. If poor performance persists, we may limit the type of loans the servicer can service, or in extreme cases terminate its right to service Freddie Mac mortgages.

We have found, however, that while mandates provide clarity, the best way to encourage effective delinquency management is to combine carrots with any sticks. We therefore reinforce "good" behavior by providing financial incentives to servicers who help families avoid foreclosure – through per loan fees for completing repayment plans, modifications and foreclosure alternatives. These fees are in addition to the fees we pay servicers on each of our mortgages. We absorb these fees, rather than pass them on to families who are already in financial trouble, because we believe they are cost-effective in the long run. In 2007, we paid about $12 million in various incentive fees to our servicers.

Freddie Mac backs up these efforts by heavily investing in a variety of technology tools to assist servicers in prioritizing resources for resolving delinquencies, analyzing workout options and tracking workouts.

- EarlyIndicator® is a tool developed by Freddie Mac and widely utilized in the servicing industry. It scores the likelihood that a delinquent mortgage will cure or evolve into a more serious default. This score permits the servicers to prioritize staff resources and outbound contact, and provide special attention to the borrowers who are most likely to require help.

- Workout Prospector® is a tool available to servicers to analyze the optimal workout option based on a borrower's individual circumstances. The tool uses data regarding the loan, including borrower income/expenses and property value, and helps the servicer choose the best foreclosure alternative, such as loan modification, short sale, or deed-in-lieu of foreclosure.

- Workout Manager® enables servicers to analyze their entire portfolios of pending and completed workouts online. Workout Manager's intended users are a servicer's managers who need portfolio workout information on a daily basis. By using Workout Manager, a servicer has the daily workout information, which can be accessed to help the servicer spot problems sooner and increase the probability of successful completion of a workout. Essentially, this tool enhances the likelihood of workouts by applying portfolio technology to create workout processes that are efficient, effective and consistent.

Other Initiatives

We also have initiatives that focus specifically on at-risk borrowers. For example, we know that low- and moderate-income families are at higher risk of foreclosure, largely because they are more likely to live paycheck to paycheck than more affluent families, and may lack adequate reserves to get through tough times. We reinstated our requirement of pre-purchase counseling for some high-risk borrowers, and developed an intervention that linked delinquent borrowers who had financed their homes with certain "affordable" Freddie Mac mortgage products with housing counselors. We found that the counselors became a trusted intermediary between the borrower and the servicer until the borrower developed the confidence that the servicer could help. Through this initiative, nearly 8700 borrowers have avoided foreclosure. Our experience underscores the wisdom of H.R. 5679's incorporation of housing counselors into the loss mitigation process.

Consumer education is a critical component of our strategies – borrowers need to know that there are alternatives to foreclosure and that they should work with their mortgage servicer to see what alternatives might work in their circumstances. Falling behind on your mortgage is frightening and embarrassing, and in more than half of Freddie Mac's foreclosures servicers report they were unable to make contact with the borrower. Families have to understand that help is available before they can benefit from it. A 2007 Roper survey of delinquent borrowers we commissioned found that most – 86 percent – knew that their lender had tried to contact them, but more than half – 57 percent – were unaware of the availability of foreclosure alternatives. That is the bad news. The good news is that public awareness had increased from a previous survey in 2005. So consumer education is a keystone.

H.R. 5679

This hearing is about H.R. 5679, "The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008." Chairwoman Waters has explained that the bill reflects her frustration that subprime mortgage servicers are not moving quickly enough to offer delinquent borrowers sustainable alternatives to foreclosure. The bill would therefore

create a legal duty on servicers to make "reasonable" efforts to keep delinquent borrowers in their homes before foreclosing.

We do not believe that it is necessary to create an affirmative statutory duty that imposes particular loss mitigation activities on the entire mortgage market. Such a measure would add unneeded costs and complexity to delinquency management. Moreover, no matter what standard – FHA, VA, Freddie Mac, Fannie Mae, or some private mortgage investor – is picked, that standard and the practices underlying it may not be equally effective for all borrowers and in any event can always be improved upon. In the long run, a federal standard could chill innovation, discourage some investors from getting into the mortgage market, and ultimately raise costs for all borrowers.

If Congress decides legislation is needed, we recommend that it focus on the arena in which the problems arose – the servicing practices in the private-label mortgage securities market. The servicing practices in the prime market served by the GSEs and the government-insured market served by FHA and VA are not the problem, and should be not be covered by the bill. We also have some concerns with some of the bill's particulars. We have discussed these with Subcommittee staff, and we are pleased to continue those discussions.

We are pleased that H.R. 5679 recognizes that servicers need to be compensated for engaging in loss mitigation activities. I described how we use monetary incentives to reinforce our contractual loss mitigation requirements. But subprime servicing was never set up to deal with anything like the current level of delinquencies, and the servicing compensation structure reflects that. My understanding is that while the trusts reimburse servicers for foreclosures costs, they are not typically paid for working out a loan. This compensation arrangement is not sustainable if servicers are to help borrowers avoid foreclosure. H.R. 5679 would allow servicers to charge borrowers a "reasonable fee" for working out a loan, but we think this just adds to the burden on an already financially-strapped family and lowers the borrowers' chance of success. To fix this, one writer suggested that the FHA pay subprime servicers a fee for each workout, on the theory that this would be cheaper for the government than other interventions.[1]

Another idea is to protect subprime servicers from legal liability if they work out securitized mortgages. For example, under most PSAs, servicers have authority to work out loans, but must always act in the best interests of the trust. Some servicers have therefore expressed concern that working out loans would open them up to lawsuits from the investors. In addition, accounting rules may prevent servicers from taking action before borrowers become seriously delinquent. Senator Dodd has proposed creating a

[1] Steven Rattner, "Fixing the Housing Crunch," Washington Post A 17 (March 27, 2008).

"safe harbor" to protect against these eventualities – and we think it is certainly something to consider.

Conclusion

At Freddie Mac, we spend a lot of time thinking about how to address the turmoil in the mortgage markets. Like almost everybody else, we have concluded that there is no silver bullet, and that, unfortunately, things are going to get worse before they get better. For the moment, the combination of lack of borrower capacity and falling house prices demonstrates that there are no easy solutions to this problem.

Nevertheless, let me suggest some things that can be done to mitigate its effects:

- We agree that subprime servicing practices should focus on keeping families in their homes on a sustainable basis. Loan modifications, repayment plans and other foreclosure prevention initiatives are important, but we must recognize that that not all borrowers can afford the house they are now living in, and may have to transition to less expensive homes or rental housing.

- Help some borrowers refinance into mortgage products like Freddie Mac's SafeStep mortgages and FHASecure. It may be appropriate to consider other approaches that take house price declines into account. But unless the borrower has the capacity to afford the monthly payments, a refinance simply sets up both the lender and the borrower for a repeat of the earlier failure.

- Support, with the participation of the public and private sectors, community stabilization efforts of local and national non-profits and state and local governments hard-hit by the crisis. For this reason, we should not limit our interventions to principal residences. Any foreclosure has a negative impact on the whole community, lowering everyone's property values, evicting tenants, and cutting the supply of affordable rental housing.

I wish I could be more optimistic, but the housing crisis is going to be painful and take time to resolve. At Freddie Mac, we are committed to working with Congress, the Administration, our customers and other industry participants to find and implement effective solutions to this very difficult problem.

Thank you for the opportunity to address the Subcommittee. I will be pleased to answer any questions.

STATEMENT OF
JUDITH CADEN, DIRECTOR
LOAN GUARANTY SERVICE
DEPARTMENT OF VETERANS AFFAIRS
BEFORE THE
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY
HOUSE COMMITTEE ON FINANCIAL SERVICES

APRIL 16, 2008

**

Ms. Chairwoman and members of the Subcommittee, I appreciate the opportunity to appear before you today to discuss the underwriting standards used by the Department of Veterans Affairs (VA) Loan Guaranty Program at time of loan origination, the loss mitigation tools available to our borrowers over the course of their loans, including guidance given to loan servicers, and performance data of loans guaranteed by VA over the past ten (10) years.

First, I would like to describe VA's underwriting standards. Lenders underwriting VA loans must ensure that the contemplated terms of repayment bear a proper relation to the veteran's present and anticipated income and expenses, and that the veteran is a satisfactory credit risk. VA's credit standards employ the use of residual income guidelines and debt-to-income ratios in determining the adequacy of the veteran's income.

Residual income is the amount of net income remaining (after deduction of debts and obligations and monthly shelter expenses) to cover family living expenses such as food, health care, clothing, and gasoline. VA considers

minimum residual income (balance available for family support) as a guide. Minimum residual income does not automatically trigger approval or rejection of a loan. Instead, underwriters should consider residual income in conjunction with all other credit factors. If residual income is marginal, underwriters should look to other indicators, such as the applicant's credit history, and, in particular, whether and how the applicant has previously handled similar housing expenses. However, an obviously inadequate residual income alone can be a basis for disapproving a loan.

VA uses the borrower's debt-to-income ratio to compare total monthly debt payments (housing expense, installment debts, and so on) to gross monthly income. In our program, a ratio greater than 41 percent generally would require close scrutiny of the loan package. The debt-to-income ratio is also a guide and lenders should consider the debt-to-income ratio in conjunction with all other credit factors. In practice, it is a secondary underwriting factor to residual income.

Lenders are expected to use good judgment and flexibility in applying these guidelines, and the underwriting decisions must be based on the sound application of the underwriting standards. VA seeks to give veterans the benefit of the doubt with regard to credit and instructs lenders to examine compensating factors when making an underwriting decision.

The Committee also requested that I describe VA's guidance given to mortgage servicers regarding loss mitigation for loans guaranteed under the VA Loan Guaranty program. VA published guidance to mortgage servicers in February 1994 in the VA Servicing Guide, Handbook H26-94-1, in Chapter 3, titled Alternatives to Foreclosure. As an introduction, the guide states "VA ... expects every realistic alternative to foreclosure which may be appropriate in light of the facts in each case to be explored before a loan is terminated by foreclosure.... Alternatives to foreclosure should be discussed with borrowers by the holder as soon as possible in the course of the default, preferably before legal action is initiated...." The guide provides specific information on extended repayment plans, forbearance, loan modifications, "short" sales (with VA paying a compromise claim for the mortgage balance not satisfied by proceeds of a private sale), and deeds in lieu of foreclosure.

In 1995, VA established a Servicer Loss Mitigation Program to provide specific guidelines on processing short sales and deeds in lieu of foreclosure without VA prior approval. VA also began paying incentives for the successful completion of those alternatives for servicers, which had agreed to comply with the program guidelines.

Over the years, VA has also taken an active role in supplementing the servicing of private loan holders by attempting to contact veteran borrowers when their loans are reported as being seriously delinquent. VA has provided financial

counseling and assistance in developing reasonable repayment plans, which could be proposed to the private loan servicers. VA's efforts in fiscal year 2007 resulted in foreclosure avoidance of more than 57% of seriously delinquent cases. VA representatives helped arrange 8,453 repayment plans or other forbearance agreements on such cases that eventually reinstated, thereby avoiding claim payments estimated at more than $181 million.

In February of this year, VA published an extensive regulatory package that was the result of a business re-engineering effort to assess the servicing of VA-guaranteed home loans. The project goal was to improve service to veterans by standardizing internal operations, while also recognizing best practices within the mortgage servicing industry. VA developed procedures to ensure that servicers would utilize the full range of alternatives previously considered by VA in its supplemental servicing in order to help veterans mitigate potential losses. The new environment utilizes the latest information technology to assist VA in gaining greater oversight of efforts to help veterans retain their homes during financial difficulties. The new environment is called VALERI, which stands for the VA Loan Electronic Reporting Interface.

VALERI is being phased in during the remainder of this calendar year and presently covers about 30% of the delinquent VA home loans. Under VALERI, VA has provided regulatory definitions for repayment plans and special forbearance assistance, and has prescribed conditions for consideration of loan

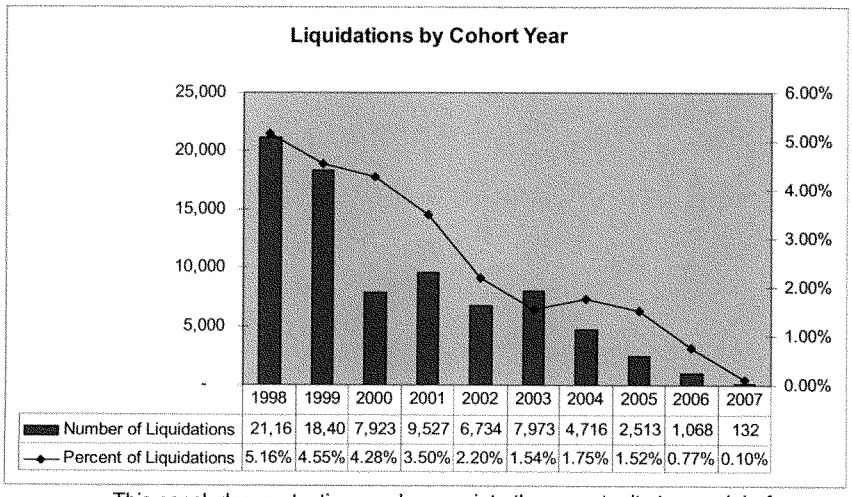
modifications, short sales, and deeds in lieu of foreclosure. VA also has established a system of incentive payments for completion of loss mitigation alternatives, that will vary in part based on servicer performance on criteria that will be determined over the next two years. Those criteria will factor into servicer tier rankings, with all servicers entering into VALERI in Tier two of the ranking system, with rankings to be adjusted based on performance in servicing loans.

Lastly, the Committee asked that I describe the performance of loans guaranteed under the VA Loan Guaranty program under recent (last 10 years) standards, including the number and percentage of loans ending in foreclosure. The VA program has fared well in recent years with regard to foreclosure rates. According to data from the Mortgage Bankers Association, the quarterly delinquency rate for VA loans during the past five years declined from 7.81% to 6.49% as compared to prime loans, which increased from 2.69% to 3.24%. Over that same time period, delinquency rates for subprime loans increased from 14.74% to 17.31% and, for FHA loans, the rates increased from 11.23% to 13.05%. Similarly, during that same period, the percentage of VA foreclosures started in the first quarter of 2002 was .47% and decreased to .39% in the fourth quarter of 2007. In comparison, the rates increased from .20% to .41% for prime loans, 2.18% to 3.44% for subprime loans, and .81% to .91% for FHA loans.

The MBA data is obtained from members that report information on a voluntary basis, and is considered to be the best measure of outstanding

delinquencies at the present time. Once VA has the new VALERI environment fully operational, we will be able to easily track delinquencies on all outstanding VA loans. Until that time, VA relies on actual defaults and terminations reported to determine the rate of liquidation by cohort year.

Looking back ten years, for loans originated in 1998, 5.16% have been liquidated. Since that time, there has been an overall decline in the liquidation percentage as displayed in the chart below.[1]



	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Number of Liquidations	21,16	18,40	7,923	9,527	6,734	7,973	4,716	2,513	1,068	132
Percent of Liquidations	5.16%	4.55%	4.28%	3.50%	2.20%	1.54%	1.75%	1.52%	0.77%	0.10%

This concludes my testimony. I appreciate the opportunity to speak before you today. I will be pleased to answer any questions you may have at this time.

[1] Liquidations generally peak between year 3-5 of the loan, so the actual liquidations for cohort years 2002 and later are likely to increase, however, total liquidations have been declining along the same path as foreclosures since 1998.

TESTIMONY OF

TOM DEUTSCH
DEPUTY EXECUTIVE DIRECTOR
AMERICAN SECURITIZATION FORUM

BEFORE THE

UNITED STATES HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

HEARING ON

H.R. 5679, THE FORECLOSURE PREVENTION AND
SOUND MORTGAGE SERVICING ACT OF 2008

APRIL 16, 2008

Madame Chairwoman, Ranking Member Capito and distinguished Members of the Subcommittee,

My name is Tom Deutsch and I am the Deputy Executive Director of the American Securitization Forum ("ASF")[1]. I very much appreciate the opportunity to testify before this Subcommittee again on behalf of the 370 member institutions of the ASF and the 650 member institutions of the Securities Industry and Financial Markets Association ("SIFMA")[2]. These members include all of the major lenders, servicers, underwriters and institutional investors in all forms of mortgage and asset-backed securitizations.

Background

No securitization market constituency–including lenders, servicers and investors–benefits from loan defaults and foreclosures. Foreclosure is usually the most costly means of resolving a loan default. As a result, it is typically the least-preferred alternative for addressing a defaulted loan whether or not the loan is held in a securitization trust. We therefore strongly support the policy goal of avoiding foreclosures wherever reasonable alternatives exist.

Overview of Typical Securitization Document Modification Provisions

A basic principle underlying the servicing of non-performing loans in securitization transactions is to maximize recoveries and minimize losses on those loans. This principle is embodied in the contractual servicing standards and other provisions that set forth the specific duties and responsibilities of servicers in securitizations. In turn, these contractual provisions, and the duties they impose on servicers and other securitization transaction participants, are relied upon by investors in mortgage-backed securities who depend primarily upon cash flows from pooled mortgage loans for the return on their investment.

Servicing of residential mortgage loans included in a securitization is generally governed by either a pooling and servicing agreement (PSA) or by a servicing agreement (SA). Typical PSA and SA provisions require servicers bound by those contracts to follow accepted servicing practices and procedures as they would employ "in their good faith

[1] ASF is a broad-based professional forum of over 370 member organizations that are active participants in the U.S. securitization market. Among other roles, ASF members include issuers, investors, financial intermediaries, professional advisers and rating agencies working on securitization transactions backed by all types of assets. ASF's mission includes building consensus, pursuing advocacy and delivering education on behalf of the securitization markets and its participants. Additional information about the ASF, its members and activities may be found at ASF's internet website: www.americansecuritization.com.

[2] SIFMA brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

business judgment" and that are "normal and usual" in their general mortgage servicing activities.

Most subprime securitization transactions authorize the servicer to modify loans that are in default or for which default is imminent or reasonably foreseeable. Generally, permitted modifications include changing the interest rate on a prospective basis, capitalizing arrearages, extending the maturity date, and forgiving principal, among other actions. The "reasonably foreseeable" default standard derives from the restrictions imposed by the Real Estate Mortgage Investment Conduit (REMIC) sections of the Internal Revenue Code of 1986 on modifying loans included in a securitization for which a REMIC election is made. Market participants interpret the two standards of future default—"imminent" and "reasonably foreseeable"—to be substantially the same.

Contractual loan modification provisions in securitizations typically also require that the modifications be in the best interests of the security holders or not materially adverse to the interests of the security holders, and that the modifications not result in a violation of the REMIC status of the securitization trust. Market participants generally interpret the standards "in the best interest of" or "not materially adverse to the interests of" investors or securityholders in a securitization to refer to investors in that securitization in the aggregate, without regard to the specific impact on any class of investors or any class of securities.

Consistent with typical contractual provisions governing servicing activities in securitizations and applicable law and regulation, we believe that a loan modification may be appropriate where the loan is either in default or where default is reasonably foreseeable, and if the latter, where there is a reasonable basis for the servicer to determine that the borrower is unlikely to be able to make scheduled payments on the loan in the foreseeable future. The servicer must also have a reasonable basis for concluding that the borrower will be able to make scheduled payments on the loan as modified, and for modifying the loan in a manner that is likely to be sustainable, but that does not reduce required payments beyond the magnitude required to return the loan to performing status, or beyond the anticipated period of borrower need.

We believe that loan modifications meeting the above criteria are generally preferable to foreclosure where the servicer concludes that the net present value of the payments on the loan as modified are likely to be greater than the anticipated net recovery that would result from foreclosure. Whichever action is determined by the servicer to maximize recovery should be deemed to be in the best interest of investors in the aggregate.

In addition to the authority to modify the loan terms, most PSAs and SAs permit other loss mitigation techniques, including forbearance, repayment plans for arrearages and other deferments which do not reduce the total amount owed but may extend the term of payment. In addition, these arrangements typically permit loss mitigation through non-foreclosure alternatives to terminating a loan, such as short sales or deeds-in-lieu.

Although most PSAs and SAs in securitizations either expressly permit or do not restrict loan modifications, some agreements do impose restrictions. For example, certain transactions limit the total number of permitted occurrences of modifications for any individual loan. Other transactions may limit the amount of modifications to a certain percentage of the initial size of the mortgage loan pool. Some agreements require prior consent (for example, from a rating agency or bond insurer) to allow the amount of modifications to exceed a specified percentage of the initial size of the mortgage pool. In a more limited number of cases, governing agreements may restrict the types of modifications that can be effected, or limit the amount by which the mortgage interest rate may be changed. However, it does not appear that any securitization requires investor consent to a modification that is otherwise authorized under the operative documents.

Based upon the economic and contractual principles outlined above, and consistent with applicable governing documents and regulatory and accounting standards, we have supported the use of loan modifications (along with other loss mitigation tools) by servicers in securitization transactions in appropriate circumstances. In general, "appropriate circumstances" would include situations where a servicer has concluded that a particular loan is in default or that default is reasonably foreseeable, and that the loan modification or other loss mitigation action contemplated by the servicer is likely to maximize recovery and minimize loss on that loan.

As part of its efforts to inform members of the industry and promulgate relevant guidance in light of the widespread challenges currently confronting the securitization market, ASF has published several recommended market standards and practices. One such set of recommendations relevant to the topic of this hearing is ASF's June 2007 *"Statement of Principles, Recommendations and Guidelines for the Modification of Securitized Subprime Residential Mortgage Loans."* This document is designed to provide guidance to servicers modifying subprime residential mortgage loans that are included in securitization transactions, and to provide a common framework for interpreting loan modification standards and contractual provisions, thereby promoting greater uniformity, clarity and certainty of application of these standards and provisions throughout the industry. Our testimony here incorporates by reference the more detailed analysis and discussion set forth in that Statement.

ASF Streamlined Loan Modification Framework

Since I last testified before this Subcommittee on November 30, 2007 in Los Angeles, CA, a significant amount of progress has been made by the industry to help struggling homeowners stay in their homes. One very significant initiative was launched on December 6, 2007, less than a week after your hearing, Madame Chairwoman. On that day, the ASF announced and President Bush and Treasury Secretary Paulson supported and endorsed the ASF streamlined loan modification framework (executive summary attached as Exhibit A) for industry servicers to "fast track" subprime ARM borrowers into interest rate loan modifications in certain circumstances.

The ASF framework uses objective criteria to determine the continued affordability of subprime loans, based on factors such as the borrower's payment history, credit standing, owner occupancy, and amount of home equity. Using these criteria, servicers can segment borrowers into three categories: 1) borrowers who are able to refinance; 2) current borrowers who occupy the home and are eligible for a "fast-track" loan modification; and 3) borrowers who have shown difficulty making their loan payments prior to an upward reset. By streamlining the evaluative procedures of borrowers falling into the first two categories, servicers will be able to devote more resources to borrowers in category three who may require a customized solution based on a comprehensive analysis of that borrowers' debts and income. The net effect of the framework then is to address more efficiently and effectively the needs of all subprime borrowers who may face challenges in making their mortgage payments. The ASF framework was adopted with strong consensus support by our members, including loan servicers, institutional investors and other market participants.

There of course have been differences of opinion regarding the utility and impact of the framework. Much of this debate revolves around individual views regarding how many subprime loans will default without refinancing or modification, how many loans that are modified will nevertheless default in the future, and what form of loan modification would be sufficient to avoid foreclosure. None of these questions can be answered with complete certainty, as they require predictions of future events, such as home price appreciation or depreciation rates. What does seem clear, however, is that absent a balanced, more systematic approach for addressing the wave of subprime ARM resets, a larger number of those loans might default, producing higher foreclosures and losses for borrowers and institutional investors alike.

Unfortunately, many questions and criticisms of this framework appear to be driven by misunderstandings which bear correction and clarification. In particular, the framework is consistent with and builds upon basic loss mitigation principles that mortgage servicers have employed for decades. In simple terms, these principles dictate that if a loan cannot perform according to its contractual terms, a servicer should take steps that are reasonably calculated to minimize loss on that asset. In most cases—and especially in today's environment of higher default rates and home price depreciation—a servicer must carefully consider whether options other than foreclosure are available since foreclosure nearly always produces the lowest returns for investors. Quite simply, the framework identifies loan modifications as one method that servicers can use to minimize losses on impaired mortgage assets.

Positive Interest Rate Developments

The purpose of the ASF Framework was to address the rising tide of subprime ARM borrowers who may not be able to meet their higher payments at their initial reset. Most subprime 2/28 and 3/27 borrowers pay a fixed introductory rate for two to three years, and then adjust to a floating rate based on six month LIBOR thereafter. For most of these ARM borrowers, the formula for arriving at their new rate is simply the addition of approximately 5.5% to 6 month LIBOR. As 6 month LIBOR was approximately 5% in

December, 2007, the average subprime ARM borrower was resetting, on average, from an approximate introductory rate of 7.5% to a new floating rate of 10.5%. For an average principal balance, that borrower's payments would rise by $450 a month. In many cases, borrowers didn't have the ability to meet those increases, so it was in everyone's best interest—borrowers and investors—to modify that borrower to a reasonable rate that they could afford.

Importantly, since the ASF framework was announced, 6 month LIBOR has dropped precipitously to 2.6% as of today, April 16, 2008. As a result, the average subprime ARM borrower has had little or no rate increase at their reset.

What has really changed then for subprime ARM borrowers since December 6th is that every resetting subprime ARM borrower in America has experienced the equivalent of a 2.5% loan rate modification through the normal contractual functioning of their mortgage note. Falling rates have obviated the need to make contractual rate modifications for these subprime ARM borrowers which largely explains why an even more significant increase in industry contractual rate modification activity hasn't been observed over the last couple of months.

In this period of significant housing market correction, the ASF and SIFMA, including all of our various constituencies of servicers, investors and originators, remains committed to taking vigorous and proactive steps in working with borrowers to address preventable foreclosures.

H.R. 5679, The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008

The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008 would establish a new federal duty for servicers to "engage in reasonable loss mitigation activities that provide for (1) long-term affordability of the loan; and (2) the maximum retention of home equity." Unless or until this new duty is fulfilled, servicers would be unable to exercise their existing legal rights to the collateral and proceed with foreclosure.

The underlying premise of the legislation appears to be that servicers of securitized mortgage loans are not sufficiently engaging in loan modification and workout activity because they do not have sufficient incentives to do so. However, it is worth noting that servicers today face potential legal exposure from overly conservative, as well as overly aggressive, loss mitigation activity, to the extent that a servicer may be accused of not fulfilling its obligations to maximize recoveries on mortgage loans.

It is important to recognize then that servicers are already engaged in expanded loan modification and loss mitigation efforts, consistent with their existing contractual obligations and in response to the challenges presented by current housing market turmoil. Servicers have been increasing their investments in loss mitigation personnel and have developed enhanced processes and procedures to expedite delivery of loan workout, modification and home retention alternatives wherever feasible. Hard data supports these observations, and indicates that an increasing number and accelerating

pace of workouts and modifications are taking place with over 1.2 million homeowners being helped since last summer.

We fully agree that all servicers should engage in "reasonable loss mitigation activities," which as described above, servicers are already contractually obligated to engage in for the benefit of the security holders. But the new duty the bill proposes compels all servicers nationwide to rewrite every mortgage and PSA contract solely to benefit borrowers in default, rather than to "act in the best interest of security holders" as the mortgage and PSA contracts specify. This bill then disregards the original loan terms to which the borrower agreed as well as the servicers' obligations under the PSAs to institutional investors.

As a general matter, we have strong concerns with any legislation that would abrogate or interfere with previously established, private contractual obligations. This bill would fundamentally alter the contractual standards of PSAs to require servicers to be the agent of the borrower, rather than the MBS institutional investor. Changing this standard would alter the commercial expectations of investors and would seriously undermine the confidence of investors in the sanctity of contracts which are the bedrock to extension of consumer credit and the process of securitization. Consequently, future investors would be dissuaded from investment in mortgage markets that are in dire need of liquidity.

Since all parties to a contract, including investors, rely on the legal, valid, binding and enforceable provisions of the governing contracts, any legislation that would dilute, amend, or modify such contractual obligations or prejudice how the obligor fulfills its obligations is considered by the ASF to represent dangerous policy. Legislated intervention into otherwise valid legal contracts threatens the stability and predictable operation of the contractual legal framework supporting our capital markets system, and would have a chilling effect on the willingness of investors to participate in our markets.

While we fully support and encourage servicers to meet their contractual obligations by engaging reasonable loss mitigation, we strongly oppose this bill from the very premise that it starts from—mortgage contracts should be modified to serve solely the borrowers interests rather than the original contractual obligations that borrowers have agreed to fulfill.

Conclusion

The shared goal of participants in the mortgage financing markets is to keep people in their homes. Loan modification is one effective method which mortgage loan servicers are using to avoid foreclosures, but it is not the only solution. Refinancing, forbearance, borrower counseling and other loss mitigation tools are also effective options available to troubled borrowers, and servicers are employing all viable alternatives to preserve home ownership wherever possible. There is no silver bullet that will fix the current problems in the mortgage market and there is no single plan that will address all the problems related to the housing market. Market participants have and continue to collaborate and work towards developing coordinated solutions to the current issues in the mortgage

financing market, recognizing that it is essential to balance the interests of borrowers and investors, while preserving the significant benefits of the securitization market.

I thank you for the opportunity to testify on this important and timely issue today. While the ASF and SIFMA are not able to support H.R. 5679 in its current form, we look forward to working with you, Madame Chairwoman, Congress and the Administration in the pursuit of reducing preventable foreclosures.

APPENDIX A

American Securitization Forum

Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans

Executive Summary

December 6, 2007

Scope:

This streamlined framework applies to all first lien subprime residential adjustable rate mortgage (ARM) loans that have an initial fixed rate period of 36 months or less (including "2/28s" and "3/27s"), referred to below as "subprime ARM loans" that:

- were originated between January 1, 2005 and July 31, 2007;
- are included in securitized pools; and
- have an initial interest rate reset between January 1, 2008 and July 31, 2010.

This streamlined framework would be applied to subprime ARM loans in advance of an initial reset date. Typically, servicer/borrower communication should begin 120 days prior to the initial reset date.

Overarching Principles:

- The servicer will not take any action that is prohibited by the pooling and servicing agreement ("PSA") or other applicable securitization governing document, or that would violate applicable laws, regulations, or accounting standards. ASF's Statement of Principles, Recommendations and Guidelines for a Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans, published concurrently with this document, analyzes how the framework described in the Executive Summary is consistent with typical PSA provisions. The ASF urges readers of this Executive Summary to review the full Statement.

- The ASF believes that this framework is consistent with the authority granted to a servicer to modify subprime mortgage loans in typical PSAs. The ASF expects that the procedures in this framework will constitute standard and customary servicing procedures for subprime loans.

- The servicer will expeditiously implement the ASF Investor Reporting Guidelines for the Modification of Subprime ARM Loans recommended by the ASF, which is simultaneously released with this framework.

- LTV and CLTV will be determined based on information at origination. If an origination LTV is below 97%, a servicer may obtain an updated home value by obtaining an AVM, BPO or other means.

- All servicers of second liens to subprime borrowers should cooperate fully with this framework by providing information needed by first lien servicers and by agreeing to subordinate the second lien to any new first lien resulting from a refinance (with no cash out) under this framework.

- All existing contractual obligations and remedies related to fraudulent mortgage origination activity should be strictly enforced.

- The streamlined framework outlined in this framework represents the consensus view of the membership of the ASF, acting through its Board of Directors, as to the parameters used to determine the segmentation of subprime ARM loans, including the numeric values included in those parameters. It is understood by the ASF's members that the numeric values included in the parameters are not based on historic data, but rather simply represent a consensus view as to appropriate numeric values for use within this framework for the purpose of supporting a streamlined approach to loan modifications that complies with typical securitization governing documents. The ASF, acting through its Board of Directors, may in the future change these numeric values or further refine these parameters as experience is gained and market conditions evolve.

Borrower Segmentation:

Under this framework, subprime ARM loans are divided into 3 segments.

Segment 1 includes current (as defined below) loans where the borrower is likely to be able to refinance into any available mortgage product, including FHA, FHA Secure or readily available mortgage industry products.

- Generally, the servicer will determine whether loans may be eligible for refinancing into readily available mortgage industry products based on ascertainable data not requiring direct communication with the borrower, such as LTV, loan amount, FICO and payment history. Servicers will generally not determine current income or DTI to determine initial eligibility for refinancing.

- If the borrower also has a second lien on the property, this framework contemplates that the borrower is able to refinance the first lien only, on a no cash out basis. In order for the loan to fall into this segment, the second lien does not have to be refinanced; however, any second lien holder will need to agree to subordinate their interest to the refinanced first lien.

Segment 2 includes current loans where the borrower is unlikely to be able to refinance into any readily available mortgage industry product.

- *Current*: For purposes of this framework "current" means the loan must be not more than 30 days delinquent, and must not have been more than 1 x 60 days delinquent in the last 12 months, both under the OTS method. Corresponding tests would apply under the MBA method if the servicer uses that standard.

- *LTV test*: All current loans with an LTV (based on the first lien only) greater than 97% are deemed not to be eligible for refinance into any available product, and thus are within Segment 2. (97% is the maximum LTV allowed under FHA Secure.)

- *Not FHA Secure eligible*: All current loans that otherwise do not satisfy FHA Secure requirements, including delinquency history, DTI at origination and loan amount standards for this program, are within Segment 2 unless the servicer can determine whether they may meet eligibility criteria for another product, by reviewing eligibility criteria without performing an underwriting analysis.

Segment 3 includes loans where the borrower is not current as defined above, demonstrating difficulty meeting the introductory rate.

