LOAN MODIFICATIONS: ARE MORTGAGE SERVICERS ASSISTING BORROWERS WITH UNAFFORDABLE MORTGAGES?

HEARING

BEFORE THE

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HOUSING AND COMMUNITY OPPORTUNITY

OF THE

COMMITTEE ON FINANCIAL SERVICES

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LOAN MODIFICATIONS: ARE MORTGAGE SERVICERS ASSISTING BORROWERS WITH UNAFFORDABLE MORTGAGES?

Tuesday, February 24, 2009

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 2:42 p.m., in room 2128, Rayburn House Office Building, Hon. Maxine Waters [chairwoman of the subcommittee] presiding.

Members present: Representatives Waters, Lynch, Cleaver, Green, Clay, Ellison, Donnelly, Driehaus, Kilroy, Maffei; Capito, Marchant, Jenkins, and Lee.

Chairwoman WATERS. This hearing of the Subcommittee on Housing and Community Opportunity will come to order. Good afternoon, ladies and gentlemen.

I would first like to thank the ranking member and the other members of the Subcommittee on Housing and Community Opportunity for joining me today for this hearing on loan modifications: "Are mortgage servicers assisting borrowers with unaffordable mortgages?"

Today's hearing is the first in a series of hearings to provide Congress with an in-depth understanding of loan modifications, including their benefits and challenges. In the next few months, the subcommittee plans to hold further hearings on this issue, including an examination of the White House plan to modify loans and an investigation of the for-profit loan modification industry.

Today we have before us several key regulatory agencies and mortgage servicers who are going to tell us about their efforts to assist borrowers with affordable mortgages. In addition to learning about their loan modification efforts, I hope this hearing will also serve to educate members about some of the fundamentals of the mortgage servicing industry, including how servicers are licensed, what kinds of contracts they have with investors, and how they receive payments for servicing loans. I believe that this basic information is critical to understanding how the number of loan modifications can be increased. I hope that our witnesses will be able to educate the subcommittee in this regard.

Loan modifications changing the terms of the loan are essential to ending the foreclosure crisis. According to RealtyTrac, in 2008, 2.3 million households were in some stage of the foreclosure process, an 81 percent increase from 2007 and a 225 percent increase from 2006. The foreclosure crisis shows no signs of slowing down, with Credit Suisse estimating that 8.1 million homes will enter foreclosure over the next 4 years.

However, while the pace of loan modifications has increased, repayment plans which simply tack the missed payments onto a loan, thereby delaying the inevitable foreclosure until a later date, still offers more than other kinds of loan modifications. According to the Office of the Comptroller of the Currency and the Office of Thrift Supervision, in the third quarter of 2008, new loan modifications increased by more than 16 percent to 133,106, while new repayment plans increased by 11 percent to 154,649.

I am concerned that mortgage servicers simply aren't doing enough loan modifications. I am interested to hear the mortgage servicers before us today discuss what barriers or capacity issues are preventing them from performing more loan modifications and preventing foreclosures. And if capacity is an issue, I would like to hear about how we can streamline the modification process so that we can prevent foreclosures quickly and efficiently.

Since day one, I have been a supporter of enacting a systematic modification program. On the first day of the 111th Congress, I introduced legislation, H.R. 37, the Systematic Foreclosure Prevention and Mortgage Modification Act of 2009, to put such a plan in action.

I am also concerned about some of the redefault rates on modified loans. According to the OCC and the OTS, modified loans have been redefaulting at rates of 37 percent within 3 months after modification and 55 percent within 6 months after modification, with the rates of redefault seeming to vary by the type of loan and the entity servicing it.

In modifying loans, servicers must ensure that the new loan is more affordable to the borrower than it was before the modification. It makes little sense and benefits no one to modify a loan and to have it still be unaffordable for the borrower. It also makes little sense to do a slight modification, such as lowering the interest rate by a quarter of a point, for example. That makes the loan slightly more affordable, but still out of the reach of the borrower.

The type of loan modification being offered is also important to ensure that the modified loan is affordable for the borrower. Credit Suisse has found that principal reduction modifications have lower default rates than other kinds of modifications. If this is the case, I would expect for mortgage servicers to perform more of those kinds of modifications. I am aware that principal reduction comes with a significant cost for the investor; however, that cost is substantially less than letting the loan enter foreclosure.

Before I close, I would like to comment on the modifications that have yet to occur. There are millions of families out there who are struggling with their mortgages. They have tried to contact some of the servicers who will be testifying today, and they have not been able to get through or to reach the right person. I have experienced firsthand the challenges faced by borrowers who want to stay in their homes and who want to get current on their mortgages, but they either can't get their servicers to pick up the phone, or they get wrong, misleading, or unapproved information. I have called the servicers myself and waited hours for someone to answer, I have been misdirected and disconnected, and I understand the frustration borrowers have. It is unacceptable, and I think homeowners deserve better.

I am very interested in hearing from today's witnesses on how they plan to improve their capacity and their outreach to ensure that the borrowers reaching out to them for help are able to receive the help they need. I am looking forward to hearing from our two panels of witnesses on the benefits, the challenges, and the expenses involved in modifying loans.

I would now like to recognize our subcommittee's ranking member to make an opening statement.

Mrs. CAPITO. Thank you, Madam Chairwoman. And I would like to thank the chairwoman for convening this afternoon's hearing.

The difficulties in the housing market are central to the health of our overall economy. Some States have been affected more deeply by those difficulties than others. I know that many of my colleagues representing States that have been hardest hit by foreclosures have constituents who are struggling to make ends meet; however, we must be careful to those who are making their payments on time so that they would not be unfairly burdened. Whatever form of assistance this committee produces must be equitable to the almost 92 percent of American families still making those payments on time.

I am looking forward to hearing from our second panel this afternoon to learn more about their efforts to do loan modifications. We will be hearing from five different institutions, many of whom have different approaches to working out loans and different problems with working out those loans. I believe it is important for this process to remain in the private sector as much as possible.

Another proposal that has been put forth is to modify the terms of the loan in bankruptcy court, commonly referred to as cramdown. I have already expressed my concern in this committee about the effect this proposal will have on the Federal programs like FHA/VA and RHS. Additionally, I have concerns about the effect that this will have on the flow of credit on an already unsteady secondary market.

Recently, I joined Mr. Bachus, the ranking member of the full committee, as well as our counterparts on the House Judiciary Committee, in sending a letter to the Treasury Secretary expressing our desire to work in a bipartisan manner to narrow changes in the bankruptcy law.

Today's hearing will shed greater light on the current status of loan modifications as well as to educate members about the process and any potential improvements. I would like to thank again the chairwoman for bringing us together this afternoon and I look forward to hearing the testimony of our witnesses. Thank you.

Chairwoman WATERS. I now recognize Mr. Green.

Mr. GREEN. Thank you, Madam Chairwoman. I would like to associate myself with the comments that you made. I thought that you were quite thorough in expressing concerns, and I adopt your language.

I do want to add only this: That there is concern with reference to the defaults. When compared to loans held by servicing banks, the default rate is 35.06 percent after 3 months. Loans held by private investors, the default rate is 42.28 percent after 3 months. There seems to be a disparity that I am sure we can examine and understand why it exists. I have my suspicions, but it will be more than appropriate to receive empirical evidence of what is actually going on from this panel.

So I thank you very much, Madam Chairwoman, and I yield back the balance of my time.

Chairwoman WATERS. Thank you very much.

Ms. Jenkins for 2 minutes.

Ms. JENKINS. Thank you, Madam Chairwoman.

I know that many Americans are honestly struggling to pay their monthly mortgage payments. Unemployment is on the rise, yet more than 90 percent of homeowners are still able to scrimp and save enough each month to pay their mortgage.

Congress and government agencies have thrown billions at the crisis, yet we have little to show for it. Many people inside the Beltway appear willing to reward lenders who sold irresponsible loans and reward people who purchased houses that were too expensive. How is this fair to those American families who made cuts in their monthly budget and still pay their mortgage on time? We may see later this week on the House Floor a proposal to allow bankruptcy judges to cramdown mortgages. While the goal of the proposal, to help more folks be able to stay in their homes, may be admirable, when we see redefault rates at 55 percent in only 6 months, is this really solving the problem?

I am eager to hear from today's witnesses to see what we can work toward to find effective solutions. I yield back the remainder of my time. Thank you, Madam Chairwoman.

Chairwoman WATERS. Thank you very much.

We have no more opening statements. I am pleased to welcome our distinguished first panel. Our first witness will be Mr. Vance Morris, Director for Single Family Asset Management, U.S. Department of Housing and Urban Development. Our second witness will be Ms. Grovetta Gardineer, Managing Director, Corporate and International Activities, Office of Thrift Supervision. Our third witness will be Mr. Joseph H. Evers, Deputy Comptroller for Large Bank Supervision, Office of the Comptroller of the Currency. Our fourth witness will be Mr. Patrick J. Lawler, Chief Economist, Federal Housing Finance Agency.

Thank you for appearing before the subcommittee today, and, without objection, your written statements will be made a part of the record. You will now be recognized for a 5-minute summary of your testimony.

Mr. Morris.

STATEMENT OF VANCE T. MORRIS, DIRECTOR FOR SINGLE FAMILY ASSET MANAGEMENT, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Mr. MORRIS. Madam Chairwoman, Ranking Member Capito, and members of the subcommittee, on behalf of the Department of Housing and Urban Development, I would like to thank you for the opportunity to speak about FHA's loss mitigation practices, and in particular loan modifications practices.

I am the Director of the Office of Single Family Asset Management. I am responsible for managing the servicing and loss mitigation activities of FHA-insured mortgages and also the Real Estate Owned activities. My office responsibilities include establishing and updating general servicing guidelines for FHA lenders, helping homeowners remain in their homes while overcoming difficulties that cause mortgage defaults, monitoring lenders for compliance with loss mitigation requirements, and managing and selling single-family properties acquired by HUD. These activities are instrumental in maintaining the FHA insurance fund, which currently has over 4½ million insured loans at a value of $534 billion.

In 1996, HUD completed a study titled, "Providing Alternatives to Mortgage Foreclosure: A Report to Congress," which formed the basis of our loss mitigation program. During the same year we introduced our loss mitigation program with the primary objective of keeping homeowners in their home in the event of a serious default, finding effective solutions to cure defaults, and reduces to the losses to the government by effectively finding alternatives to foreclosure.

HUD's most utilized loss mitigation tool is loan modification. Loan modifications account for nearly 60 percent of FHA's loss modification activity annually. Loan modifications are intended to bring the delinquent borrower current. This is done by either re-amortizing the loan up to 30 years, changing the interest rate both up and down, and adding the delinquency into the loan modification.

In most cases when a lender modifies the loan, they modify the term, and the rate is unchanged. In other cases the interest rate may increase or decrease. Typically, though, after the loan modification, the borrower's payment increases slightly, on average $22. The increase is due to the fact that the arrearages were included into the loan balance, so it causes a slight increase in the mortgage payment.

Over the past 12 years, through the end of January 2009, FHA lenders have completed over 324,000 loan modifications. The numbers vary from year to year. For example, in Fiscal Year 2008, 58,000 loan modifications were done by FHA lenders. We estimate that there will be a 12 percent increase this year to 65,000 loan modifications.

The loan modification process is fairly simple. The lender reviews the borrower's qualifications prior to the loan becoming 4 months past due. The borrower sends financial information to the lender, who performs an analysis and determines that the information is independently verified as correct, and then determines if the loan modification would benefit the borrower. If so, the loan modification—the lender at that time sets the rate, and a term, and the terms of the modification. The lender then sends the documents to be executed by the borrower, and the modification is recorded, and the loan is brought current. For completing the loan modifications, HUD provides an incentive fee to the lender of $750, plus we pay up to $250 in title work.

HUD measures the effectiveness of its loss mitigation action by determining if the loan ended in foreclosure 24 months following that action. According to our Office of Evaluation, this is the best measure, because past 24 months, if a loan goes in default, there were other actions or activity that caused the default. By that measure, home applications are an effective tool, because over 85 percent of our loans that were modified, 24 months following that loss mitigation action were still not submitted for foreclosure.

This is not to say that our loans do not redefault. We do have an annual redefault rate of modified loans of 35 percent. However, we continue to work with the borrowers to avoid foreclosure. Just because a person has one loss mitigation action, that does not preclude us from continuing to work with the borrower.

In closing, HUD is requesting new authority to enhance partial claim authority to enable FHA to buy down mortgage balances. The buydown amount would be reported as a second mortgage, but it would be a tool that would make the payment affordable to the borrower. The Administration is developing changes that would allow FHA to assist homeowners with reductions in income that are more than just temporary in nature.

Again, I want to thank you for the opportunity to explain FHA loan modifications. I am prepared to answer your questions.

[The prepared statement of Mr. Morris can be found on page 146 of the appendix.]

Chairwoman WATERS. Thank you very much.

Ms. Gardineer.

STATEMENT OF GROVETTA GARDINEER, MANAGING DIRECTOR, CORPORATE AND INTERNATIONAL ACTIVITIES, OFFICE OF THRIFT SUPERVISION

Ms. GARDINEER. Good afternoon, Chairwoman Waters, Ranking Member Capito, and members of the subcommittee. I am Grovetta Gardineer, Managing Director for Corporate and International Activities at the Office of Thrift Supervision. Thank you for the opportunity to testify on behalf of OTS about loan modifications and how best to keep more American families in their homes.

The importance of this topic is hard to overemphasize. Turning back the tide of home foreclosures is an essential element in combating the economic crisis confronting this Nation and much of the rest of the world. Foreclosed homes spell tragedy for the uprooted families, they harm neighborhoods by driving down property values, and they add downward pressure to already depressed home values in communities.

Although about 90 percent of all home mortgages in this country are being repaid on time, the remaining 10 percent that are delinquent or in foreclosure represent a historically high number and a contagion in our economic system. My written testimony goes into detail about the efforts the OTS has made, both in partnership with other Federal banking regulators and on its own, to prevent foreclosures.

In the time I have this afternoon, I will emphasize just a few aspects of those efforts, but the key point I want to make is that OTS initiatives to reduce foreclosure are not new. They extend back nearly 2 years, and they are continuing today.

Just 2 weeks ago, OTS Director Reich urged OTS-regulated institutions to suspend foreclosures on owner-occupied homes until the home loan modification program in the Administration's financial stability plan is finalized. Since then, OTS leaders have continued their work on the interagency team, led by the Treasury Department, to develop the details of this modification program.

On February 20, 2008, almost 1 year ago to the day, the OTS unveiled the foreclosure prevention plan that identified three elements that are key to a successful loan modification program: an expedited process; an affordable monthly payment; and an approach to dealing with underwater mortgages in which borrowers owe more on their mortgages than their homes are worth. These elements were included in the legislation eventually passed by Congress.

OTS has also been a central player first on its own and later in partnership with the Office of the Comptroller of the Currency in gathering for the first time extensive validated loan-level data on about 60 percent of all mortgages in the United States. The data have already yielded valuable insights and will enable us to gauge which modification strategies work best for affordable, sustainable solutions. With this useful yardstick for measuring progress, policymakers will know with greater precision where to focus scarce resources to achieve the most success.

The next OCC–OTS Mortgage Metrics Report scheduled for release next month will reflect an expanded data collection effort to zero in on the elements that make loan modifications work. The scope of this effort is broad, covering more than 34 million loans. The two agencies have made sizable commitments to this project, and we intend to stick with it, especially since so many families are being forced to pack up their American dreams of homeownership. The OTS remains committed to continuing its efforts until the foreclosure crisis is over.

Thank you again, Madam Chairwoman, for your commitment to this important issue, and I look forward to answering your questions.

[The prepared statement of Ms. Gardineer can be found on page 100 of the appendix.]

Chairwoman WATERS. Thank you very much.

Our next witness, please.

STATEMENT OF JOSEPH H. EVERS, DEPUTY COMPTROLLER FOR LARGE BANK SUPERVISION, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Mr. EVERS. Chairwoman Waters, and members of the subcommittee, on behalf of the Office of the Comptroller of the Currency, thank you for holding this hearing and inviting the OCC to testify on this important topic.

My name is Joe Evers. I am a national bank examiner, and I currently serve as Deputy Comptroller for Large Bank Supervision. In that capacity, I am responsible for large bank analytics. Over the past year, I have led the OCC's project to develop more comprehensive and timely data on mortgage lending and servicing activities of national banks. This project, known as Mortgage Metrics, is now a joint undertaking of the OCC and the Office of Thrift Supervision.

Since as early as 2005, the OCC has encouraged national banks to work with troubled homeowners to prevent avoidable foreclosures and meet the needs of creditworthy borrowers. Since then, the OCC has joined other regulators to urge banks to continue to implement effective programs to prevent avoidable foreclosures and to minimize potential losses.

Several years ago, we realized the importance of obtaining more detailed information about the performance of mortgages held in the national banking system. This was done to both aid our supervisory activities and to incent servicers to implement effective programs to prevent avoidable foreclosures and to minimize potential losses. We have continued these efforts, particularly with respect to increasing affordable and sustainable modifications, and that improved information we are obtaining is helping in that effort.

Clearly more must be done to address this challenge. The OCC supports the Administration's Homeowner Affordability and Stability Plan. This new plan takes significant steps towards addressing these issues, and we are taking additional steps as well. The Mortgage Metrics project represents an unprecedented effort to collect detailed information on the performance of loans serviced by institutions supervised by the OCC and OTS.

Our quarterly Mortgage Metrics Report was first published in 2008. The Mortgage Metrics Report now covers approximately 90 percent of the first-lien mortgages serviced by national banks and thrifts, and represents over 60 percent of all mortgages in the United States.

Our report for the third quarter of 2008 gathered a vast amount of data on the effectiveness of loan modifications. It showed an unexpectedly high percentage of borrowers receiving loan modifications in the first and second quarters of 2008 were past due on the new loan modification payment terms. An examination of these results led to our decision that more detailed information was required to enhance our analysis.

Since then we have been working to collect additional details on how different types of modifications have changed monthly principal and interest payments resulting from modifications. We plan to present expanded information on actual changes in monthly principal and interest payments resulting from loan modifications in the next quarterly Mortgage Metrics Report due out in March. Further details on modifications are planned for subsequent reports.

My written testimony addresses these efforts in more detail and the specific issues raised in your letter of February 17th by describing: one, our efforts to improve the understanding of loan modification performance through our Mortgage Metrics data collection effort; two, findings from our most recent Mortgage Metrics Report, including what we have learned about loan modifications; three, current challenges facing effective loan modifications; and four, our ongoing efforts to encourage responsible lending and appropriate loss mitigation activities, particularly achieving affordable and sustainable loan modifications.

Again, thank you for holding this important hearing. I look forward to answering your questions.

[The prepared statement of Mr. Evers can be found on page 80 of the appendix.]

Chairwoman WATERS. Thank you very much.

Now, we will have Mr. Patrick Lawler.

STATEMENT OF PATRICK J. LAWLER, CHIEF ECONOMIST, FEDERAL HOUSING FINANCE AGENCY

Mr. LAWLER. Chairwoman Waters, Ranking Member Capito, and members of the subcommittee, thank you for the opportunity to testify on behalf of the Federal Housing Finance Agency. My name is Patrick Lawler, and I am Chief Economist of the FHFA.

Today the country faces an enormous challenge to stabilize the housing market. This morning we announced that our House Price Index declined 3.4 percent in the fourth quarter last year. That is twice the average rate of decline in the previous four quarters.

Many borrowers are in trouble on their mortgages, or soon will be. To address this need, FHFA and the housing GSEs are actively working on foreclosure prevention. This is a major component of FHFA's efforts to ensure the housing GSEs fulfill their mission of providing liquidity, stability, and affordability to the housing market.

The housing plan outlined last Wednesday by President Obama includes a prominent role for Fannie Mae and Freddie Mac. My testimony today will summarize recent initiatives already underway to promote effective loan modifications and the new policies announced last week.

FHFA began in September a foreclosure prevention report, which is a transparent review of key performance data on foreclosure prevention efforts. These monthly and quarterly reports present data for more than 3,000 approved servicers on 30.7 million first-lien residential mortgages serviced on behalf of Fannie Mae and Freddie Mac of which 84 percent are prime.