Segment 1 – Refinance:

- It is expected that borrowers in this category should refinance their loans, if they are unable or unwilling to meet their reset payment. However, a servicer may evaluate each borrower in this category on a case by case basis or apply any framework consistent with the applicable servicing standard in the transaction documents for a loan modification or other loss mitigation outcome.

- The servicer will facilitate a refinance in a manner that avoids the imposition of prepayment penalties wherever feasible. This may be accomplished by timing the refinance to occur after the upcoming reset date.

- Servicers should take all reasonable steps permitted under the PSA and other governing documents to encourage or facilitate refinancing for borrowers in Segment 1, or to borrowers in Segment 2 who become eligible for a refinance, including, where permitted, providing borrowers with information about FHA,

FHA Secure and other readily available mortgage industry products, even if that servicer is not able to provide those products through any affiliated originator.

Segment 2 – Loan Modification:

- The servicer will determine the following for each Segment 2 borrower: current owner occupancy status (based on information known to the servicer, including billing and property address), current FICO score and the FICO score at origination of the loan.

- FICO test:

  - If the current FICO score is less than 660 and is less than a score 10% higher than the FICO score at origination, the borrower is considered to have met the "FICO test." If the borrower meets the FICO test, the servicer will generally not determine the borrower's current income.

  - If either a) the current FICO score is 660 or higher, or b) the current FICO is at least 10% higher than the FICO score at origination, the borrower is considered to not meet the "FICO test." If the borrower does not meet the FICO test, the servicer will use an alternate analysis to determine if the borrower is eligible for a loan modification.

- Segment 2 loans will only be eligible for a fast track loan modification if:

  - The borrower currently occupies the property as his or her primary residence;

  - The borrower meets the FICO test; and

  - The servicer determines that, at the upcoming reset, the payment amount would go up by more than 10%.

- Borrowers in this segment and eligible for a fast track loan modification as described above may be offered a loan modification under which the interest rate will be kept at the existing rate, generally for 5 years following the upcoming reset.

- As to Segment 2 loans eligible for a fast track loan modification, the servicer may make the following presumptions:

  - The borrower is able to pay under the loan modification based on his or her current payment history prior to the reset date.

- The borrower is willing to pay under the loan modification, as evidenced by a) an agreement to the modification after being contacted or b) in the event that the affirmative agreement of the borrower cannot be obtained, the borrower's payment of two payments under the loan as modified after receiving notice of the modified terms.

- The borrower is unable to pay (and default is reasonably foreseeable) after the upcoming reset under the original loan terms, based on the size of the payment increase that would otherwise apply.

- The modification maximizes the net present value of recoveries to the securitization trust and is in the best interests of investors in the aggregate, because refinancing opportunities are likely not available and the borrower is able and willing to pay under the modified terms.

- For borrowers that do not meet the FICO test, the servicer will use an alternate analysis to determine if the borrower is eligible for a loan modification, as well as the terms of the modification (which may vary). This may include a) conducting an individual review of current income and debt obligations, debt-to-income analysis, and considering a tailored modification for a borrower, or b) applying any other framework consistent with the applicable servicing standard in the transaction documents to determine if a borrower is eligible for a loan modification.

- For borrowers that are eligible for a fast track modification, the fast track option is non-exclusive and does not preclude a servicer from using an alternate analysis to determine if a borrower is eligible for a loan modification, as well as the terms of the modification.

Segment 3 – Loss Mitigation:

- For loans in this category, the servicer will determine the appropriate loss mitigation approach in a manner consistent with the applicable servicing standard in the transaction documents, but without employing the fast tracking procedures described under Segment 2. The approach chosen should maximize the net present value of the recoveries to the securitization trust. The available approaches may include loan modification (including rate reduction and/or principal forgiveness), forbearance, short sale, short payoff, or foreclosure.

- These borrowers will require a more intensive analysis, including where appropriate current debt and income analysis, to determine the appropriate loss mitigation approach.

Testimony of Julia Gordon
Center for Responsible Lending

Before the U.S. House of Representatives
Committee on Financial Services
Subcommittee on Housing and Community Opportunity

"H.R. 5679: The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008"

April 16, 2008

Chairwoman Waters, Ranking Member Capito, and members of the subcommittee, thank you for holding this hearing on the Foreclosure Prevention and Sound Mortgage Servicing Act of 2008. We applaud the subcommittee for focusing on tools that can encourage economically rational behavior in the servicing of mortgage loans and help avoid those foreclosures that can and should be avoided. We hope that the Foreclosure Prevention and Sound Mortgage Servicing Act will be included in the Chairman's housing package.

The U.S. economy faces significant challenges today, as 20,000 foreclosures on subprime mortgages take place every single week.[1] The negative spillover effects from these foreclosures are substantial: property values are dropping by billions of dollars, crime is up in high-foreclosure communities, cities are losing their tax bases, and millions of Americans who depend on a robust housing market are losing jobs and income. As foreclosures accelerate during the next two years, these economic effects will be felt even more strongly.

This crisis is only getting worse. Yet efforts to encourage lenders and servicers to modify unsustainable loans on a voluntary basis simply are not working. It is too late to stop a severe downturn driven by reckless lending, but it is not too late to minimize the massive damage ahead. In these comments, I will discuss the following points:

- We face a severe foreclosure crisis with substantial negative effects on whole communities and the broader economy.

- Voluntary loan modifications cannot adequately address the problem. The common presence of "piggy back" second mortgages makes it virtually impossible for servicers to modify loans even when they want to, and perverse financial incentives and fear of investor lawsuits often dissuade servicers from pursuing meaningful modifications at all. It is clear that legislation requiring better and more consistent servicing standards and practices is needed to avert the massive foreclosure crisis now underway.

- Loan servicing is not an industry subject to typical economic incentives because homeowners have no choice about who their servicer is. If the servicer does not provide them with the help they need, homeowners are not able to shop for a better servicer. Instead, servicers are driven more by the interests of the investors who now stand in the shoes of the original lender, and who receive the benefits of payments received by the servicer. But even here economic incentives often put the interests of the servicer in conflict with the interests of the investors. Given the complicated nature of the relationship between borrower, servicer, and investor, and in the absence of normal market forces, it is crucial for the government to ensure that servicers are treating their customers fairly and appropriately and providing transparency throughout the process.

- The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008 establishes a sound framework for requiring mortgage servicers to evaluate a homeowner's situation and provide appropriate loss mitigation. Employing such an approach saves the home for the family, helps keep communities thriving, and saves investors money.

- The Act also contains provisions that will improve communication between homeowners and their servicers; assist in crucial data collection and reporting; and strengthen the Real Estate Settlement Procedures Act.

Self-Help and Center for Responsible Lending

I am Policy Counsel at the Center For Responsible Lending (CRL), (www.responsiblelending.org), a not-for-profit, 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 (www.self-help.org), which consists of a credit union and a non-profit loan fund.

For the past 28 years, Self-Help has focused on creating ownership opportunities for low-wealth families, primarily through financing home loans to low-income and minority families who otherwise might not have been able to get home loans. In other words, we work to provide fair and sensible loans to the people most frequently targeted for predatory and abusive subprime mortgages. Self-Help has provided over $5 billion of financing to 55,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across America.

In addition to making direct loans, Self-Help encourages sustainable loans to borrowers with blemished credit through a secondary market operation. Self-Help buys these loans from banks, holds on to the credit risk, and resells them to Fannie Mae. Self-Help has used the secondary market to provide $4.5 billion of financing to 50,000 families across the country, loans that have performed well and increased these families' wealth.

Self-Help makes loans specifically to families and business with little borrowing experience and few external support resources. While our loans have had somewhat

higher delinquency rates than the prime market, we have had extremely few loans end up in foreclosure. It has been our experience that while borrowers may fall behind temporarily on mortgage payments, they will make every effort to catch up and hold on to their home. By working closely with every delinquent customer and by providing loss mitigation services aimed at keeping homeowners in their homes, Self-Help has successfully minimized foreclosures and has kept our loan losses to less than one percent per year.

I. We face a severe foreclosure crisis that will grow even worse without significant government action.

Just one year ago, some in the mortgage industry claimed that the number of coming foreclosures would be too small to have a significant impact on the economy overall.[2] No one makes that claim today. As foreclosures reach an all-time high and are projected to grow higher,[3] the "worst case is not a recession but a housing depression."[4] Projections by Fitch Ratings indicate that 43% of recent subprime loans will be lost to foreclosure,[5] and at least two million American families are expected to lose their homes to foreclosures initiated over the next two years.[6]

As we show in our recent report on the "spillover" effect of subprime foreclosures, the negative effects of foreclosures are not confined to the families who lose their homes. Forty million of their neighbors will see their property values decline as a result by over $200 billion.[7] Federal Reserve Chairman Ben Bernanke recently noted

> At the level of the individual community, increases in foreclosed-upon and vacant properties tend to reduce house prices in the local area, affecting other homeowners and municipal tax bases. At the national level, the rise in expected foreclosures could add significantly to the inventory of vacant unsold homes—already at more than 2 million units at the end of 2007—putting further pressure on house prices and housing construction.[8]

This housing crisis has rippled throughout the global economy, causing worldwide alarm. According to the IMF, direct economic losses stemming from this crisis will likely top $500 billion, and consequential costs will total close to a trillion dollars.[9]

Sadly, many of the families losing their homes to foreclosure today might not have found themselves in this position if they had been given the type of loan that they actually qualified for. The Wall Street Journal found that of the subprime loans originated in 2006 that were packaged into securities and sold to investors, 61% "went to people with credit scores high enough to often qualify for conventional [i.e., prime] loans with far better terms."[10] Even those borrowers who did not qualify for prime loans could have received sustainable, thirty-year, fixed-rate loans for -- at most -- 50 to 80 basis points above the "teaser rate" on the unsustainable exploding ARM loans they were given.[11]

Wall Street's appetite for risky loans incentivized mortgage brokers and lenders to aggressively market these highly risky ARM loans instead of the sustainable loans for which borrowers qualified. As Alan Greenspan told Newsweek,

> The big demand was not so much on the part of the borrowers as it was on the part of the suppliers who were giving loans which really most people couldn't afford. We created something which was unsustainable. And it eventually broke. If it weren't for securitization, the subprime loan market would have been very significantly less than it is in size.[12]

Market participants readily admit that they were motivated by the increased profits offered by Wall Street in return for risky loans. After filing for bankruptcy, the CEO of one mortgage lender explained it this way to the New York Times, "The market is paying me to do a no-income-verification loan more than it is paying me to do the full documentation loans," he said. "What would you do?"[13] Even the chief economist of the Mortgage Bankers Association, when asked why lenders made so many loans that they knew were unsustainable, replied, "Because investors continued to buy the loans."[14]

Currently, 30% of families holding recent subprime mortgages now owe more on their mortgage than their home is worth.[15] These families are at an increased risk of foreclosure because "negative equity" precludes the homeowner from selling, refinancing or getting a home equity loan or other mechanism for weathering short-term financial difficulty.[16] Regulators and economists are increasingly cautioning that loan balances must be reduced to avoid unnecessary foreclosures that will further damage the economy.[17]

For the sake of the economy as a whole, as well as individual families and their communities, it is essential that strong measures be implemented to avoid unnecessary foreclosures. Requiring servicers to engage in appropriate loss mitigation efforts is one such measure.

II. Voluntary loan modifications are not sufficient to prevent the foreclosure crisis from continuing to escalate.

To date, Congress and the regulatory agencies have relied largely on voluntary efforts by servicers to reduce the number of foreclosures. Yet despite the support for servicer loss mitigation efforts from President Bush,[18] all of the federal banking agencies and the Conference of State Banking Supervisors,[19] voluntary efforts by lenders, servicers and investors continue to be insufficient to stem the tide of foreclosures. According to a recent report by the State Foreclosure Prevention Working Group, a collection of state Attorneys General and Bank Commissioners, only 24% of seriously delinquent borrowers were working with professionals in any type of loss mitigation activity that could lead to preventing a foreclosure.[20]

Efforts of the Hope Now Alliance also continue to fall short.[21] Despite increases in reported loss mitigation, a close look at the Hope Now data reveals that the current crisis

in the housing market dwarfs the servicing industry's response. Foreclosures still outnumber loan modifications three-to-one, and the numbers of delinquencies and foreclosure starts continue to rise precipitously. Most important, the majority of the loss mitigation activity being undertaken is not likely to lead to continued homeownership. As recently acknowledged by the vice chair of Washington Mutual, who helps run the program, many of the homeowners who have sought Hope Now assistance "will not receive long-term relief and could ultimately face higher total costs."[22]

In particular, loan modifications thus far have not successfully reached the approximately 30% of recent subprime loans that are underwater—that is, borrowers owe more than the house is worth. Chairman Bernanke noted that loan modifications involving "reductions of principal balance have been quite rare."[23]

It has become clear that there are a number of reasons for this lack of loss mitigation activity. One reason is that the way servicers are compensated by lenders pushes toward foreclosure. As reported in Inside B&C Lending, "Servicers are generally dis-incented to do loan modifications because they don't get paid for them but they do get paid for foreclosures." In fact, "it costs servicers between $750 and $1,000 to complete a loan modification."[24] So, even when a loan modification would better serve investors and homeowners, some loan servicers have an economic incentive to proceed as quickly as possible to foreclosure.

But even those servicers who want to do loss mitigation face significant obstacles. One such obstacle is the fear of investor lawsuits, because modifying loans typically affects various tranches of securities differently. This problem raises the specter of investor lawsuits in which one or more tranches claim that the servicer could have structured the modification differently to provide a greater return to a particular tranche.

Another is the existence of "piggyback" mortgages (second liens) on many homes. When there is a second mortgage, the holder of the first mortgage has no incentive to provide modifications that would free up borrower resources to make payments on the second mortgage. At the same time, the holder of the second mortgage has no incentive to support an effective modification, which would likely cause it to face a 100% loss; rather, the holder of the second is better off waiting to see if a borrower can make a few payments before foreclosure. A third to a half of 2006 subprime borrowers took out piggyback second mortgages on their home at the same time as they took out their first mortgage.[25]

There is an emerging consensus that half-measures in the private sector are not working. FDIC Chairman Sheila Bair recently said that the current economic situation calls for a stronger government response, since voluntary loan modifications are not sufficient.[26] The necessity of government action also is gaining recognition among Wall Street leaders. Just last week, a senior economic advisor at UBS Investment Bank stated that, "when markets fail, lenders and borrowers need some sort of regulatory and legislative framework within which to manage problems, rather than be forced to act in the chaos of the moment."[27] Moreover, as former Federal Reserve Board Vice Chairman Alan

Blinder recently noted, the fact that most of the mortgages at issue have been securitized and sold to investors across the globe "bolsters the case for government intervention rather than undermining it. After all, how do you renegotiate terms of a mortgage when the borrower and the lender don't even know each other's names?"[28]

III. The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008 will help prevent foreclosures and will improve communication between servicers and their customers.

By requiring loan servicers to engage in loss mitigation prior to foreclosure, this legislation will assist homeowners, lenders, investors, and communities. First, the bill recognizes the importance of keeping homeowners in their homes. By establishing a priority system that places continued homeownership as the highest priority, this bill aims to support the type of loss mitigation that will not only aid homeowners themselves, but will also provide crucial support to the housing values and tax base of surrounding homes and neighborhoods.

Second, and equally important, the legislation requires that any agreement reached through loss mitigation be affordable by the homeowner. We think careful consideration of the borrower's income as well as any expenses, including debt and residual income left over for other living expenses, is critical in determining the affordability of any solution intended to keep homeowners in their home.

We are also supportive of the bill's efforts to require that servicers provide advance notice by telephone and in writing to homeowners with ARMs of upcoming payment increases; refer homeowners who are late on their mortgage payments to HUD-certified housing counselors; and respond to homeowner inquiries and requests for information in a timely way, providing payment histories, loan documents, and loss mitigation documents as requested.

Another important aspect of this legislation is its requirement that servicers report various loss mitigation efforts disaggregated by activity and geographical designation. This simple and important requirement will ensure that policymakers and stakeholders have an accurate understanding of the kinds of loss mitigation being provided, so that policy responses can be appropriately tailored to address current needs.

Finally, the bill provides a long overdue update to the Real Estate Settlement Procedures Act by allowing damages actions for individual violations and increasing maximum damages recovery amounts. This change will significantly enhance enforcement of the law's provisions as RESPA does not currently provide for a private right of action by the borrower but can only be enforced through supervision or other regulatory enforcement efforts.

IV. It is crucial that the Foreclosure Prevention and Sound Mortgage Servicing Act apply to existing loans.

The Foreclosure Prevention and Sound Mortgage Servicing Act must be made applicable to existing loans so that it can help address the current foreclosure crisis. Applying the bill to existing loans is fair to investors and servicers. Requiring servicers to pursue economically rational loan modifications before proceeding to foreclosure provides servicers with a mechanism for maximizing returns to the investors as a whole, while reducing the harm to the family and the community. Indeed, many of the bill's requirements – that the servicers contact borrowers, provide direct access to loss mitigation personnel, and refer delinquent borrowers to HUD-certified housing counselors – are measures that industry representatives have committed to undertake and claim to be doing now.

Requiring servicers to report on their activities will enable policymakers to assess the extent to which these steps are occurring, so that they can properly evaluate the progress and effectiveness of solutions to date. The scale of the current crisis puts beyond question the need for an effective Congressional response. The Foreclosure Prevention and Sound Mortgage Servicing Act could take immediate effect to break the negative downward spiral in the housing sector of the economy.

V. Court-supervised loan modifications are a necessary complement to the proposed legislation.

Even with the passage of the Foreclosure Prevention and Sound Mortgage Servicing Act, a significant proportion of troubled homeowners will be forced into foreclosure because the loan servicer cannot modify the loan due to a conflict between multiple lienholders or other constraints. In those cases, the failure to modify will be to the clear detriment of investors as a whole. It is critical, as a last alternative to foreclosure, to permit a bankruptcy court to adjust the mortgage if the borrower can afford a market rate loan.

Currently, bankruptcy courts can modify any type of loan, including mortgages on yachts and vacation homes, with the exception of one type: primary residences. Removing this exclusion would help homeowners (not speculators) who are committed to staying in their homes, without bailing out investors and without costing taxpayers a dime. The Emergency Home Ownership and Mortgage Equity Protection Act (HR3609) provides a narrow, time-limited mechanism for enabling court-supervised loan modifications to break the deadlock that is forcing into foreclosure families who can afford a market rate loan.[29] The bill has been marked up in both Chambers, and is an important part of any effective solution to the foreclosure crisis.

We believe that the court-supervised loan modifications bill is a necessary complement to the Foreclosure Prevention and Sound Mortgage Servicing Act because it provides an important backstop for families who cannot get a sustainable loan modification due to piggyback loans or for whatever other reason. Moreover, as loans get modified through the bankruptcy process, these modifications will effectively create a "template" for

modification that will ease the process of loss mitigation for servicers, as all parties involved will have a better idea of how the courts would handle a particular situation.[30]

Together, the Foreclosure Prevention and Sound Mortgage Servicing Act and the Emergency Home Ownership and Mortgage Equity Protection Act will help stem the tide of coming foreclosures and provide urgently needed relief to struggling homeowners, the communities they live in, and the economy as a whole.

Conclusion

Effective government action is urgently needed to avoid a flood of needless foreclosures that will devastate families, destroy communities, and do further damage to the economy as a whole. We believe that the Foreclosure Prevention and Sound Mortgage Servicing Act of 2008 is a narrowly tailored proposal that will provide an effective tool for stabilizing the economy and speeding recovery. We applaud the Committee for focusing on the need to break the cycle of spiraling losses in the housing and mortgage markets.

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[1] *See* Written Testimony of Mark Zandi, Moody's Economy.com before House Subcommittee on Commercial and Administrative Law (January 28, 2008), available at: http://judiciary.house.gov/media/pdfs/Zandi080129.pdf; *See also* Center for Responsible Lending , Subprime Spillover, (Rev. Jan. 18, 2008), http://www.responsiblelending.org/issues/mortgage/research/subprime-spillover.html

[2] *See, e.g.*, Statement of John M. Robbins, CMB, Chairman, Mortgage Bankers Association at the National Press Club's Newsmakers Lunch – Washington, DC (May 22, 2007) (Speaking of predicted foreclosures, Mr. Robbins stated: "As we can clearly see, this is not a macro-economic event. No seismic financial occurrence is about to overwhelm the U.S. economy."); Julia A. Seymour, "Subprime Reporting , Networks blame lenders, not borrowers for foreclosure 'epidemic,'" Business & Media Institute (Mar. 28, 2007) ("[T]here are experts who say the subprime 'meltdown' is not the catastrophe reporters and legislators are making it out to be. 'We don't believe it will spill over into the prime market or the U.S. economy,' said [Laura] Armstrong [Vice President, Public Affairs] of the Mortgage Bankers Association.").

[3] Renae Merle, Home Foreclosures Hit Record High, Washington Post, March 6, 2008.

[4] David M. Herszenhorn and Vikas Bajaj, "Tricky Task of Offering Aid to Homeowners," The New York Times (Apr. 6, 2008) (quoting Susan M. Wachter, a real estate finance professor at the Wharton School of the University of Pennsylvania. According to Professor Wachter, "In the market that we have in front of us, prices decline and supply increases, driving prices down further.").

[5] Fitch Ratings estimates total losses of 25.8% of original balance in Q4 2006 loans placed in MBS they rated, and that loss severity will be at 60%, which means that 43% of the loans are projected to be lost to foreclosure (25.8/60); lack of home price appreciation said to increase defaults. Glenn Costello, Update on U.S. RMBS: Performance, Expectations, Criteria, Fitch Ratings, p. 17-18 (not dated, distributed week of February 25, 2008). According to Michael Bykhovsky, president of Applied Analytics, an estimated 40% of outstanding subprime mortgage loans could go into default over the next three years; the dire outlook due to declining home values (press briefing at the Mortgage Bankers Association's National Mortgage Servicing Conference, February 27, 2008).

[6] *See* Written Testimony of Mark Zandi, Moody's Economy.com before House Subcommittee on Commercial and Administrative Law (January 28, 2008), available at: http://judiciary.house.gov/media/pdfs/Zandi080129.pdf; *See also* Center for Responsible Lending , Subprime Spillover, (Rev. Jan. 18, 2008), http://www.responsiblelending.org/issues/mortgage/research/subprime-spillover.html

[7] *See* Center for Responsible Lending, Subprime Spillover, (Rev. Jan. 18, 2008), http://www.responsiblelending.org/issues/mortgage/research/subprime-spillover.html

[8] Statement of Federal Reserve Chairman Ben Bernanke on March 4, 2008, reprinted by Bloomberg.com and available at http://www.bloomberg.com/apps/news?pid=newsarchive&sid=apeU.0laETdM ("Bernanke statement")

[9] Christopher Swann, *IMF Says Financial Losses May Swell to $945 Billion,* April 8, 2008, *available at* http://www.bloomberg.com/apps/news?pid=email_en&refer=home&sid=aK1zAj5FZ9Io.

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

[11] January 25, 2007 letter from CFAL to Ben S. Bernanke, Sheila C. Bair, John C. Dugan, John M. Reich, JoAnn Johnson, and Neil Milner, at 3.

[12] "The Oracle Reveals All," *Newsweek* (Sept. 24, 2007) pp. 32, 33.

[13] Vikas Bajaj and Christine Haughney, Tremors At the Door -- More People with Weak Credit Are Defaulting on Mortgages," The New York Times (Fri. Jan. 26, 2007) C1, C4.

[14] "Subprime Loans Defaulting Even Before Resets," CNNMoney.com, February 20, 2008.

[15] Edmund Andrews, Relief for Homeowners is Given to a Relative Few, New York Times (March 4, 2008) (loans originated in 2005 and 2006).

[16] Kristopher Gerardi, Adam Hale Shapiro & Paul S. Willen, Subprime Outcomes: Risky Mortgages, Homeownership Experiences, and Foreclosures, Federal Reserve Bank of Boston Working Papers, No 07-15 (Dec. 3, 2007) at 3-4 (this otherwise good article misses the fact that certain loans themselves can create the cash flow shortfall that cause underwater loans to fail, when they are structured with initial low payments that are scheduled to rise, such as subprime 2/28 hybrid ARMs, and that certain loan terms have been statistically demonstrated to increase foreclosures, such as prepayment penalties)

[17] Federal Reserve Chairman Ben Bernanke recently said, "When the mortgage is 'underwater,' a reduction in [loan] principal may increase the expected payoff by reducing the risk of default and foreclosure." "Preventable foreclosures" could be reduced, he said, by enabling loan servicers to "accept a principal writedown by an amount at least sufficient to allow the borrower to refinance into a new loan from another source." This would "remove the downside risk to investors of additional writedowns or a re-default." See Bernanke statement.; see also, Edmund L. Andrews, Fed Chief Urges Breaks for Some Home Borrowers, The New York Times (Mar. 4, 2008); John Brinsley, Bernanke Call for Mortgage Forgiveness Puts Pressure on Paulson, Bloomberg.com (Mar. 5, 2008).; Phil Izzo, Housing Market Has Further to Fall, The Wall Street Journal (Mar. 13, 2008) ("Last week, Federal Reserve Chairman Ben Bernanke suggested that lenders could aid struggling homeowners by reducing their principal — the sum of money they borrowed — to lessen the likelihood of foreclosure. Some 71% of respondents [i.e., economists surveyed by the NYT] agreed with the suggestion.")

[18] White House press release, August 31, 2007. See also the Interagency Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages, http://www.federalreserve.gov/newsevents/press/bcreg/20070904a.htm (Encouraging lenders to address subprime hybrid ARM resets by pursuing "appropriate loss mitigation strategies designed to preserve homeownership. . . . Appropriate loss mitigation strategies may include, for example, loan modifications, deferral of payments, or a reduction of principal.")

[19] Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages http://www.federalreserve.gov/boarddocs/srletters/2007/SR0716.htm.

[20] Analysis of Subprime Servicing Performance, Data Report No. 1, February 2008.

[21] All statistics in this paragraph are based on data through February 2008 released by HOPE NOW. http://www.hopenow.com/media/press_releases/pdf/February_Data.pdf

[22] David Cho and Renae Merle, Merits of New Mortgage Aid Are Debate – Critics Say Treasury Plan Won't Bring Long-Term Relief, The Washington Post (Mar. 4, 2008) (citing remarks of Bill Longbrake, senior policy adviser for the Financial Services Roundtable and vice chair of Washington Mutual).

[23] Bernanke statement (see Note 8).

[24] Inside Mortgage Finance Reprints, Subprime Debt Outstanding Falls, Servicers Pushed on Loan Mods (Nov. 16, 2007) (Quoting Karen Weaver, a managing director and global head of securitization research at Deutsche Bank Securities).

[25] Credit Suisse, Mortgage Liquidity du Jour: Underestimated No More, March 12, 2007, p. 5; see also Bernanke Statement ("data collected under the Home Mortgage Disclosure Act suggest that nearly 40 percent of higher-priced home-purchase loans in 2006 involved a second mortgage (or 'piggyback') loan.").

[26] FDIC Chairwoman Sheila Bair (stating ""We've got a real problem. And I do think we need to have more activist approaches. And I think it will be something we need to be honest with the American public about. We do need more intervention. It probably will cost some money."), Real Time Economics, The Wall St. Journal (April 7, 2008) available at: http://blogs.wsj.com/economics/2008/04/07/fdic-chairwoman-calls-for-activism/?mod=google_newsThe

[27] George Magnus, "Large-scale action is needed to tackle the credit crisis," Financial Times (Apr. 8, 2008).

[28] Alan S. Blinder, "From the New Deal, a Way Out of a Mess," The New York Times (Feb. 24, 2008).

[29] CRL Issue Brief, Solution to Housing Crisis Requires Adjusting Loans to Fair Market Value through Court-Supervised Modifications (Apr. 1, 2008), available at http://www.responsiblelending.org/pdfs/senate-bankruptcy-support-brief-feb27.pdf; see also http://www.responsiblelending.org/pdfs/senate-bankruptcy-support-brief-feb27.pdf.

[30] Testimony of Richard Levin, Partner, Cravath, Swaine & Moore LLP, on behalf of the National Bankruptcy Conference, before the House Judiciary Committee, Subcommittee on Commercial and Administrative Law, "Straightening Out the Mortgage Mess: How Can WE Protect Homeownership and Provide Relief to Consumers in Financial Distress," (Oct. 30, 2007), available at http://judiciary.house.gov/media/pdfs/Levin071030.pdf, at 5.

Statement of David G. Kittle, CMB

Chairman-Elect,
Mortgage Bankers Association

before the

Subcommittee on Housing and Community Opportunity

Committee on Financial Services

United States House of Representatives

Hearing on

"H.R. 5679, the Foreclosure Prevention and Sound Mortgage Servicing Act of 2008"

April 16, 2008

Chairman Waters, Ranking Member Capito, members of the Subcommittee, I am David G. Kittle, CMB, President and Chief Executive Officer of Principle Wholesale Lending, Inc. in Louisville, Kentucky and Chairman-Elect of the Mortgage Bankers Association[1] (MBA). I appreciate the opportunity to appear before you on behalf of MBA to discuss H.R. 5679, the Foreclosure Prevention and Sound Mortgage Servicing Act of 2008.

H.R. 5679 seeks to specify and require certain loss mitigation procedures to reduce the level of foreclosures on home mortgages. MBA's members share your desire to avoid foreclosure whenever possible. Such a goal serves the interests not only of borrowers, but also of our members and of the communities in which they do business.

Avoiding Foreclosures

None of us wants a family to lose its home, and MBA members are devoting significant time and resources to finding ways to help borrowers keep their homes. The tools mortgage loan servicers use to avoid foreclosure include forbearance and repayment plans, loan modifications, refinances and partial claims.[2] Servicers also use short sales and deeds in lieu of foreclosure to avoid foreclosure when the borrower does not wish to or cannot retain the home.

It makes good economic sense for mortgage servicers to help borrowers who are in trouble. Borrowers who are not able to stay current on their loans are costly to the servicer. Servicers must forward principal and interest payments to investors as well as remit taxes and insurance payments, even if borrowers are not paying them. In addition, servicers must employ significant human resources to contact borrowers, assess the situation, work on repayment plans and other loss mitigation solutions, and if these efforts do not resolve the situation, initiate and manage the foreclosure process.

Informal forbearance and repayment plans are generally the first tool servicers use to help borrowers. Servicers allow mortgagors to miss up to three monthly payments, with the explicit understanding that the borrower will make up the payment(s) over a short period. If the situation is more involved than a short-term cash crunch due to temporary unemployment or illness, a servicer may turn to a special forbearance plan, which will typically combine a period of postponed or reduced payments followed by repayment of the arrearage over an extended period.

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 370,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,400 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

[2] A partial claim is a one-time advance of mortgage insurance benefits from FHA to the servicer in an amount necessary to bring a mortgage current. A borrower must sign a promissory note, and a lien will be placed on the property until the promissory note is paid in full. The promissory note is interest-free and is due when the first mortgage is paid off or when the property is sold. Some private mortgage insurers offer a similar option.

Loan modifications are the next level of loss mitigation. A loan modification is a change in the underlying loan document. It might extend the course of the loan, change the rate, change repayment terms or make other alterations. Loan modifications are one solution for borrowers who have an ability to repay a loan, and have the desire to keep their home, but may need some help in meeting this goal because they cannot meet the original terms of the loan. Servicers also use refinances to assist delinquent borrowers and borrowers who are at risk of defaulting on the loans in the future.

HOPE NOW alliance members[3] have worked aggressively to make all of the available tools as efficient as possible. Lenders and servicers worked diligently with the American Securitization Forum (ASF) to create a framework[4] to quickly modify certain loans securitized in the secondary market. This effort has received the backing of the U.S. Departments of the Treasury and Housing and Urban Development (HUD), many Members of Congress, the federal banking agencies and state and local officials.

The focus of the effort has been to identify categories of current borrowers with subprime hybrid adjustable rate mortgages (ARM) who can be streamlined into refinancings or modifications. The ASF-established framework is adding to existing efforts to assist distressed borrowers. The key is to find solutions that help borrowers, but do not violate the agreements with investors who now own the securities containing these loans.

Servicers, however, can only help borrowers who make themselves available for help. Lenders today are making major efforts to increase borrower response rates. They are employing third parties, sending attention-getting mail, making phone calls, going door to door and using other means to reach out to people. The industry is working hard to promote the HOPE Hotline (1-888-995-HOPE). We need borrowers who are in trouble to contact us. Borrowers must respond to servicers' notices and phone calls, or reach out to their servicer at the first sign of trouble. The longer the borrower waits to seek help, the less likely he or she will qualify for loss mitigation. The servicer can only do so much. At some point, the servicer has to assume a non-responsive homeowner does not intend to pay off the obligation and keep the home.

It is also important to note the options for helping borrowers who purchased homes as investments are limited. During the housing boom of the last several years, there were many speculators and investors looking to profit from price appreciation. The strength of our economy relies on the willingness of people to take risks, but risk means one does not always win. During this time, a majority of these properties were purchased to try to capitalize on appreciating home values or to use rents as a source of investment income, or some combination of both. With the downturn in the housing market, a number of these investors are walking away from their properties and defaulting on their loans. In the third quarter of 2007, 18 percent of foreclosure actions started were on

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[3] See http://www.hopenow.com/members/members.html for a list of members.
[4] See http://www.americansecuritization.com/uploadedFiles/FinalASFStatementonStreamlinedServicingProcedures.pdf

non-owner occupied properties. Foreclosure starts for the same period for non-owner occupied properties in Arizona, Florida, Nevada and Ohio were at 22 percent.

HOPE NOW helps all borrowers, not just subprime ARM borrowers eligible for fast track refinance or modifications. The ASF framework for a streamlined, scalable solution for current borrowers facing a reset allows servicers to give more detailed attention to at-risk, hard-to-reach borrowers. Servicers will be able to work closely with homeowners, directly or through credit counselors, to explore options to avoid foreclosure. The scalable outreach and modification effort in no way precludes ongoing work out solutions for the highest risk delinquent borrowers. By having this framework in place, mortgage company personnel and other resources are able to focus on the cases that require the most attention.

Why Mortgages Have Lower Rates than Credit Cards
While considerable effort is being made by lenders, borrowers and public officials to avoid foreclosure, we all recognize that there will be cases where this goal cannot be achieved. Ultimately, the mortgage contracts rest on two pillars: the promise of the borrower to pay and the ability of the lender to rely, in the last resort, on the house that is pledged as security for the loan. It is the pledging of the house as security that makes mortgage credit considerably less expensive than unsecured consumer debt. The rate of interest on mortgage loans is significantly lower than the rate on unsecured consumer loans. If Congress deprives borrowers, by legislation, of the ability to reliably pledge their homes as security for mortgage loans, it is probable that the rates borrowers pay for mortgage credit will approach the rates paid for unsecured credit.

In evaluating any legislation designed to reduce mortgage foreclosures, we would submit that Congress should ensure that the legislation:

(i) enhances the likelihood that borrowers experiencing economic difficulties will be able to remain in their homes;
(ii) does not unfairly deprive investors of the value of their investments in mortgage instruments; and
(iii) preserves for all consumers the benefits of reasonably priced mortgage credit by maintaining the essential elements of the mortgage contract, particularly the ability to reliably pledge a house as security for the loan.

Provisions of H.R. 5679 that Should be Removed or Modified
In reviewing H.R. 5679, there are elements of the bill that fail one or more of the above three criteria.

A. *Backdoor Moratorium on Foreclosures:* The bill would authorize borrowers' counsel to use "qualified written requests" and other procedural demands to block foreclosure indefinitely, imposing a backdoor moratorium on foreclosures.

B. *Rewriting Mortgage Terms:* The bill's prescriptive loss mitigation provisions could require lenders not only to restructure mortgages, but to write down mortgage debt. The effects of these provisions will be (i) to deprive the holders of existing

loans of the ability to exercise their rights and remedies under the mortgage contract, and (ii) to increase the cost of mortgage credit to future borrowers.

C. *First Mortgages Subsidizing Second Mortgages and Unsecured Debt:* By mandating debt-to-income ratios on first loans, the bill would appear to require holders of first liens to subordinate their economic interests to the interests of junior lien holders and unsecured creditors, which may be the source of the borrower's inability to stay current on the first mortgage payments.

D. *Eliminating Flexibility Needed to Work Out Loans:* By prescribing detailed procedures and the order in which lenders are to proceed in mitigating losses, the bill would deprive lenders the flexibility required to negotiate effectively with borrowers to achieve a manageable debt payment schedule.

E. *Paperwork Burden:* The bill would impose expensive and time-consuming paperwork requirements on lenders without any corresponding benefit to borrowers.

What follows is a more thorough explanation of each of these points.

A. Backdoor Moratorium on Foreclosures

The right created under H.R. 5679 for borrowers to file extensive "qualified written requests" for information regarding the status of their loans coupled with a prohibition on proceeding with foreclosure until a response to the "qualified written request" has been delivered will empower borrowers' attorneys to impose an effective foreclosure moratorium. Subsection (c) of the bill requires mortgage loan servicers to provide "at all times" responses to "qualified written requests." The bill also mandates that "no foreclosure proceeding may be initiated or continued against the borrower or the principal residence of the borrower during any period in which a qualified written request under this subsection is pending."

Borrowers' attorneys will have the opportunity to delay foreclosure indefinitely by issuing "qualified written requests" after default. The bill provides no restrictions on these requests. Without limiting the number, timing, content or delivery of "qualified written requests," the law effectively denies mortgagees the opportunity to exercise their right to foreclosure.

This *de facto* foreclosure moratorium will not benefit borrowers. In fact, a delay to foreclosure may unintentionally harm the borrower's ability to recover from defaulting on their loan. Through experience with borrowers who have defaulted, mortgage loan servicers have learned that the longer the borrower remains delinquent, the less likely he or she will be able to cure the delinquency and avoid foreclosure. An efficient foreclosure process actually benefits the borrower by stopping debt from continuing to accrue, and giving the borrower a reasonably clean break from a mortgage loan he or she cannot afford.

A law that indefinitely delays foreclosure through procedural hurdles will deprive the lender of necessary discretion and encourage borrowers to remain in delinquency or become delinquent hoping to use delay as a tactic to negotiate more favorable terms. Thus, what the bill intends as a procedural "safeguard" will, in fact, create a procedural barrier to resolving the status of the property.

Currently, the delinquency and foreclosure process provides adequate time for borrowers and lenders to work out a reasonable debt repayment schedule before borrowers lose their homes. Cases are generally not referred to a foreclosure attorney until the loan is 90-120 days past due. The foreclosure attorney must prepare the petition for foreclosure and file it with the appropriate court or begin the statutorily prescribed notices that pre-condition non-judicial foreclosure. In most cases, foreclosure is not a quick process. In New York, for example, it takes approximately 13 months from the petition filing date to reach foreclosure sale (i.e., an average of 19 months from due date of last paid installment to foreclosure sale). In Pennsylvania, it takes approximately 10 months. Foreclosure timelines are shorter in non-judicial states and those processes have been developed and vetted by the state legislatures over many decades.

It is important to stress that servicers continue to solicit borrowers for loss mitigation even when the loan is "in foreclosure." In today's market, trends indicate that about half of all people who enter foreclosure are able to avoid losing the home in a foreclosure sale (there are no reliable data to produce exact numbers). In fact, servicers will execute a viable loss mitigation arrangement up to the foreclosure sale date, provided state law does not require the servicer to restart the foreclosure action all over again for stopping or postponing the sale. Some states also offer redemption periods that allow a borrower to tender payment to the servicer after the foreclosure sale is complete and get the property back. Diligent borrowers have sufficient time to prevent a foreclosure if they qualify for loss mitigation.

H.R. 5679, by creating a new right to make virtually an unlimited number of "qualified written requests" regarding loan status and staying the foreclosure process until responses are received, sets up a procedural barrier to foreclosure that could turn into a backdoor moratorium on foreclosures. While foreclosure is not a desired outcome for the borrower or the lender, if legislation eliminates the possibility of foreclosure in any reasonable period, the incentive for a borrower to participate in work out negotiations is significantly diminished. Given the fact that lenders are already having difficulty persuading borrowers to contact them and to enter into negotiations regarding work outs, indefinitely postponing foreclosure is unlikely to facilitate resolution of the problems associated with delinquent loans. The only certain impact will be to call into question the right of the lender to realize on its security interest in the property, thus undermining a core element of the mortgage lending paradigm.

B. Rewriting Mortgage Terms

H.R. 5679's provision for delay of foreclosure through "qualified written requests" and the mandatory loss mitigation activities required under the bill seem designed to force

mortgage loan servicers to rewrite the terms of the mortgage loan contract. The proposed addition of Section 6A to RESPA mandates that mortgage servicers "shall engage in reasonable loss mitigation activities that provide for -- (1) the long-term affordability of the loan; and (2) the maximum retention of home equity."

The bill then provides a list of priority and secondary loss mitigation activities. While the bill's mandate to engage in specific loss mitigation activities is ambiguous, these provisions, coupled with the "affordability" and "maximum equity" standards, can be read as a statutory redefinition of essential loan terms. Procedural barriers to the timely exercise of property rights can effectively eliminate those rights as a matter of law, and we fear that this could be the ultimate impact of H.R. 5679 on mortgage contracts. This being the case, (i) current holders of mortgage loans will be deprived of their legal rights, and (ii) because lenders will not be able to rely upon the security interests created under mortgage contracts in the future, the price of mortgage credit can be expected to rise.

This bill's provisions that adjust a security interest in real property raise issues under the takings clause of the Constitution. The government may acquire property for public use or benefit, but it must provide just compensation to the owner. In this bill, Congress would alter the terms of mortgage loan holders' security interest in real property, for the apparent public purpose of encouraging continued homeownership. A security interest vests a real property right protected by the Fifth Amendment of the Constitution. Under takings clause jurisprudence, a lender must receive just compensation if its preexisting property rights are to be extinguished.[5] Federal Courts of Appeal have also consistently held that an indefinite delay on the right to foreclose constitutes a taking.[6] Since this bill does not explicitly limit its effects to future loans, if Congress does enact the provisions of H.R. 5679 referenced above, it should include authorization for an appropriation to compensate lenders for any taking of their preexisting property rights that may result.

Given that mortgages often back securities that are widely held by institutional investors, including pension funds, university endowments and insurance companies, whose interests will be negatively affected if Congress enacts a mandate to write down principal and interest on home mortgage loans, there are strong public policy reasons supporting the constitutional mandate to provide just compensation.

The effectiveness of the mortgage market rests on the ability of the loan holder to recoup money lent based on the terms of the mortgage contract. If Congress, by statute, alters mortgage loan terms for existing and future mortgages, calling into question the ability of the loan holder to realize on its security interest in real estate, then the mortgage market as it exists today can be expected to change dramatically. One result may be a return to an era when borrowers with riskier credit profiles were shut out of the mortgage loan market altogether because lenders are unable to offer

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[5] *See Lingle v. Chevron U.S.A. Inc.*, 544 U.S. 528, 538-39 (2005)(holding that to determine whether a taking has taken place particular weight will be given to the extent the law interferes with investment backed expectations)
[6] *See e.g. Simon v. Cebrick*, 53 F.3d 17, 24 (3d Cir. 1995); *Donna Independent School District v. Balli*, 21 F.3d 100, 101 (5th Cir. 1994); *Matagorda County. v. Russell Law*, 19 F.3d 215, 225 (5th Cir. 1994).

affordable mortgage loans. Even borrowers with good credit histories will likely have to pay more for credit, because they will be unable to effectively pledge their homes as security for their loans.

Further, any provision that *mandates* an adjustment to the terms governing the amount of principal or interest paid over the course of the loan is unacceptable. The bill includes as a priority loss mitigation activity: "Waiver, modification or variation of any material term of the loan . . . that change the interest rate, forgive the payment of principal or interest, or extend the final maturity date of the loan." MBA believes that while adjustments may be made to certain mortgage loan terms, providing by statute that borrowers may avoid their financial responsibility creates a moral hazard that would have serious repercussions throughout the consumer credit markets.

C. First Lien Mortgages Subsidizing Second Mortgages and Unsecured Debt
Through the bill's affordability provisions, first lien holders may, in effect, subsidize secondary creditors by providing for the borrower's junior debt in loss mitigation activities. Subsection (d)(3) of the bill requires "each mortgagee or servicer with respect to a senior lien shall reasonably take into account the obligations of the borrower or mortgagor under subordinate liens," and "any other secured or unsecured obligations." Under this provision, when making the debt-to-income calculations, a mortgage loan servicer will have to provide lower monthly payments for a borrower who has larger debts to junior lien holders, and even unsecured creditors. This would essentially reverse the priority position of the lien holders. Junior lien holders and unsecured creditors would have no incentive to adjust the terms of their credit agreement when the first lien holder faces a statutory obligation to provide loss mitigation activities, including principal write-downs that ensure "the long-term affordability of the loan and maximum retention of home equity."

If enacted, this provision could also have the perverse effect of rewarding the most financially irresponsible borrowers. Since a first lien holder must provide for unsecured debt in rewriting loan terms, some borrowers may take advantage of this provision to increase credit card and other unsecured debt, knowing higher unsecured debt will cause further favorable adjustments in the payment terms of their first mortgage loan.

D. Eliminating Flexibility Needed to Work Out Loans
The bill prescribes in statutory terms a specific listing of activities a lender must take with respect to delinquent loans and prescribes the order in which they must be taken. It is extraordinary to use statutory language like this to micromanage the loan administration process.

The bill's rigid loss mitigation prescriptions do not accord to the realities of the mortgage marketplace. For instance, not all borrowers want to stay in their homes. Some have decided to stop making mortgage payments because to do so no longer suits their economic interests.[7] For these individuals, loss mitigation would clearly be

[7] See, for example, Said, Carolyn: "More in Foreclosure Choose to Walk Away," San Francisco *Chronicle*: March 16, 2008 (http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2008/03/16/MNFFVI036.DTL)

unproductive. Focusing efforts on these borrowers would prevent mortgage loan servicers from giving full attention to borrowers who would benefit from loss mitigation activities.

For those borrowers that can use loss mitigation to keep their homes, the current goal within the mortgage loan servicing industry is to determine the appropriate loss mitigation activity as quickly as possible. Obviously, the faster the servicer can adjust terms of a loan, the greater the chance the borrower has to avoid foreclosure. The list of required loss mitigation activities that a mortgage loan servicer must employ in this bill would make a fast turnaround impossible.

This bill does not allow mortgage loan servicers the flexibility to include a merit test, which is essential to making loss mitigation economically feasible. Some borrowers have misused their credit by running up credit card or other debt. Some borrowers vandalize their property after becoming delinquent on their mortgage payments. Other borrowers stop making payments after unsuccessful home improvement projects. Recently borrowers with sufficient income to pay their mortgages are demanding principal write-downs simply because they now owe more on their mortgages than their homes are worth due to recent price declines in some markets. Federal policy should not encourage this behavior. By allowing these borrowers to remain in their homes, and in effect mandating modifications to their mortgages, this bill would increase mortgage and insurance costs, further drive down property values and absorb the servicer's limited capital resources to make modifications. Mortgage loan servicers need the flexibility to separate those borrowers who are deserving of loss mitigation and those who would abuse the opportunity to retain one's home that loss mitigation provides.

The duty to refer borrowers to a HUD-certified housing counselor raises another concern about industry flexibility. Subsection (i) in the bill requires the mortgage servicer to "forward to a housing counseling agency approved by the Secretary the contact information of the borrower." While housing counseling may be beneficial in some instances, mortgage loan servicers would like to have more flexibility in determining whether counseling would be productive. After all, mortgage loan servicers have the most information about the borrower and his or her property. As noted above, some borrowers are not interested in keeping their home. Other borrowers may be able to negotiate a beneficial loss mitigation activity without any counseling. Still others may be uncomfortable with an unfamiliar "counselor" knowing that they are delinquent in their mortgage payments. The bill also conflicts with existing privacy laws that restrict servicers' ability to share this information with third parties without the borrower's consent. There is no provision in the bill that addresses this conflict.

E. Paperwork Burden

Mortgage servicers could not feasibly comply with the bill's "qualified written request" provision. Subsection (4) of the bill requires mortgage loan servicers to "have available" for the borrower: (i) information regarding whether the account is current, (ii) the current balance due on the mortgage loan, (iii) full payment history, (iv) the initial terms of the loan, (v) a copy of the original note and security instrument, (vi) identification of the

owner of the mortgage note and any investors, (vii) any documents that limit or explain loss mitigation activities, and (viii) "any other information requested by the borrower that is reasonably related to loss mitigation activities." This "availability" would require an extraordinary amount of paperwork for each loan at a significant cost to the mortgage servicer. The current mortgage servicing computer software may not include all of this information, and this provision would be a compliance nightmare for loans made before the effective date of the bill. Further, we do not believe this mass production of documents would benefit borrowers. Most borrowers would be flooded with information that would not assist them in resolving their delinquency or achieving a payment schedule that will allow them to keep their home.

Conclusion

While we share the goal of preventing foreclosures, MBA must oppose H.R. 5679 because of the harm it will cause to the mortgage market and borrowers. H.R. 5679 will increase rates, reduce availability of credit and dampen investor interest in mortgage instruments. Affordable mortgage loans depend on the security interest in the pledged home and the certainty that loan terms are enforceable. Combined with additional regulatory burdens placed on mortgage servicers through paperwork and unnecessary bureaucracy, H.R. 5679 would strike a significant financial blow to the industry. With investor appetite for U.S. mortgages waning, it is ill advised to pass legislation that will further disrupt the mortgage market.

We urge Representatives to consider carefully the long-term implications of H.R. 5679, not just the perceived benefits the bill would provide to some homeowners whose loans are delinquent. We believe that even the intended beneficiaries are unlikely to be advantaged by this legislation, and investors in mortgage assets are likely to be significantly disadvantaged as their investments become illiquid because of uncertainties the legislation would introduce. We are convinced that, upon review, Congress will agree that this bill is not a prudent solution to current challenges.

Thank you for the opportunity to share our thoughts with the Subcommittee. I look forward to answering your questions.

Written Statement of Laurie Maggiano
Deputy Director, Office of Single Family Asset Management, Federal Housing Administration

U.S. Department of Housing and Urban Development

"H.R. 5679, The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008"

Subcommittee on Housing and Community Opportunity
Committee on Financial Services

U.S. House of Representatives

April 16, 2008

Chairwoman Waters, members of the subcommittee, on behalf of Secretary Jackson and Commissioner Montgomery, thank you for allowing the Federal Housing Administration to participate in this hearing and to discuss the critical difference that sound servicing practices can make in preventing mortgage foreclosures. While a mortgage servicer is rarely the cause of a default, timely and comprehensive servicing actions can and do enable many delinquent borrowers to avoid foreclosure and retain homeownership.

This dynamic is well illustrated by looking at the highly successful FHA Loss Mitigation Program, which encompasses a series of flexible workout options for managing seriously delinquent loans – defined as those that are more than 90 days delinquent – in the FHA portfolio. These workout options are administered not by government staff, but by FHA servicers. FHA provides monetary incentives to encourage servicers to help borrowers recover from serious default and provides additional incentives to those servicers with an exemplary record of working with borrowers and mitigating claim costs to the FHA insurance funds.

Mandatory Participation

It is important to stress that although loan servicers have delegated authority to execute individual loss mitigation actions, participation in the FHA Loss Mitigation Program is not optional.

- Within 45 days of default, every delinquent borrower must be provided comprehensive written information about workout options, including contact information for HUD-approved housing counseling agencies.
- Each borrower must be evaluated for loss mitigation by the 90th day of default.
- No servicer may initiate foreclosure until their senior management committee has reviewed the loss mitigation analysis and determined that the borrower does not qualify for any option.
- Servicers must offer loss mitigation throughout the foreclosure process any time the borrower requests such consideration or the servicer becomes aware that the borrower's financial situation may have improved and assistance is now an option.
- And finally, these activities must be reported to FHA monthly and documented in the loan file.

To ensure compliance, FHA has developed a sophisticated tiered ranking system to both monitor and rate each servicer's commitment to loss mitigation. Top ranked servicers – those who reported some type of loan work action for at least 80 percent of their seriously delinquent loans – are eligible to earn increased incentives. In the most recent round of tier ranking published in January 2008, 89 servicers ranked in Tier One and only five servicers ranked in Tier Four. Servicing lenders that do not take loss mitigation seriously are in jeopardy of paying to FHA a fine equal to triple the cost of their foreclosure claim and can also be held accountable with other sanctions.

Focus on Home Retention

The vast majority of delinquent loans are reinstated through simple repayment plans executed in the first or second month of delinquency. FHA's home retention options are targeted at seriously delinquent borrowers who demonstrate an ongoing commitment to keep their homes but who require more than just a short-term repayment plan to help them regain their financial footing. These options include:

Special Forbearance – A long-term repayment plan that provides one or more special repayment provisions, such as a reduction or suspension of payments for a period of time while the borrower recovers from the cause of the default.

Mortgage Modification – A permanent change to one or more of the mortgage terms including capitalization of delinquent payments, re-amortization of the payments or a change in the interest rate that will fully reinstate the loan and potentially result in a lower monthly payment.

Partial Claim – A loan provided by FHA in an amount necessary to reinstate the delinquent mortgage. The loan is interest free and is not due and payable until the first mortgage is paid off. This option provides up to 12 months of mortgage payment assistance to borrowers who have the ability to resume making full payments but do not have funds to bring their loan current. Until recently, this option was only available through FHA, but recently Fannie Mae introduced a HomeSaver Advance workout patterned on the FHA model.

Disposition Options

For borrowers who are financially unable or no longer wish to retain homeownership, perhaps because of a death or divorce, FHA provides pre-foreclosure sale and deed-in-lieu of foreclosure options. In these "disposition" options, FHA provides the borrower with compensation of up to $2,000 to ease the transition to more affordable housing.

A **Pre-Foreclosure Sale** allows a borrower to sell the house on the private market and use the proceeds of the sale to fully satisfy the mortgage debt, even if the proceeds are less than the amount owed.

The **Deed-In-Lieu** option allows a borrower who has been unable to sell his or her home, the ability to deed the property to FHA in full satisfaction of the debt rather than be subjected to a foreclosure action.

While these disposition options provide needed relief to borrowers whose financial situation has changed to the extent that they cannot resume making payments, FHA's commitment to home retention is evident in use patterns. In FY 2007, for example, 95 percent of all loss mitigation workouts resulted in the borrower keeping the home, while less than 5 percent of borrowers received loss mitigation through a pre-foreclosure sale or a deed-in-lieu.

Program Flexibility

One of the significant strengths of the FHA Loss Mitigation Program is its flexibility. FHA is continually monitoring market conditions and making changes to its loss mitigation options in response to economic or other trends. For example, following the terrorist attacks of September 11th, FHA added a new home retention tool, "Special Forbearance for the Unemployed Borrower," to address the specific needs of borrowers who were temporarily un- or under-employed but had a strong employment history and no prior defaults. After a series of hurricanes struck the Gulf Coast region in 2005, FHA created a special Mortgage Assistance option to advance up to 12 months' worth of mortgage payments to borrowers who were in the process of rebuilding their homes but could not rebuild and make monthly mortgage payments at the same time. Currently we are working on potential policy improvements that will eliminate some of the impediments to the mortgage modification and preforeclosure sale options to assist more borrowers who have negative equity while remaining actuarially sound.

Loss Mitigation Results

The dual goals of the FHA Loss Mitigation Program are to help FHA insured borrowers avoid foreclosure and to minimize losses to our Insurance Funds. The program is successfully achieving both of these goals.
Use of loss mitigation tools to prevent foreclosure has increased exponentially since the program was first introduced in 1997. In that year, only 773 families received help keeping their homes, while 64,000 properties were acquired through foreclosure. That dynamic has shifted dramatically in the ensuing years. In five of the past six years, loss mitigation use exceeded the number of foreclosures. Last year alone, FHA helped 86,500 seriously delinquent borrowers retain home ownership.

As loss mitigation use has increased over time, there has been a corresponding reduction in foreclosure claims. Contrary to the incorrect report in last Sunday's *Washington Post*, the percentage of FHA insured loans that terminated in foreclosure has decreased every year for the past three years, from 1.64 percent of all FHA loans in fiscal year 2004 to 1.42 percent in 2007. It is equally important to note that these workouts are not a temporary fix. While it is unrealistic to expect that every loss mitigation action will be a success, 87 percent of borrowers who received home retention workouts in 2005 still had active loans in 2007. And, in terms of preserving the financial integrity of the insurance funds, the $158 million paid in home retention claims last year had a net benefit of $2 billion in loss avoidance.

The FHA Loss Mitigation program is comprehensive, dynamic and successful at both reducing financial losses and helping ever increasing numbers of FHA borrowers retain homeownership. It is also a central reason that FHA is considered a safe and affordable loan product. Many subprime borrowers would have benefited from an FHA loan. Going for the quick close, many mortgage originators and borrowers ignored the warning signs that these products were not economically viable in the long term.

Fortunately, many borrowers now stuck in uneconomic subprime ARMs have the option of refinancing through FHA*Secure*. This program, introduced by President Bush in September 2007, gave the Department greater flexibility to allow borrowers who became delinquent as the result of an interest rate reset the option to refinance to FHA. As of April 10, 2008, 155,000 borrowers had closed on a fixed rate, FHA*Secure* loan. Just last week, in this hearing room, Commissioner Montgomery announced additional mortgage assistance for subprime borrowers by giving FHA the ability to insure loans for borrowers who are a few payments late or who have received a voluntary mortgage principal write-down. FHA*Secure* is now expected to assist 500,000 at risk borrowers by the end of December 2008.

However, FHA*Secure* may not be the most appropriate workout solution for every borrower. We strongly encourage servicers to consider all available loss mitigation strategies.

In closing, I would like to again thank the Subcommittee for its thoughtful consideration of loss mitigation. The Administration is committed not only to helping American families achieve homeownership but also to helping them preserve it.

Statement of

Faith Schwartz

Executive Director, HOPE NOW Alliance

Before the

Subcommittee on Housing and Community Opportunity
Committee on Financial Services
United States House of Representatives

April 16, 2008, 10:00 a.m.

Hearing on

"H.R. 5679, The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008"

2128 Rayburn House Office Building

Madam Chairwoman, Ranking Member Capito and Members of the Subcommittee, I am Faith Schwartz, Executive Director of the HOPE NOW Alliance. I appreciate the opportunity to appear before you today on behalf of HOPE NOW to talk about the efforts to help at-risk homeowners stay in their homes during this time of serious challenges in the housing market.

The HOPE NOW Alliance is a broad-based collaboration between credit and homeownership counselors, lenders, investors, mortgage market participants and trade associations. Since last October, the HOPE NOW Alliance has worked to dramatically expand and coordinate the efforts that individual companies and non-profits are making to help homeowners in difficulty. HOPE NOW builds on efforts that individual companies were making to reach borrowers and it is also an expansion of an industry partnership with NeighborWorks and the Homeownership Preservation Foundation to reach at-risk borrowers and provide counseling to them.

HOPE NOW was strongly encouraged by the President, Treasury Secretary Paulson and by Members of Congress and other leaders. Chairman Frank and Members of this Committee have stressed the need for this type of effort and we are responding to that direction.

HOPE NOW established and is expanding a coordinated, national approach among servicers, investors[1], non-profit housing counselors and other industry participants to enhance our ability to reach out to borrowers who may have or expect to have difficulty making their mortgage payments and to offer them workable options to avoid foreclosure. While HOPE NOW can not solve all foreclosures, HOPE NOW is achieving real results in reaching more at-risk borrowers and in providing positive solutions that avoid foreclosure.

HOPE NOW has a three-pronged approach to reach our goals of helping homeowners avoid foreclosure:

- Reaching Homeowners In Need
- Counseling Homeowners in Need
- Assisting Homeowners in Need

Progress in Helping Struggling Homeowners

The members of the HOPE NOW Alliance recognize the urgency of this issue, and we are working to reach and assist more homeowners every day. I am pleased to have the opportunity to share our progress with you, including the most recent data on our results.

First, the Alliance is continuing to expand and add companies and organizations who commit to specific efforts to reach and assist borrowers. As of April 7th, we have 27 loan servicers in the Alliance who represent over 90 percent of the subprime market. In addition, we have strong participation from respected non-profits including all HUD-approved intermediaries, led by NeighborWorks America, the Homeownership Preservation Foundation, and the Housing Partnership Network, with their networks of trained counselors.

One of the Alliance's first steps was to demonstrate our commitment to results by adopting a Statement of Principles on helping distressed homeowners stay in their homes. These principles are helping ensure that all borrowers receive quality service and assistance when they contact their lender/servicer in the Alliance.

[1] After a mortgage is made, the lender will often sell the loan to investors. A loan servicer acts as the intermediary between the borrower and the investor. The servicer's role is to collect payments, handle escrow accounts, forward principal and interest payments to the investor and deal with issues that arise from delinquency and foreclosure. A servicer is typically compensated 25 basis points (0.25%) of the loan balance for performing this service, or $250 on a $100,000 loan balance.

The following are the principles embraced by HOPE NOW servicers, which are consistent with calls for the industry to expedite solutions for borrower:

- HOPE NOW members agree to attempt to contact at-risk borrowers 120 days, at a minimum, prior to the initial Adjustable Rate Mortgage (ARM) reset on all 2/28 and 3/27 ARM loan products;
- HOPE NOW members agree to inform borrowers of the potential increase in payment and terms of the loan, in an effort to determine if the borrower may face financial difficulty in keeping their mortgage current;
- HOPE NOW members agree to establish a single port of entry for all participating counselors to use; and
- HOPE NOW members agree to make available dedicated e-mail and fax connections to support counselor and consumer contacts.

By establishing these principles, HOPE NOW members are improving the infrastructure needed to help more borrowers on a much larger scale. In addition to improving lender/servicer systems for working with counselors and borrowers, we are redoubling our efforts to reach out to at-risk borrowers.

Reaching Homeowners in Need

One of the most significant on-going challenges we face in helping consumers is a persistent reluctance of struggling borrowers to contact their servicer for help. Historically, evidence has shown that about half of borrowers who go into foreclosure never contacted their servicer for help. Freddie Mac reported at the end of January that 57 percent of the nation's late-paying borrowers still don't know that their lenders may offer alternatives to help avoid foreclosure.[2] We are working to drastically reduce that number and help as many troubled homeowners as possible avoid foreclosure.

In November, HOPE NOW servicer participants began a monthly direct mail outreach campaign to at-risk borrowers. This direct mail effort --on the HOPE NOW letterhead-- is in addition to the thousands of letters and telephone contacts made by individual servicers to their own customers. These letters provide individual servicer hotlines and, also include the Homeownership Preservation Foundation's HOPE Hotline, 888-995-HOPE.

Since November, HOPE NOW servicers have mailed 1,200,000 letters to at-risk homeowners who have not been in contact with their mortgage servicer. This outreach campaign is producing results. On average, 20 percent of those receiving the letter contact their servicer, far more than the typical 2-3 percent response rate which servicers get when sending their own mailing. In addition, the Homeownership Preservation Foundation reports that in the First Quarter of 2008, over 11% of people calling the Hotline heard about it from a HOPE NOW outreach letter.

[2] http://www.freddiemac.com/news/archives/corporate/2008/20080131_07ropersurvey.html

HOPE NOW Homeownership Preservation Workshops

In addition to the early contact, direct mail campaign and promotion of the HOPE hotline to reach at-risk borrowers, HOPE NOW is conducting a series of workshops for homeowners. These workshops are held across the country, providing at-risk borrowers an opportunity to meet in-person with their loan servicer or a local HUD-approved counselor. Counseling agencies affiliated with HUD intermediaries, such as ACORN, NeighborWorks, NID, NFCC, and others, have played an active role.

Since the first week of March, more than 1,400 homeowners have attended HOPE NOW workshops. More than 900 borrowers in California and nearly 500 borrowers in Ohio and Pennsylvania attended the HOPE NOW events. HOPE NOW mortgage servicers participate in these events and provide workout solutions on site, and non-profit counselors provide in-depth debt and credit management assistance. During the next 3 months, HOPE NOW workshops fore homeowners will be held in 10 additional markets: Atlanta, Milwaukee, Indianapolis, Chicago, Memphis, Jacksonville, Dallas, Houston, San Antonio, and Las Vegas.

These collaborative workshops are enabling more homeowners to meet with their mortgage company representative and develop workout solutions that help them stay in their home.

In the coming weeks, HOPE NOW is hosting three more outreach events: Atlanta, Georgia on Saturday, April 19th; Milwaukee, Wisconsin on Monday, April 21st; Indianapolis, Indiana on Tuesday, April 22; and Chicago, IL on Thursday, April 24th.

Counseling Homeowners in Need

The Homeowner's HOPE Hotline (888-995-HOPE) is a key component of the outreach and assistance effort for at-risk homeowners. The hotline directly connects homeowners with trained counselors at non-profit counseling agencies that have been certified by the Department of Housing and Urban Development (HUD). This counseling service is completely free to borrowers and is offered in English and Spanish. The counselors have direct access to the lender/servicers through improved single points of entry that all HOPE NOW Alliance members have agreed to create. Providing this direct point of contact for non-profit counselors to loan servicers represents real and important progress by HOPE NOW members.

The Homeowner's HOPE Hotline is having a dramatic and positive impact for at-risk homeowners. The HOPE NOW Alliance will continue to expand the Hotline's capacity and promote it to reach more at-risk borrowers.

- To date, the Homeownership Preservation Foundation Homeowner's HOPE™ Hotline has received 632,122 calls, with over 250,000 calls in first quarter 2008 alone.
- Calls are increasing monthly. In March 2008, the Hotline received over 84,000 calls and counseled more than 24,200 borrowers.
- Lender/servicers are urging borrowers to call for counseling. Homeowners primarily hear about the Homeowner's HOPE hotline from their lender.
- More homeowners with ARMs are calling – 51 percent of callers in the first quarter of 2008 were ARM borrowers, up from 34 percent in the first quarter of 2007.
- The Counseling sessions produce results. In the first quarter of 2008, one third of homeowners counseled were referred to their lender for a recommended workout.

We are proud that the Homeowner's HOPE Hotline provides a resource for free, non-profit counseling to any homeowner, anywhere in the country. Publicity for the Homeowner's HOPE Hotline continues to increase and we want more homeowners will learn about it. President Bush and Treasury Secretary Paulson have called attention to the Homeowner's HOPE Hotline several times and they have urged homeowners in trouble to seek help. Members of Congress have also highlighted the hotline, and I want to thank Chairman Frank, Ranking Member Bachus and the Members of the Committee for helping raise awareness of the hotline. In addition, thirty-eight mayors from across the country recently created public service announcements for their local media markets urging borrowers to use the hotline. Anytime the Homeowner's HOPE Hotline is mentioned by public officials or on television, calls to the hotline increase dramatically. We welcome that support we are continuing to work to expand the counseling network for the hotline.

Members of Congress, in an effort to help their constituents avoid foreclosure, have asked us on many occasions what they could do to help. Members of Congress and other community leaders can continue to assist in this critical effort to help people stay out of foreclosure by urging homeowners to seek help and publicize HOPE NOW efforts, particularly the Homeowner's HOPE Hotline, 888-995-HOPE. We would like to continue to work with the Financial Services Committee to ensure that more homeowners are aware of the HOPE hotline and other assistance from the HOPE NOW Alliance.