The recently released November report shows that for the first 2 full months of conservatorship, October and November, the number of loan modifications increased 50 percent from the previous 2 months. These modifications were achieved using a customized, labor-intensive process. Currently, though, servicers are challenged by the sheer volume of borrowers requesting assistance in their ability to effectively and efficiently modify those loans. Accordingly, we have focused on new programs with the goal of reaching more borrowers more quickly and making it easier and faster to execute a loan modification.

In November, FHFA announced the Streamlined Modification Program that was rolled out in December; 90,000 solicitations and modification offers were mailed to a targeted population of borrowers who had missed three payments. While responses to these letters are just starting to come in, early indications strongly suggest that several of the program guidelines should be liberalized to reach a broader population and to create a lower, more affordable payment. This feedback was shared with the Treasury Housing Team working on the Administration's homeowner affordability plan.

In addition to the streamline program announced in November, the enterprises have taken many additional steps to help avoid preventable foreclosures. They have suspended foreclosures and evictions and developed programs to protect renters living in foreclosed properties. They are pulling loan files back for a second look before foreclosures, and they are working with credit and housing counselors.

Recently FHFA has been pleased to work on the development of the Administration's plan. It is a major step forward in reducing preventable foreclosures and stabilizing the housing market. It aggressively builds on the FDIC's and our Streamlined Modification Programs. The key elements of the plan involve Fannie Mae and Freddie Mac. The enterprises will provide access to low-cost financing for loans they own or guarantee. This will help homeowners reduce their monthly payments and avoid foreclosure. It is designed for current borrowers who seek to refinance at a lower rate or into a safer mortgage, but who have experienced difficulties due to declining home values.

Second, a $75 billion program will establish a national standard for loan modifications. Treasury will share a portion of the costs, which will provide financial incentives to borrowers, lenders and servicers. The enterprises will monitor servicer compliance with the plan's rules, and for those loans owned or guaranteed by Fannie Mae or Freddie Mac, the enterprise will bear the full cost of the modifications.

Third, the Treasury will support low mortgage rates by strengthening confidence in Fannie Mae and Freddie Mac. The Treasury Department will double the size of its preferred stock purchase agreements to $200 billion each. This increase should remove any possible concerns that investors in debt- and mortgage-backed securities have about the strong commitment of the U.S. Government to support Fannie Mae and Freddie Mac.

In addition, the Treasury Department will continue to purchase Fannie and Freddie MBS, and is increasing the size of the GSEs' allowable mortgage portfolios by $50 billion each, to $900 billion, along with corresponding increases in allowable enterprise debt outstanding. Over the next several days, FHFA will continue working with the Administration and the enterprises to finalize the details and implement this program.

I will be happy to answer questions.

[The prepared statement of Mr. Lawler can be found on page 126 of the appendix.]

Chairwoman WATERS. Thank you very much.

I will yield to myself 5 minutes for questions. My first question is to Mr. Vance Morris, Director for Single Family Asset Management, U.S. Department of Housing and Urban Development. You have, maybe not in your unit, but you have HUD counselors or certified counselors who are responsible for counseling and advising homeowners, first-time homebuyers, etc., and now they have included in their work working with homeowners who are in trouble and trying to help them get loan modifications. Do you think that the HUD-certified counselors have the training or expertise to really help with loan modifications?

Mr. MORRIS. Well, Madam Chairwoman, to answer your question, it is a two-part answer. I think the housing counseling agencies have the training to effectively help the borrowers in trouble, because really they are advising, counseling, and providing alternatives. But the person who has the authority to effect the loss mitigation action is the servicer themselves. So you have a group of counselors who are funded, active, and well-educated, but you still have to get the actual work completed. It still has to go to the servicer, the analysis has to be completed, and then the action has to be taken.

Chairwoman WATERS. I understand that. And from what I have been able to see and understand about what is happening between the HUD counselor and the homeowner is the homeowners find the HUD counselors through nonprofits and churches and other kinds of things, but they have as many problems—the counselors have as many problems getting to the servicer and getting the servicer, if they get them, to do a loan modification. So I am trying to determine what is the most effective use of the HUD counselors, because my experience is they are not able to really facilitate the loan modifications. The servicers are not responding to them, I have discovered. So how can we best use these HUD counselors?

Mr. MORRIS. I would hate to characterize it as not responding. What has happened from the feedback that I have gotten from the servicers is that we have established hotlines. There is a foreclosure crisis. So what happened is there is this gigantic influx of inquiries and activity that had been literally pushed on the servicers themselves. So as a result, based on this demand, it just seems like there is insufficient staffing to cope with all the inquiries and demands and loan modifications.

So if you are asking what should we do with the housing counseling agencies, that is a hard question. Technically it is a separate section. It seems as though they are playing a proper role because the housing counseling agency does housing counseling for origination.

Chairwoman WATERS. In those activities some of them are good, particularly with first-time homebuyers, but I have yet to see the effectiveness of their role in dealing with foreclosures and helping to facilitate loan modifications by getting in touch with the servicer, helping to interpret to the servicer the particular case before them. You have homeowners with all kinds of problems related to that mortgage, and oftentimes they do need some help in interpreting to the servicers, once you get them, what the problem is with this homeowner.

But the reason I ask this is because I am thinking about what to do about the HUD counselors in relationship to foreclosures, because we shouldn't fool each other that somehow they are being effective when it is not their fault, it is more the servicers' fault, because, as you are saying, they are overloaded or what have you.

Let's move on to Ms. Gardineer. When did your agency begin to understand what was happening with the mounting foreclosures, and what took so long to get involved?

Ms. GARDINEER. Well, Chairwoman Waters, I would say that our efforts began to really focus on the mounting loan foreclosures—in April of 2007, we issued a statement that encouraged financial institutions to work with homeowners who were having difficulty making their payments. We encouraged them to reach out to those homeowners to try to modify and engage in prepayment plans at this point.

Chairwoman WATERS. Is that the extent of your authority to encourage?

Ms. GARDINEER. Well, with regard to that, Chairwoman Waters, we wanted to make sure that our regulated servicers understood that it was more prudent for them to reach out and make an effective modified loan as opposed to having a failure on both sides of the transaction that would result in a foreclosure.

Chairwoman WATERS. And If they did not do this?

Ms. GARDINEER. We would look through it through our supervisory process.

Chairwoman WATERS. Look at what?

Ms. GARDINEER. Look at their efforts to reach out to those homeowners.

Chairwoman WATERS. And if they did not do it?

Ms. GARDINEER. Are you asking would they be—

Chairwoman WATERS. What is your authority?

Ms. GARDINEER. With regard to enforcement of this?

Chairwoman WATERS. Yes.

Ms. GARDINEER. I don't believe we have enforcement authority.

Chairwoman WATERS. I see. So when you talk about encouragement and doing whatever you can do to get them to work closely with the homeowner, that is the best you can do with the authority that you have; is that right?

Ms. GARDINEER. I would say that with respect to the creation of our Mortgage Metrics Report, which we have made a part of our supervisory process, we are looking to gain more information with regard to how effective the modifications are being done. And because it is a part of our supervisory process, and we will examine for this going forward, then I think our safety and soundness authority will cover our ability to take more effective action.

When we look at the methodology and the data that we are gaining from this report, and by making it a part of supervision, we are helping to shape our supervisory expectations in understanding how servicers can do more and what they are doing in regard to what their current authority is, how we can look at how we can expand on that current authority, as well as helping them understand the parameters that we as supervisors and regulators expect.

Chairwoman WATERS. How long is it going to take you to include that in your supervisory responsibilities? You know, a lot of foreclosures are happening every day, and I guess the numbers that we saw here today, 2.5, or something like that, million. So how long is this is going to take you?

Ms. GARDINEER. As far as this being our third quarter, we released three quarters' worth of data, and with every release of the report and our analysis of the report, it allows us to see the information that we need to continue to understand the supervisory process and help shape this. We are in the midst of helping the Administration work out the details of the loan modification streamlined efforts to impact these foreclosures to see if we can stave them off earlier. We want servicers—

Chairwoman WATERS. What should we do in the future to get in front of a problem like this? We are late.

Ms. GARDINEER. Well, I think in the past, Madam Chairwoman, we have looked at lagging indicators, we have looked at data that has been based on model estimates as opposed to what we are getting with our fellow regulator, the OCC, at this point. We are looking at original loan-level data, the actual loans of homeowners that are being serviced by these servicers, and enabled to do that, and our ability to now look at that data in real time, today, to see what is happening in a specific ZIP code, geographic location, FICO scores, income verification or employment, and how all of these impact an ability for a loan to perform for that borrower. This is the kind of information this helps us to get in front of the problem as opposed to looking at model estimates, which we have—

Chairwoman WATERS. I have a great appreciation for that, but what you just told me gives me even greater worry. So I am going to move on to Ms. Capito. Thank you very much.

Mrs. CAPITO. Thank you.

Mr. Morris, can you explain to me, in your testimony you mentioned that in the refinancing, that $750 goes to the lender for a successful refinancing.

Mr. MORRIS. $750 is just incentive payment for the cost of them doing the work. It has to be tied to cost by statute. So we have to be able to justify that they are experiencing the cost. It is the cost of them collecting the information, analyzing.

Mrs. CAPITO. Is this similar, in your mind, to the incentive that the President has built into his program that he has put before Congress, or is this different, in addition to that?

Mr. MORRIS. We have been operating our program since 1996. And I am just talking to you specifically about FHA's authority. Based on FHA's authority, according to our Office of General Counsel, when we pay an incentive fee, it has to be linked to some work that was actually performed. This is the fee structure for the work that was performed to complete the loan modification, plus the reimbursement for the title work.

Mrs. CAPITO. If there is a 35 percent redefault rate recently, then every time, if you are redefaulting and you are going to come in to try to remanage the loan or refinance the loan, is there still a $750 payment every time that loan gets looked at?

Mr. MORRIS. Yes, because the same analysis and due diligence is being done every time. A 35 percent default rate is not new.

Mrs. CAPITO. That is over 10 years?

Mr. MORRIS. Over the past 5 to 10 years that I have information, it is average, about that amount.