The Homeownership Preservation Foundation, the HOPE NOW Alliance member managing the telephone network, is continuing to add trained, experienced counselors to the program to handle the increasing call volume from concerned homeowners. Tremendous progress has been made in just the last few months to increase counseling capacity. The hotline now has 450 trained counselors assisting borrowers, up from 64 at the beginning of 2007. The agencies providing counseling include Auriton Solutions, CCCS Atlanta, CCCS San Francisco, Novadebt, Springboard CCCS Central Florida, CCCS Dallas, By Design, Greenpath and Money Management International.

NeighborWorks America, known formally as the Neighborhood Reinvestment Corporation, is a Congressionally-chartered non-profit organization with a national network of more than 240 community-based organizations In 50 states. NeighborWorks is a leader in the HOPE NOW Alliance, and with its partners, is actively providing in-person counseling services to consumers across the country. NeighborWorks has also been the leader in working with the Ad Council on the national advertising campaign for the Homeowners' HOPE hotline, which includes television, radio and print materials.

HOPE NOW is working to add more non-profit agencies to the effort. HOPE NOW is working with HUD and HUD counseling intermediaries to review ways to include additional grass-roots counseling groups. We are working to broaden the HOPE NOW effort to ensure it is a model that works broadly for industry, non-profits and consumers to maximize the ability to reach troubled borrowers.

Servicers' ability to reach borrowers, either directly or through an intermediary is the key to helping them stay in their homes. The solutions will vary with the circumstances of the borrower. Loan modifications, repayment plans and other types of workout options are all solutions that can help borrowers keep their homes and minimize losses to investors. The HOPE NOW Alliance is committed to pursuing all viable solutions to help people stay in their homes.

Assisting Homeowners in Need

The HOPE NOW mortgage servicers recognize that it also makes good economic sense to help borrowers who are in trouble. Borrowers who are not able to stay current on their loans are very costly to the servicer, who must forward principal and interest payments to investors as well as remit taxes and insurance payments, even if borrowers are not paying them. In addition, loan servicers must expend significant staff resources to contact the borrower, assess the situation, work on repayment plans and other loss mitigation solutions, and if these efforts do not resolve the situation, initiate and manage the foreclosure process.

Informal forbearance and repayment plans are generally the first tool servicers employ to help borrowers. Servicers allow mortgage borrowers to miss a payment, with the explicit understanding the payment(s) will be made up some time soon. If the situation is more involved than a short- term cash crunch due to temporary unemployment or illness, a servicer may turn to a special forbearance plan, which will typically combine a period of postponed or reduced payments followed by repayment of the arrearage over an extended time frame, but within the original term of the loan.

Loan modifications are the next level of loss mitigation options. A loan modification is a change in the underlying loan agreement. It might extend the term of the loan, change the interest rate, change repayment terms or make other alterations such as having a principal write down. Similarly, a servicer may attempt to refinance the delinquent borrower into a new loan. Loan modifications are one solution for borrowers who have an ability to repay a loan, and have the desire to keep their home, but may need some help in meeting this goal because the current loan terms are not sustainable for that borrower.

HOPE NOW members have worked aggressively to make all of the available tools as efficient as possible. In December 2007, the American Securitization Forum (ASF) announced a framework that allows servicers to more readily modify certain at-risk loans that are securitized in the secondary market. This effort has received the backing of the Departments of the Treasury and HUD, many Members of Congress, the federal banking agencies and state and local officials.

The focus of the ASF framework is to identify categories of current subprime hybrid ARM borrowers who can be streamlined into refinance or modifications. We believe that the ASF-established framework is adding to existing efforts to assist distressed borrowers. The key is to find solutions which help borrowers but do not violate the agreements with investors who now own the securities containing these loans.

The ASF has worked with servicers and investors to create and implement a process which identifies, in advance of loan resets, borrowers who would qualify for refinancing, loan modifications or other workout options. To ensure that investors accept and support far-reaching loan modification and other workout solutions, this process cannot violate pooling and servicing agreements with investors. The goal is to minimize the risk of legal action by investors against servicers who help borrowers.

The ASF framework covers securitized subprime adjustable rate mortgage loans, the so-called 2/28's and 3/27's that were originated between January 1, 2005 and July 31 2007 with an initial interest rate that resets between January 1, 2008 and July 31, 2010. In other words, the framework is for loans that have just begun to adjust. The ASF framework will help provide

solutions for homeowners with these subprime hybrid ARMs who qualify for three different types of help: refinancing, modification and other loss mitigation efforts.

- *Refinancing:* One segment of borrowers is comprised of those who are current, likely to remain current even after reset, or likely to be able to refinance into available mortgage products, including the Federal Housing Administration (FHA), FHA Secure or industry products. Generally, the servicer will determine whether loans may be eligible for refinancing into various available products based on readily available data such as LTV, loan amount, FICO and payment history. The servicer will facilitate a refinance in a manner that avoids the imposition of prepayment penalties whenever feasible. HOPE NOW will continue to work with the alliance to ensure that all servicers have access to products and programs generally available in the market to refinance eligible borrowers.

- *Loan Modifications:* A second segment of borrowers is comprised of those with good payment records who will not qualify for refinancing for any variety of reasons, such as a drop in home equity or insufficient credit score. These borrowers will be targeted for streamlined loan modifications if the loan is a primary residence (i.e., not an investment or vacation property) and meets additional criteria. Borrowers in this category will be offered a loan modification under which the interest rate will be kept at the existing rate of the loan for five years. This fast track option does not in any way preclude a servicer from conducting a more individual in-depth review, analysis and unique modification for a borrower to determine if a longer term modification would be appropriate.

  The fast track framework allows the servicer to make these decisions:

  - Whether the borrower is unable to pay under the original loan terms after the upcoming reset and default is reasonably foreseeable, based on the size of the payment increase, and the current income if the borrower did not pass the FICO improvement test;

  - Whether the borrower will be able to pay a modified loan based on payment history prior to the reset date;

  - Whether the borrower is willing to pay a modified loan; and

  - Whether the modification will maximize the net present value of recoveries to the securitization trust and is in the best interests of investors in the aggregate, because refinancing opportunities are not available and the borrower is able and willing to pay under the modified terms.

- *Loss Mitigation:* This third segment of borrowers is comprised of those for whom the loan is not current and who will not be able to refinance into any available product. These borrowers are significantly behind in their payments before the loan resets and their situations need to be evaluated individually. It is especially important for us to reach this group of borrowers through efforts such as the HOPE NOW direct mail campaign and through the national advertising campaign for the Homeowner's HOPE hotline. For loans in this category, the servicer will determine the appropriate workout and loss mitigation approach on a loan-by-loan basis. Referrals from counselors if the borrowers contact the Homeowners' HOPE hotline will also be important. Approaches for these borrowers may include loan modification (including longer-term rate reductions, capitalization of arrearages and term extensions), forbearance, short sale,

deeds in lieu of foreclosure or foreclosure. Because these borrowers are already behind in their payments, and may face challenges such as a loss of income or other issues, they require a more intensive analysis, including current debt and income analysis, to determine the appropriate loss mitigation approach.

Servicers, however, can only help borrowers who come forward for help. Borrowers must respond to servicers' notices and phone calls. That is why the outreach effort is so important. If borrowers do not respond, at some point the servicer has to assume the homeowner has no intention of paying off the obligation. It is also important to note that the options for helping borrowers who purchased homes as investments are limited. During the housing boom of the last several years, there were many speculators and investors looking to profit from price appreciation. The strength of our economy relies on the willingness of people to take risks, but risk means that you do not always win. During this time, a majority of these properties were purchased to try to capitalize on appreciating home values or to use rents as a source of investment income, or some combination of both. With the downturn in the housing market, a number of these investors are walking away from their properties and defaulting on their loans.

HOPE NOW is seeking to help all borrowers at risk, not just subprime ARM borrowers eligible for fast track refinance or modifications. The ASF framework for a streamlined, scalable solution for current borrowers facing a reset allows servicers to give more detailed attention to at-risk, hard-to-reach, delinquent borrowers. Servicers will be able to work closely with housing counselors and/or homeowners to ensure all options are explored to avoid foreclosures. The scalable outreach and modification effort in no way precludes on-going workout solutions for the highest risk delinquent borrowers. By having this framework in place, human capital and other resources are able to focus on the cases that require the most attention.

Project Lifeline

HOPE NOW members are continuing to work to develop new methods and programs to assist at-risk homeowners. Project Lifeline is the latest effort to help the most at-risk borrowers – those borrowers who are 90 days or more late on their mortgage and face the greatest risk of losing their home. HOPE NOW servicers are adopting the principles of this effort to reach the most at risk borrowers (90-day plus delinquent), work with agreed upon steps with borrowers and if appropriate, put a 30-day "pause" on foreclosures. Project Lifeline is initiated by servicers sending a letter to seriously delinquent homeowners. This program reaches most loans, Prime, Alt-A, Subprime, and second liens. The servicers will reach out to homeowners with the following straightforward message and steps that may qualify them for a loan modification:

1. Call your mortgage servicer
2. Tell the servicer you received a letter, you want to stay in your home and you are willing to seek counseling, if necessary.
3. Provide updated financial information so the servicer can explore a suitable solution.
4. If appropriate, any pending foreclosure will be 'paused' for up to 30 days during the review process until a formal decision is made and a plan is created.

5. If a workout plan is established and the homeowner follows the plan for three consecutive months, their loan will be formally modified as they have demonstrated their ability to meet their requirements.

Measuring HOPE NOW's Results

The members of HOPE NOW recognize that results are the key to this national effort to assist at-risk homeowners. We are regularly collecting data and updating our results on the efforts to help homeowners. I am pleased to share with you the latest results from HOPE NOW servicers on their efforts. This latest HOPE NOW data shows that additional homeowners are continuing to receive assistance to avoid foreclosure and remain in their homes.

National Results:

- From July 2007 to February 2008, nearly 1.2 million borrowers avoided foreclosure through loan workouts.
- This includes an estimated 848,000 formal repayment plans and an estimated 330,000 modifications.
- Subprime loan workouts totaled 717,500, including 485,500 repayment plans and 232,000 loan modifications.
- In January and February 2008, HOPE NOW servicers provided 309,700 loan workouts to subprime and prime borrowers. This included 196,200 repayment plans and 113,500 loan modifications.
- Since the beginning of 2008, subprime loan modifications have increased more than four fold from the same period in 2007.

Data on Hybrid ARM Resets

We now have initial data results on modifications for subprime hybrid ARMs. As I noted earlier, on December 6, the American Securitization Forum announced a plan to fast-track solutions for subprime ARM borrowers who could afford their starter rate but could not afford the reset rate. This plan has minimized foreclosures for borrowers who could afford their starter rate. With recent reductions in short-term interest rates, the threat of payment shock has become much smaller than it was in December, so far fewer homeowners need modifications to avoid unaffordable resets.

Preliminary results, representing 45% of the market, on subprime ARM workouts and foreclosures for loans resetting in January and February are as follows:

- There were 140,562 subprime 2/28 and 3/27 loans that were scheduled to reset in January or February 2008.
- Of the loans that were current at reset, only 60 have entered the foreclosure process.
- 5,607 of these subrime hybrid loans have been modified and more than 60% were modified for 5 years or more.
- 60,000 of these loans (43%) were paid in full through refinancing or sale

The number of hybrid ARMS receiving fast-track resets have been significantly affected by lower interest rates. That is good news. With short-term interest rates declining dramatically in the last few months, many homeowners are receiving new fixed rates much like the rates prior to any potential reset. These homeowners' monthly payments are holding steady and there is no payment shock. All remaining loans are still eligible for a loan by loan review.

Data on Foreclosure Activity

In addition, HOPE NOW is continuing to collect information on foreclosure activity and trends. There is no doubt that foreclosures are a serious issue that HOPE NOW members are trying to address. It is also important to carefully review and understand data on foreclosures initiated and foreclosures completed. Less than half of those initiated actually result in a completed sale. It is possible to find solutions to avoid foreclosures before they are completed. Frequently borrowers do not respond to their servicer's attempts to contact them until they receive their first legal action notice. HOPE NOW's borrower outreach initiatives are intended to reach borrowers and try to get them to respond before a foreclosure action is initiated. In addition, efforts continue to be made after a foreclosure is initiated to avoid a foreclosure sale whenever possible. Foreclosures are a serious issue and will continue to be for the foreseeable future. However, HOPE NOW's efforts are dedicated to trying reduce foreclosures and we will continue to do so.

Data Efforts Will Continue

We are tracking and measuring outcomes through HOPE NOW and other efforts. In addition to the data reported here, we are measuring trends in delinquencies and resolution outcomes (i.e. reinstatement, repayment plans, modifications, short sales, deeds in lieu of foreclosure, partial claims and foreclosure). We want to provide consistent and informative data reports based on common definitions and to provide information that provides insights into the nature and extent of the current mortgage crisis that will help in the development of workable solutions that avoid foreclosure whenever possible.

As our data collection efforts continue and the data are validated, we will provide more detailed information nationally and on a state by state basis. Our participating servicers have been engaged in developing standard definitions for key loss mitigation data. The data collection effort is an enormous undertaking, which will take time to develop fully and perfectly. We are confident, however, that we will be able to deliver systematic information at the state level that will help measure what servicers are doing to resolve difficult situations and to assist homeowners.

Conclusion

The HOPE NOW Alliance and those working with it are committed to enhanced and on-going efforts to contact at-risk homeowners and to offer workable solutions. Our top priority is to keep people in their homes and to avoid foreclosures whenever possible. As I reported today, close to 1.2 million homeowners were helped through modifications or work-outs since July 2007 and the rate of loan modifications continues to increase. We are working to help many more at-risk homeowners.

We need the active involvement of all Members of Congress to alert constituents that help is available when they contact either their lender/servicers or a non-profit counselor through the Homeowner's HOPE Hotline.

The HOPE NOW Alliance will continue its work until the problems in the housing and mortgage markets abate. My testimony today includes results that show a significant increase in the number of homeowners who have been helped. It is not a perfect solution, but it is very significant that over a million homeowners have been helped to avoid foreclosure.

We understand this effort must continue and be expanded and we will provide updates on our progress to Congress and other concerned policymakers in the coming weeks.

We want to work with the Housing Subcommittee to ensure that homeowners are aware of and can take advantage of the assistance offered by HOPE NOW.

Thank you for this opportunity to share this information on our efforts with the Subcommittee.

HOPE NOW Membership

Counselors

- ACORN Housing Corporation
- Catholic Charities USA
- Citizens' Housing and Planning Association, Inc.
- Consumer Credit Counseling Service of Atlanta
- HomeFree- USA
- Homeownership Preservation Foundation
- Housing Partnership Network
- Mission of Peace
- Mississippi Homebuyer Education Center-Initiative
- Mon Valley Initiative
- Money Management International, Inc.
- National Association of Real Estate Brokers- Investment Division, Inc.
- National Council of La Raza
- National Credit Union Foundation
- National Foundation for Credit Counseling, Inc.
- National Urban League
- NeighborWorks America
- Rural Community Assistance Co.
- Structured Employment Economic Development Co.
- West Tennessee Legal Services, Inc.

Servicers/Lenders/Mortgage Market Participants

- Acqura Loan Services
- Assurant, Inc.
- Aurora Loan Services
- Avelo Mortgage, LLC.
- Bank of America
- Carrington Mortgage Services
- Chase
- Citigroup, Inc.
- Countrywide Financial Corporation
- EMC Mortgage Corporation
- Fannie Mae
- First Horizon Home Loans and First Tennessee Home Loans
- Freddie Mac
- GMAC ResCap
- Home Loan Services, Inc. (d/b/a First Franklin Loan Services & NationPoint Loan Services)
- HomEq Servicing
- HSBC Finance
- Indymac Bank
- LandAmerica Financial Group, Inc./LoanCare Servicing Center
- Litton Loan Servicing
- MERS
- National City Mortgage Corporation
- Nationstar Mortgage, LLC.
- Ocwen Loan Servicing, LLC.
- Option One Mortgage Corporation
- PMI Mortgage Insurance Co.
- Saxon Mortgage Services
- Select Portfolio Servicing, Inc.
- State Farm Insurance Companies
- SunTrust Mortgage, Inc.
- Washington Mutual, Inc.
- Wells Fargo & Company
- Wilshire Credit Corporation

Trade Associations

- American Bankers Association
- American Financial Services Association
- American Securitization Forum
- Consumer Bankers Association
- Consumer Mortgage Coalition
- The Financial Services Roundtable
- The Housing Policy Council
- Mortgage Bankers Association
- Securities Industry and Financial Markets Association

Current as of 4-10-08

HOMEOWNER'S HOPE HOTLINE:

888-995-HOPE

Servicer Contact Numbers for Homeowners

Below are the customer contact telephone numbers of HOPE NOW servicer members. If you are a homeowner having trouble with your mortgage, please call your servicer's hotline for assistance (please have your account number ready when calling).

If you would like to talk to a HUD-approved homeownership counselor, please call the Homeowner's HOPE Hotline, 888-995-HOPE, operated by the Homeownership Preservation Foundation. Free counseling is available 24 hours a day, 7 days a week. You can also visit www.995hope.com for more assistance.

Servicer	Hotline
Aurora Loan Services	800-550-0509
Avelo Mortgage, LLC.	866-992-8356
Bank of America	800-846-2222
Carrington Mortgage Services	800-790-9502
CitiFinancial/Citi Trust Bank	800-422-1498
CitiMortgage/ Loss Mitigation	866-272-4749
CitiResidential Customer Care	800-430-5262
Countrywide Home Loans	800-669-6650
EMC Mortgage, Inc.	877-362-6631
First Horizon Home Loans	800-364-7662
GMAC/Homecomings/ResCap	800-799-9250
Home Loan Services, Inc. (d/b/a First Franklin Loan Services and NationPoint Loan Services)	800-500-5022
HomEq Servicing	888-270-6663
HSBC Consumer Lending	800-333-5848
HSBC Mortgage Services	800-365-6730
HSBC Mortgage Corporation	888-648-3124
Indymac Bank	800-880-6848
JPMorgan Chase Prime Loans	800-446-8939
JPMorgan Chase Non-Prime	877-838-1882
JPMorgan Chase Home Equity	866-582-5208
JPMorgan Chase Default HPO Help Line	866-345-4676
LandAmerica Financial Group	800-909-9525
Litton Loan Servicing	800-999-8501

Servicer	Hotline
National City Mortgage Corporation	800-523-8654
Nationstar Mortgage, LLC.	888-480-2432
Ocwen Loan Servicing, LLC.	877-596-8580
Option One Mortgage Corporation	888-275-2648
Saxon Mortgage Services	888-325-3502
Select Portfolio Servicing	888-818-6032
SunTrust Mortgage, Inc.	800-443-1032
Washington Mutual, Inc.	866-926-8937
Wells Fargo Home Mortgage	877-216-8448
Wells Fargo Financial	800-275-9254
Wilshire Credit Corporation	888-917-1050

HOPENOW Support & Guidance For Homeowners

HOPE NOW Alliance

2008 Homeownership Preservation Workshops Schedule

As of Thursday, April 10, 2008

Targeted Week	State	Cities
Week of March 3rd	California	Stockton – Friday, March 7th Anaheim – Wed., March 5th Riverside – Mon., March 3rd
Week of March 31st	Ohio	Columbus – Sunday, March 30th
	Pennsylvania	Philadelphia, April 1st
Week of April 21	Georgia	Atlanta, Sat. April 19th
	Wisconsin	Milwaukee, Mon. April 21st
	Indiana	Indianapolis Tues. April 22nd
	Illinois	Chicago Thurs. April 24th
Week of May 5th	Florida	Jacksonville
	Tennessee	Memphis Sat. May 3rd
	Alabama	Birmingham
Week of June 2nd	Texas	Dallas Houston San Antonio

H.R. 5679, The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008 and the Status of Voluntary Loss Mitigation Efforts Undertaken by Mortgage Servicers

Written Testimony of

Kevin Stein
Associate Director
California Reinvestment Coalition

Before the United States House of Representatives Subcommittee on Housing and Community Opportunity

April 16, 2008

Chairwoman Waters, Ranking Member Capito and Member of the Subcommittee thank you for holding this important hearing today and for inviting the California Reinvestment Coalition ("CRC") to testify. There is no issue more important for California's communities today than foreclosure prevention. The situation is dire and we need some relief.

My name is Kevin Stein. I am the Associate Director of the California Reinvestment Coalition, and the author of CRC's report, "The Growing Chasm Between Words and Deeds: Lenders Still Failing to Live Up To Their Public Commitments to Modify Home Loans and Help Borrowers Avoid Foreclosure." This report was based on a survey of 38 home loan counseling agencies in California and describes their experiences dealing with loan servicers in an effort to keep borrowers in their homes.

There are 3 main points I would like to make to the Subcommittee:

- Loose underwriting and predatory lending have created a growing foreclosure crisis in our communities
- The current framework for loss mitigation, which relies on voluntary efforts by the industry, is not working to stop the wave of foreclosures
- Congress must act to require good faith efforts in loss mitigation, as well as push for broader solutions, such as allowing a federal agency to buy and rework distressed loans

California Reinvestment Coalition

The California Reinvestment Coalition (CRC), based in San Francisco, is a nonprofit membership organization of two hundred fifty (250) nonprofit organizations and public agencies across the state of California. We work with community-based organizations to promote the economic revitalization of California's low-income communities and communities of color. CRC promotes increased access to credit for affordable housing and community economic development, and to financial services for these communities.

CRC and its members have embarked on a campaign to keep borrowers in their homes. The key components of the campaign are 1) supporting and building capacity for home loan counselors who are on the front lines in helping distressed homeowners; 2) promoting the long term loan modifications that borrowers need and deserve from loan servicers; and 3) reforming the mortgage lending process to ensure that the scourge of predatory lending does not recur. We believe that the Foreclosure Prevention and Sound Mortgage Servicing Act can go a long way towards encouraging long term loan modifications that keep borrowers in their homes.

Foreclosure Crisis in California

According to Realtytrac, foreclosure filings were reported on a total of 64,711 California properties in March, the most of any state for the 15th consecutive month, up 21 percent from

February 2008 and up 106 percent from March 2007.[1] Seven of the top ten metro areas in the nation hardest hit by foreclosure are in California. The Stockton, Calif., metro area documented the second highest metro foreclosure rate, with one in every 87 households receiving a foreclosure filing in February. Other California metro areas in the top 10 were Modesto at No. 3, Merced at No. 4, Riverside-San Bernardino at No. 5, Bakersfield at No. 7, Vallejo-Fairfield at No. 8 and Sacramento at No. 9.[2]

The foreclosure crisis is devastating working families who are uprooted from their homes and may face homelessness. But foreclosures also have large impacts on the broader community. Tenants who have been dutifully paying rent are forced to leave investor-owned homes, often illegally, sometimes after their water and utilities have been shut off when the owner or foreclosing bank stops paying the bill. Neighboring families see their property values decline further, making it harder for them to refinance their home loans to avoid foreclosure. Communities suffer from foreclosed homes that sit on the market, leading to neighborhood blight, and possibly inviting unsafe and illegal activity. Local governments are unable to collect property taxes which help fund basic services, and are forced to incur costs to process an increasing number of foreclosures.[3] And the California state economy is facing a large budget deficit, in part, as a result of the foreclosure crisis.

What Happened?

Over the last few years, lenders and brokers aggressively sold loans to borrowers that they could not understand or afford to repay. Even the banking regulators recognized this and have since enacted new guidance on nontraditional and subprime lending to tighten underwriting standards. A current investigation by New York Attorney General Andrew Cuomo reportedly is confirming there was a clear and significant decrease in lending standards over these last few years.[4] Indeed, the loans that banks bought and sold on Wall Street during this time are increasingly going into

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[1] RealtyTrac, *Foreclosure Activity Increases 5 Percent in March According to Realtytrac U.S. Foreclosure Market Report*, (April 15, 2008), available at http://www.realtytrac.oom.

[2] RealtyTrac, *Foreclosure Activity Decreases 4% in February* (March 13, 2008), available at http://www.realtytrac.oom.

[3] William C. Apgar and Mark Duda, *Collateral Damage: The Municipal Impact of Today's Mortgage Foreclosure Boom*, Homeownership Preservation Foundation, May 2005, http://www.995hope.org/content/pdf/Apgar_Duda_Study_Short_Version.pdf, (accessed February 26, 2008).

[4] Jenny Anderson and Vikas Bajaj, "Firm Gets Immunity for Information on Risky Loans," San Francisco Chronicle, January 17, 2008, from the New York Times. The article reported that a company that analyzes the quality of thousands of home loans agreed to cooperate with an investigation by New York Attorney General Andrew Cuomo into whether information was improperly withheld from investors of mortgage backed securities. The firm, Clayton Holdings, has reportedly told prosecutors that starting in 2005, it saw a significant deterioration of lending standards and a parallel jump in loans that did not meet even lowered lending standards. Clayton was also reportedly directed by Wall Street firms to evaluate half as many loans as it had been, which would make finding problematic loans less likely.

default.[5] As a result, borrowers are stuck with loans that have resetting interest rates that will make the loans impossible to repay.

In March, CRC and national allies released a report highlighting the danger facing neighborhoods as a result of mortgage lending by high-risk lenders. Subprime lenders that have ceased operations in 2007 had saturated minority communities across the country with high risk loans before going under. The report, *Paying More for the American Dream: The Subprime Shakeout and Its Impact on Lower-Income and Minority Communities,* (California Reinvestment Coalition, Community Reinvestment Association of North Carolina, Empire Justice Center, Massachusetts Affordable Housing Alliance, Neighborhood Economic Development Advocacy Project, Ohio Fair Lending Coalition, and Woodstock Institute, March 2008)[6] examined the geographic lending patterns of these defunct subprime lenders in seven metropolitan areas in the United States. These areas include large urban areas - New York City, Los Angeles, Chicago, and Boston, - as well as the smaller urban areas of Cleveland, Charlotte, NC and Rochester, NY.

Most of these lenders had captured large market shares in minority communities and made few, if any, loans elsewhere. In Los Angeles, high-risk lenders' presence was 9.5 times greater in high minority neighborhoods than in white neighborhoods. As these institutions' loans enter into default and foreclosure, minority and lower-income communities will certainly bear the brunt of the negative impacts, such as increased crime and depressed property values.

How bad were these lenders? Two of the largest lenders examined were New Century Mortgage and Fremont Investment & Loan. Before filing for bankruptcy, New Century account agents are alleged to have coached loan brokers on how to draw up fake business cards for borrowers getting stated income loans that are prone to abuse. And a Massachusetts court recently agreed with the state Attorney General that many of Fremont Investment & Loan's loans were "presumptively unfair" and should not be allowed to proceed to foreclosure through the normal court process.[7] Fremont Investment & Loan was previously subject to a rare cease and desist order from the FDIC. These are the kinds of loans that are sitting in California's communities.

CRC Efforts to Respond to the Crisis

For the last several years, CRC has fought against predatory lending practices, negotiating with lenders and urging regulatory reform. Yet the ability of predatory lenders and predatory financiers to outpace legislation and regulation has forced CRC and others to focus resources on

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[5] Jenny Anderson and Vikas Bajaj, "Wary of Risk, Bankers Sold Shaky Debt: SEC Inquiry Focuses on Firms' Holdings," New York Times, December 6, 2007. The article reports that almost a quarter of the subprime loans securitized last year by Deutsche Bank, Barclays, and Morgan Stanley were in default, according to Bloomberg. About a fifth of the loans underwritten by Merrill Lynch were in default.

[6] Available at www.calreinvest.org.

[7] See, Commonwealth of Massachusetts v. Fremont Investment & Loan and Fremont General Corporation, Superior Court Civil Action, No. 07.4373-BLS 1.

preventing foreclosures.

A year ago, CRC called for a 6 month moratorium on foreclosures in our state. In a week's time, one hundred twenty-five (125) community groups endorsed this effort. We proceeded to meet with the largest financial institutions in our state to press for a moratorium and to discuss their foreclosure prevention efforts. Each institution asserted that it was committed to foreclosure avoidance, that it loses money in foreclosure and therefore has an incentive to keep borrowers in their homes, that it is committed to conduct outreach to borrowers to let them know about their options before they fall behind on their loans, and that loan modifications are a vital component of loss mitigation efforts. Within days of these meetings, counseling agencies and borrowers throughout the state contacted CRC and told us that loan servicers were not willing to work with borrowers in distress.

In response, CRC decided to raise money to build the capacity of home loan counseling agencies in the state so that they could better serve borrowers, and to conduct a survey of home loan counseling agencies in California to inform policy making at the federal and state level.

CRC's California Homeownership Preservation Initiative (CHOPI) has succeeded in raising over $5 million from financial institutions to fund 39 housing counseling agencies in the state. The survey of counseling agencies received a strong response from agencies overwhelmed by the demand for their services. The success of these efforts reflects the dire situation that exists in California.

Survey of Home Loan Counseling Agencies

In these times of exploding foreclosure rates and economic instability, the most important conversation taking place day to day is the one between home loan servicers and borrowers and their representatives. Shockingly, there are virtually no rules, no oversight, and no clear data concerning these critical —often life-changing—discussions.

The *Chasm between Words and Deeds* reports provide a snapshot of whether mortgage loan servicing companies are living up to their public commitments to help borrowers avoid foreclosure. These reports reflect the experiences of nonprofit home loan counseling agencies in California who are on the front lines of the foreclosure crisis, and who are working hard to help keep families in their homes. The previous report, released earlier in 2007, focused on counselors' experiences in August of 2007, at a time when relatively little data on foreclosure prevention outcomes were publicly available. That first CRC survey found that loan servicers were not modifying loans to any significant degree, were not conducting early outreach to borrowers facing rising mortgage payments, and were most likely to foreclose on borrowers.

CRC's second report, *The Growing Chasm between Words and Deeds*, focuses on loan counselors' experiences in December 2007, a time when government officials, industry associations, and individual companies were representing publicly that great strides were being made to help borrowers in distress. Sadly, after months of public discourse about the growing foreclosure crisis and the need for loan

modifications, this new survey demonstrates that loan servicers' failures to meaningfully respond to the crisis continues; the servicers are neither modifying home loans on any scale nor conducting sufficient outreach to borrowers facing rising mortgage payments, and they continue to turn to foreclosure as their most common response to borrowers in distress. For the month of December, counselors again report the most common outcome for borrowers is foreclosure.

Mortgage counseling agencies are often the only place for borrowers to turn when they are faced with foreclosure. Counselors help borrowers understand their options and often act as intermediaries between borrowers and their lenders. In California, there are roughly 80 mortgage counseling offices approved by the Department of Housing and Urban Development (HUD) to provide services that include loss mitigation, mortgage delinquency and default resolution, predatory lending and post-purchase counseling. More than one-third of these counseling agencies took part in CRC's survey. The groups that responded to this second CRC survey served 8,174 consumers during December. Though several groups reported that their offices were closed for part of this holiday month, groups still saw 4,091 more clients in December than they did in June, confirming the widespread belief that things are only getting worse for homeowners.

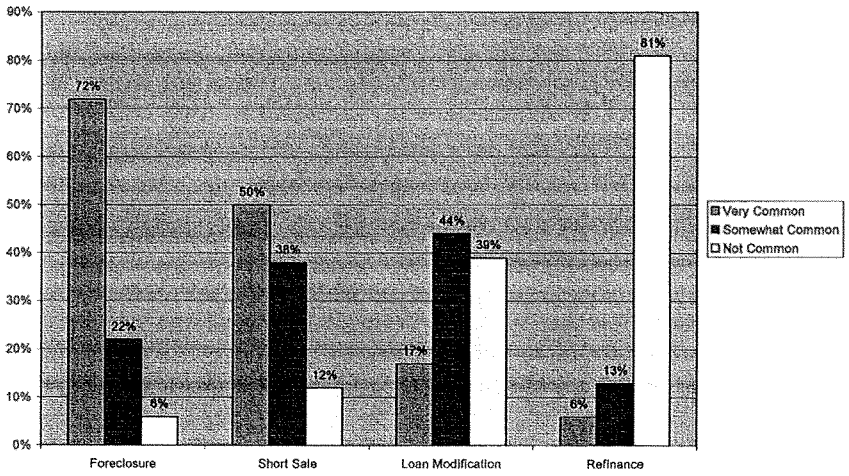
California housing counseling agencies responding to this survey confirm that more could have been done to keep these families in their homes.

Lenders not responsive. Agencies were asked if both particular servicers, and the industry as a whole, have been consistently modifying loans by fixing interest rates for the life of the loan. 17 groups responded that the industry as a whole is not consistently modifying loans for long-term affordability. No groups reported that the industry as a whole was modifying loans for the long term.

Postponing the day of reckoning. In general, for borrowers in early delinquency or facing unaffordable interest rate resets, servicers are not fixing rates for the long term. Counseling groups were most likely to respond that when servicers were willing to modify loans, they were only willing to fix interest rates for one year at a time; this was true for 8 of the 12 servicers considered in the survey, and for the industry as a whole. Rather than provide a sustainable solution for borrowers in distressed loans, these short-term modifications most likely only delay the problem, and are akin to giving the borrower another bad loan with a short period of affordability followed by increasing payments that may be difficult to afford.

Devastating borrower outcomes. Counseling agencies were asked how common different outcomes were for their clients.

Borrower Outcomes: % of Counselors Reporting Frequency of Various Loss Mitigation Outcomes: California December 2007



- **Foreclosures lead.** Groups were most likely to report foreclosure a "very common" outcome for borrowers. A shocking 26 groups, or 72% of those reporting, said that foreclosures are a very common outcome for their clients. This was an increase from the 19 groups reporting so four months ago. In December, a total of 34 groups, or 94% of those reporting, said that foreclosures were a "very common" or "somewhat common" outcome for borrowers.

- **Short sales next.** 17 groups, or 50% of those reporting, cited "short sales"—where servicers minimize their losses by allowing homeowners to sell their property for less than the amount of money owed—as a "very common" outcome for borrowers. An additional 13 agencies reported short sales as "somewhat common," meaning that for the month of December, 88% of groups responding reported that short sales were "very common" or "somewhat common." While preferable to foreclosure, short sales still leave the borrower without a home or equity, and may result in a higher tax bill.

- **Loan modifications are not happening.** In contrast, only 6 counseling agencies, or 17% of groups reporting, said that loan modifications are a "very common" outcome for borrowers. At the same time, 14 groups, or 44% of those reporting, said that loan modifications are "not common."

Outreach to borrowers in trouble is poor. Despite lenders' assertions that they are reaching out to borrowers BEFORE they face problems from rising interest rates and higher monthly payments, most counseling agencies do not see this happening. A surprising 20 respondents, or 91% of groups responding, said that in their experience, industry-wide, lenders were NOT making contact with borrowers before delinquency. Only 2 groups reported that early contact was being made with borrowers at risk of foreclosure.

Servicers are hard to work with. Counseling agencies were asked, "In your experience, which lenders/servicers are the most difficult to work with in trying to keep borrowers in their homes?" A total of 23 companies were named as servicers that are difficult to work with. Washington Mutual and HomEq were named most often, with 9 groups reporting these two servicers as being difficult to work with. GMAC was named by 8 groups. Countrywide and Wells Fargo were named by 6 groups as being difficult to work with.

Out of the Mouths of Counseling Agencies. When asked to comment on companies that are especially difficult to work with, counseling agencies had a lot to say. Respondents expressed frustration with companies that do not offer any real solutions and that provide poor customer service. Comments described long wait times on the phone, lost faxes, changing personnel, unfamiliarity with loans and prior conversations, non returned calls, lack of authority to make decisions, statements at odds with company policies, and decisions that make no sense. Most groups reported increasing caseloads and poor outcomes. Below are representative comments.

- "Overall, the lenders are still unwilling to be proactive in their approach with loss mitigation. Our lending team has several deals that are 'pending' but there are few if any resolutions."

- "1. They do not return calls; 2. Take 30-60 days to give us a written answer; 3. Require their own authorization to release information forms; 4. Take too long to assign cases; 5. Keep changing officers when cases are assigned; 6. They give wrong information regarding the loan; 7. Always have to refax and explain the situation to different people; 8. Customer Service sends us to the wrong department; 9. They hang up; and 10. Never willing to work any details—they always have new personnel."

- "We are still experiencing significant resistance from lenders. Across the board we are being told by lenders that they will not even talk to us if the borrower is current, despite the media advice to borrowers to contact lenders before they are in default. This policy seems to directly contradict the supposed agreement to freeze rates for borrowers who remain current."

Counseling Agencies Large and Small. The groups that took the time to fill out this survey represent a cross section of counseling agencies in the state. Groups came from various parts of California and range from small groups to large offices. These groups served 8,174 consumers in the month of December alone. This was an increase of 4,091 consumers from June of 2007.

The report concludes with recommendations for lenders and policy makers. A key recommendation is for Congress to pass laws that promote loan modifications and refinance loans. More specifically, CRC recommends prohibiting foreclosures unless loan servicers offer borrowers meaningful loss mitigation options, and requiring detailed HMDA-like reporting of loan servicers that will let the public know which companies are keeping their promises to help borrowers remain in their homes.

Update From Housing Counselors

An informal poll of housing counselors and legal service offices in the last week confirms that the situation on the ground has not improved for borrowers since December 2007. Groups report difficulty in accessing the right person in loss mitigation, getting the "run around," increasing strain on resources in light of high borrower demand, loans that were clearly unaffordable and should never have been made, need for more funding for housing counseling agencies, response time from servicers is longer than before, lost documents and faxes, being told to call back when borrower is in default, and being strung along by servicers who say a borrower can get a loan modification only to decline the modification before foreclosure.

A growing concern is that borrowers are being pushed in "loan mods" and "workouts" that do not benefit them. "The workouts are not logical and make no sense," according to one counselor. Said another, "we are still seeing ridiculous repayment plans that the homeowners obviously cannot afford but the servicer is calling it a modification."

According to one counselor, "I was pretty optimistic early on in the year but now it's becoming very difficult to work with servicers that are not at all interested in making any effort to work with our clients, even those that can really afford a modification at a good decent rate."[8]

More Talk, More Data, Same Results

Since the release of CRC's first home loan counseling agency survey results in October, there have been increasing media reports of foreclosures, and increasing discussions by politicians, public agencies, industry associations and consumer groups about what is being done and what should be done to solve the problem. But lenders are still not required to verify that they are keeping their promises and, as an industry, have offered no meaningful and verifiable reporting to show that they are working with borrowers to prevent foreclosure.

While many of these efforts are well intentioned, the bottom line is that, on the ground, servicers are simply not helping California borrowers to avoid foreclosure to any significant degree. A few of the plans and data releases of the past few months will be examined, briefly.

Inadequate Plans

[8] Quotes from housing counselors contacted by CRC in April 2008.

- **Governor Schwarzenegger's Subprime Loan Agreement**

  On November 21, 2007, Governor Schwarzenegger announced an agreement with several loan servicers to streamline the loan modification process for subprime borrowers who are living in their home, making timely payments and likely to default when their loan jumps to a scheduled higher rate.[9] Initially, the agreement was signed by 4 large loan servicers. Now, 10 companies have signed on,[10] and the Administration is continuing to encourage others companies to sign on as well. While important information is being collected from loan servicers by the state Department of Corporations (see, below), no progress reports have been provided on the success of the Agreement or the performance of participating lenders to date.

  The Subprime Loan Agreement and state data collection efforts are positive, but need to be expanded if they are to yield meaningful results for California's homeowners. Some of the companies that signed the Subprime Loan Agreement fared poorly in CRC's latest survey, and were cited by counseling agencies as unwilling to offer loan modifications, not conducting adequate outreach, and being difficult to work with. The Administration must be more proactive and aggressive in ensuring that servicers are keeping their promises. This should be accomplished through a more rigorous reporting scheme that is public and that breaks out data by servicing company; a simple complaint process whereby consumers and home counseling agencies can get redress if they are experiencing difficulties with a signatory to the Agreement; and expanding the terms of the Agreement itself to require servicers to work with borrowers who are in default as a result of their interest rate resetting.

- **President Bush's "Teaser Freezer" Plan**

  In December 2007, President Bush and Treasury Secretary Paulson announced a plan that urged loan servicers to agree to freeze the interest rates on certain loans for certain borrowers for a five-year period. This reflected a change from prior Administration assertions that the market would be able to deal with the foreclosure crisis. Nevertheless, the plan fails in relying on voluntary compliance by the lending industry, and in covering too few borrowers. The Center for Responsible Lending estimates that only 3% of borrowers with outstanding subprime mortgages with adjustable rates will benefit from this plan.[11]

  And it may be that the streamlined loan modifications promoted by the Plan, where they occur, work to the interest of investors over borrowers. A recent analysis by Fitch Ratings found that the Hope Now's voluntary streamlined modification yields the smallest amount of lost interest, relative to other strategies, for investors. However, Fitch said reducing the teaser rate costs the trust

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[9] See, www.corp.ca.gov/press/news/SubprimeLending/asp

[10] To date, the companies that have signed the Agreement include: Carrington Mortgage Services; Countrywide Home Loans; GMAC Mortgage; LLC; Home Loan Services, Inc.; Homeq Servicing; HSBC Mortgage Services; Litton Loan Servicing; OCWEN Loan Servicing, LLC; Option One Mortgage; and Wilshire Credit. Ibid.

[11] Center for Responsible Lending, "U.S. Treasury Plan Helps Only 3% of At-Risk Homes," January 28, 2008.

only slightly more cash flow while making the payment more affordable for the borrower.[12]

- **Project Lifeline**

  In February, six large loan servicers announced the Project Lifeline program. Participating lenders agree to pause foreclosures for certain seriously delinquent borrowers for up to 30 days. Initial participants include Washington Mutual, Bank of America, Wells Fargo, JP Morgan Chase, Citigroup and Countrywide, though other lenders have since joined. But this plan, like the President's earlier plan, is doomed to fail because it relies on voluntary compliance and will help too few borrowers. Even "Wall Street analysts ... said the plan fell short of the broad reforms necessary to help people meet mortgage payments as home values drop and foreclosures rise."[13]

Inadequate or Discouraging Data

The only way to determine if servicers are working with borrowers as they claim to be is to collect data in a unified, comprehensive and public fashion. In the last few months, several data collection efforts have emerged, though the results of these efforts are unclear.

- **The Mortgage Bankers Association** released a report on January 17, 2007, that was meant to demonstrate that servicers were improving outcomes for home loan borrowers.[14] Yet the data showed that 40% of borrowers in subprime adjustable rate loans that went into foreclosure in the third quarter of 2007 had experienced a repayment plan or loan modification, which suggests that workouts offered by the industry were unrealistic and ineffective. The MBA also suggests that in the third quarter of 2007, servicers were seven times as likely to offer subprime ARM borrowers a repayment plan as opposed to a loan modification.[15] Repayment plans fail to provide a long-term solution for borrowers and, in fact, increase the payment burden on already overburdened homeowners.

  The MBA also appears to go out of its way to blame borrowers for the foreclosure crisis, saying, "Even in the current environment, loan modification of ARMs in the form of freezing interest rates can be seen as rewarding borrowers who decided to take a risk and take out loans with lower initial payments than what they would have been required to make with fixed rate, fully amortizing loans."[16] This analysis ignores the fact that brokers and lenders were pushing borrowers into unaffordable products, and that Wall Street firms and investors were paying a premium to lenders for selling these very risky loans.

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[12] "Hope Now Under Fire; Seen as Benefitting Investors," Inside B&C Lending (April 2008).
[13] Michael M. Grynbaum, "Plan to Aid Borrowers is Greeted by Criticism," New York Times, February 13, 2008.
[14] Jay Brinkmann, "An Examination of Mortgage Foreclosures, Modifications, Repayment Plans, and Other Loss Mitigaiton Activities in the Third Quarter of 2007," Mortgage Bankers Association, January 2008.
[15] *Id.* , p. 11.
[16] *Id.*, p. 5.

- **The Hope Now Alliance**, a Washington, D.C.-based coalition of mortgage servicing companies, industry trade groups and housing counseling agencies, has been collecting its own data and releasing it in the aggregate. The group reported that in the second half of 2007 it had "helped" 545,000 subprime borrowers, but the majority of this assistance (on 395,000 loans)[17] came in the form of short-term repayment plans which may just postpone the crisis. Even industry observers are critical of the group's data release.[18]

  Recently released data from Hope Now tell a similar story. An estimated 39,000 subprime loan modifications were completed in February, according to Hope Now, down from 43,000 in January. At the same time, foreclosures were started on 98,000 subprime financed homes, an increase from January.[19]

- **The Conference of State Bank Supervisors**, comprised of bank regulators and attorneys general from various states, including California, recently issued a report based on data from thirteen participating servicers for the month of October.[20] The report's findings include:
  - 75% of seriously delinquent borrowers are not on track for any loss mitigation option;
  - A rising number of loan delinquencies are swamping the increase in loss mitigation efforts;
  - Servicers report an increase in the number of loan modifications "in progress," but the rate of loan modifications that were "closed" was low. Only 10% of the 205,270 loans received a loan modification; and,
  - The large number of loans going into default before interest rates reset suggests poor underwriting or mortgage fraud.

  The report cited the following as possible reasons for the disappointing numbers: lack of servicer capacity, lack of success in contacting borrowers, or investor resistance to loss mitigation. The report also noted that of the loss mitigation efforts that closed in October 2007, 73% were due to borrowers bringing their accounts current, and not the efforts of the servicers.[21] In what has become a distressing theme, the Office of the Comptroller of the Currency, the federal regulator of national banks, reportedly advised or directed J.P. Morgan Chase and Wells Fargo not to provide data to the working group.[22]

- **Countrywide** was one of the few companies to provide data to the public on its servicing performance. For the month of December, Countrywide asserted that it completed 13,273 loan

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[17] Bloomberg News, "Mortgage Servicers Helped 545,000 Subprime Homeowners in the Second Half of 2007," The Mercury News, February 7, 2008.
[18] Cheyenne Hopkins, "Hope Now Under Fire – Even From Within; Infighting, Flawed Statistics, and Other Problems are Cited." American Banker, February 20, 2008.
[19] "Hope Now Under Fire; Seen as Benefitting Investors," Inside B&C Lending (April 2008).
[20] State Foreclosure Prevention Working Group, "Analysis of Subprime Mortgage Servicing Performance," Data Report No. 1, February 2008.
[21] "State Group Finds Subprime Servicers' Efforts Lacking," Inside B&C Lending, February 15, 2008.
[22] Ruth Simon, "States Say Mortgage Companies Fall Short on Loan Modifications," Wall Street Journal, February 7, 2008.

workout plans, up 243% from a year earlier. Countrywide also entered into an agreement with community group ACORN to improve its servicing practices. While Countrywide reports a large increase in loan modifications towards the end of 2007, Countrywide still completed more foreclosures (77,820) than loan modifications (55,801) for the year.[23] While Countrywide promotes its programs and releases more data than other companies, it remains difficult to put its data in context and to know to what degree Countrywide borrowers are receiving meaningful and long term assistance. Significantly, in February, Bank of America applied to the Federal Reserve for approval to acquire Countrywide, which threatens to take Countrywide out from under state regulatory oversight.

- **Moody's Investor Services** attracted national attention in 2007 when it surveyed loan servicers and found that only 1% of loans scheduled for an interest rate reset were modified. Moody's updated the survey and found that loan modifications had improved, but only to a still unacceptably low 3.5%.[24]

- **The Federal Reserve Board** conducted a survey of senior loan officers in January of 2008. The survey found that the vast majority of banks are taking a case by case approach to loan modifications, and many don't expect the streamlined, loan modification plan endorsed by the Hope Now alliance to have much of an impact on their loan mitigation efforts. Only 13% of banks surveyed said streamlined loan modifications would play a "very significant" role in their loss mitigation efforts, while 64% said that loan modifications would not play a significant role.[25]

- **The California Department of Corporations** has been collecting loan servicing data from state-licensed servicers, and making aspects of that data available to the public in aggregate form. Data collected has been fairly detailed, and the Commissioner of the Department reported an increase in loan modifications in helpful comments accompanying the data report.

  Yet the data reported by the Department showed that there were only 5,630 loan modifications in January, while there were over 10,000 foreclosures in the same month.[26] In fact, several of the servicing companies that have signed on to the Governor's Subprime Loan Agreement were cited by counseling agencies in the state as not modifying loans, not conducting adequate outreach, and being difficult to work with.

CRC Support for HR 5679

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[23] Data from "Testimony of Mary Jane M. Seebach of Countrywide Financial Corporation Before the Banking Finance, and Insurance Committee of the California State Senate," January 16, 2008.
[24] Al Yoon, "Subprime Loan 'Mods' Still Fall Short – Moody's," Reuters, December 18, 2007.
[25] "Banks Take 'Case by Case' Approach,'" *Mortgage Servicing News*, March 2008.
[26] Memo from Department of Corporations Commissioner Preston DuFauchard, March 3, 2008, available at www.corp.ca.gov

The experiment with voluntary industry initiatives has failed. Congress needs to act to obligate loan servicers to act in good faith to keep borrowers in their homes. There are several provisions in HR 5679 which would help home loan borrowers, including requirements that fees be reasonable, notification be given to borrowers of impending interest rate resets, second and first lien holders work to facilitate loan modifications, borrowers have access to loss mitigation personnel with authority, referrals be made to counselors, borrowers receive protection against coerced waiver of rights, and loan servicers report on loss mitigation outcomes. CRC supports these important provisions.

We urge that loss mitigation data be collected and made publicly available by company. Much as Home Mortgage Disclosure Act (HMDA) data has improved company practices by shedding light on them, so too can loss mitigation data reporting lead to better outcomes for homeowners and their communities.

At the same time, we know that loan modification and effective loss mitigation will not be enough to stave off foreclosure for thousands of homeowners. Broader solutions are needed, such as authorizing a federal agency to purchase and rework distressed loans on a broad scale.

Conclusion

Voluntary measures are not working. Hundreds of thousands of borrowers are falling through the cracks into foreclosure and communities are suffering as a result. Most observers recognize that things will get worse before they get better given the large number of rate resets that are imminent, coupled with falling home prices and a slowing economy. We need bolder measures, including mandatory loss mitigation as outlined in HR5679.

Madame Chairwoman and members of the Subcommittee, thank you again for the opportunity to testify today. The California Reinvestment Coalition looks forward to working with you to help borrowers remain in their homes, and to help communities avoid the devastating impacts of foreclosure.

H.R. 5679, The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008

Written Testimony
of

Tara Twomey
National Consumer Law Center

also on behalf of
National Association of Consumer Advocates

Before the Unites States House of Representatives Subcommittee on Housing and Community Opportunity

April 16, 2007

I. Introduction

Chairwoman Waters and members of the Subcommittee, thank you for inviting me to testify today regarding H.R. 5679, The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008. I am an attorney, currently of counsel to the National Consumer Law Center (NCLC).[1] Prior to joining NCLC, I was a Clinical Instructor at Harvard Law School where my practice focused on foreclosure prevention in the low-income communities of Boston.

I testify here today on behalf of the National Consumer Law Center's low-income clients. On a daily basis, NCLC provides legal and technical assistance on consumer law issues to legal services, government and private attorneys representing low-income consumers across the country. I also testify here today on behalf of the National Association of Consumer Advocates.[2]

II. The Foreclosure Crisis Requires Substantial Action

We are facing the greatest foreclosure crisis since the Great Depression. As we know the statistics are grim. In February 2008, home foreclosures filings nationwide were up 60% over February 2007.[3] Nearly a quarter million properties were in some stage of foreclosure.[4] One in every 557 households faced the loss of their home.[5]

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[1] The **National Consumer Law Center, Inc.** (NCLC) is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of sixteen practice treatises and annual supplements on consumer credit laws, including *Truth In Lending*, (5th ed. 2003) and *Cost of Credit: Regulation, Preemption, and Industry Abuses* (3d ed. 2005) and *Foreclosures* (1st ed. 2005), as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low-income people, conducted training for thousands of legal services and private attorneys on the law and litigation strategies to deal predatory lending and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. This testimony was written by Alys Cohen, Staff Attorney, and Tara Twomey, Of Counsel, to NCLC.

[2] The **National Association of Consumer Advocates** (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.

[3] Realty Trac, *New York City Foreclosure Activity Up 19 Percent In February* (Mar. 28, 2008), *available at* http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=4438&accnt=64847.

[4] *Id.* Foreclosure filings were reported for 1,285,873 discrete properties in 2007. *See* Realty Trac, U.S. Foreclosure Activity Up 75 Percent in 2007, *available at* http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=4303&accnt=64847.

[5] *Id.*

The trouble is not behind us. Foreclosures continue to surge in early 2008.[6] In both the prime and subprime markets, seriously delinquent[7] loans have continued to rise at an alarming rate, increasing two-fold since early 2006.[8] The figures for adjustable rate mortgages (ARMs) are more shocking. As the chart below demonstrates,[9] seriously delinquent ARMs have nearly quadrupled in the past two years. At the beginning of 2008, one in five subprime ARMs were more than 90 days late or in foreclosure. Nationwide, it is estimated that 2.2 million households with subprime mortgage loans have lost or will lose their home to foreclosure over the next several years.[10]

YEAR	SERIOUSLY DELINQUENT ARMS: PRIME	SERIOUSLY DELINQUENT ARMS: SUBPRIME
2006	Q1: .82 Q2: .92 Q3: 1.14 Q4: 1.45	Q1: 6.28 Q2: 6.52 Q3: 7.72 Q4: 9.16
2007	Q1: 1.66 Q2: 2.02 Q3: 3.12 Q4: 4.22	Q1: 10.13 Q2: 12.40 Q3: 15.63 Q4: 20.43

The consequences of this foreclosure crisis have not only ripped through Wall Street, they are taking a heavy toll on Main Street. Abuses in the subprime market have undermined the efforts of hardworking families to acquire and retain the dream of homeownership. Instead of building wealth, families are losing equity.[11] Renters suffer, too, as lenders quickly evict

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[6] *See* Chris Reidy, *2008 could be even worse for local foreclosures*, Boston Globe (Mar. 28, 2008)(estimating 2008 foreclosures to be at least 15 to 25 percent higher than the historic highs reached in 2007), *available at* http://www.boston.com/business/ticker/2008/03/report_2008_wil.html#

[7] Seriously delinquent loans includes loans that are at least 90 days delinquent plus the loans in foreclosure inventory.

[8] The seriously delinquent rate for subprime loans, both fixed and adjustable in the first quarter of 2006, was 6.22%. By the end of 2007 that number had grown to 14.44%. Similarly, in the prime market the number of seriously delinquent loans has climbed from .77% in the first quarter of 2006 to 1.67% in the last quarter of 2007.

[9] This chart contains data from the Mortgage Banker's Delinquency Survey for each of the quarters listed.

[10] Ellen Schlomer, et al., *Losing Ground, Foreclosures in the Subprime Market and Their Cost to Homeowners*, Center for Responsible Lending (Dec. 2006) at 3.

[11] *Id.* (estimating that foreclosures will cost homeowners as much as $164 billion, primarily in lost home equity).

tenants from foreclosed homes.[12] More and more Americans are being driven into bankruptcy.[13] And, neighborhoods are deteriorating as foreclosed homes are boarded up and left vacant.[14] Crime in high-foreclosure neighborhoods is on the rise.[15] Overgrown lawns and trash-strewn yards symbolize growing community abandonment and disinvestment.[16]

Numerous strategies have been proposed to address the current foreclosure crisis and its consequences. Loan modification consistently has been identified as one of the preferred strategies. Despite the potential benefits of loan modifications, the magnitude of the foreclosure crisis dwarfs the current response from the financial services industry.

III. Voluntary Loan Modifications Are Insufficient To Stem the Rising Tide of Foreclosures

A loan modification is a written agreement between the loan servicer and the homeowner that changes one or more of the original terms of the note in order to help the homeowner bring a defaulted loan current and prevent foreclosure. Loan modifications may be short-term (less than 5 years), long-term (more than 5 years), or for the life of the loan. Modifications may reduce the interest rate or principal amount of a mortgage loan, may change the mortgage product (for example, from an adjustable rate to a fixed rate), may extend the term of the loan, or may capitalize delinquent payments. While not a panacea for all that is ailing in the subprime mortgage market, long-term, sustainable loan modifications can provide significant relief to the nation's distressed homeowners.

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[12] It is estimated that 18% of the foreclosure started in the third quarter 2007 were not occupied by the owners. *See* Brinkmann, *infra* note 30 at 10. *See also* Testimony of Sheila Crowley to the Financial Services Committee, U.S. House of Representatives (April 10, 2008)(discussing the affects of the foreclosure crisis on renters), *available at* http://www.house.gov/apps/list/hearing/financialsvcs_dem/crowley041008.pdf; John Leland, *As Owners Feel Mortgage Pain, So Do Renters, New York Times* (Nov. 18, 2007);

[13] More than 90,000 consumer bankruptcies were filed during March 2008. This represents a 30% increase over filings from March 2007, and the highest number of filings since October 2005 when significant amendments to the Bankruptcy Code became effective. Bill Rochelle and Bob Willis, *Bankruptcies Jump 30% in March, Led by Housing-Bust States*, Bloomberg (Apr. 5, 2008), *available at* http://www.bloomberg.com/apps/news?pid=20601087&sid=aw8ifLmYMFlI&refer=home

[14] *See* Letter, Senator Dodd to Senator Reid (Jan. 22, 2008)(describing cycle of disinvestment, crime, falling property values and property tax collections resulting from foreclosures), *available at* http://dodd.senate.gov/multimedia/2008/012308_ReidLetter.pdf; Brad Heath and Charisse Jones, *Mortgage defaults force Denver exodus*, USA Today (Apr. 1, 2008)(in some Denver neighborhoods as many as one-third of residents have lost their homes).

[15] *See, e.g.,* J.W. Elphinstone, *After foreclosure, crime moves in*, Boston Globe (Nov. 18, 2007)(describing Atlanta neighborhood now plagued by house fires, prostitution, vandalism and burglaries).

[16] *See* Daphne Sashin and Vicki Mcclure, *Foreclosure leave painful ripple effect*, Orlando Sentinel (Oct. 15, 2007)(describing a once safe neighborhood now dotted with empty homes and overgrown lawns).

For nearly a year now, the financial services industry has been encouraged to meet this growing foreclosure crisis by scaling-up voluntary loan modifications efforts. In May 2007, Senate Banking Committee Chairman Dodd announced a set of servicing principles aimed at long-term affordability.[17] Those principles called, in part, for loan modifications that would "create a solution for the borrower to ensure that the loan is sustainable for the life of the loan."[18] In June 2007, Chairman Sheila Bair of the FDIC called for automatic loan modifications for borrowers with subprime ARMs.[19] Like Senator Dodd's servicing principles, Chairman Bair emphasized the importance of providing sustainable loan modifications. A report from the Joint Economic Committee also suggested that automatic loan modifications were needed.[20] In September 2007, the federal and state banking regulators issued a joint statement on loss mitigation strategies, referencing earlier guidance and encouraging use of loss mitigation authority available under pooling and servicing agreements.[21] In October 2007, Treasury Secretary Paulson sought voluntary commitments from servicers to contact borrowers and explore new loan modification approaches.[22] Then in December 2007, Secretary Paulson announced a plan for "fast track" loan modifications.[23]

Despite widespread efforts to encourage voluntary loan modifications, it is clear that the financial services industry has failed to implement a loan modification strategy on a scale commensurate with the problem. As Chairman Bair recently acknowledged, "[w]hile voluntary loan modifications have shown significant progress, at this point, it must be

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[17] Senator Dodd Unifies Industry Members, Consumer Representatives to Help Preserve the American Dream of Homeownership (May 2, 2007), *available at* http://dodd.senate.gov/index.php?q=node/3863/print

[18] Homeownership Preservation Summit Statement of Principles (May 2, 2007), *available at* http://dodd.senate.gov/multimedia/2007/050207_Principles.pdf.

[19] Remarks of FDIC Chairman Sheila C. Bair, American Securitization Forum (ASF) Annual Meeting (June 6, 2007).

[20] *The Subprime Lending Crisis: The Economic Impact on Wealth, Property Values and Tax Revenues, and How We Got Here*, Report and Recommendations by the Majority Staff of the Joint Economic Committee (Oct. 2007)(one of the key policy recommendations put forth in the report was to direct servicers and lenders to make safe and sustainable loan modifications).

[21] Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages (Sept. 2007), *available at* http://www.occ.treas.gov/ftp/bulletin/2007-38a.pdf.

[22] Associated Press, *Paulson to Mortgage Industry: Help Curb Defaults* (Oct. 31, 2007), *available at* http://money.cnn.com/2007/10/31/real_estate/paulson_housing.ap/.

[23] American Securitization Forum, "Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans", Executive Summary (Dec. 6, 2007), *available at* http://www.treas.gov/press/releases/hp706.htm.

acknowledged that the pace has not been sufficient to achieve the scale necessary to contain broader harm to communities and our economy."[24]

Housing counselors, attorneys and borrowers still report major problems in seeking loan modifications for unaffordable loans. In September 2007, Moody's Investor Services surveyed 16 mortgage servicers that accounted for 80 percent of the market for subprime loans and found that most of those companies had modified only about 1 percent of loans with interest rates that reset in January, April and July 2007.[25] In a December 17, 2007 update, Moodys reported that the number had only slightly increased to 3.5%.[26]

In October 2007, the California Reinvestment Coalition surveyed 33 percent of the California's mortgage counseling agencies that offer assistance to financially distressed borrowers and found that servicers were not consistently modifying loans for long-term affordability.[27] Instead most borrowers were being pushed into foreclosure or short sales.

The data available thus far support the conclusion that little is being done by the financial services industry to help homeowners facing foreclosure. The HOPE NOW program issued its first data in early 2008.[28] Although touted as showing substantial improvement, the HOPE NOW report actually demonstrates that little progress has been made. The same can be said about the Mortgage Bankers Association's report on loan modifications issued in January 2008.[29] Both reports confirm that servicers are relying heavily on repayment plans

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[24] Statement of Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation on Using FHA for Housing Stabilization and Homeownership Retention, Testimony before the Committee on Financial Services, U.S. House of Representatives (Apr. 9, 2008).

[25] Michael P. Drucker, et al., *Moody's Subprime Mortgage Servicer Survey on Loan Modifications*, Moody's Investor Services (Sept. 21, 2007), *available at* http://americansecuritization.com/uploadedFiles/Moodys_subprime_loanmod.pdf.

[26] Moody's, *U.S. Subprime Market Update: November 2007, Structured Finance, Special Report* (Nov. 2007). The Moody's report provides detailed definition of "workout agreements," however, it does not distinguish between short-term, long-term and life-of-loan modifications.

[27] California Reinvestment Coalition, *Survey Results Show Lenders not Helping Borrowers Keep their Homes* (October 10, 2007), *available at* http://www.calreinvest.org/news-room/2007-10-10.

[28] *See* HOPE NOW: Results in Helping Homeowners (Feb. 2008)(data covers 18 servicers representing 2/3 of the industry), *available at* http://www.fsround.org/hope_now/pdfs/JanuaryDataFS.pdf. The HOPE NOW data covers the period from July 1, 2007 to January 31, 2008. ***See also*** HOPE NOW Alliance Servicers, Prime and Subprime Residential Mortgages: 2007 Loss Mitigation Activities (February 2008), *available at* http://www.fsround.org/media/pdfs/NationaldataFeb.pdf.

[29] Jay Brinkmann, An Examination of Mortgage Foreclosures, Modifications, Repayment Plans and other Loss Mitigation Activities in the Third Quarter of 2007, Mortgage Bankers Association (Jan. 2008), *available at* http://www.mortgagebankers.org/files/News/InternalResource/59454_LoanModificationsSurvey.pdf.

rather than loan modifications. Repayment plans require homeowners to make increased monthly payments to cure arrears. They do not address payment affordability problems caused by high interest rates and resets.

The MBA report finds that in the third-quarter of 2007, mortgage servicers worked out 183,000 repayment plans and 54,000 loan modifications,[30] while starting 384,000 new foreclosures.[31] Repayment plans outnumbered loan modifications by an 8 to 1 ratio for subprime ARMs as compared with 3 to 1 for all mortgages. Clearly, the "mortgages most in need of modifications are being modified the least."[32] For the HOPE NOW participants, repayment plans also outnumbered loan modifications by a ratio of almost 3 to 1.[33] The most recent HOPE NOW press release heralded an increase in the loan modification rate for subprime loans in January and February 2008.[34] However, a close look at the numbers show that only 4% of borrowers with outstanding subprime ARMs resetting during that period received loan modifications lasting five or more years.[35] Three weeks ago Fitch released its revised loss expectations for 2006 and 2007 subprime loans.[36] The report finds that "[d]espite initial indications of growing borrower participation in the streamlined modification and other outreach loan workout programs initiated by the Hope Now

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[30] Notably, the MBA does not distinguish between short-term modifications, such as 6-month interest rate freezes, and long-term or life of loan modifications. There is presently little data available on the types of modifications servicers are providing. However, anecdotal information suggests that a majority of "modifications" are short-term, often providing interest-rate freezes for a period of six month to two years.

[31] *See* Brinkmann, *supra* note 29 (Table 9)

[32] Comments of Professor Alan M. White, Valparaiso University School of Law, *Mortgage Modifications: More Data*, January 17, 2008, available at: http://pubcit.typepad.com/clpblog/2008/01/mortgage-modifi.html.

[33] Press Release: HOPE NOW New Data Released : More Than Half-Million Subprime Mortgage Holders Helped, (Feb. 6, 2008), *available at* http://www.fsround.org/hope_now/pdfs/10-6FebruaryRelease.pdf. The February HOPE NOW report indicates that for subprime ARMs repayment plans outnumbered loan modification by a 2 to 1 ratio. The discrepancy between the subprime numbers in the HOPE NOW report (2 to 1) and the higher ratio in the MBA report (8 to 1) likely results from less robust data collection by the HOPE NOW Alliance from subprime loan servicers. Fully one-third of the servicing industry has opted-out of the HOPE NOW initiative. *See* HOPE NOW: Results in Helping Homeowners (Feb. 2008)(data covers 18 servicers representing 2/3 of the industry), *available at* http://www.fsround.org/hope_now/pdfs/JanuaryDataFS.pdf.

[34] Press Release, HOPE NOW: Servicers Provided Nearly 1.2 million Loan Workouts Since July '07, *available at* http://www.hopenow.com/media/press_releases/pdf/25-3_April_Release.pdf.

[35] The HOPE NOW press release states that 140,652 subprime 2/28 and 3/27 loans were scheduled to adjust in January or February 2008. Of that number, 60,000 were paid in full through refinancing or sale leaving 80,652 outstanding loans. Of these remaining loans, 5,607 loans were modified and 60% (3,334) of those loans were modified for a period of five or more years.

[36] Fitch Ratings, *Structured Finance: Revised Loss Expectations for 2006 and 2007 Subprime Vintage Collateral* (Mar. 25, 2008).

Alliance…Fitch has seen little evidence to date that these alternatives have helped mitigate foreclosure rates."