Mrs. CAPITO. I would like to ask Mr. Lawler, you know, I think we encouraged folks who are in trouble, telling them, go to your lender, try to start working on a loan modification. My understanding of the President's plan is that the loan modifications have to be done by those loans that are held by Fannie and Freddie. How does a regular person figure this out? And what kind of outreach are you doing to make sure people are aware that they actually have this connection to those institutions?

Mr. LAWLER. There are two different parts to the President's plan. One deals with loan modifications, and for those it is not restricted to loans held or guaranteed by Fannie Mae and Freddie Mac. There is another part that involves refinances by borrowers who are current on their loans.

Mrs. CAPITO. Let me just stop you right there. If you are current, you are refinancing; if you are in arrears, you are modifying?

Mr. LAWLER. Yes. Although you could qualify for a modification in some cases if you are current if there is a hardship, for example.

Mrs. CAPITO. What is the difference between a modification and a refinance?

Mr. LAWLER. Refinance is just changing the interest rate, if the borrower qualifies for a new loan with a new maturity of 30 years or 15 years.

Mrs. CAPITO. But you are modifying a loan?

Mr. LAWLER. You are paying off the first loan, and you are getting a brand new loan.

Mrs. CAPITO. Okay.

Mr. LAWLER. The other is modifying the terms of an existing loan.

Mrs. CAPITO. Which would change the interest rate or the length of time?

Mr. LAWLER. Or the principal amount or the way the rates are computed.

Mrs. CAPITO. In the President's plan can you refinance or change the principal amount; is that within the purview of this plan? I don't believe it is.

Mr. LAWLER. It is within the loan modification plan, yes. There is a provision for that, and the Treasury will participate in some of the cost in that.

Mrs. CAPITO. I see.

Let me ask you another question about the kind of complaints I have heard.

Mr. LAWLER. If I could finish?

Mrs. CAPITO. Yes.

Mr. LAWLER. If it is a refinance, then that part of the plan is only for loans that are held or guaranteed by Fannie Mae or Freddie Mac, and one way for the borrower to find out if that is the case, obviously, is to call Fannie Mae or Freddie Mac. But I think on March 4th, there will be more details about exactly how to find out.

Mrs. CAPITO. I think that is confusing to a lot of people, because they naturally assume that wherever they got the loan or whoever they are sending the check to is going to be the person or the only person they will have to be aware of as they are moving through the process.

I heard—and maybe you can help me with this. I heard complaints from people who are buying the first-time loan or trying to refinance, and they maybe have credit scores that are not up in the 700s, but they are still good credit scores, and that Fannie and Freddie are assessing fees, and began assessing fees more here recently, that are putting, again, the price of refinancing that mortgage out of reach for a lot of people. Can you help me with this?

Mr. LAWLER. Well, part of Fannie Mae and Freddie Mac's problems most recently has been that this risk was underpriced, and so they are trying to make new loans that are priced fairly, but fairly to them and fairly to the borrowers. And they have made more use of distinctions of relative credit quality of borrowers. The difference between a very high credit rating and a good, but slightly lesser credit rating is a matter of basis points, but that is a distinction that they are making.

Mrs. CAPITO. Would that same standard be applied in the President's plan?

Mr. LAWLER. For the refinances, Fannie Mae and Freddie Mac will determine what terms those loans will be available on, and there will be more details March 4th. For the loan modifications, it is really a question of lowering payments, not raising anybody's payments.

Mrs. CAPITO. So the answer is, not really.

Mr. LAWLER. Not for loan modifications. Thank you.

Mrs. CAPITO. Thank you.

Chairwoman WATERS. With that line of questioning, if you would like, I will yield you an additional minute, because you have an additional loan modification type in the HOPE for Homeowners program that is a refinancing program. Maybe knowing the difference between that, the GSEs refinancing and the loan modification may help us all.

Mrs. CAPITO. Now you have totally confused me.

Well, I guess I am getting to in my original statement looking at the fairness equation of people who are refinancing or loan modification or however. I am mixing them all up together, but I realize they are not the same; that if that borrower comes in and is held to one standard, and that person maybe has been doing all the right things, paying, working with their debt, paying all their credit cards on time, all these sorts of things, and then you have another person who is coming in under a different set of circumstances are not going to be assessed these fees, so it is going to be easier for that person to stay in their home than maybe this other person to purchase a home in the beginning or to refinance.

Mr. LAWLER. Well, people who are current can qualify for the loan modifications if there is hardship, if there is a special need.

Mrs. CAPITO. Beyond a poor credit score.

Mr. LAWLER. Beyond a poor credit score, right. Losing a job, for example.

Mrs. CAPITO. Or an illness or something to that effect. Thank you.

Chairwoman WATERS. Thank you.

Mr. Green.

Mr. GREEN. Thank you, Madam Chairwoman, and I thank the witnesses for appearing today.

My frustration with this process emanates from an inability to understand why people won't do what is in their best interests. All of the evidence seems to indicate that it is in the best interests of investors to restructure the loans and allow the borrowers to continue to make payments, but all of the actions are inconsistent with what is in the best interests of the investors. Would someone care to just give me a very terse comment on this in terms of why investors are not amenable to doing what is in their best interests?

Ms. GARDINEER. Congressman, I think the difficulty lies in the pooling and servicing agreement contracts that govern the securitizations that many mortgages have ended up in. Those contracts in terms generally allow for losses that would be incurred under those securities to be borne by the junior persons who have purchased into those securities, with the investors protected against such losses such that it appears as though they would be moving against their interest. But I think the contracts are written in such a way to guarantee that their interests are paramount and protected against those losses.

Mr. GREEN. Is this when we have something called tranche warfare to develop?

Ms. GARDINEER. Yes, Congressman.

Mr. GREEN. If we provide a safe harbor for the servicer, do we now overcome the consternation that servicer has by virtue of liability and exposure; is that going to be a part of the key to safe harbor?

Ms. GARDINEER. I think so, Congressman. Our servicers have communicated to us that there are both legal and accounting impediments to their ability to service those loans or modify those loans that are in those securitizations. Our reports have demonstrated that it is far easier and more effective to modify the loans that are in portfolio. There is great latitude and great ability to change all of those terms. However, there are legal concerns about the way the contracts govern what a servicer's abilities to reach into those securities pools and modify those loans are. So providing that safe harbor to give them some protection against the legal liabilities and making—or having them being accused of doing something against the best interests of the trust I think would further the ability of the servicers to actually modify those types of loans.

Mr. GREEN. Yes, sir?

Mr. EVERS. A little different perspective, particularly thinking of it from an investor's perspective. If an investor thinks the future path of home prices is going down, and if they are looking at modification activity, and those modifications are kind of just nipping and cutting at the edges, and there is a lot of redefaults on those, they are thinking they could have a bigger loss down the road. If the loan is modified and still ends up in foreclosure, and home prices still go down, they are thinking, I could have a bigger loss 18 or 24 months down the road than if I just foreclosed today at the current prices.

Mr. GREEN. I see.

Mr. LAWLER. I can add one more. Investors typically analyze the problem from their own perspective, how many loan modifications is it in my interest to do, but we are in a situation now where the cost of foreclosures affect everybody else. There are substantial external costs that are not perhaps being fully taken into account, and the sort of broader social benefits of modifications may be greater than the benefits to the investor making the decision.

Mr. GREEN. Because my time is about up, someone tell me quickly how or what percentage of the loans that are questionable and may go into default are ARMs that are about to reset? Does anyone know? Do we have a high percentage of ARMs that are about to reset, or have we gotten through the ARMs?

Mr. LAWLER. We have mostly gotten through that, the 3/27s and 2/28s.

Mr. GREEN. Right.

Mr. LAWLER. Most of those hit the first reset date through last year. That was at one time the main cause of problems. Now we are past the hump on that, but we have a whole bunch of new problems.

Mr. GREEN. Madam Chairwoman, I cannot see the clock. Do I have any time left?

Chairwoman WATERS. The discussion about whether we have gotten over the hump of the resets? I have been led to believe that we have yet to hit the height of the resets. That should be coming in 2009 and 2010. So would you please go ahead and pursue that question?

Mr. GREEN. Thank you, Madam Chairwoman.

Simply restating what the chairwoman has called to our attention, and I think what we were trying to get to is this: The ARMS and 3/27s, 3 years prior to this would take us to 2006 or thereabouts. You would still have a good number of those resetting at this time; would you not?

Mr. LAWLER. We still have some, but the biggest volume was in 2/28s. There was a bigger volume of 2/28s than 3/27s. So it is not that we don't have a good number coming up, it is that we are past the peak of them. That is what I meant.

Mr. GREEN. I understand.

My final question is this: If we provide the safe harbor, if we encourage loan modifications as opposed to refinance, if we provide an incentive by way of an emolument, meaning a payment of dollars for remodification, is this going to have a sizable impact on the problem, or will we find ourselves with so many loans to be modified that we won't have enough servicers to accommodate the persons who are seeking modification?

Mr. LAWLER. Certainly capacity constraints are a matter of concern. But we need to have a lot more modifications than we have been having. There is certainly room to do a lot more. We need to press that capacity.

Mr. GREEN. Does that mean we will have to hire more people is the bottom line?

Mr. LAWLER. I think servicers will find that in many cases they will have a need for more people, and the incentive should make it possible for them to hire more people.

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

Chairwoman WATERS. Thank you.

Mr. Marchant.

Mr. MARCHANT. Thank you for your testimony. If I were sitting back in my district watching this hearing, the summary that I would have taken away from the testimony is that HUD is studying and encouraging, the OTS is studying and encouraging, the Office of the Comptroller is studying and collecting data, and the Federal Housing Finance Agency is studying, evaluating, and implementing monthly and quarterly foreclosure reports.

Now, nobody should be encouraged by that. In fact, there doesn't seem to be a workable plan in place. In HUD's case, they have a dual role of protecting; in fact, HUD cited a report in their study, and they cited a report that was made in 1996. And we are working off of a plan from 1996. In the case of the Office of Thrift Supervision, in many cases at the same time you are studying and urging your members and those that you supervise to modify, at the same time your examiners are out in those banks examining the very portfolios and the very loans that you are urging them to modify. And, in fact, if they do modify them, then they are put on a watch list, and they are required to reserve against those loans. So the very thing that you are urging them to do your examiners could very well penalize them for following through and doing.