Repayment plans and short-term modifications do not solve homeowners' long-term affordability problems. The MBA report demonstrates that repayment plans are ineffective at solving the serious foreclosure problems associated with subprime loans. Of the foreclosures started in the third quarter of 2007, 40% were on subprime ARMs, and 37% were on subprime fixed rate loans, in which the borrower had failed on a repayment plan.[37]

In response to limited voluntary loan modifications to date, Chairmen Frank and Dodd have proposed similar plans to refinance unaffordable loans through the Federal Housing Administration. Like previous calls for large-scale loan modifications, the focus of these FHA refinancing programs is on ensuring affordable and sustainable homeownership. And, like previous calls for loan modifications, servicer/lender participation in the program is *voluntary.*

We appreciate Congressional leadership on this issue and this Committee's continuing persistence in seeking solutions to the foreclosure crisis. While voluntary measures may be able to help some borrowers, structural barriers inherent in the mortgage servicing industry hamper the effectiveness of voluntary programs. Accordingly, we believe that an essential component of any mortgage crisis solution involves enhanced obligations on the part of servicers to communicate with borrowers and seek reasonable loss mitigation prior to foreclosure.

IV. The Servicing Industry Is Fundamentally Broken When It Comes To Meeting The Needs of Borrowers.

Mortgage servicers provide the critical link between mortgage borrowers and the mortgage owners. Since the 1990s, mortgage servicing has become an increasingly specialized and lucrative industry, driven in part by the need for one party to coordinate the distribution of mortgage revenues to the investors in securitized loans. The rights to service mortgage loans are routinely sold or transferred independently of the loans themselves. The servicers' goals in managing loans are generally two-fold: 1) to maximize its own profits and 2) to maximize the returns to the owner of the loan.[38]

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[37] *See* Brinkmann, *supra* note 29 (Tables 2 and 3).

[38] When loans are in default these goals may be in conflict as the servicer's attempts to minimize its cost and maximize its revenues may not result in the highest possible returns to investors.

Servicers are generally responsible for account maintenance activities such as sending monthly statements, accepting payments, keeping track of account balances, handling escrow accounts, calculating interest rate adjustments on adjustable rate mortgages, reporting to national credit bureaus, and remitting monies to the owners of the loans. Servicers also are responsible for engaging in loss mitigation activities and prosecuting foreclosures.

Despite the important functions of mortgage servicers, borrowers have few market mechanisms to employ to ensure that their needs are met. While borrowers must be notified about any change in servicer,[39] they cannot choose the servicer that handles their loan or change servicers if they are dissatisfied. Recent headlines and court decisions around the country have called into question servicer and holder conduct with respect to borrowers in default.[40] For some time now homeowners and consumer advocates have struggled with servicers who have no interest in helping families stay in their homes. Rather, in the interest of maximizing profits servicers have engaged in a laundry list of bad behavior and exacerbated foreclosure rates.[41] The most common abuses in loan servicing include misapplication of payments, use of suspense accounts, failure to make timely escrow disbursements, and cascading fees imposed upon homeowners in default.[42] These abuses exist because there are market incentives, rather than deterrents, for this type of behavior.[43]

A. Voluntary Loan Modifications Are Hampered By Industry Structure

Cutting Cost, Cutting Service. As with all businesses, servicers add more to their bottom line to the extent that they can cut costs. Servicers have cut costs by relying more on voicemail systems and less on people to assist borrowers, by refusing to respond to borrowers' inquires and by failing to resolve borrower disputes. Recent industry efforts to "staff-up" loss mitigation departments have been woefully inadequate. As a result, servicers remain unable to provide affordable and sustainable loan modifications on the scale needed

[39] *See* 12 U.S.C. § 2605 (detailing transfer notice requirements).

[40] *See, e.g.,* Gretchen Morgensen, *Dubious Fees Hit Borrowers in Foreclosures,* New York Times (Nov. 6, 2007); Porter, Katherine M., *Misbehavior and Mistake in Bankruptcy Mortgage Claims* (November 6, 2007). University of Iowa College of Law Legal Studies Research Paper Series Available at SSRN: http://ssrn.com/abstract=1027961 (describing the systematic failure of mortgage servicers to comply with bankruptcy law and fees and charges that are poorly identified and do not appear to be reasonable); *In re Foreclosure Cases*, 2007 WL 3232430 (October 31, 2007)(dismissing 14 foreclosure cases because purported holder could not demonstrate ownership of the loan at the time the foreclosure action were filed).

[41] *See* National Consumer Law Center, *Foreclosures*, Ch. 6 (2d ed. 2007)(describing the most common mortgage servicing abuses).

[42] *Id.*

[43] *See* Kurt Eggert, *Comment on Michael A. Stegman et al.'s "Preventive Servicing Is Good Business and Affordable Homeownership Policy": What Prevents Loan Modifications?,* 18 Housing Pol'y Debate 279 (2007).

to address the current foreclosure crisis. Instead borrowers are being pushed into short-term modifications and unaffordable repayment plans. These "kick the can" approaches to solving the foreclosure crisis do not provide real solutions for those affected borrowers. Instead, they merely postpone the day of reckoning.[44]

Obtaining Timely, Accurate and Consistent Information Is Difficult. The widespread use of automated voice response systems and the decline in "live" assistance for borrowers may improve the servicers' profits, but it is enormously frustrating and counterproductive for borrowers in need of help. From the homeowner's perspective one of the biggest obstacles to loan modification is finding a live person who can provide reliable information about the loan account and who has authority to make loan modification decisions. Stories abound of exasperated homeowners attempting to navigate vast voice mail systems, being bounced around from one department to another, and receiving contradictory information from different servicer representatives.[45] For example, an October 2007 survey from the Neighborhood Housing Services of Chicago found that "countless counselors shared stories of having a client in the office ready to begin dealing with long-deferred financial problems, but then having to wait 30 minutes or more in order to talk to an appropriate loss mitigation staff person."[46] Unfortunately, things have not improved in recent months as servicers struggle to keep up with the increased workload caused by the foreclosure crisis.[47]

Finding a Decision Maker Is Not Straightforward. Borrowers have no ability to call upon the owners of their loans to make decisions about loss mitigation options. In fact, most borrowers do not know who owns their loan and find it difficult to discover the true owner.

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[44] *See* Brinkmann, *supra* note 30 (Tables 2 and 3 showing that a large number of foreclosures result from failed repayment plans).

[45] *See, e.g.,* Gretchen Morgensen, *Can These Mortgages Be Saved?,* New York Times (Sept. 30, 2007)(describing one homeowner who identified 670 calls relating to her home foreclosure in the previous three months and who received nine different answers about how best to proceed from 14 different people at the company); *Miller v. McCalla*, Raymer, 214 F.3d 872, 875 (7th Cir. 2000)(describing the process of trying to get through to an 800 number as a "vexing and protracted undertaking").

[46] Neighborhood Housing Services of Chicago, Inc., *Lessons from the Front Lines: Counselor Perspectives on Default Intervention*, p.6 (Oct. 29, 2007).

[47] *See* Kate Berry, *The Trouble with Loan Repayment Agreements*, American Banker (Jan. 9, 2008)(noting that servicers push repayment plans instead of modifications because they "need twice the staff, and in part they can't manage the volume").

Instead, borrowers are forced to rely on middlemen—the servicers.[48] Even if borrowers can get through to a servicer representative, there may be no one within the servicer operation who has the authority to negotiate a loan modification. In a response to FDIC Chairwoman Bair's call for automated loan modifications, the Consumer Mortgage Coalition described a structure devoid of decision-makers.[49] For private securitizations, the CMC complained that there is simply no active manager the servicer can call to get approval on a loan modification or a waiver of restrictions on modifications found in the pooling and servicing agreements (PSAs). The CMC stated: "While this passive structure may appear to give the servicer more discretion, in fact, because of the lack of an active decision-maker from which the servicer could obtain waivers of the usual requirements, no entity exists with the authority to grant waivers." An industry structure that provides no decision maker to deal with loan modifications is of little value to financially distressed borrowers trying to save their homes from foreclosure.

Unanswered Requests and Unresolved Disputes Are the Norm. Responding to borrowers' written requests for information or written disputes is also time-consuming and costly for servicers. Currently, the Real Estate Settlement Procedures Act (RESPA) requires servicers to respond to such requests within 60 days.[50] However, anecdotally consumer advocates describe large-scale non-compliance with this RESPA requirement. Borrowers' remedies for the servicers' disregard are limited. As a result, many borrowers' requests simply go unanswered.[51] In fact, under current law, even if borrowers dispute the servicers' loan accounting, servicers may nevertheless continue a foreclosure proceeding without resolving the dispute.[52] It appears that the cost of compliance outweighs the cost of non-compliance.

Getting to Affordable Loan Modifications Takes Work. Creating affordable and sustainable loan modifications for distressed borrowers is labor intensive.[53] The borrower's financial circumstances must be evaluated. Property valuations and debt service levels must be

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[48] See In re Schuessler, No. 07-35608 (Bankr. E.D.N.Y. April 10, 2008)(describing conflicting pleadings and testimony regarding the true owner of the note; "It is not possible to tell from any of the documents submitted, or from testimony whether or not JPMorgan Chase Bank is still the owner of the Note, whether the Note was sold to Chase Home Finance, or someone else, or whether Chase Home Finance is the Loan Servicer, the purchaser of the Note, or something else.").

[49] Sam Garcia, *Group Warns on Large Scale Modifications: Consumer Mortgage Coalition sends letters to the FDIC*, Mortgage Daily News (Oct. 9, 2007).

[50] 12 U.S.C. § 2605(e).

[51] See, e.g., Maxwell v. Fairbanks Capital Corp., 281 B.R. 101 (Bankr. D. Mass. 2002).

[52] Reg. X, 24 C.F.R. § 3500.21(e)(4)(ii)(servicer not prohibited from pursuing collection activities during 60-day response period).

[53] Joseph R. Mason, *Mortgage Loan Modification: Promises and Pitfalls*, at 7(Oct. 3, 2007), *available from SSRN at* papers.ssrn.com/sol3/papers.cfm?abstract_id=1027470.

considered. In many respects, reaching affordable results requires servicers to requalify the loan.[54] Under many pooling and servicing agreements, additional labor costs incurred by servicer's engaged this process are not compensated by the loan owner. By contrast, most servicers are reimbursed for costs associated with foreclosure. Under this cost and incentive structure, it is no surprise that servicers continue to push borrowers into less labor-intensive repayment plans or towards foreclosure. As Moody's has noted "[i]t is not advantageous to modify a loan without knowing if the borrower can afford the modified obligations. If they can't, it may simply serve to postpone an eventual foreclosure and increase, rather than decrease, the ultimate loss on the loan."[55] Despite this obvious proposition, the financial services industry continues to oppose a duty to consider affordable alternatives to foreclosure.

B. Maximizing Income is a Servicer's Main Goal

Unpaid Principal Loan Balance Is the Key to Servicer Income. Customarily, the servicer collects a monthly fee in return for the services provided to the trust (or investors). The servicing fee is the largest of the three income streams for servicers. The fee is based on the unpaid principal loan balance and typically ranges from 25 basis points (prime loans) to 50 basis points (subprime loans). A PSA with a 50 basis point servicing fee and a principal balance of $2 billion would result in a servicing fee of just over $9.5 million per year. Reductions in principal cut directly into the servicers' primary source of income. It is no wonder that "[t]o date, permanent modification that have occurred typically involved a reduction in the interest rate, while reductions of principal balance have been quite rare."[56] Chairman Bernanke recently speculated that servicers preference for interest rate reductions could reflect greater familiarity with that technique.[57] More likely, however, it is basic economic principles driving choices in loss mitigation techniques.

Unreasonable and Unearned Fees Boost Servicer Income. Ancillary fees are imposed on borrowers to compensate servicers for the occurrence of particular events. The most common ancillary fee is a late fee, although a variety of other "servicer" fees exist. Such fees are a crucial part of the servicers' income because servicers are typically permitted under PSAs to retain such fees. Ocwen Financial Corporation reported that in 2007 nearly 12%

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[54] Moody's, *U.S. Subprime Mortgage Market Update* (Apr. 2007), *available at* http://www.americansecuritization.com/uploadedFiles/US%20Subprime%20Mortgage%20Market%20Update%20%20April%202007.pdf

[55] *Id.* at 3.

[56] Chairman Ben S. Bernanke, *Reducing Preventable Mortgage Foreclosures* (Mar. 4, 2008), *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20080304a.htm.

[57] Id.

(just over $40 million) of its servicing income was derived from late fees and other loan collection fees.[58] In 2006, Countrywide reported $285 million in revenue from late fees alone.[59] Because servicers are permitted to retain these ancillary fees, they have a strong incentive to charge borrowers as much in fees as they can. Just one improper late fee of $15 on each loan in one average size loan pool (3500 loans) would generate an additional $52,500 in income for the servicer. The profit potential of retained fee income gives servicers a financial incentive to overreach in imposing ancillary fees and to load up accounts with such fees even when doing so may lower the ultimate return to investors.

C. New Opportunities for Abuse Must Be Curbed.

Loan modifications present new opportunities for servicer abuse. The information asymmetry often critiqued in the loan origination context is even worse in the loss mitigation process.[i] The disclosure of information is entirely one-sided. The borrower is required to provide much of the same documentation related to their financial status as is required (or should have been required) at the origination stage. The servicer produces nothing except a "take-it-or-leave-it" agreement.

Often loan modification or forbearance agreements contain a waiver of claims provision that purports to release the servicer and holder from any past or future claims that the borrower may have. For example, in a December 2007 case from North Carolina, Ocwen Federal Bank asserted that the borrower's claims should be dismissed because she released "all of her claims against Ocwen Federal" when she entered into a forbearance agreement.[60] Similarly, in a recently reviewed forbearance agreement the borrower upon execution of the agreement released the "lender" from any claims or damages, including those that were unknown, including "tort claims, demands, actions and causes of action of any nature whatsoever arising under or relating to the Loan Documents or any of the transactions related thereto, prior to the date hereof, and borrowers waive application of California Civil Code Section 1542."[ii] Broad release language potentially cuts off all claims the borrower may have related to the origination or servicing of the loan and is simply inappropriate in the context of a loan modification or forbearance agreement.

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[58] Ocwen Financial Corporation, Form 10-K (March 13, 2008), at 27 available at http://www.sec.gov/Archives/edgar/data/873860/000101905608000419/ocn_10k07.htm

[59] *See* Gretchen Morgenseon, *Dubious Fees Hit Borrowers in Foreclosures*, New York Times (Nov. 6, 2007).

[60] *See In re Tetterton*, 379 B.R. 595 (Bankr. E.D.N.C. 2007).

V. H.R. 5679 Aligns Mortgage Servicers' Interests with Those of Homeowners Seeking to Prevent Foreclosure.

Because of systemic problems in the mortgage servicing industry, large-scale, affordable loan modifications are an aspiration rather than a reality. We applaud the Chairwoman for recognizing these industry shortcomings and proposing a bill that will align mortgage servicers' interests with those of borrower trying to save their homes.

Mandating Borrower Access to a Decision Maker. From the homeowner's perspective, one of the biggest obstacles to loan modification is finding a live person who can provide reliable information about the loan account and who has authority to make loan modification decisions. H.R. 5679, section 2(a) requires mortgage servicers to provide borrowers with contract information for a real person "with the information and authority to answer questions and fully resolve issues related to loss mitigation activities for the loan."

Requiring Information and Dispute Resolution Prior to Foreclosure. While the Real Estate Settlement Procedures Act currently requires servicers to respond to borrowers' request for information and disputes within 60 days, in practice many such inquires go unanswered. Despite this failure to respond, servicers are still permitted to proceed to collection activities, including foreclosure. H.R. 5679 ensures that borrowers facing foreclosure are no longer at the mercy of their servicer. Section 2(c) provides transparency to the servicing process by allowing the homeowner to obtain key information about the loan and its servicing history. The section also prohibits a servicer from initiating or continuing a foreclosure proceeding during the period in which an outstanding request for information or dispute is pending.

Getting to Affordable Loan Modifications Takes Work. Creating affordable and sustainable loan modifications for distressed borrowers is labor intensive. It is no surprise, then, that servicers continue to push borrowers into less costly repayment plans and short-term modifications. H.R. 5679 would align mortgage servicer incentives with those of the homeowner seeking to prevent a foreclosure. Section 2(a) of the bill creates a duty to provide reasonable loss mitigation prior to any foreclosure and prioritizes "home-saving" loss mitigation options over those that result in loss of the home. Any loss mitigation must be based on an affordability analysis that considers the borrowers debt to income ratio and residual income—to ensure enough actual dollars for non-housing expenses—as well inclusion of the borrower's full debt profile, including junior liens on the property.

Curbing Opportunities for Abuse. Loan modification or forbearance agreements often contain a waiver of claims provision that purports to release the servicer and holder from any past or future claims that the borrower may have. Broad release language potentially cuts

off all claims the borrower may have related to the origination or servicing of the loan and is inappropriate in the context of a loan modification or forbearance agreement. H.R. 5679, Section 2(a) nips this pernicious practice in the bud by banning such waiver of rights in loan modification or forbearance agreements. The section also prohibits the equally abusive practice of forcing borrowers to arbitrate any disputes with the lender or servicer.

VI. Conclusion

The foreclosure crisis is real, it is big, and it is growing. To date, the financial industry has failed to voluntarily scale up their loss mitigation activities to address the magnitude of the problem. The structure of the mortgage servicing industry is simply not designed to meet the needs of borrowers. Borrowers need to have access to someone that can provide timely and reliable information about their loans. Borrowers need to be able to discuss their situations with someone that has authority to make necessary loan modifications. And, borrowers need some protection from the abusive behavior of servicers. A right to reasonable loss mitigation that promotes home-saving options over home-losing options is not too much to ask from an industry that has failed to implement sufficient voluntary measures. Without a bill such as H.R. 5679 that aligns the interest of mortgage servicers and borrowers, we are unlikely to see any real progress in the numbers of affordable and sustainable loan modifications. We look forward to working with Representative Waters and the Committee to help financially distressed borrowers save their homes.

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[i] *See* Mason, *supra* note 53, at 9-10 (noting that the modification proposal and acceptance by the consumer are not required to generate any of the records, disclosure, and restrictions placed on loan originations).

[ii] Section 1542 of California's Civil Code provides that: "A general release does not extend to claims which the creditor does not know or suspect to exist in his favor at the time of executing the release, which if known by him must have materially affected his settlement with the debtor."

Statement of

Kenneth D. Wade
Chief Executive Officer
Neighborhood Reinvestment Corporation
(now doing business as NeighborWorks® America)

Before the
House Financial Services Subcommittee on
Housing and Community Opportunity

April 16, 2008

Chairwoman Waters, Ranking Member Capito and Members of the subcommittee, my name is Ken Wade, and I am CEO of NeighborWorks America. I appreciate the opportunity to talk with you today about the goals of H.R. 5679, the mortgage crisis and some of the actions that NeighborWorks America has taken in addressing the problem.

By way of background, NeighborWorks America was established by Congress in 1978 as the Neighborhood Reinvestment Corporation. As you know, the Corporation receives a federal appropriation from the Transportation, Housing and Urban Development, and Related Agencies Appropriations Subcommittee. For fiscal year 2008, the Corporation's appropriation is $119.8 million, in addition to a targeted amount of $180 million for foreclosure prevention counseling grants. The corporation's Board of Directors is made up of the heads of the federal financial regulatory agencies (the Federal Reserve; the Federal Deposit Insurance Corporation; The Comptroller of the Currency; the Office of Thrift Supervision; the National Credit Union Administration) and the Secretary of HUD.

NeighborWorks America's primary mission is to expand affordable housing opportunities (rental and homeownership) and to strengthen distressed urban, suburban and rural communities across America, working through a national network of local community-based organizations, known collectively as the NeighborWorks network.

The NeighborWorks network includes 234 nonprofit organizations, serving more than 4,450 communities across the United States -- in all 50 states, the District of Columbia and the Commonwealth of Puerto Rico. NeighborWorks organizations operate in our nation's largest cities and in some of its smallest rural communities.

NeighborWorks organizations provide a wide variety of services that reflect the needs of their neighborhoods and communities, and in recent years, with the generous support of Congress, NeighborWorks has:

- Provided homeownership counseling to more than 500,000 families;
- Assisted nearly 150,000 families of modest means to become homeowners (of which, 91 percent are low-income and 53 percent are ethnic/racial minorities); and
- Provided nearly 50,000 professional training certificates to community development practitioners from over 5,000 organizations and municipalities nationwide.

NeighborWorks organizations also own and manage more than 65,000 units of affordable rental housing.

In FY 2007 alone, the NeighborWorks network generated more than $4.25 billion in direct reinvestment in distressed communities across the nation.

But today's focus is what efforts need to be made to help stem the foreclosure crisis.

The number of loans that entered into the foreclosure process hit an estimated 1.5 million nationwide in 2007, according to an analysis of data from the Mortgage Bankers Association conducted by NeighborWorks America's Applied Research division. While more than three quarters of all existing loans were prime, subprime loans accounted for more than half (54.6%) of all foreclosure starts. Approximately 823,000 subprime loans started the foreclosure process in 2007, compared to 534,000 prime loans, even though there were six times as many prime as subprime loans being serviced.

The Corporation identified the problem of rising foreclosures over four years ago and created the NeighborWorks Center for Foreclosure Solutions, which is an unprecedented partnership between leading nonprofit organizations as well as state, local and federal agencies and members of the mortgage lending and servicing sectors that involves a comprehensive, multi-faceted approach to the foreclosure crisis.

NeighborWorks America has been working in partnership with the Homeownership Preservation Foundation to support a national toll-free Homeowner's HOPE™ Hotline for borrowers facing foreclosure (888-995-HOPE). The HOPE NOW Alliance has embraced the HOPE Hotline as a key component of their outreach and counseling efforts, the hotline provides high quality telephone-based assistance (in English and in Spanish) around the clock. Individuals needing more intense service than can be provided over the phone are referred to local NeighborWorks organizations or other HUD-approved housing counseling agencies.

We know that early intervention is critical for helping borrowers at risk of foreclosure. To encourage borrowers to reach out for assistance before it is too late, NeighborWorks America also launched a public awareness campaign through the Ad Council. The national public awareness campaign encourages struggling homeowners to reach out for assistance by calling the Homeowner's HOPE Hotline.

Because NeighborWorks America has been so active in foreclosure prevention over the past four years, the Corporation was invited to participate in the HOPE NOW Alliance, announced by the Secretaries of the Treasury and HUD in October 2007. The mission of the HOPE NOW Alliance is to preserve homeownership and prevent foreclosures through outreach to delinquent borrowers, counseling and loan workouts based on the borrower's ability to repay. The HOPE NOW Alliance is also working to improve communications between lenders and counselors to assist homeowners more efficiently and effectively. There are 27 mortgage servicers in the HOPE NOW Alliance and they account for over 90% of the subprime mortgage market. Since November 2007, HOPE NOW servicers have mailed 1.2 million letters to homeowners at-risk of foreclosure. Although HOPE NOW has made great progress, we need more.

In a recent speech, Secretary Paulson stated: "We have an immediate need to see more loan modifications and refinancing and other flexibility. For many families, this will be the only viable solution. The current process is not working well."

I couldn't agree more. There still appears to be a lack of servicer responsiveness to the scale and scope of the foreclosure problem. Many foreclosure counselors continue to experience a significant level of slow responsiveness, lack or transparency or inflexibility by lenders and servicers in regard to loan modifications and refinancings.

This problem (inflexibility) has been exacerbated by falling home prices, where the loan balance exceeds the present appraised value of the property.

One way to significantly reduce foreclosures would be to insist that no foreclosure of any mortgage should be initiated unless the mortgagee or servicer undertook priority loss mitigation activities, such as: waivers of late payment or other charges; repayment plans; forbearance; loan modifications; and/or refinancing of the loan.

I also encourage investors and servicers to develop more standardized approaches and rules to loan modifications and to share those with the counseling community so that we can all aggressively increase the volume of successful loan modifications and workouts.

The HOPE NOW Alliance has also identified the need for a sustainable funding model for quality housing counseling. It is imperative that servicers agree to a fee-for-service model to compensate housing counseling agencies for foreclosure counselors who are meeting standards and working with thousands of borrowers to find successful solutions. Thus far, foreclosure counseling services have been almost exclusively supported by public funds and charitable grants.

There also continues to be an unequal distribution of foreclosure counseling providers across the country, resulting in underserved areas and populations. This continues to be a particular challenge in rural areas and with linguistically isolated populations.

The disparate impact of the foreclosure problem on low-income and minority communities and populations is also troubling. Studies confirm that foreclosures are much more likely to occur in predominantly minority neighborhoods, even when all other variables such as borrower credit and income are held steady. Rising foreclosure rates are currently threatening decades of gains in minority homeownership and community revitalization. Recent studies conducted in Atlanta, Philadelphia and Baltimore confirm that lower income, minority neighborhoods are at greater risk for concentrations of foreclosures.

NeighborWorks America was named in the FY 2008 Consolidated Appropriations Act to administer the National Foreclosure Mitigation Counseling program. The legislation requires that NeighborWorks America grant at least $167,800,000 to qualifying organizations that provide mortgage foreclosure mitigation assistance primarily in states and areas with high rates of defaults and foreclosures primarily in the subprime housing market. These funds are targeted to provide foreclosure mitigation counseling to help eliminate the default and foreclosure of mortgages of owner-occupied single-family homes that are at risk of foreclosure. NeighborWorks America received grant requests totaling nearly $350 million, demonstrating a very high demand for resources to support foreclosure counseling services.

On February 26, 2007, NeighborWorks America announced National Foreclosure Mitigation Counseling program grants totaling $130,438,408 to 130 organizations (including HUD-approved housing counseling intermediaries, State Housing Finance Agencies, and NeighborWorks organizations.)

Summary of National Foreclosure Mitigation Counseling Program Applications				
	Number of Applicants	**Number Awarded Funds**	**Dollar Amount requested (rounded)**	**Dollar Amount Awarded (rounded)**
State Housing Finance Agencies	36	32	$70.0 million	$38.7 million
HUD-Approved Housing Counseling Intermediaries	17	16	$254.1 million	$80.3 million
NeighborWorks Organizations	90	82	$23.8 million	$11.4 million
Totals	**143**	**130**	**$348 million**	**$130.4 million**

Up to $5 million in National Foreclosure Mitigation Counseling funds is being used to build the capacity of mortgage foreclosure and default mitigation counseling agencies.

We anticipate awarding more than 3,000 certificates for foreclosure prevention counseling training through the National Foreclosure Mitigation Counseling program. More than 475 people have been trained already this calendar year. This training builds on NeighborWorks America's existing training programs, which issued more than 12,000 training certificates to community development professionals in FY 2007.

It's clear that when homes go into foreclosure, the impact reaches far beyond the individual tragedies confronting homeowners who lose their home. Foreclosed homes can threaten the stability of entire communities. As foreclosed properties are abandoned, crime rates increase. The value of surrounding homes declines and other homeowners will have difficulty selling or refinancing their homes, leading to further disinvestment in communities. As a result, property taxes collected will be lower, affecting schools and government services, creating a downward spiral that is detrimental to the entire community.

A report (*The Impact of Single-Family Mortgage Foreclosures on Property Values*, by Dan Immergluck and Geoff Smith) demonstrated that a single foreclosure reduces total surrounding property values within an eighth of a mile radius by .9 percent. Cumulatively, this means that the foreclosures analyzed in this study resulted in average property value losses between $159,000 to $371,000 per foreclosure. Multiple foreclosures in an area compound the reduction in property values of surrounding homes even further. Another study, *The Municipal Cost of Foreclosures: A Chicago Case Study*, by William C. Apgar and Mark Duda) reports that one foreclosed property can end up costing a municipality as much as $34,000. Furthermore, lenders report that each foreclosure can cost them from $35,000 to $58,000.

Indeed, the negative impacts of foreclosure are now reverberating throughout the entire U.S. economy – and all projections indicate the problem is going to worsen.

NeighborWorks America is also providing support to our affiliated network of community-based nonprofit organizations and partnering with other national nonprofits, foundations and the public sector to develop strategies and tools to mitigate the impact of vacant and abandoned foreclosed properties on communities, especially in communities with high concentrations of foreclosure.

In May 2008, NeighborWorks will be sponsoring a symposium, *Battling Foreclosure in a Changing Environment* as part of the NeighborWorks Training Institute in Cincinnati, Ohio to help build awareness of the challenges and potential strategies and solutions available to communities impacted by the foreclosure crisis.

From our experience, we know that the best defense against delinquency and foreclosure is objective education and advice before the borrower begins shopping for a home and selecting a mortgage product. The most reliable and trusted home buyer counseling is provided through objective non-profit agencies (including local NeighborWorks® organizations and other HUD-approved nonprofit housing counseling agencies) that put the consumers' and the communities' interest first. We also know that homeowners' odds of success are increased even further when they have access to post-purchase counseling and homeowner education.

To ensure that consumers have access to the highest quality pre- and post-purchase homeownership counseling, NeighborWorks America, together with our partners, has developed National Industry Standards for Homeownership Education and Counseling. The National Industry Standards advance the highest quality of service across core areas ranging from competency of the counselor to performance in the delivery and recordkeeping

NeighborWorks America has been closely tracking the loan performance of the many low-income families assisted by NeighborWorks organizations over the years, particularly with the overall rise in foreclosures in the broader marketplace. These loans continue to perform well. We have not seen any significant up-tick in delinquencies or foreclosures among NeighborWorks-assisted families.

The data indicate that low- and moderate-income families can achieve sustainable homeownership through effective pre-purchase assistance and responsible loan products. Efforts to address the present foreclosure crisis should not limit homeownership opportunities for households of modest means or curtail our efforts to close the homeownership gap that persists for minority Americans.

As conventional mortgage originators have lost ground to mortgage brokers, the threat to sustainable homeownership continues to grow. Of the $2.5 trillion in mortgages taken out last year, roughly 60 percent was handled by the nation's 120,000 mortgage brokers, up from just 20 percent in 1987. While there are many reputable and responsible mortgage brokers, the growth of this non-federally regulated sector has clearly contributed to the foreclosure crisis.

Many consumers are unaware that they should shop around for the best loan terms when purchasing a home. Instead, these borrowers choose the most expedient or readily available credit, even if the terms are not competitive. For credit-impaired borrowers the challenge is even greater, because they are often willing to accept any rate offered to secure the loan they need. Subprime and predatory lenders use these circumstances to their advantage, often steering borrowers to loans that hold a greater profit for their institution – and greater risk and cost to the borrower.

Unfortunately, many families did not have the benefit of pre-purchase education and counseling—assistance in determining whether homeownership is the right decision and what price house and what mortgage product works best for that family. Many of those families entered into situations that were not sustainable, whether due to budget, house price, mortgage product or other factors.

Studies demonstrate that women, minorities and lower-income borrowers rely on subprime lenders for a disproportionate share of mortgage and refinance loans, and are sometimes steered toward these loans even if their credit rating would qualify them for a prime loan.

At the same time, the outdated, paper-driven underwriting processes of most community-based lenders is time consuming and expensive. To compete against subprime and predatory lenders the nonprofit sector must have the tools and ability to respond quickly to meet borrower needs.

NeighborWorks is working to expand the market share of nonprofit lenders by increasing the capacity of the NeighborWorks network to directly originate first mortgages, and by providing research, training, financial support, technology tools and a secondary market to the NeighborWorks network. Several NeighborWorks organizations have been direct originators of first mortgage loans for some time. However, this is a critical area of growth for the NeighborWorks network in order to assure sustainable homeownership.

While the desire to own a home is strong across all socioeconomic groups, the responsibilities of homeownership are not for everyone. Therefore it remains important to have viable rental housing – especially units that allow a safe, stable environment – with rents affordable enough for occupants to accumulate savings.

In sum, Federal, state, local governments and nonprofits will have to continue to work together with private industry—lenders, servicers and investors-- to address the foreclosure crisis.

I again thank you for the opportunity to testify and stand ready to answer any questions.

SERVICING BEST PRACTICES FOR SUBPRIME BORROWERS

Countrywide Financial Corporation ("Countrywide") and the Association of Community Organizations for Reform Now ("ACORN") are committed to home preservation best practices to assist subprime borrowers who find themselves in financial distress. Countrywide and ACORN believe that no borrower who has demonstrated the ability and willingness to make their payments should lose his/her home to foreclosure, and certainly not solely as a result of a rate reset.

The following best practices with regard to subprime borrowers are consistent with Countrywide's mission to maintain borrowers in their homes whenever possible.

- **Home retention options for subprime hybrid ARM borrowers who cannot afford the payment reset**:
  - **Notification Standards:** Countrywide is conducting outbound calls and providing written notices to subprime hybrid ARM borrowers 180, 90, and 45 days prior to the loan reset date to notify them of:

    (i) the upcoming rate reset;

    (ii) the amount of the new interest and payment based on interest rates as of the time of the notification; and

    (iii) the options available to them (including counseling resources) if the Borrower believes he/she will not be able to make his/her mortgage payments based on the reset rate.
  - **Servicing Portfolio Review Standards:** For borrower's currently in a subprime hybrid ARM loan, Countrywide will review payment history, Combined Loan-to-Value Ratio (CLTV), and credit score information. Based on this review, Countrywide will contact these borrowers and offer the following options:

(i) **Prime Refinance**: For all borrowers who can qualify for a refinance, Countrywide will offer prime refinance programs. Countrywide will work with its borrowers to try to arrange for the closing of any refinance transaction to occur after the expiration of any prepayment penalty period applicable to the loan being refinanced.

(ii) **Streamlined Rate Freeze:** For borrowers who do not qualify for a refinance and tell us that they cannot afford the payment after the rate reset, Countrywide will conduct a streamlined review of each such borrower's financial situation. If the qualified borrower has been current in his/her payments prior to the reset, he/she will be offered the rate in effect prior to the reset for a five year period. These borrowers will be required to execute a modification agreement to ensure that at the end of the 5-year period, the loan adjusts to a sustainable mortgage payment for the remaining term of the loan.

(iii) **Rate Rollback:** For qualified borrowers who are experiencing difficulties as a result of a recent reset, Countrywide has implemented a simplified loan modification process. Countrywide sends such borrowers a notice offering a pre-determined, pre-approved rate reduction. This rate will be in effect for a period of 5 years from the date of the notice, and past due amounts will be capitalized over the remaining term of the loan. These borrowers will be required to execute a modification agreement to ensure that at the end of the 5-year period, the loan adjusts to a sustainable mortgage payment for the remaining term of the loan.

- **Home retention options for all other delinquent subprime borrowers:**
    - **Short-term Repayment Plan:** If the borrower is experiencing a temporary financial hardship and is able to repay the missed payments within a three month period, Countrywide will enter

into a short term repayment plan with the borrower (generally 1-3 months).

- If the borrower is unable to repay the missed payments within such short term period but desires to retain the home, the borrower's situation will be analyzed utilizing a streamlined methodology developed by Countrywide and ACORN. The methodology is intended to expedite the analysis and still provide prudent and reasonable analysis that complies with Countrywide's regulatory and contractual obligations. Countrywide and ACORN have established reasonable parameters for determining when a long-term repayment plan or a loan modification provides an affordable option to borrowers.

  (i) **Long-term Repayment Plan**: Borrowers may be offered a long term repayment plan that provides borrowers up to 6 months to make up the missed payment(s).

  (ii) **Loan Modification – Capitalization:** If a long-term repayment plan is not affordable, borrowers will be evaluated for a loan modification that results in capitalizing outstanding payments but does not include a rate reduction.

  (iii) **Loan Modification – Rate Reduction:** If a loan modification does not provide an affordable solution, then Countrywide will evaluate a loan modification involving a possible rate reduction. The terms of a rate reduction modification will be determined as follows:

  - Countrywide and ACORN have mutually established "safe harbor" rates that should allow for affordable payments for borrowers in these situations.

    - If the safe harbor rate provides for a payment that can be sustained by the borrower, then the borrower will be offered the reduced rate for 5 years, and thereafter, will be offered a sustainable mortgage payment for the remaining term of the loan.

- If the borrower cannot sustain the payment at the safe harbor rate, then ACORN and Countrywide agree that additional analysis will be completed to determine if there are ways to increase income or decreases expenses within the borrower's household. The analysis will also focus on whether the borrower's financial hardship is due to a temporary situation (e.g., short term disability) or a more permanent situation and will develop options more aligned with the borrower's individual circumstances.

- **Home Retention Guidelines to Identify Qualified Borrowers**

  - **Eligibility**: Countrywide and ACORN agree that the following rules govern in all situations when the extension of the existing rate or a rate reduction is contemplated:
    - The combined loan-to-value ratio ("CLTV") analysis must establish a greater loss on a foreclosure sale than the loss on the restructured loan. Countrywide will use the same information regarding property values, property disposition timelines and property holding costs that it uses in connection with its own REO.
    - Property must be owner-occupied.
    - Borrower must own only one property.
    - Taxes and insurance are to be impounded as part of the rate reduction agreement.
    - If there is a junior lien on the property, no payment may be made on such junior lien if there is to be any reduction of the rate or principal balance of the loan secured by the first lien.

  - **Second Review**: If the Countrywide solution offered to the borrower under one of the streamlined approaches discussed above is not acceptable to the borrower, Countrywide will review the borrower's individual circumstances and, based on a detailed analysis of the borrower's income, expenses and other relevant factors, will determine whether another home retention solution can be implemented.

- **Training:** Countrywide reaffirms its commitment to train its collection and home retention personnel to be sensitive to the often difficult and nuanced individual situations of its borrowers. Such training shall include being respectful to the borrowers, eliciting from the borrowers such information as may be necessary to provide the borrowers with options appropriate to their individual situations, and discussing such options with the borrowers. If a customer indicates to a Countrywide collection employee that the monthly payment then in effect is not affordable, then the collection employee will attempt to obtain financial information from the borrower to begin the analysis contemplated by this agreement.

- **Compliance with Legal Requirements:** ACORN and Countrywide agree that Countryw

Information for the Record referenced in line 1208

- The forbearance period is at least one month in duration.
- It cures the default.

If a repayment plan is developed at the end of the forbearance period, then the special forbearance is not eligible for an incentive payment, although the subsequent repayment plan will be eligible upon loan reinstatement.

VA has additional requirements for special forbearances. For example:

- You must determine a reason for the default and ensure that the reason for default has been resolved.
- You must verify the borrower's financial ability to support the proposed forbearance.
- Special forbearance plans must result in loan reinstatement.
- Special forbearance plans have no maximum duration.

You must report the Special Forbearance Approved event to VA by the seventh day of the month following the month in which you approve a special forbearance. This informs VA that acceptable terms have been reached to cure the delinquency. Once the loan reinstates, you report the Default Cured/Loan Reinstated event to VA to begin the incentive payment process. Reinstatement occurs when you receive all amounts contractually due at the time of payment (including late fees, legal fees, and property preservation fees), and the due date of the next installment is no earlier than the first of the month following the month the payment was made.

Post-Audit Document Retention Requirements for Special Forbearance Approved

You must retain the following documents for at least three years in accordance with 38 CFR 36.4833:

- Written executed special forbearance agreement
- Servicing case notes

For more information on post-audit document requirements, refer to Form 26-8714, Post-Audit Requirements and Retention of Documents.

5.2.3 Servicer Considers Loan Modification

(38 CFR 36.4815)

A loan modification is a written agreement that permanently changes one or more of the terms of a loan, and includes re-amortization of the balance due. VA requires you to consider a loan modification only after determining that a repayment plan and special forbearance are not feasible. You should only modify loans when the borrower has both the ability and desire to remain in the home.

A loan modification is eligible for an incentive payment if:

- It is completed on a loan at least 61 days delinquent.
- It meets all VA requirements. An exception applies if VA granted pre-approval to complete a loan modification that does not meet one or more requirements.
- The servicer reports the Default Cured/Loan Reinstated event.

5.2.3.1 Authority to Modify VA Guaranteed Loans

You have the delegated authority to modify a loan when all of the following requirements are met:

- The loan is in default.
- The event or circumstances that caused the default has been or will be resolved and is not expected to re-occur.
- The obligor is considered to be a reasonable credit risk, based on your review of the obligor's creditworthiness under the criteria specified in 38 CFR 36.4840, including a current credit report. You must determine whether or not the obligor has the financial ability to resume regular mortgage installments when the modification becomes effective based upon a review of the obligor's current and anticipated income, expenses and other obligations as provided in 38 CFR 36.4840.
- At least 12 full monthly installments have been paid since the closing date of the loan.
- The current owner(s) are obligated to repay the loan, and are party to the loan modification agreement.
- The loan will be reinstated to performing status by virtue of the loan modification.

You may contact VA to request pre-approval to modify a loan when it does not meet one or more of these requirements. For more information on requesting pre-approvals, refer to Chapter 13, Pre-Approvals.

5.2.3.2 Requirements for Modifying VA Guaranteed Loans

You must comply with the following regulatory requirements when completing a loan modification on a VA guaranteed loan:

- The loan may not be modified more than once in a three-year period and no more than three times during the life of the loan.
- The modified loan must bear a fixed-rate of interest, which may not exceed the Government National Mortgage Association (GNMA or Ginnie Mae) current month coupon rate that is closest to par (100) in effect as of the close of business the last business day of the month prior to the approval of the loan modification, plus 50 basis points. A basis point is equal to .01 percent interest. For example, if the current Ginnie Mae production rate is six percent, the corresponding fixed rate for VA-guaranteed loan would be 6.5 percent (the Ginnie Mae production rate plus 50 basis points).
- The unpaid balance of the modified loan may be re-amortized over the remaining life of the loan. The loan term may extend the maturity date to the shorter of: (1) 360 months from the due date of the first installment required under the modification, or (2) 120 months after the original maturity date of the loan.
- Only unpaid principal, accrued interest, deficits in taxes and insurance impound accounts and advances required to preserve the lien position, such as homeowner association fees, special assessments, water and sewer liens, etc., may be included in the modified indebtedness. Late fees and other charges may not be capitalized.

- You may not charge a processing fee under any circumstances to complete a loan modification. However, late fees and any other actual costs incurred and legally chargeable, including but not limited to the cost of a title insurance policy for the modified loan, but which cannot be capitalized in the modified indebtedness, may be collected directly from the borrower as part of the modification process.
- The modification does not provide the obligor with any cash back.

You may contact VA to request pre-approval to approve a loan modification that does not meet one or more of these requirements. For more information on requesting pre-approvals, refer to Chapter 13, Pre-Approvals.

5.2.3.3 Approval and Execution of Loan Modification Agreement

You must report the Loan Modification Approved event to VA by the seventh day of the month following the month in which you approve a loan modification. This event informs VA of the date you approved the loan modification, ensuring that VALERI will check the appropriate Ginnie Mae coupon rate against the interest rate you applied to the loan modification.

Post-Audit Document Retention Requirements for Loan Modification Approved

You must retain the following documents for at least three years in accordance with 38 CFR 36.4833:

- Loan modification approval letter
- Servicing case notes

[illegible]

Upon execution of the loan modification, you must ensure the first lien status of the modified loan and comply with disclosure or notice requirements applicable under state or Federal law. Any amount of a modified loan that is not in the first priority lien position is excluded from the VA guaranty. No obligors will be released from liability as a result of executing the modification agreement without prior approval from VA. Releasing an obligor from liability to repay the loan releases the Secretary from liability under the guaranty.

You must report the Loan Modification Complete event to VA by the seventh day of the month following the month in which you and the borrower executed the loan modification agreement. This event informs VA of the terms of the modified loan and allows VALERI to check the loan for compliance with VA requirements. To begin the incentive payment process, you must report the Default Cured/Loan Reinstated event to VA with the Loan Modification Complete event. If you received a loan modification pre-approval, a VA technician must generate a manual incentive payment for the modification. If you complete a modification but do not receive an incentive for the loan modification within a reasonable amount of time, you may contact the technician assigned to the loan to resolve the issue.

Post-Audit Document Retention Requirements for Loan Modification Complete

You must retain the following documents for at least three years in accordance with 38 CFR 36.4833:

- Loan modification agreement
- Loan modification worksheet
- Underwriting package

[illegible]

5.2.3.4 Review of Suspicious Loan Modification

VA will conduct a review of the loan modification after you report the Loan Modification Complete event, if one or more of the following applies:

- The loan modification completion date reported with the event is before the loan origination date.
- The loan does not amortize to within $50 of zero over the proposed term.
- The interest rate exceeds the maximum allowable rate. The maximum allowable rate is calculated by adding 50 basis points to the Ginnie Mae coupon rate applicable for the loan modification approval date. A basis point is equal to .01 percent interest.
- The term of the loan exceeds the maximum allowable term. The maximum allowable term is the lesser of: (1) 360 months from the due date of the first installment required under the modification, or (2) 120 months after the original maturity date of the loan.
- The loan received fewer than 12 full monthly payments prior to modification.
- The property is other than owner-occupied.
- The loan has been modified three times prior to the current modification.
- The loan has been modified within three years of a current modification.
- The due date of the first payment on the modified loan is less than one month after the loan modification completion date.

Upon initiating a review of the loan modification, VA may require you to submit the loan modification approval letter, servicing case notes, loan modification agreement, loan modification worksheet, and underwriting package. Following the review, VA may instruct you to correct the loan modification or allow the modification to go forward without corrections.

If you are instructed to correct the loan modification, you have 60 days to execute a corrected loan modification agreement and report a new Loan Modification Complete event. Failure to execute a corrected loan modification within the required timeframe could result in VA's refusal to pay a claim, or an adjustment to the claim, if the loan becomes delinquent and is subsequently terminated.

VA Refunded Loans

Fiscal Year 2003 –	1,711
Fiscal Year 2004 –	1,185
Fiscal Year 2005 -	861
Fiscal Year 2006 -	812
Fiscal Year 2007	722
Fiscal Year to date 2008 -	247

Follow-up from April 16, 2008 Subcommittee Hearing on Loss Mitigation
(Laurie Maggiano was HUD's witness)

Question:
How many actions were taken as a result of servicing reviews in the past few years, with specific focus on Countrywide?

Response:
Since 10/1/2002 to present, the Single Family Quality Assurance Division conducted 204 *servicing* lenders reviews. This figure represents 16.8% of FHA-approved servicing lenders. As a result of the reviews completed, QAD obtained:

a) 290 loan indemnifications.
b) Reimbursements to borrowers or HUD: $17,161

With respect to Countrywide Home Loans, QAD has performed 7 reviews of the lender servicing practices. In 2001, QAD referred Countrywide to the Mortgagee Review Board (MRB) for servicing violations. As a result, the MRB imposed administrative sanctions in the amount of $30,000. In addition, Countrywide agreed to indemnify HUD on 3 loans, for the amount of $126,626.

On 1/2006 QAD performed a comprehensive review of Countrywide servicing practices. QAD staff review 235 loans, and the most common findings were:

- Escrow analysis issues.
- Servicing of 203K loans issues
- Untimely/inadequate property inspections
- Inadequate loss mitigation documentation
- Unrealistic forbearances

As a result of the review, Countrywide reimbursed HUD incentives fees totaling $3,600.

Department of Justice

STATEMENT OF

CLIFFORD J. WHITE III
DIRECTOR
EXECUTIVE OFFICE FOR UNITED STATES TRUSTEES
UNITED STATES DEPARTMENT OF JUSTICE

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY
UNITED STATES HOUSE OF REPRESENTATIVES

CONCERNING

"H.R. 5679, THE FORECLOSURE PREVENTION AND SOUND MORTGAGE SERVICING ACT OF 2008"

PRESENTED

APRIL 16, 2008

Madam Chairman, Ranking Member Capito, and Members of the Subcommittee:

Thank you for the opportunity to submit a statement describing the activities of the United States Trustee Program (USTP or Program) to protect homeowners who file for bankruptcy relief. We are the component of the United States Department of Justice with a duty to oversee bankruptcy cases, ranging from consumer bankruptcy cases to large corporate reorganizations. Our mission is to promote the integrity and efficiency of the bankruptcy system.[1/] Our responsibilities, which are set forth in titles 11 and 28 of the United States Code, include the performance of administrative, regulatory, and litigation functions.

The duties of the USTP are carried out by the Executive Office for United States Trustees, 21 regional United States Trustees, and 95 field offices. The Program employs nearly 1,300 staff, including trial attorneys, financial analysts, and support staff.

Civil and Criminal Enforcement

One of the core functions of the USTP is to combat bankruptcy fraud and abuse. This is reflected both in our statutory mandate and in our track record over the past 20 years. In launching a Civil Enforcement Initiative in 2002, the Program adopted a balanced approach to address wrongdoing both by debtors and by those who exploit debtors. The Program combats fraud and abuse by debtors by seeking denial of discharge for the concealment of assets and other violations, by seeking case dismissal if a debtor has an ability to repay debts, and by taking other enforcement actions. We protect consumer debtors from wrongdoing by attorneys, bankruptcy petition preparers, creditors, and others by pursuing a variety of remedies, including the disgorgement of fees, the imposition of fines, and injunctive relief.

In Fiscal Year (FY) 2007, the Program initiated more than 74,000 civil enforcement and related actions, including actions not requiring court resolution, with a monetary impact of more than $865 million in debts not discharged, fines, penalties, and other relief. Since we began tracking our results in 2003, we have taken more than 290,000 actions with a monetary impact in excess of $3.5 billion.

Criminal enforcement is another key component of the Program's efforts to uphold the integrity of the bankruptcy system. We have a statutory duty to refer suspected criminal conduct to the United States Attorney and to assist in prosecuting bankruptcy crimes. We participate in more than 50 local working groups, including bankruptcy fraud working groups, mortgage fraud working groups, and other specialized task forces that are led by federal law enforcement agencies around the country. We also work closely with the Federal Bureau of Investigation, the

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[1/] The USTP has jurisdiction in all judicial districts except those in Alabama and North Carolina. In addition to specific statutory duties and responsibilities, United States Trustees "may raise and may appear and be heard on any issue in any case or proceeding under this title but may not file a plan pursuant to section 1121(c) of this title." 11 U.S.C. § 307.

Internal Revenue Service - Criminal Investigation, the Office of Inspector General of the Department of Housing and Urban Development, and other federal law enforcement agencies.

In FY 2007, we made 1,163 criminal referrals, including cases involving housing fraud. This represents an increase of 26 percent in the number of cases formally referred over the previous year. Furthermore, the number of cases referred in FY 2006 represented an increase of 24 percent over the previous year.

Protecting Homeowners in Bankruptcy

Protecting consumer debtors is an important objective of the Program's enforcement efforts. One of the basic principles of our bankruptcy system is that the honest but unfortunate debtor deserves a fresh start. Those who prey upon debtors for their own financial gain undermine that basic principle.

Among the most egregious mortgage-related schemes we encounter are those perpetrated upon consumers facing foreclosure on their homes. From our experience, it sometimes seems that those facing foreclosure on their homes receive more mail than any other group of Americans. As soon as a foreclosure notice is posted in a public record, debtors are apt to receive flyers and other mailings telling them how to save their homes. Although debtors are vulnerable to a wide variety of fraudulent schemes or other improper conduct, two of the fact patterns uncovered most often by United States Trustees are described below.

Bankruptcy Petition Preparers

A common problem we see in the bankruptcy system is the distressed homeowner's use of a bankruptcy petition preparer. Instead of going to see a lawyer, some seek a less expensive alternative. A debtor is not required to retain an attorney before filing for bankruptcy. Some non-attorneys perform a legitimate service by providing and typing bankruptcy forms at a charge of $200 or less. Unfortunately, however, we frequently learn about homeowners in need of debt relief who turn to a non-lawyer bankruptcy petition preparer (BPP) who provides advice that is both illegal and catastrophically wrong. Non-attorneys are not permitted to offer legal advice. If a debtor owns a home, many factors go into whether to file a chapter 7 or a chapter 13 petition.[2/] Legal issues such as the amount of equity in the home, availability of state exemptions, calculation of disposable income to make up for mortgage arrearages, and other factors need to

[2/] In general, debtors in chapter 7 give up all non-exempt property to a case trustee appointed by the United States Trustee. The chapter 7 trustee liquidates non-exempt property and distributes the proceeds to creditors. Debtors in chapter 13 retain their home and other property, but must remain current on post-petition secured debt payments (e.g., mortgage and auto loans). Chapter 13 debtors also must make up any pre-petition arrearages on secured debts and repay at least a portion of unsecured debts (e.g., credit card obligations) under a three to five year repayment plan.

be carefully considered before deciding whether to file bankruptcy and under which chapter to file.

Following are two examples of improper bankruptcy petition preparer conduct pursued by United States Trustees:

- In a series of cases in New York City, homeowners who fell behind on their debts responded to an advertisement from a BPP. When the debtors came to the BPP's office, the BPP filled out chapter 7 forms, collected a fee, and then filed the bankruptcy petition. The next thing the debtors knew, they were attending a formal meeting of creditors presided over by a trustee where they learned for the first time that the trustee planned to take their home, sell it, and distribute the proceeds to creditors. After the debtors told their story, we were able to obtain both injunctive relief against the BPP, prohibiting it from the unauthorized practice of law, and affirmative relief requiring the BPP to make disclosures to future clients regarding the nature and cost of its services. More importantly, the affected debtors were able to convert their cases to chapter 13 where they could retain their homes.

- In another case decided within the past year, the bankruptcy court in the Western District of Pennsylvania entered a default judgment against a BPP following a complaint filed by the Office of the United States Trustee. The out-of-state BPP contacted several Pittsburgh area residents faced with foreclosure by mailing a postcard that guaranteed the BPP could help them keep their homes. In exchange for fees ranging from $250 to $2,100, the BPP provided the homeowners with skeletal chapter 13 petitions to file to stay foreclosure. The debtors' bankruptcy cases were ultimately dismissed. The court fined the BPP $72,000, ordered the disgorgement of fees in the amount of $8,200, and permanently enjoined it from acting as a BPP and offering legal advice or otherwise engaging in the unauthorized practice of law in the district.

Foreclosure Rescue Operators

Another frequent fact pattern involves foreclosure rescue operators who use the bankruptcy system to victimize distressed homeowners. The perpetrators of this fraud promise to assist the victims in saving their homes from foreclosure. By filing bankruptcy petitions, the fraudsters use the automatic stay[3/] to delay foreclosure and to convince the victims that they are performing a valuable service.

In one variation of this scheme, the perpetrator promises to renegotiate the terms of the victim's mortgage. The fraudster often directs the victim to make mortgage payments to him or to pay him a monthly fee. In reality, the fraudster does nothing except pocket the victim's money. To ensure the victim will continue to pay the perpetrator, and prevent foreclosure in

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[3/] By statute, the filing of a bankruptcy petition generally stays any actions to collect on debts, including actions to foreclose on a debtor's residence.

spite of the non-payment of mortgage, bankruptcy petitions may be filed in the name of the victim.

If the perpetrator is filing the bankruptcy papers without the debtor's knowledge, it may be a long time before the debtor learns about the bankruptcy. In such cases, it is critical that the homeowners contact a lawyer, the bankruptcy court, or the United States Trustee as soon as they become aware that a bankruptcy petition was filed in their name.

In another scenario, the "rescue servicer" takes the debtor's equity and the home ultimately is lost to foreclosure. In these cases, the fraudster seeks out individuals who are losing their homes to foreclosure and prevails upon them to transfer their homes to him to avoid a foreclosure on their credit reports. To stop the foreclosure, the rescue operator files bankruptcy petitions in the homeowners' names. While the cases are pending, he collects rental income on the properties from the victims.

Following are four recent cases involving criminal prosecution:

- In Kansas, a Los Angeles man was charged in an indictment unsealed on February 29, 2008, with six counts of mail fraud and six counts of aggravated identity theft for his role in a bankruptcy foreclosure scheme. The defendant allegedly solicited homeowners whose homes were in foreclosure, and told them that for a fee he could help them keep their homes. He allegedly filed false bankruptcy petitions in the names of non-existent businesses that claimed to be part owners of the properties in foreclosure. The petitions were filed in the Bankruptcy Court for the District of Kansas, and contained false names, Social Security numbers, and other information. The United States Trustee in Kansas referred the matter and assisted in the investigation. A copy of a news release issued by the United States Attorney announcing the indictment is attached.
- In the Northern District of Illinois, a defendant was sentenced on June 25, 2007, after pleading to wire fraud and false declaration in bankruptcy. The defendant preyed on homeowners facing foreclosure by making false representations that the defendant's company and its team of experts could stop foreclosures and eliminate all of a homeowner's mortgage debt in two years. The defendant falsely represented to some of his victims that mortgage debt was illegal and that the mortgage companies would forgive their debt when faced with lawsuits and persuasive arguments. The defendant charged the homeowners a large retainer as well as monthly payments, but essentially did nothing except file serial bankruptcy petitions to delay foreclosure. Approximately 29 victims lost a total of around $180,000, and all eventually lost their homes. The defendant was sentenced to 135 months incarceration and six years of supervised release, and was ordered to make restitution in the amount of $187,604. The United States Trustee in Chicago referred the matter and a USTP Regional Criminal Coordinator assisted in the prosecution as a Special Assistant U.S. Attorney.

- In the Northern District of Ohio, a Grand Jury returned an indictment last December alleging that the defendant committed eight counts of mail fraud. The indictment alleges that the defendant engaged in a scheme to defraud financially troubled homeowners. The indictment states that the defendant made representations that his company specialized in helping people save their homes from foreclosure with highly trained and qualified specialists. The indictment charges that the defendant requested and received funds from these homeowners to be used to pay their mortgage lenders, but that he instead used these funds for his own personal and business purposes. The indictment states that the defendant fraudulently obtained approximately $500,000 from various homeowners. The indictment further alleges that the defendant hired attorneys to prepare and file bankruptcy petitions on behalf of the homeowners to delay foreclosure actions. A Trial Attorney from the Cleveland office of the United States Trustee is assisting in the prosecution of the case as a Special Assistant U.S. Attorney.

- In Arizona, last August a foreclosure rescue operator was sentenced to 33 months in prison, fined $5,000, and ordered to pay $86,409 in restitution, based on his guilty plea to two counts of false declaration in bankruptcy. The operator sought out individuals who were losing their homes to foreclosure and prevailed upon them to transfer their homes to him to avoid having a foreclosure on their credit reports. To stay foreclosure, he filed bankruptcy petitions in the homeowners' names without their knowledge. While the cases were pending, he collected rental income on the properties. When we were alerted to the scam, we took action to remove the bankruptcy filing from the debtors' records and worked closely with the United States Attorney on the criminal prosecution. A copy of a news release issued by the United States Attorney announcing the sentencing is attached.

Mortgage Servicer Violations in Bankruptcy Cases

Apart from the kind of fraudulent or improper activities described above, we also have been involved in significant litigation involving national mortgage servicing firms. Most of these cases involve homeowners who are behind on their mortgage payments and file for relief under chapter 13 of the Bankruptcy Code. To date, we have commenced actions or intervened in 16 pending cases involving mortgage servicers in eight judicial districts around the country. In addition, we are actively reviewing more than 30 cases in which we have not yet filed court papers.

The United States Trustee Program has investigated complaints that some mortgage servicers were filing inaccurate papers in court claiming that debtors owe more money than they actually owe. We also investigated complaints that some mortgage servicers were tacking on charges that were undisclosed and impermissible under the terms of the loan contract or other applicable law. In the most extreme cases, the debtor makes all payments required in chapter 13 and, after emerging from bankruptcy, is hit with a new bill for previously undisclosed charges.

If those new bills are not paid, then the lender can foreclose on the property and the entire chapter 13 process will have been for naught.

More specifically, the United States Trustee has investigated or pursued actions involving mortgage servicers who inflate the amount of money due from the debtor in two primary ways:

- Proof of Claim: Creditors are generally required to file with the court a proof of claim stating the amount owed by the debtor. In the case of a mortgage debt, the proof of claim should reflect the principal due and the arrearages from pre-petition missed payments. If the homeowner wishes to retain the home, then the arrearage must be repaid under a three to five year chapter 13 repayment plan. We have investigated or taken action against mortgage servicers who file proofs of claim in inflated amounts that are not documented by reliable billing records.

- Motions for Relief from Stay: By filing a bankruptcy petition, the debtor receives an automatic stay preventing creditors from taking any collection action on most debts without a court order. Generally, chapter 13 debtors may keep their home if they can make up past due payments as described above and remain current in their post-petition mortgage payments. If debtors are delinquent in their post-petition payments, the creditor may seek relief from the stay and foreclose on the property. We have investigated or taken action against mortgage servicers who file motions for relief from stay based upon inaccurate financial information. For example, the mortgage servicer may misapply post-petition plan payments or add various charges, such as high attorney fees, that are not permissible under the mortgage contract or applicable law. Unless the mortgage servicer's accounting is challenged, then the court may grant the relief from stay and the debtor may be subject to foreclosure.

In response to an increasing number of complaints about the accuracy of bankruptcy court filings made by some mortgage servicers, approximately 18 months ago, I established an informal working group within the USTP to review the complaints and devise a coordinated approach for addressing the problem. The working group considered many legal and practical issues. As a threshold matter, it is not always clear when the United States Trustee should intervene in a case. We take the legal position that the Program has authority to redress violations by creditors, particularly when the abuse is systemic or multi-jurisdictional. In many cases, however, creditor abuse is best addressed by the private case trustees we appoint who object to claims, or by debtors' lawyers who dispute loan agreement terms. The Program should focus its attention on cases in which the integrity of the bankruptcy system as a whole is at stake. In those cases that have broader system-wide implications, it is important for the Program to take direct enforcement action.

In addition to the difficulty of case selection, civil litigation of mortgage servicing issues requires resource intensive fact finding and resolution of strongly contested legal issues. In one recent case, we completed seven days of trial, examined 22 witnesses, and reviewed thousands of

pages of documents. Moreover, a creditor's procedural obligations under chapter 13 may be quite different under disparate local court rules, practice, and case law. In addition, our standing to intervene has been challenged and litigation over that issue can slow down our investigation and civil prosecution.

Insofar as we are currently in litigation and discovery in many mortgage servicer cases, it would not be appropriate to discuss these cases in detail. However, a summary of three recent bankruptcy court decisions is provided below.

- In re Countrywide Homes Loans, Inc., __ B.R. __, 2008 WL 868041 (Bankr. W.D. Pa. Apr. 1, 2008): The bankruptcy court consolidated several cases for administrative purposes to resolve the creditor's challenge to the authority of the United States Trustee to examine Countrywide's mortgage servicing practices. In a lengthy opinion handed down on April 1, 2008, the bankruptcy court ruled in favor of the United States Trustee. The court declared that "the UST was undoubtedly intended to be a 'watchdog' of the bankruptcy system" and, in the cases at bar, "made a showing of a common thread of potential wrongdoing in each of the cases that is sufficient to meet the general standard of good cause necessary" to proceed.

- In re Parsley, __ B.R. __, 2008 WL 622859 (Bankr. S.D. Tex. Mar. 5, 2008): After several days of trial and extensive briefing on legal and factual issues arising in the case, the bankruptcy court handed down a 72 page opinion resolving Orders to Show Cause against a mortgage servicer and its counsel. The United States Trustee argued that Countrywide Home Loans, Inc., or its outside counsel should be sanctioned for bad faith conduct for repeatedly averring inaccurate facts in papers filed with the court. The court earlier had upheld the United States Trustee's standing to pursue the matter. The court noted that "[t]he level of vituperation against the UST merits some discussion of the UST's role in the bankruptcy system." The court concluded that "the UST was well within its authority to investigate" the mortgage servicer and its counsel "to determine if their activities undermined the integrity of the bankruptcy system," and stated that the United States Trustee's litigation "has been very thorough and skillful." Although the court found many instances of inaccurate court filings and inappropriate conduct, and criticized the mortgage servicer's "corporate culture," the court did not impose additional sanctions. The court reasoned that sanctions required a heightened burden of proof beyond negligence, the parties already had suffered some penalties, and the parties had taken some corrective actions.

- In re Allen, No. 06-60121, 2007 WL 1747018 (Bankr. S.D. Tex. June 18, 2007): The bankruptcy court imposed sanctions of $150,000 against a law firm representing mortgage servicers. The court found that the law firm repeatedly filed motions for relief from the stay to permit foreclosure based upon inaccurate statements of the amount of past due debt. The sanction was remitted to $75,000 because the law firm was attempting to cure its deficiencies. As in other cases, the

> court noted that the respondent had "complained bitterly about the participation of the U.S. Trustee in this matter," but found that we were a "party in interest with the authority to be heard," and "provided an invaluable benefit to the case and to the process . . . ."

Conclusion

The mission of the USTP is to carry out the bankruptcy laws for the benefit of all stakeholders in the system – debtors, creditors, and the public. The integrity of the bankruptcy system is threatened whenever debtors violate the Bankruptcy Code by seeking a discharge of debt despite their ability to pay creditors out of disposable income or by concealing assets that should be liquidated for distribution to creditors. Similarly, the integrity of the bankruptcy system is compromised by creditors who file false financial information that inflates the amount of money due to them or deprives debtors of the Bankruptcy Code's protection against foreclosure. Actions to protect consumer debtors who may be victims of fraud or abuse have a high priority, have yielded positive results, and will continue to be aggressively pursued.

The United States Department of Justice
Welcome to the District of Kansas

FOR IMMEDIATE RELEASE
News releases are available at www.usdoj.gov/usao/ks/press.html

Contact: Jim Cross
PHONE: 316-269-6481
FAX: 316-269-6420

Feb. 29, 2008

LOS ANGELES MAN CHARGED WITH FILING FRAUDULENT BANKRUPTCY CLAIMS IN KANSAS

Federal indictment alleges Isacc Yass told homeowners in foreclosure he could solve their problems

TOPEKA, KAN. – A federal indictment in Kansas accuses a Los Angeles man of running a scam in which homeowners who were behind on their mortgage payments paid him to hold off foreclosure by filing fraudulent bankruptcy petitions.

Isacc Yass, 41, is charged in a federal indictment unsealed Friday in Topeka with six counts of mail fraud and six counts of aggravated identity theft. He was arrested Thursday in California.

"The indictment alleges Mr. Yass fraudulently represented to home-buyers who were delinquent in their mortgage payments that he could stop foreclosure, prevent them from having to file bankruptcy and free them from having to make mortgage payments," said U.S. Attorney Eric Melgren.

According to the indictment:
– Yass solicited homeowners who were going through foreclosure proceedings. He told them that for a fee he could help them keep their houses.
– Yass filed fraudulent bankruptcy petitions in federal bankruptcy court in Topeka, Wichita and Kansas City, Kan. The petitions were filed in the name of nonexistent businesses that claimed to be part owners of properties that were in foreclosure.
– The result was an automatic stay in the foreclosures, halting any further actions by creditors against the properties.

According to the indictment, Yass used the U.S.Postal Service to deliver fraudulent petitions to the bankruptcy court. The petitions contained false names and Social Security numbers, and addresses for the creditors that were in fact mailboxes or UPS Store locations in Kansas.

"Bankruptcy foreclosure schemes are aimed at homeowners in financial distress," said Richard Wieland, United States Trustee for Kansas, Oklahoma, and New Mexico (Region 20). "We appreciate the efforts of the U.S. Attorney's Office, FBI, U.S. Postal Inspection Service, and Social Security Administration Office of Inspector General as we work together to pursue the perpetrators of these schemes, in order to protect homeowners as well as the integrity of the bankruptcy system. We welcome information that will help detect bankruptcy foreclosure schemes, and we encourage citizens to report suspected bankruptcy fraud through our Internet hotline at USTP.Bankruptcy.Fraud@usdoj.gov."