In the case of the FHFA, the Federal Housing Finance Agency, it is important. I will not argue that we have statistics and knowledge of the redefaults, etc., etc., but, in fact, all of the information that is brought forward in these reports actually reinforces, in my view, a lender's resolve probably not to modify and not to reset the mortgage, because what shareholder in any institution would urge its institution or board member would urge its institution to modify or extend or renew a loan that has one in three chances of relapsing?

And, as was stated, it might be more beneficial to let them take the loss now, get the thing back on the market.

So, Madam Chairwoman, the frustration on my part, and I know that everybody is concerned about it, is that we continue to pile study, letters, urgings, statistics, reports on top of reports, and in fact, your HUD counselors don't have anybody to turn to because we have as many disincentives built into the system to not modify and not extend and to foreclose than we have to do that. And it has been proven in the fact; it has been proven in the failure. I don't fault the attempts to come up with these programs, but it is very clear after, what, we have been working on it a year, that most of the things that we have tried have been counterproductive.

So, thank you.

Mr. MORRIS. Madam Chairwoman, am I allowed to—I just want to be accurate by my testimony. Can I make a comment?

Chairwoman WATERS. Please, yes, go right ahead.

Mr. MORRIS. I am Vance Morris from the Department of Housing and Urban Development. The 1996 study that was referenced in the testimony was the basis for our loss mitigation program. By statute, if a lender does not engage in loss mitigation and they file a claim with us and we find out, we charge them 3 times the claim amount. That means if we paid $30,000 and they failed to execute loss mitigation strategies, if we paid them $30,000, they would have to pay us $90,000.

We monitor lenders electronically. We review thousands of loan files per year. So we do have an active loss mitigation program. We would like to have more expansive authorities, but we are not in the study mode. We have been active in modifying loans, doing partial claims which brings people's arrearages current. We do special forbearances. And we have been very active with trying to actively manage our portfolio.

So if I misspoke and made it seem that we are studying, we don't have a study program. We have an active loss mitigation program. Lenders are penalized if they don't follow the program. But we do like to see additional authority.

Chairwoman WATERS. We didn't misunderstand you. Mr. Marchant didn't misunderstand you. But we are quite frustrated because of what this country is experiencing. And when you talk about loss mitigation, we have discovered what some of these loss mitigation programs are in the banks. How do you regulate loss mitigation programs that are basically handled offshore?

Mr. MORRIS. Well, the loss mitigation activities for FHA are currently not outsourced. It has to be done by an FHA-approved servicer. It is not an outsourced activity.

Chairwoman WATERS. I am sorry. So you are only speaking for the FHA?

Mr. MORRIS. Yes, ma'am.

Chairwoman WATERS. Thank you very much. I am going to move on to Mr. Lynch.

Thank you.

Mr. LYNCH. Thank you, Madam Chairwoman, and Ranking Member Capito.

I want to thank the witnesses on this panel and others for coming to help this committee with its work.

I want to go back to a point that Madam Chairwoman raised a little earlier, a good point. The Federal Reserve does a very good job in my district in terms of the data that they provide me. They can actually, the Boston office of the Federal Reserve, can actually tell me the number of mortgage resets that are going to happen in my district. Actually, by town, they can tell me these mortgage resets. And while right now, the mortgage resets are for the most part very low because the rates are low, the volume of those mortgages, as the Chair pointed out, in 2009 and 2010 are very high, and we really don't know what the picture will be at that point, although we heard Mr. Bernanke today say that rates would have to stay historically low for some time.

More troubling for me, though, is what I am seeing now is, rather than reset-related defaults, I am seeing layoff-related defaults. People are getting thrown out of their jobs, and so a sound and stable mortgage is now in trouble.

Here is my question. We have a provision that is being considered this week for a so-called cramdown provision, where a homeowner in bankruptcy would have the opportunity to have their mortgage modified in bankruptcy if the judge determined that was the right thing to do.

If this cramdown provision succeeds, what impact do you see it having on the voluntary modification framework that you are dealing with, where—what I am saying is, are we going to see lenders and servicers incentivized to deal? Remember, it is all voluntary. Or are we going to see homeowners who are saying, I am so far underwater, I might as well just roll the dice, not go for a voluntary modification, and see what I can get out of the bankruptcy court?

I know this is conjecture. It is opinion, but in your case, it is educated opinion. What do you think will happen if we do adopt that provision?

Mr. MORRIS. Well, I looked at the legislation as well, and the net effect is still being ascertained by the Department.

But your question refers to voluntary modifications. The authority that I talked about that we are requesting is additional authority to do larger voluntary modifications; it is actually called partial claim authority. We think with that authority, it gets us further ahead so someone would avoid bankruptcy, because it would actually be an alternative.

Currently, the way our loss mitigation programs work, it helps you if you have a temporary but not permanent disruption in income. That means 12, 14, 16 months. But what is happening now, as you pointed out, Congressman Lynch, is that families are having permanent reduction of income. So we have to have a tool to bring the payment down to an affordable level. We are hopeful that we will get the authority to have this voluntary modification, then it will not push people to bankruptcy, because that will just cause the cascading effect of all the borrower's credit.

Mr. LYNCH. That is helpful. Could I get a couple more opinions on that, just different perspectives?

Ms. GARDINEER. Congressman, I think that what we are seeing with regard to the bill, I have looked at the Helping Families Save Their Homes Act, the proposal that will be on the Floor this week, and at OTS, we believe that another tool that would help us reach as many homeowners as possible if it is effectively done that can reach those homeowners would be a good thing.

Whether or not this would incentivize servicers to engage in more modifications, I think that another point that Congressman Green raised is also important to note: Servicers are constrained by the contracts, the pooling of servicing agreements, that are in place with regard to securitizations.

What we have seen from the data that we collect is that if there is a modification, a mortgage that is in portfolio, the modification is often far more sustainable because the powers to modify that loan are greater. Again, the ability to provide some legal insulation through additional legal action for the servicers would assist in that as well. So, again, the more tools that we see that can get to the most homeowners to effectively stave off the foreclosures is the better approach.

Mr. LYNCH. Thank you, Madam Chairwoman.

Chairwoman WATERS. Thank you very much.

Ms. Jenkins.

Ms. JENKINS. Thank you, Madam Chairwoman, and thank you all for your testimony today.

I would like to share with you an excerpt from an article I read recently in Business Week, and I would just ask maybe a few of you to comment on the problem it describes. Federal banking regulators reported in December 2008 that 53 percent of consumers receiving loan modifications were again delinquent on their mortgages after 6 months.

A law professor, Allen M. White, says the redefault rates are high because modifications often lead to higher rather than lower payments. An analysis that White did of a sample of 21,219 largely subprime mortgages modified in November 2008 found that only 35 percent of the cases resulted in lower payments. In 18 percent, payments stayed the same, and in the remaining 47 percent, they rose. The reason for this strange result was lenders and loan servicers were tacking on missed payments, taxes, and big fees to borrowers' monthly bills.

Now, it seems to me that payments that rise after the loan is modified is counterproductive. Could some of you just comment on this particular problem?

Mr. LAWLER. I would be glad to. The program that we have been working on with the Administration is designed specifically to avoid that kind of problem. It is specifically targeted at the debt-to-income ratios of the borrowers and working them down to 31 percent. In many cases, they will have been much higher. And so the whole focus is to make an affordable mortgage, not simply to tack on all the arrearages, to figure out how much that will amortize over to over the existing life of the loan.

Mr. EVERS. I just would add, there may be some cases where the loan payment may increase, and that may be a situation where it is a temporary credit repair strategy going on where the borrower has a temporary situation and, fees and stuff are getting rolled into the loan getting reset. But we want to know the answer to that question. We want to know if this is a pattern of practice, just how many of these types of mods are out there. That is why we are collecting changes in monthly payments before and after the mod to know what is going on, and then looking at the redefault rates for the various classes for loans where there has been an increase in payment, where there has been no payment change, and where there has been a decrease to get a better understanding of that.

Mr. MORRIS. Congresswoman Jenkins, as I mentioned in my testimony, that is a correct statement. On average, after the loan modification, the average increase is about $22. And that is the result of the past due amount being put into the new loan balance.

The reason why I keep emphasizing this is the way that the loss mitigation program is set up currently is to help people who have temporary reductions in income. So what the servicers do is, when they do the financial analysis, they analyze the payments so that they can determine that it is an affordable payment. What is happening now, though, there is a permanent reduction in income, so we need a way to effectively reduce the payment in a tangible way, and that is why we are requesting the additional authority, so we will have additional tools to assess people in this situation.

Chairwoman WATERS. I am going to turn to Mr. Cleaver at this point. Before I do, has there been a formal request for additional authority so that you could basically reduce the amount of the mortgage payment?

Mr. MORRIS. I was looking at the legislation yesterday. It was written in the Help Families Save Their Homes Act. It was in that authority. But I don't know exactly at what stage it is, and I will follow up.

Chairwoman WATERS. We will take a look.

Mr. Cleaver.

Mr. CLEAVER. Thank you, Madam Chairwoman.

With some concern, perhaps even fear, that the redefault rate will be used by opponents to fight most of what some of us are interested in doing with either cramdown or loan modification, is there anything that we can do to reduce the redefault rate, considering of course, I mean, obviously, if you go by the percentages with the subprime primers generally having a redefault rate higher, is there a way that we can undergird them or do something to reduce that? Anybody?

Ms. GARDINEER. Congressman, I think that, as my colleague Mr. Evers said, one of the things that our mortgage metrics report after the release of the third quarter data showed the increase in the redefaults at the 30- and 60-day past due mark; we did go out for a broader data collection to look at how loans were modified that resulted in an increase in principal as well as payment, where there was no change to the payments, to reduce payments by 10 percent or less, or reduce payments by more than 10 percent. And our goal in getting that information and then sharing it with the Administration's working group, which our agencies are continually working to help find the right criteria that we believe we can get from looking at how these modifications were done so we can see which ones were more effective and what that structure was.

In sharing that with the working group with the Administration and with Treasury, we hope to find that streamlined effort where we can show the most effective modifications as demonstrated from the information we get. And hopefully we will be able to look at the lower rates of redefaults and see a correlation between some of these criteria, and utilize that to give some structure to our servicers as far as trying to make the most affordable and sustainable modifications as opposed to the ones that could easily slip back into a redefault situation.

In addition to that, I think it is important to note that we do see a correlation with unemployment as well as underwater mortgages. All of those things, I think, that we get the increased data and we share that with our fellow agencies, it allows us to have the ability to try to form that more sustainable mortgage and avoid those redefaults.

Mr. CLEAVER. Mr. Evers.

Mr. EVERS. I would just follow up on what Grovetta said. We have interagency retail credit company guidance, and in that guidance, it basically requires servicers to try to do one mod, not multiple mods for a borrower. And that is in there to make sure that they do the mod right and they are not doing multiple mods. And the only time they would do a multiple mod, if the borrower has some life-changing event, like loss of a job or unemployment or some medical problem or major loss of income. But the real issue is, do the mod right, install for affordable, sustainable payment, and structure it properly.

Mr. CLEAVER. Is there way to do this with triage? That is, can it also be done in a just way?

Mr. EVERS. In terms of doing more?

Mr. CLEAVER. No, no. Is there a way—I mean, there are some loan modifications that we—I think Ms. Gardineer has just done a little, some loan modifications that we should know are not going to work. And so there is—it is pointless to try to force it to work, and we actually feed the people, we feed our opponents when we do that because they use that to, you know, say you are throwing away money, and the whole 9 yards. And I like to feed everybody, but I don't want to feed my opponents.

Mr. MORRIS. Congressman Cleaver, I think I can respond to that question. As I mentioned in my testimony, it is really not the redefault rate. It is really that you end up foreclosing. The cost between throwing someone on the street and doing another modification through FHA is $750. So we will spend another $750 to try to keep somebody in the home, because what happens is, 2 years after the fact, more than 85 out of 100 people are still in their homes, and we are saving a lot of money as opposed to saying, oh, the redefault didn't work this time; let's not try it again.

What happens is it takes time for people to recover from change in household income. It could be a disability. And it is—because, like I said, the current tools now, you have to go back to essentially your full payment. So we do have the redefaults, but still we work with them again to make certain that it sticks. And for another $750, if we can save another 60 families from losing their homes, that is what we are doing. So your opponent is going to look at the redefault rate, but my question is, has a person still been living in the house 2 years after the fact? Because 2 years really is the measure that says they fully recovered from any type of activity. If something happens 5 years down the road, it is probably another life event.

So the question, this is just my opinion, is, what happens to the family? Are they ultimately foreclosed? And is it worth $750 to try to keep somebody in their house by doing another loan modification? FHA says it is worth another $750.

Mr. CLEAVER. Thank you, Madam Chairwoman.

Chairwoman WATERS. Mr. Lee.

Mr. LEE. I will try to be brief, but it is such an important issue, and I just want to touch on a few points because this has been such a major issue in my district. I have a district between Buffalo and Rochester, New York, and a very hardworking community who this group, we never really had a boom to bust in the housing market. And in some way, that has been a blessing because people have been able to, up until now, been able to stay within their homes. But we are now starting to see the job losses, and people who, through no fault of their own, now are starting to have issues, be it a medical illness or they had two incomes and a wife or husband has been laid off. And these are people who have been paying their credit cards. Every day in and day out, they have been meeting their mortgage payments, but it has been harder and harder.

And the calls that I am receiving by the dozens is the fact that they are making their payments, and they now go back to their service provider—and I won't name names of the institutions—but some are finding, in some cases, are finding relief through a service provider A, but service provider B under no circumstances really has been willing to either remodify the loan amount, lower interest rates, or try to work with them. And it is very hard to go back to them and say, we don't have a policy.

I would be curious to know, can we—and I know most banks do have a process in place, but it doesn't seem to be consistent. I would like to hear your views. Do we, without trying to hamstring, I am not a big believer in Big Brother, but do we have the ability to come with some standard uniform process so that we can tell those who are struggling that these are options that are available to you, those people who are struggling but are making their payments right now, to try to assist them? And then I have a follow-up.

Mr. LAWLER. This is something we are definitely trying to address in the program we have been working with the Administration on, and we will have further details on March 4th.

What we are trying to do is set up a standardized program that can be adopted throughout the country, and that will include people who are extremely stressed and therefore in imminent danger of default even though they are currently making their payments. And we are very hopeful that this will work, as we are certainly directly trying to attack this problem.

Mr. LEE. And in follow up to that, because that is the number one call, then the follow-up call is the fact that, again, these hard-working individuals are frustrated because I think they are worried a percentage of individuals who misrepresented their income who, be it in different parts of the country where there was escalating prices, where they took advantage of that system. And is there any way, because I don't think there is anybody who wants to, if someone was trying to do this for personal gain versus those who have been truly hardworking citizens, how do we protect and make sure that we are not bailing out those who are trying to make a profit from this housing issue?

Ms. GARDINEER. Just to follow up. We are also working with the Administration to develop this loan modification program. And key to that is going to be verification of things such as income and employment. We believe it is important not only to reach as many homeowners as we can to put them into sustainable affordable modifications, but to be able to verify the veracity of the information that the borrower provides to that servicer.

But the uniformity that we are striving for, I think, gets to the heart of your first question, which is the disparity that may be incumbent upon different servicers and the approaches that they use to modify different loans, and going to servicer A, who is willing to use a certain set of criteria, but that may not be utilized by servicer B.

Our hope is that we will be able to create the streamlined modification effort that is able to verify, to weed out fraud, to make sure that those who are owner-occupied properties are able to get that sustainable affordable modification that will allow them to stay in the home and avoid an avoidable foreclosure.

Mr. LEE. Thank you.

Chairwoman WATERS. Thank you very much.

Before I call on Mr. Clay, keeping in line with that testimony, Ms. Gardineer, I have seen loans that—mortgages that people got involved in, in 2006 and 2007, where they were predatory loans, and the interest rates were 9 percent, 9.5 percent, and I had one at 10.5 percent. When you are constructing a model that can be used to do modifications, is there some consideration given to the high price of mortgages when the interest rates were basically at 5 or 6 percent? I mean, could we say or is it advisable to recommend that all of those interest rates be reduced to 4.5 percent or something that would be consistent with somewhere what the mortgages would be today?

Ms. GARDINEER. Chairwoman Waters, I believe that part of the criteria that we are looking at may not be an across-the-board interest rate, but certainly looking at the home price depreciation as well as the interest rate at the time of origination and the payments that the borrower would be able to afford, looking at the debt-to-income ratio as well as the loan-to-value. So taking all of those things into consideration as well as the highest rates that may have been advanced at the origination, I think it is possible for us to come up with a streamlined approach that would indeed include a reduced interest rate in order to make that modification an affordable payment for that borrower.

Chairwoman WATERS. I do understand that, now, with the modification efforts that I have been involved in helping some of my constituents, all of those things are taken into consideration for the most part. But I was really asking about the reduction of interest rates based on what appears to be a predatory interest rate that was given at a time when the market interest rates were 5 or 6 percent, that you see, I mean, it just jumps out at you that this person is charged 10.5 or 9 percent. Wouldn't that kind of be an automatic reduction without all the other considerations?

Ms. GARDINEER. Congresswoman, I believe that you made an excellent point that I will take back to the working group this afternoon and include in our dialogue as we move towards our March 4th deadline to provide that criteria and the parameters for the servicers. But that is an excellent point that we should be considering as we move forward.

Chairwoman WATERS. I appreciate that, because I have run across a few of those.

Mr. Clay.

Mr. CLAY. Thank you, Madam Chairwoman, and I thank the panel for being here today.

Let me start with Mr. Lawler.

Mr. Lawler, in your testimony, you state that it is important to note that when calculating and analyzing redefault rates, common definitions are required, and there is much debate within the industry as to what those definitions are, how redefault rates should be measured, and over what timeframes.

I am curious as to how you would define redefault terms and definition. When reporting your data, what do you consider a modification, and is a repayment plan a modification?

Mr. LAWLER. A repayment plan that doesn't change the terms of the mortgage but simply when it can be paid is not a modification. If it were a major change like a change in the term from a 30-year mortgage to a 40-year mortgage, that would be a modification. If it is simply taking the existing amount owed and saying, you can make up payments that you are behind at the end of the 30 years, that would just be a repayment plan or redistributing those amounts owed so that your payment goes up. Those are just repayment plans.

As far as the definitions of redefault, the key things are, how many days delinquent, and over what timeframe? So, for example, Mr. Morris is suggesting that if you are still in your house 2 years later, that probably shouldn't count as a redefault. Sometimes you don't have as long a period. You don't want to wait 2 years to see how you are doing, so you compute how the loans are doing that you modified in a more recent time period and you want to know, well, how many 30-day delinquencies do I have, how many 60-day, how many 90-day and so forth.

Mr. CLAY. Thank you for that response.

Let me ask Mr. Evers.

Mr. EVERS. I just want to follow up on that. We agree that there needs to be clear, standard definitions. You need to have a clear definition of what is a mod and what is not. A repayment plan, an informal repayment plan is not a mod. A mod is when the contractual terms of the payment have been changed in writing. And we only count that when it is done; nothing before that, nothing informal. And then we track subsequent performance, post-modification. And we look at the number of payments the borrower has made subsequent to that. That is, in our opinion, the best way to get an apples-to-apples comparison in terms of monitoring performance of post-modification loans.

Mr. CLAY. Thank you for that response. How do we establish a guideline to ensure that we take into account the trend of the day that has several people in the household contributing to the mortgage payment? Many of these households stayed current in their payments until this current crisis. When considering a workout with the applicant, what do you include as gross income? Do you include the wife or other family members living in the home as additional sources of income if they are not on the mortgage? And anyone can take a stab at it on the panel.

Ms. GARDINEER. Congressman, currently, the person who is actually on the note is the—or the couple or whoever is actually on the original note, that is the income that is the measure by which you are looking at how to modify that loan. There can be, and we recognize and it is a continued topic of discussion in the working groups right now working on the Treasury and Administration plan, recognizing that there are many households with contributors to the monthly mortgage income that are not actually on the note and how to recognize or work within that structure to create an affordable modification. But the current legal requirements would limit our ability to look at only those who are actually on the note for repayment modifications.

Mr. CLAY. But you know that is not traditional.

Ms. GARDINEER. I do recognize there are many households, as you described, and the working group is aware of that as well.