Yass faces a maximum penalty of 30 years in federal prison and a fine up to $1 million on each count of mail fraud, and a mandatory 2 years and a fine up to $250,000 on each count of aggravated identity theft. The Federal Bureau of Investigation, the U.S. Postal Inspection Service, the Social Security-Office of Inspector General and the U.S. Trustees Office worked on the case. Assistant U.S. Attorney Richard Hathaway and Assistant U.S. Attorney Christine Kenney are prosecuting.

As in any criminal case, a person is presumed innocent until and unless proven guilty. The indictment filed merely contains allegations of criminal conduct.

Office of the United States Attorney
District of Arizona

FOR IMMEDIATE RELEASE
August 9, 2007

For Information Contact Public Affairs WYN HORNBUCKLE
Telephone: (602) 514-7625
Cell: (602) 525-2681

CHANDLER MAN SENTENCED TO 33 MONTHS FOR BANKRUPTCY FRAUD

PHOENIX –A Chandler man was sentenced on Wednesday in United States District Court to 33 months in prison for filing false statements in bankruptcy proceedings. Mario G. Bernadel, 48, pleaded guilty nearly one year ago to two counts of fraudulently filing bankruptcy petitions on behalf of people who had no knowledge that he was doing so.

In 2002 Bernadel approached two Valley married couples whose homes were in foreclosure. He prevailed upon the homeowners to sign their homes over to him by convincing them that by doing so, they would each avoid having a mortgage foreclosure on their credit reports. After obtaining the homes in this manner, Bernadel then rented or leased the properties and collected rents on them.

In April 2003 and again in October 2003, Bernadel fraudulently filed Chapter 13 voluntary bankruptcy petitions in the names of the homeowners. The filing of a petition in bankruptcy results in the automatic issuance of a stay of collections proceedings, including mortgage foreclosures and trustee's sales. The homeowners had no knowledge that Bernadel had filed bankruptcy petitions in their names and that he did so to halt the foreclosures so that he could continue to profit from renting the properties to others. Eventually the homes were foreclosed upon, resulting in a detrimental impact upon the homeowners' credit ratings and financial losses to them.

In imposing sentence, United States District Judge James A. Teilborg noted that Bernadel preyed upon people who were particularly vulnerable due to the stresses produced by facing the likelihood of losing their homes to foreclosure. In addition to 33 months of imprisonment, Bernadel was ordered to pay more than $86,000 in restitution, a $5000 fine and a $100 assessment. Upon completing his prison term, Bernadel must serve three years of supervised release.

The investigation of this case was conducted by Tom Kadotani of the United States Trustee's Office. The prosecution was handled by Frank T. Galati, Assistant United States Attorneys, District of Arizona, Phoenix.

CASE NUMBER: CR-06-0260 PHX–JAT
RELEASE NUMBER: 2007-179(Bernadel)

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March 31, 2008

Chairwoman Maxine Waters
Subcommittee on Housing and Community Opportunity
Committee on Financial Services
U.S. House of Representatives
Washington, DC

Dear Chairwoman Waters:

We are writing to express our strong support for the Foreclosure Prevention and Sound Mortgage Servicing Act of 2008.

Abuses in the mortgage market have resulted in a crisis in which over two million homeowners are expected to face foreclosure. As defaults and foreclosures have increased over the last months, voluntary measures by mortgage servicers have left most homeowners with no long-term solutions to their unaffordable loans. Most homeowners who have received help have been provided only with short-term panaceas, at best.

The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008 addresses this problem by establishing consistent standards for mortgage servicers to do what many claim to be doing already: evaluate a homeowner's situation and provide appropriate loss mitigation. Employing such an approach saves the home for the family, helps keep communities thriving, and saves investors money. Months of voluntary measures have made it clear that legislation requiring better and more consistent servicing standards and practices are needed to avert the massive foreclosure crisis now underway.

The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008 will help homeowners get the deal they deserve from the mortgage servicers who can modify loans to make them fair and affordable to homeowners, and profitable to servicers and investors. The bill's measures include loss mitigation duties and minimum standards for loan servicer communications with homeowners, including:

A duty to engage in loss mitigation. It requires loan servicers to seek alternatives to foreclosure and to prioritize home-saving options, such as loan modifications, over home-losing options, such as short sales. Foreclosures only can proceed after reasonable loss mitigation. Loss mitigation analysis would be required to consider long-term affordability of the home loans, including analysis of junior liens and other secured or unsecured debt. Loan servicers must provide direct phone access to parties with authority to fully resolve loss mitigation matters.

Notice to homeowners with ARMs. Borrowers must be contacted by telephone and in writing to inform homeowners in advance of the date of any payment increases.

Referrals to housing counselors. Servicers are required to refer homeowners who are late on their mortgage payments to HUD-certified housing counselors.

Reporting by loan servicers. Servicers are required to report various loss mitigation activities with specific geographical designations

A duty for loan servicers to respond to homeowners inquiries and requests for information. Servicers must provide timely responses to requests from homeowners for payment histories, loan

documents, and loss mitigation documents. Foreclosures can not proceed while a request for information is pending.

Enhanced remedies. The bill amends the Real Estate Settlement Procedures Act by allowing damages actions for individual violations and increases maximum damages recovery to $2,000 per violation and $1 million for class actions.

The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008 would improve consistency and restore fairness to mortgage servicing and give homeowners facing default and foreclosure a chance to save their homes. We look forward to working with you on the bill as it moves through the legislative process.

Sincerely,

ACORN
AFL-CIO
Center for Responsible Lending
Consumer Action
Consumer Federation of America
Lawyers' Committee for Civil Rights Under Law
Leadership Conference on Civil Rights
National Alliance to End Homelessness
National Association for the Advancement of Colored People (NAACP)
National Association of Consumer Advocates
National Community Reinvestment Coalition
National Consumer Law Center (on behalf of its low income clients)
National Council of La Raza
National Fair Housing Alliance
National Low Income Housing Coalition
National Policy and Advocacy Council on Homelessness

House Financial Services Committee Subcommittee on Housing and Community Opportunity
Hearing on H.R. 5679: The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008
Wednesday, April 16, 2008, 10:00 a.m., 2128 Rayburn House Office Building
Testimony from Jane DeMarines, Executive Director
National Alliance of Community Economic Development Associations (NACEDA)

We appreciate the opportunity to provide testimony to the Subcommittee on Housing and Community Opportunity regarding H.R. 5679: The Foreclosure Prevention and Sound Mortgage Servicing Act (FPMSA). We applaud Chairwoman Waters for introducing this pragmatic and much needed legislation. We also want to acknowledge the honor she bestowed on NACEDA members by choosing our Annual Summit on April 2 to announce this bill, as she recognizes that community development corporations (CDCs) and their associations are integral facilitators in solving the country's foreclosure crisis. It is well understood that CDCs are a central component of the solution to this growing crisis, as two-thirds of CDCs are involved in housing and foreclosure counseling.

Through our member state and city associations, NACEDA represents more than 2,200 CDCs across the country. In 2005, as an industry total (aggregate) CDCs produced/created: 1.3 million homes (since 1988), 774,000 new jobs and 126 million sq feet of commercial/industrial space, and housing for special needs populations.

NACEDA is committed to helping transform distressed communities and neighborhoods into healthy ones: good places to live, work and raise families. We assist our members and their networks' efforts to build strong communities and increase housing and economic opportunities for low-wealth populations. CDCs are at the frontlines of dealing with this ongoing national foreclosure crisis.

As Congresswoman Waters noted at our event, mortgage servicers say they want to halt foreclosures, but the rates keep rising. It is for this essential reason that legislation like H.R. 5679 is so necessary right now. This bill would amend the Real Estate Settlement Procedures Act of 1974 to create a legal duty for mortgage servicers to engage in reasonable loss mitigation activities before foreclosing.

Once borrowers get into trouble, they often cannot find anyone to deal with at their mortgage company. However, this legislation intends to make it as easy for the homeowner to get help from their mortgage provider once they are in trouble, as it was to get the loan in the first place. NACEDA supports the bill's mandate that all servicers provide a toll-free or collect-call phone number that provides the borrower with direct access to a person with the information and authority to fully resolve issues related to loss mitigation. NACEDA supports provisions in this bill that:

- Would establish that a mortgage servicer has a duty to engage in reasonable loss mitigation strategies, or it cannot foreclose on a borrower's principal residence. We support measures that it does prioritize alternatives to

foreclosure that keep homeowners in their homes and turning to the foreclosure process only when clearly warranted.

- Ensures that it is cost-effective for servicers to engage in loss mitigation, by authorizing fees for loan modifications and other loss mitigation activities, and provides guidance to them about the kinds of loss mitigation offers that courts are likely to deem reasonable.

Community Development Corporations: Part of the Solution

The bill has a goal of keeping homeowners in the home. This will be done through sound methods that include resources and partnerships with organizations like CDCs. H.R. 5679 would also require mortgage servicers to forward a borrower's information to a HUD certified counselor if they are more than 60 days delinquent on a loan. **NACEDA's** members are currently helping to solve the foreclosure crisis by counseling distressed homebuyers and revitalizing foreclosed vacant properties to be used for affordable housing.

A federal legislative response to the foreclosure situation is imperative, as foreclosures have passed the 1 million mark and expected to pass 2 million by the end of 2009. We know the problem is going to worsen before it improves. We hope Congress will act on Rep. Waters' legislation: H.R. 5679.

NACEDA appreciates this opportunity to present NACEDA's positions on H.R. 5679. For additional information on NACEDA, please contact our headquarters at: (703) 741-0144. Web: http://www.naceda.org/.

NACEDA member organizations:

AR Coalition of Housing and Neighborhood Growth for Empowerment
Association for Neighborhood and Housing Development
Association of Oregon Community Development Organizations
Atlanta Housing Association of Neighborhood-based Developers
California Community Economic Development Association
Community Development Council of Greater Memphis
Community Economic Development Association of Michigan
Community Housing Developers Association of Tennessee
Connecticut Housing Coalition
Florida ALLIANCE OF CDCS

ssociation of CDCs
Georgia State Trade Association of Nonprofit Developers
Housing & Community Development Network of New Jersey
Housing Action Illinois
Housing Alliance of Pennsylvania
Housing Network of Rhode Island
Indiana Association for Community Economic Development
Maryland Asset Building Community Development Network
Massachusetts Association of CDCs
Metropolitan Consortium of Community Developers
NC Association of Community Development Corporations
Ohio CDC Association
Philadelphia Association of Community Development Corporation
SC Association of Community Development Corporations
South New Hampshire University School of Community Economic Development
Southern California Association of Non-Profit Housing
Texas Association of Community Development Corporations

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The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008

Written Testimony
of

Katherine Porter
Associate Professor
University of Iowa College of Law

Before the
United States House of Representatives
Subcommittee on Housing and Community Opportunity
of the Financial Services Committee

April 16, 2008

Witness Background

I am an Associate Professor of Law at the University of Iowa College of Law.[1] I joined the faculty in 2005. I received my J.D. degree *magna cum laude* from Harvard Law School and my B.A. degree *cum laude* from Yale College. I teach commercial law, consumer law, and bankruptcy and have published empirical research on consumer credit in several respected journals, including the *Michigan Law Review*, the *Cornell Law Review*, the *Wisconsin Law Review*, and the *American Bankruptcy Law Journal*.[2]

With Tara Twomey, I am a co-investigator in the Mortgage Study, an original, empirical study of the mortgage loans of Chapter 13 bankruptcy debtors. My research on mortgage servicing shows that more than half of mortgage claims in bankruptcy lack required documentation and highlights discrepancies between debtors' and creditors' calculations of the amounts of outstanding mortgage debt.[3] My new research focuses on analyzing the procedural barriers to loan modification and examining the housing costs of bankruptcy debtors.

I have not received any federal grants or contracts relevant to this testimony.

Introduction

Mortgage servicing is a critical component of the foreclosure crisis. Mortgage servicers, rather than the oft-mentioned lenders, are the parties with whom distressed homeowners must communicate and negotiate with when a default occurs.[4] Yet, mortgage servicers do not have incentives to perform loan modifications. While the pooling and servicing agreements may give them a duty to the investors to engage in loss mitigation, the financial incentives of servicers point in the opposite direction.[5] A consumer in default can generate late fees or other servicing charges that provide revenue to the servicer, even though a prolonged default and spiraling default fees may increase the chances that a borrower loses their home to foreclosure, producing lower returns to investors. In the existing market, servicers have insufficient incentives to perform loan modifications. the

The proposed legislation, The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008 (H.R. 5679), would impose a statutory duty on mortgage servicers to engage in loss mitigation activities. Without such legislation, mortgage servicing will continue to obstruct the best interests of both homeowners *and* investors, each of whom benefits from a loan modification or other loss mitigation efforts, rather than a foreclosure.

My testimony focuses on two aspects of H.R. 5679. First, I explain the dire need for reliable federal data on loss mitigation activities. Section 2(a)(k) of the bill would ensure that regulators, policymakers, and advocates have timely access to data on how the mortgage market is responding to defaults. Second, I describe the difficulty that borrowers face in communicating with their loan servicers, and in particular, advocate for the requirement in Section 2(c) that servicers provide the address for qualified written requests in their correspondence with borrowers. Such a change would improve the effectiveness of the Real Estate Settlement Procedures Act. It would help empower consumers to exercise their rights under federal law to understand how their mortgage is being serviced and to take corrective action if they identify errors or overreaching by mortgage servicers.

Part I
Importance of Data on Loss Mitigation

The current spike in foreclosures has highlighted the importance of robust loss mitigation activities. Yet, there is no readily available data on loss mitigation. The industry and consumer advocates make differing assertions,[6] putting policymakers and regulators in the unenviable situation of trying to interpret conflicting numbers. H.R. 5679 remedies the current vacuum of information by requiring mortgagees or servicers to regularly disclose their actual loss mitigation activities in a consistent and measurable fashion. Federal, state, and local regulators cannot monitor the health of the mortgage market without shared, reliable data on loss mitigation activities.

The existing data are woefully inadequate to assess the extent of loss mitigation activity and its impact on consumers. Despite assurances from industry representatives about their willingness to modify loans or communicate with borrowers, there is a thriving controversy about the extent to which servicers are engaging in loss mitigation.[7] The Mortgage Bankers Association produced a report based on a voluntary survey of servicers that asserted that "the mortgage industry is doing its part to help those borrowers who can be helped."[8] Yet, the study eliminated 63 percent of all loans from its analysis because the industry researcher determined that these loans were not, in his apparent judgment, candidates for loss mitigation activities.[9] It then opines that the numbers of loss mitigation outcomes "are large and compare favorably with the number of foreclosure actions started."[10] Just one month later, the State Foreclosure Prevention Working Group, a group of state attorneys general and state banking regulators, concluded that only three out of ten seriously delinquent borrowers are likely to be offered a loss mitigation option.[11] The remaining seven in ten borrowers will struggle to save their homes without the cooperation of the industry. The State Foreclosure group undertook its study due to its perception that a "considerable disconnect existed" between "corporate pronouncements" and the implementation of actual loss mitigation steps.[12] Only reliable data from a neutral government agency can bridge these controversies and build consensus on the empirical state of loss mitigation.

A further controversy concerns how to delineate a loss mitigation activity. The mortgage industry seems to define loss mitigation to include several outcomes that eliminate a debtor's equity in a home such as a deed in lieu transactions or short sales.[13] The counter argument to such a definition is that these types of loss mitigation rarely represent any concession by the servicer or the investors/lenders and should not be placed on par with loan modifications. Indeed, the ratings agency Moody's report determined that loan modifications were the appropriate metric for measuring loss mitigation on subprime adjustable-rate mortgages.[14] Even if the scope is narrowed to a single loss mitigation approach, there is not consensus on how to define those activities. Consider loan modification. The HOPE NOW alliance defines a loan modification in a generic fashion. "A modification occurs any time any term of the original loan contract is permanently altered. This can involve a reduction in the interest rate, forgiveness of a portion of principal or extension of the maturity date of the loan."[15] This definition could include a short-term freeze on an interest rate, such as a three-month delay in implementing an interest rate

adjustment. It also encompasses life-of-loan modifications that permanently reduce an interest rate. Yet, these two solutions are not equivalent and likely have very different impacts on the long-term sustainability of a home loan for a borrower. To evaluate the likely need for additional modifications in the future, the data must distinguish between short-term modification, long-term modifications, and life-of-loan modifications.

The federal government does not currently collect reliable information on loss mitigation. While the HOPE NOW alliance has issued some reports, its future as an entity is not clear. Also, the public may regard its data with skepticism, seeing HOPE NOW as a mere arm of the mortgage industry. A serious barrier to government data collection is the fractured regulatory framework for mortgage companies. States frequently have to contend with arguments about federal preemption, even when just seeking to gather data.[16] At the federal level, regulators may refrain from investigating mortgage servicers because they believe it is appropriate to defer to another agency. Because mortgage loans may be made by different types of financial institutions or guaranteed by different federal agencies, several separate entities have oversight authority for servicing practices.[17] A cycle of non-action results, with no agency having taken the lead in gathering detailed data and with states and localities being stifled with preemption arguments. The result is that Congress and regulators at all levels of government remain deprived of uniform, consistent data about mortgage servicing and loss mitigation.

The government cannot rely on private actors to fill these information gaps. Neither industry nor academic researchers nor consumer advocates can produce data with the depth and breadth that is necessary for effective policymaking. The most prudent course of action is for Congress to enact H.R. 5679 to arm itself and federal regulators with a robust understanding of loss mitigation activities.

Data on loss mitigation activities are essential for regulators to monitor the economic health of American families and the changes in responses to delinquency rates. Policymakers are handicapped in assessing the relative advantages and disadvantages of different solutions to the rising foreclosure rate because they do not know how the mortgage market is currently responding in its voluntary efforts. On an aggregate level, consistent data on loss mitigation would provide a harbinger of rising delinquencies and could save valuable time in the next housing downturn in trying to decipher the functioning of the market. An additional problem is that the lack of data masks any abusive or untoward practices of particular servicers. With data for each servicer, regulators could identify particular companies whose practices may deviant from industry standards or violate best practices standards. Basic data are a prerequisite to effective regulatory oversight of mortgage servicers.

Section 2(a)(k) of H.R. 5679 would strengthen the collective knowledge about how mortgage markets respond to rising delinquencies by requiring the disclosure of loss mitigation activities. The bill would require mortgagees or servicers of covered federally related mortgage loans to report at least monthly to the Secretary of the Treasury on the extent and scope of its loss mitigation activities.[18] Servicers would be prohibited from constructing their own definitional categories of loss mitigation or hiding behind aggregate data. Instead, each mortgagee or servicer would have to disaggregate its loss mitigation activities into the categories in section 2(c) of the bill, which include waivers of default charges, repayment plans,

forbearance agreements, short sales or delays in foreclosures. These servicer-level data are to be compiled on an annual basis and then reported by different geographic areas.[19] These data are to be produced in tables that present the pattern of loss mitigation for census tracts based on characteristics such as income level, age of housing stock, and racial demographics. These data would then be made public, which would permit state and local regulators, consumer advocates, and academics to produce targeted interventions or policy proposals.

H.R. 5679 would require the disclosure of another critical type of information—the extent to which loans that were subject to loss mitigation became performing or proceeded to foreclosure.[20] These data would allow regulators to monitor whether the mortgage industry is offering loss mitigation tools that are likely to prevent foreclosure or if it is merely making token efforts at mitigation that result in nothing more than a short delay before a foreclosure. Because the incentives of servicers and investors/lenders are not currently aligned, these data are an important safeguard on whether servicers are satisfying their obligation to investors/lenders to ensure the highest stream of revenue on the mortgage receivables as possible.

If enacted, H.R. 5679 would give Congress and regulators timely and regular information about the mortgage industry's efforts to engage in loss mitigation and about the effectiveness of loss mitigation as a response to delinquency. These insights are instrumental to enabling effective policy responses to downturns in the housing market. Enacting H.R. 5679 would arm regulators with the information that they need to monitor the mortgage market and weigh proposed interventions.

Part II
Improving Consumers' Ability to Make Qualified Written Requests

H.R. 5679 would require all written communications from the mortgagee or servicer to the borrower to include the address for receipt and handling of qualified written requests.[21] This requirement may seem trivial but it is the gateway to a critical consumer right under the Real Estate Settlement Procedures Act. A qualified written request is a tool to let a borrower inform a servicer of an alleged error or other problem with the servicer's handling of the mortgage account.[22] The law requires servicers to conduct an investigation, make any appropriate corrections, and provide the borrower with a written explanation of its actions.[23]

However, these rights are meaningless unless consumers are able to invoke them, an ability that rests on knowing where to submit a qualified written request. Homeowners do not have any consistent or reliable access to the correct address to which to direct a qualified written request. The proposed legislation would remedy this problem.

As part of my research on mortgage servicing, I asked four upper-class law students (two from the University of Iowa College of Law where I currently teach and two from my prior institution, the Boyd School of Law at the University of Nevada, Las Vegas) to generate a list of the addresses at which the top 25 largest servicers receive qualified written requests. None of the students was able to locate a single address with any level of confidence, despite each student spending approximately five hours searching the Internet and calling the available numbers for the leading servicers. If law students are not able to locate the qualified written request

addresses, it is unreasonable to impose this burden on vulnerable consumers facing foreclosure or their pro bono advocates.

The Department of Housing and Urban Affairs has not taken any regulatory initiative to correct this difficulty. Their website does not provide any information on where to send qualified written requests, merely advising consumers that a qualified written request should not be mailed with a payment.[24] This does not help consumers determine where to send a qualified written request. At best, it merely suggests that sending it to the payment address may not suffice. For consumers who may want to seek the aid of a regulator in locating such an address, the Department of Housing and Urban Affairs provides *eight* different agencies that may have jurisdiction over a particular mortgage loan. This fractured regulatory environment only heightens the need for clear communication from the servicer to the borrower of how to contact the servicer.

H.R. 5679 would empower consumers to use the existing provisions of the Real Estate Settlement Procedures Act by ensuring that they know how to invoke its protections. The bill also would clarify that a mortgagee or servicer who receives a qualified written request must consider it valid, even if it was not sent to the designated address for such requests. This so-called "wrong door" defense is a lame effort to rely on a technicality to avoid complying with the Real Estate Settlement Procedures Act. The law should foreclose this loophole and ensure that qualified written requests offer consumers a meaningful tool for resolving disputes with their loan servicers.

Conclusion

Servicers are the intermediaries between homeowners and investors/lenders. Inefficient or abusive loan servicing can increase the rate of default and dramatically raise loss severities.[25] H.R. 5679 recognizes the important role of loan servicing in loss mitigation. It would realign the incentives of servicers to motivate them to act in the best interests of investors/lenders and borrowers. The bill would strengthen the usefulness of the qualified written request as a tool to resolve disputes between consumers and servicers, ensuring that the substantive protections of the Real Estate Settlement Protection Act are not eroded by evasive industry tactics. The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008 will help reduce the hardships of the current foreclosure crisis on borrowers and investors/lenders and will impose sensible and enduring changes to mortgage servicing practices for the future.

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[1] Additional biographical information and my curriculum vitae are available at my faculty page at the University of Iowa College of Law at http://www.law.uiowa.edu/faculty/katie-porter.php.

[2] My research papers may be downloaded from my SSRN author page at http://ssrn.com/author=509479.

[3] *See* Katherine Porter, *Misbehavior and Mistake in Bankruptcy Mortgage Claims*, 87 TEX. L. REV. ___ (forthcoming 2008), *available at* http://ssrn.com/abstract=1027961.

[4] Negotiating with the Mortgage Company, Post of Katherine Porter to *Credit Slips* blog on April 12, 2008, *at* http://www.creditslips.org/creditslips/2008/04/negotiating-wit.html.

[5] Kurt Eggert, *Comment: What Prevents Loan Modifications*, 18 HOUSING POLICY DEBATE 279, 285-87 (2007) (explaining how servicers' self-interest may inhibit loan modifications).

[6] *Compare* Statement of David G. Kittle, Chairman-Elect of Mortgage Bankers Association Before the Subcommittee on Commercial and Administrate Law, U.S. House of Representatives 10 (Oct. 30, 2007) ("Servicers are providing loss mitigation to eligible borrowers in distress.") *with* Ruth Simon, *States Say Mortgage Companies*

Fall Short on Loan Modifications, WALL ST. J. D3 (Feb. 7, 2008) (quoting Mark Pearce, banking commissioner of North Carolina as saying that "servicers are trying hard, but their efforts are falling far short of what is needed.").
[7] *See* sources cited in note 6, *supra*.
[8] Jay Brinkmann, Mortgage Bankers Ass'n, *An Examination of Mortgage Foreclosures, Modifications, Repayment Plans and Other Loss Mitigation Activities in the Third Quarter of 2007* 13 (Jan. 2008).
[9] *Id.* at 8 and Tbl. 1. The author concludes that these borrowers "clearly could not be helped." *Id.* at 13.
[10] *Id.* at 13.
[11] State Foreclosure Prevention Working Group, *Analysis of Subprime Mortgage Servicing Performance: Data Report* 1 (Feb. 2008).
[12] *Id.* at 6.
[13] Brinkmann, *supra* note 8 at Tbl. 9.
[14] Michael P. Drucker & William Fricke, *Moody's Subprime Mortgage Servicer Survey on Loan Modifications* (2007).
[15] HOPE NOW, *Results in Helping Homeowners: July 1, 2007 to January 31, 2008*, at http://www.fsround.org/hope_now/pdfs/januaryDataFS.pdf.
[16] Several mortgage servicers declined to provide data on loss mitigation activity to the Foreclosure Prevention Working Group of state attorneys general, saying that they were acting on the advice or direction of the Office of the Comptroller of the Currency to refuse to provide data. *See* Ruth Simon, *States Say Mortgage Companies Fall Short on Loan Modification*, WALL ST. J. D3 (Feb. 7, 2008).
[17] While the Department of Housing and Urban Development has enforcement responsibility for the Real Estate Settlement Procedures Act, their website directs consumers to eight other agencies in its "Consumer Complaint Reference List." *See* Dep't. of Housing and Urban Development, Consumer Complaint Reference List, *at* http://www.hud.gov/offices/hsg/sfh/res/resrefer.cfm (last visited April 15, 2008).
[18] H.R. 5679, 110th Cong. § 2(a)(k)(1) (2008).
[19] H.R. 5679, 110th Cong. § 2(a)(k)(2) (2008).
[20] H.R. 5679, 110th Cong. § 2(a)(k)(1) (2008). The bill would also require mortgagees or servicers to report the total number of foreclosures initiated during each period, a basic statistic on the economic well-being of our country that is currently not gathered by any public agency.
[21] H.R. 5679, 110th Cong. § 2(c)(5) (2008).
[22] 12 U.S.C. § 2605(e).
[23] Id.
[24] Dep't. of Housing and Urban Development, Your Rights and the Responsibilities of the Mortgage Servicer, *at* http://www.hud.gov/offices/hsg/sfh/res/rightsmtgesrvcr.cfm (last visited April 15, 2008).
[25] Eggert, *supra* note 5, at 281 (describing importance of servicing to default management and citing relevant empirical studies).

April 16, 2008

Statement for the Record

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Subcommittee on Housing and Community Opportunity

Committee on Financial Services

United States House of Representatives

Statement for the Record

On Behalf of the

American Bankers Association

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Subcommittee on Housing and Community Opportunity

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United States House of Representatives

April 16, 2008

The American Bankers Association is pleased to submit for the record this statement regarding H.R. 5679, the Foreclosure Prevention and Sound Mortgage Servicing Act of 2008, introduced by the Chairwoman of this subcommittee, Representative Maxine Waters (D-CA). ABA brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $12.7 trillion in assets and employ over 2 million men and women.

We share Representative Waters's concerns about rising foreclosures and appreciate the desire to limit such actions wherever possible in order to preserve homeownership. Everyone suffers – lenders, investors and borrowers – when a foreclosure occurs. It is, therefore, in all our interests to find ways to avoid such an outcome. In fact, banks are actively engaged in voluntary loan modifications and other loss mitigation programs both on an individual basis and as part of broad industry efforts such as the HOPE NOW initiative.

While we all seek appropriate solutions for reducing foreclosures, and we commend Representative Waters for putting forward ideas for public consideration, we believe that the H.R. 5679 would create significant disruptions in the mortgages markets. It would replace the current efforts by banks to avoid foreclosure with a mandated set of requirements which would

detrimentally impact the safety and soundness of banks, raise privacy and litigation concerns, and ultimately increase loan costs for all borrowers. As a consequence, the ABA must oppose H.R. 5679.

There are three key points we make in this statement:

- H.R. 5679 would raise the cost of any new mortgage loan as it would undermine contract law, increase expected losses to lenders and investors, and lead to greater litigation.
- H.R. 5679 would raise serious safety and soundness issues because it shifts the risks associated with a change in the borrower's circumstances from the borrower to the lender well after the mortgage contract has been signed.
- H.R. 5679 raises both implementation and privacy issues as some notification requirements would be virtually impossible to meet and others could violate the borrower's privacy rights.

H.R. 5679 Would Increase the Cost of Any New Mortgage

H.R. 5679 would require that no foreclosure could be initiated against any federally-related mortgage without the lender or servicer first engaging in specified loss mitigation activities. The requirements of the legislation would apply to any foreclosure or attempted foreclosure occurring after the enactment of the legislation without regard to when the mortgage at issue was originated. This requirement has the potential to abrogate the current contract between the lender and borrower, as well as the contract between the lender and any investors in the loan. Placing new requirements on a lender or servicer not contemplated in the pricing or other terms of the original contracts will lead to safety and soundness concerns and would undermine contract law including raising constitutional issues relating to the right to contract.

This would destabilize our mortgage market system by putting the willingness of investors to purchase securities backed by mortgages at risk. If mortgage contracts can be altered after they are made, investors will be less willing to purchase them or investors will demand a higher rate of return to compensate for the additional uncertainty. This will make mortgages harder to obtain and/or more expensive for all borrowers.

Additionally, the bill prohibits foreclosure if "at any time" the lender or servicer fails to engage in loss mitigation. This requirement will lead to litigation over the adequacy of any

mitigation undertaken, which will in turn lead to further costs for all consumers as lenders and investors price the risk of litigation into future loans.

H.R. 5679 Would Raise Safety and Soundness Issues

A serious safety and soundness concern raised by the legislation is the provision relating to determination of loan affordability which gives a borrower the right to elect to use current income information rather than that provided at the time of loan origination. Again, this provision undermines the existing contract. If a borrower has had a decline in income, they can seek to have the loan terms changed through loss mitigation. The lender/servicer/investor would then bear the risk of any economic changes to the borrower. In addition to the safety and soundness concerns that arise when giving the borrower the ability to rewrite the terms of a mortgage contract, this provision is likely to drive investors from the marketplace, as there will be no certainty in a mortgage lending contract.

H.R. 5679 Raises Both Implementation and Privacy Issues

The legislation raises a number of privacy concerns. First, the bill requires that 60 to 120 days prior to any interest rate reset for any federally related mortgage loan with an adjustable rate, a notification to the borrower both in writing and via telephone. Existing laws limit which messages can be left on answering machines and with third parties. If a lender cannot reach a borrower by telephone (and is prohibited from leaving a message), they have failed to comply with this provision of the legislation. Second, it will be very difficult for a lender or servicer to determine 60 to 120 days in advance of an interest rate reset what rate will be applicable at the time of reset. The legislation requires only a "projection" based upon "prevailing rates" but the fact remains that lenders cannot control interest rates, and requiring this notice so far in advance will lead to information being provided to the consumer that is inexact at best, and alarmingly misleading at worst.

Another privacy concern relates to a provision in the legislation requiring a lender or servicer to notify a counseling agency when a loan becomes 60 days past due. While the legislation seems to contemplate the borrower choosing a counseling agency of their preference (at least for loans closed after the effective date of the bill), it does not specify that the borrower authorizes such counseling agency to receive communications about the delinquency status of any loans. Additionally, the legislation gives the borrower the ability to change which counseling agency they prefer at any time,

so the likelihood of a miscommunication to the wrong party is significant. For existing loans, it is unclear when or how a borrower would be required to specify a counseling agent of their choice. Certainly for borrowers who are making timely payments, any notification that they must choose a housing counselor who may be contacted should they fall past due on payments may be very unsettling.

Finally, we would note that there are a number of compliance burdens in the legislation which are either impossible to achieve and or which will significantly increase costs for lenders – costs which will inevitably be borne by consumers. These include a requirement that each account statement on a federally related mortgage loan include a telephone number of a person whom the borrower may contact for direct access to the information and authority to answer questions and fully resolve issues related to loss mitigation activities. It is unlikely that any institution will be able to provide direct access to a single person with such abilities. Loss mitigation tends to be a complicated process with many bank staff involved and levels of approval required for safety and soundness.

Another provision calls for monthly reports to the Secretary of the Treasury from each lender or servicer reporting on the extent and scope of loan loss activities. These are likely to be detailed, labor intensive descriptions of activities which may take months to resolve. It is unclear what benefit such detailed accounts will provide to the either the government or the public.

ABA appreciates this opportunity to comment on H.R. 5679. While we understand the motivation behind this legislation, and our members, in fact, engage in many of the loss mitigation activities it prescribes, we must oppose it. Making loans to eligible borrowers on terms that are fair and affordable is the essence of banking. When situations arise which lead to the need for loss mitigation, banks voluntarily take appropriate action. Mandating such activities inflexibly in the manner prescribed by H.R. 5679 would lead to instability in the mortgage markets, higher costs for all borrowers, and troubling privacy and litigation concerns for lenders and borrowers alike.