Mr. CLAY. I think, Mr. Morris, you may be able to help me with this. Are we trying to force the choice of a modification over that of a refinance? The new charges added by Fannie Mae and Freddie Mac in December add up to about $15,000 to refinance costs for the borrower. Why is that? They have added up to 5 points. They have new terms like adverse market fee, adverse credit fee, and non-owner fee. Can you give me an answer to that? Do you know why?

Mr. MORRIS. Candidly, Congressman Clay, I think Mr. Lawler would have to speak about the fees.

Mr. CLAY. Mr. Lawler, could you tackle that?

Mr. LAWLER. Certainly the fees on many mortgages have gone up. The risks have also gone up. It is a lot riskier to make a loan when the expectation is that the value of the collateral is going to decline over the period of the loan, than in a time when you expect the value of the collateral to get greater. And in recognition of that risk, it is necessary to make some charges.

At the same time, whenever it is possible, a refinance is probably on average going to be more successful than a modification if the borrower can qualify for the refinance.

Mr. CLAY. But don't we want to kind of look at what is reasonable here? I mean, what is actually doable for the average consumer?

Mr. LAWLER. We certainly do. And the most important thing in that area that we can do is try to get the general level of mortgage interest rates down.

Mr. CLAY. Without Fannie and Freddie adding onerous fees and arbitrary fees?

Mr. LAWLER. I hope they are not arbitrary.

Mr. CLAY. I bet they are.

I yield back.

Chairwoman WATERS. Thank you very much.

As we wrap this up, and since you are making recommendations that supposedly will be unveiled on March 4th in the President's plan, I would like you to give some thought to the fact that I have run into constituents who say they are the victims of fraud. Even though all of us would like to think we are all responsible and we know what we are doing, I am told that certain individuals had income that was noted on the documents that was much larger than their real income, and that that is not what they told the loan initiator; and they placed it on there in order to get the loan funded, the mortgage funded. I am told that people did not sign certain documents.

What do we do where there is an indication of fraud? How do we follow that up? And how do we help the homeowner, and how do we penalize somebody? I mean, that is something I would like to give some consideration to. And FICO scores. If you have an adjustable rate mortgage and the margin is, I don't know, 3 or 4 percentage points higher, and you obviously cannot pay that large a mortgage payment, and so you are delinquent, but you are trying to get a loan modification. If you were being considered, say, by, I don't know, Fannie or Freddie or anybody else who would consider your FICO score as part of those things you consider before you do the loan modification, what do we do about that? Should you be penalized for that now having damaged your credit while you are trying and you have been working very hard to do a loan modification so that you could keep your home and you could make payments that you could afford? So I would like you to give some thought to that.

I would like to note 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.

This panel is now dismissed. Thank you very much.

I would like to welcome our distinguished second panel. Our first witness will be Mr. William C Erbey, chairman and CEO of Ocwen Financial Corporation.

Welcome.

STATEMENT OF WILLIAM C. ERBEY, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, OCWEN FINANCIAL CORPORATION

Mr. ERBEY. Thank you, Chairwoman Waters, Ranking Member Capito, and distinguished members of the subcommittee. My name is William Erbey, and I am chairman and chief executive officer of Ocwen Financial Corporation, an independent mortgage loan servicer.

First, let me thank you for the opportunity to participate in this hearing today. I share your sense of urgency to find a lasting solution to our daunting foreclosure crisis, a crisis that lies at the very heart of our economic problems and threatens millions of families with the loss of their American dream, their home.

I applaud the leadership of the chairwoman and subcommittee members in relentlessly advocating, ever since the inception of this crisis, the need for bold action to assist homeowners with unaffordable mortgages and to prevent avoidable foreclosures.

I also applaud President Obama, Secretary Geithner, and the President's economic team for answering the call for bold action in a matter of a few weeks into the new Administration by launching the Homeowner Affordability and Stability Plan. This plan includes a substantial loan modification component that is the subject of today's hearing.

Prior government-sponsored loan modification initiatives were all good first steps in the right direction, but the President's new plan is exactly the kind of insightful and decisive action that is needed to make a material impact on the foreclosure crisis.

As one of the few remaining independent mortgage servicers, Ocwen is very proud of our achievements in foreclosure prevention through loan modifications. We are not loan originators. We do not make mortgage loans. Rather, Ocwen is engaged as a loan servicer under contracts with mortgage investors, i.e., the securitized REMIC trusts.

Currently, our servicing portfolio contains approximately 325,000 mortgage loans of which approximately 85 percent are subprime. Beginning in early 2007, we proactively prepared for an increase in mortgage delinquencies by increasing our home retention consulting staff by 50 percent. When the mortgage meltdown hit with full force later that year, we increased staff by another 35 percent and were the first in the industry to adopt an aggressive and comprehensive loan modification program. Our program reengineers lower mortgage payments that are both: (A) affordable for the homeowner; and (B) will return greater cash flow to investors than the net proceeds that would otherwise be realized in a foreclosure.

Loan modifications crafted in this way are consistent with our contractual obligations and result in a win-win-win solution for all involved. The homeowner keeps their home; the investor avoids a substantial loss; and the loan servicer retains the loan in the servicing portfolio. Since the inception of the crisis, we have saved over 90,000 homes from foreclosure. And for investors, according to an industry study by Credit Suisse, Ocwen's loan modification program generates the highest cash flows by any servicer on 90-plus day delinquent loans, an amount that is twice the industry average.

If loan modifications are to have an enduring impact, the reduced mortgage payments must be sustainable by the homeowners. The salient measure of success, therefore, is the redefault rate, i.e., the percentage of loans that go into default after modification. We are pleased to report that loan modifications engineered by Ocwen have a redefault rate of 19.4 percent compared to an industry average of 42.9 percent, according to the most recent report issued by the OCC and the OTS.

The superior sustainability of Ocwen's loan modifications is the result of our customized approach that addresses homeowners' delinquencies on a loan-by-loan basis. By combining our proprietary loan analytics technology with behavioral science research, we first comprehensively re-underwrite each delinquent loan we service, i.e., the way it should have been done with the broker or the lender at origination. Second, we determine whether modification is both affordable by the homeowner on a sustainable basis and maximizes the net present value for the loan owner as compared to a foreclosure. And, third, we provide one-on-one financial counseling to the homeowner aided by interactive scripting engines to maximize the likelihood of their keeping current on the modified loan.

Another key to sustainability is principal reductions where necessary to achieve affordability: 18.7 percent of our loan modifications include writing down of the loan balance. This allows us to help more distressed homeowners with solutions. As reported by Credit Suisse, Ocwen leads the industry with 70 percent of the industry's principal reduction modifications.

Early intervention is critical to foreclosure prevention. Prevailing industry standards, as confirmed by the American Securitization Forum, make it clear that it is permissible to modify loans not only when the borrower is actually in default but also when default is imminent or reasonably foreseeable in the good faith judgment of the servicer. Adopting this standard, our early intervention unit has successfully avoided upwards of 9,000 foreclosures through proactive modifications.

If a loan modification program is to have a material impact to redress the national foreclosure crisis, it must be scalable. Ocwen has invested over $100 million in R&D in building an automated large-scale platform that incorporates artificial intelligence, decisioning models, and scripting engines. This robust technology allows us to take on many multiples of the volume of delinquencies we have already cured in our portfolio.

I would be remiss if I did not recognize the critical assistance provided to us by our nonprofit consumer advocacy partners. When, for whatever reason, a homeowner in distress does not respond to our letters or phone calls, we are unable to help them. Through grassroots outreach and educational initiatives, community groups, such as the National Training Information Center, Home Free U.S.A., National Fair Housing Alliance, National Association of Neighborhoods, National Council of LaRaza, St. Ambrose Housing Aid Center, and so many others, have greatly assisted us in making that key communication link with our customers. We have also recently established a relationship with National Community Reinvestment Coalition to broaden our homeowner outreach, and we will continue to support the foreclosure prevention efforts of the HOPE NOW Alliance.

[The prepared statement of Mr. Erbey can be found on page 70 of the appendix.]

Chairwoman WATERS. Thank you very much.

I must move on to Ms. Mary Coffin, executive vice president of Wells Fargo Home Mortgage Servicing.

STATEMENT OF MARY COFFIN, EXECUTIVE VICE PRESIDENT, WELLS FARGO HOME MORTGAGE SERVICING

Ms. COFFIN. Chairwoman Waters, Ranking Member Capito, and members of the subcommittee, I am Mary Coffin, head of Wells Fargo Mortgage Servicing.

Throughout this crisis, the mortgage industry and the government have collaborated on ways to reduce foreclosures and stabilize the economy. The homeowner affordability and stability plan is yet another positive step in addressing these challenges. As further details of the plan are defined, we fully support striking the delicate balance between providing aggressive solutions for those in need and guarding against moral hazard.

Last year, we made it possible for half-a-million families to purchase a home, and we refinanced another half-a-million families into lower mortgage payments. At the end of 2008, for 8 million mortgage customers Wells Fargo services, 93 of every 100 were current on their mortgage payments; and for the 7 who were not, we have worked hard at keeping them in their homes. Since our servicing is predominantly held by other investors, this has required gaining consensus to honor our contracts.

Over the past year-and-a-half, we have delivered more than 706,000 foreclosure prevention solutions. We work with all of our customers, including those who are not in default, to determine if they qualify for a modification. They simply need to prove they have experienced a hardship that significantly changed their income and/or expenses. When we do modify a loan, about 7 of every 10 customers remain current or less than 90 days past due 1 year later. We connect with 94 percent of our customers who have 2 or more payments past due. To be responsive to requests for help, we have more than doubled our staff to 8,000 default team members, all U.S.-based.

These times are unprecedented, and we certainly are not perfect, but we do our best. And we thank you for taking your personal time to reach out to us when our servicer does not meet the standards we have set so that we can immediately work to correct the situation.

When the foreclosure crisis began 2½ years ago, the first customers challenged were those with subprime ARM loans. To address their needs, streamlined processes to modify these loans into fixed products were created. But, clearly, as the housing and economic crisis has compounded, servicers have needed to go deeper with modification tools to provide sustainable solutions. In the fourth quarter of 2008, we provided 165,000 solutions, including term extensions, interest rate reductions, and/or principal forgiveness. Also, given the unique nature of the Wachovia option ARM loans, we used more aggressive solutions through a combination of means, including permanent principal reduction in geographies with substantial property declines. In total, 478,000 customers will have access to this program if they need it.

As the number of customers in need rises, Wells Fargo has advocated the creation of a standardized modification process that is aligned across all investors. The one described in the Administration's plan will significantly improve our ability to serve more customers and to set appropriate consumer expectations for a modification. According to third quarter 2008 FHA statistics, 56 percent of the Nation's 55 million mortgage loans are owned by Fannie and Freddie who are already aligned with this process. But more critical are the 16 percent held by private investors, which represent 62 percent of the serious delinquent mortgage loans.

In the modifications we do today, loan terms are adjusted to achieve at least a 38 percent affordability target. By bringing borrowers to a 31 percent target as defined in the Administration's plan, we further increase the odds they can better manage their overall debt, thereby lessening the likelihood of redefault.

Even though the details are not finalized, Wells Fargo has already begun to operationalize the standard modification program. We stood ready to assist our customers with information immediately following the President's announcement and our analysis to find those who may qualify is underway. We also will continue to stress the importance for FHA to be granted the authority to expand the 601 program to allow the assignment of mortgages to FHA and the payment of claims upon modification. We also support the recommended changes to HOPE for Homeowners.

When asked what makes it difficult for us to help more borrowers, it is simply that their challenges are complex. Income disruption is at the root of the issue with many customers who are in variable or commissioned income situations that began destabilizing in the early part of the crisis, and the full impact of unemployment or underemployment is still unknown. While there are many tragic hardship cases, there are also people who got caught up in the excess of the growing economy and the real estate values who can no longer sustain the lifestyles to which they have become accustomed. No loan modification alone can solve this dilemma. In certain circumstances, counseling which considers full debt restructuring is required.

In conclusion, we look forward to continuing to work with you on ways to turn the housing and mortgage industry around, and we will assist in any way possible to advance the issues we have addressed today.

Thank you for your time.

[The prepared statement of Ms. Coffin can be found on page 67 of the appendix.]

Chairwoman WATERS. Thank you very much.

Our next witness is someone who has been here more than once, Mr. Michael Gross, manager and director for loss mitigation, Bank of America.

What do you have new to tell us today, Mr. Gross?

STATEMENT OF MICHAEL GROSS, MANAGING DIRECTOR, LOAN ADMINISTRATION LOSS MITIGATION, BANK OF AMERICA

Mr. GROSS. Madam Chairwoman, and Ranking Member Capito, I must confess, it is a pleasure to be here before you again.

Chairwoman WATERS. I bet.

Mr. GROSS. Good afternoon, and thank you for the opportunity to appear again to update you on our efforts to help families stay in their homes.

As the country's leading mortgage lender and servicer, Bank of America fully appreciates its role in helping homeowners through these difficult times. We want to ensure that any homeowner who has sufficient income and the intent to maintain homeownership will be assisted using any and all tools we have available.

Bank of America applauds the Obama Administration's Homeowner Affordability and Stability Plan's focus on assisting financially distressed homeowners with their mortgage payments using their refinancing and loan modification program. Ken Lewis, our chairman, has assessed the plan as very thoughtfully constructed, and believes it has a very good chance to make a significant and positive impact on today's crisis. We strongly support the Administration's focus on affordability in the loan modification processes in order to achieve long-term mortgage sustainability for homeowners. Bank of America recently announced a moratorium on foreclosure sales that is in effect until receipt of guidelines for implementing the President's plan. Simply put, we want to have every opportunity to help eligible homeowners who can be assisted by these new initiatives. We have already begun working with the Administration to develop guidelines for the implementation of the Homeowner Affordability and Stability Plan modification and refinance initiatives in order to ensure its success.

The Administration's focus on affordability and sustainability is consistent with the approach that we have implemented which has led to more than 230,000 loan modifications for our customers in 2008 and 39,000 customers in January 2009 alone. In 2008, Bank of America committed to offer loan modifications to as many as 630,000 customers over the next 3 years to help them stay in their homes, representing more than $100 billion in mortgage financing.

I would also like to provide a brief update on our mortgage business. We strongly believe that long-term recovery in the economy and housing markets relies upon lenders' responsibility and effectively providing loans to credit-worthy borrowers. In April, we will unveil our new Bank of America home loans brand. This launch will confirm our longstanding pledge to be a responsible lender and to help our customers achieve successful sustainable home ownership.

Importantly, I want to emphasize that we are very much open for business and making new loans. In January, we produced $21.9 billion in new mortgages. We are now routinely publishing public updates on the Internet regarding our lending activity.

Since I last appeared before Congress, Bank of America launched the Homeownership Retention Program. The program, launched in December, is designed to achieve affordable and sustainable mortgage payments for borrowers who financed their homes with subprime or pay-option adjustable-rate mortgages serviced and originated by Countrywide prior to December 31, 2007.

The centerpiece of the program is a streamlined loan modification process designed to provide relief to eligible subprime and pay-option ARM customers who are seriously delinquent or at the risk of imminent default as the result of loan features, such as rate resets or payment recasts. The program's goal is the same as the President's: to reduce monthly mortgage payments to affordable and sustainable levels.

I would also like to update the committee on additional progress we have made to date on our entire home retention operations. Since early last year, the home retention staff for Bank of America has more than doubled to nearly 6,000 staff members. We also are continuously improving the training and quality of the professionals dedicated to home retention.

As we have learned through experience, early and open communication with customers is the most critical step in helping prevent foreclosures. In 2008, we participated in more than 350 home retention outreach events across the country. We are also proactively reaching out to customers by making more than 10 attempts per month to contact delinquent homeowners. In January alone, we placed nearly 12 million outbound calls.

In addition to sharply increasing the pace of workouts, we have been more aggressive in the types of workout plans completed. Loan modifications are now the predominant form of workout assistants. In 2008, loan modifications accounted for nearly 75 percent of all loan modification plans. Of these loans, interest rate modifications accounted for approximately 80 percent of all of the loan modifications.

I want to thank you for the opportunity to describe our ongoing home retention efforts. We recognize there is still much more to be done, and we look forward to working with Congress and the Administration.

Thank you.

[The prepared statement of Mr. Gross can be found on page 111 of the appendix.]

Chairwoman WATERS. Thank you very much.

Ms. Molly Sheehan, senior vice president, Chase Home Lending, JP Mortgage Chase.

STATEMENT OF MARGUERITE SHEEHAN, SENIOR VICE PRESIDENT, CHASE HOME LENDING, JPMORGAN CHASE

Ms. SHEEHAN. Chairwoman Waters, Ranking Member Capito, and members of the Subcommittee on Housing and Community Opportunity, we appreciate the opportunity to appear before you today on this most important topic of helping homeowners.

My name is Molly Sheehan. I work for the home lending division of JPMorgan Chase in housing policy.

Chase is one of the largest residential mortgage servicers in the United States, serving more than 10 million customers located in every State of the country with mortgage and home equity loans totaling about $1.4 trillion. Chase is also one of the largest residential mortgage lenders, and we continue to make mortgage credit available even in these difficult times. We provide loans directly to consumers, and we purchase loans from smaller lenders so that they can lend to their customers. In 2008, Chase originated or purchased more than $105 billion in mortgage loans, even as mortgage applications declined significantly.

At Chase, we are not only continuing to lend; we are also doing everything we can to help families meet their mortgage obligations and keep them in their homes. We believe it is in the best interest of both the homeowner and the mortgage holder to take corrective actions as early as possible, in some cases even before default occurs. We apply our foreclosure prevention initiatives to both the $325 billion of loans that we own and service, and the $1.1 trillion of investor-owned loans that we service.

We expect to help avert 650,000 foreclosures, for a total of $110 billion worth of loans, by the end of 2010. We have already helped prevent more than 330,000 foreclosures, including modifying loan terms to achieve what we expect to be long-term sustainable mortgage payments. We are well underway to implementing the commitments we made in announcing our expanded foreclosure prevention plan last October. We have commenced mailing proactive modification offers to borrowers of Chase-owned option ARM loans at imminent risk of default. We have selected sites for 24 Chase homeownership centers in areas with high mortgage delinquencies where counselors can work face-to-face with struggling homeowners. We will have 13 of these centers in California and Florida open and serving borrowers by the end of this week. The other 11 around the country will be open by the end of next month.

We have added significantly to our staff, and we continue to add more capacity in our operations to help struggling homeowners. We initiated an independent review process to ensure each borrower is contacted properly and offered modification prior to foreclosure as appropriate. We have developed a robust financial modeling tool to analyze and compare the net present value of a home foreclosure to the net present value of a proposed loan modification, which allows us to modify loans proactively while still meeting contractual obligations to our investors.

We believe programs like ours are the right approach for the consumer, all consumers, and for the stability of our financial system as a whole. We support the Administration's proposal to adopt the uniform national standard for such programs and to encourage all sensible modification efforts short of bankruptcy as much as possible.

As our CEO commented last week, we believe the Homeowner Affordability and Stability Plan announced by President Obama is good and strong, comprehensive and thoughtful. We think it will be successful in modifying mortgages in a way that is good for homeowners. Most particularly we applaud the fact that the plan focuses on making monthly payments affordable; will create a national standard and create fair and consistent treatment across the industry; and the standard will include verification of income and expense. We also applaud the partnership with government to reduce interest rates and payments for borrowers and the expanded ability of borrowers to take advantage of today's lower rates through refinancing. We look forward to working with the Administration, Congress, and others as we work forward on this plan.

As we advised Chairman Frank and the members of the House Financial Services Committee on February 12th, we have stopped adding loans owned by Chase into the foreclosure process as the Administration's plan is being developed.

Thank you.

[The prepared statement of Ms. Sheehan can be found on page 152 of the appendix.]

Chairwoman WATERS. Thank you very much.

Mr. Steve Hemperly, executive vice president, real estate default servicing, CitiMortgage.

STATEMENT OF STEVEN D. HEMPERLY, EXECUTIVE VICE PRESIDENT, REAL ESTATE DEFAULT SERVICING, CITIMORTGAGE, INC.

Mr. HEMPERLY. Chairwoman Waters, Ranking Member Capito, and members of the subcommittee, thank you for the chance to appear before you today to discuss Citi's loan modification efforts. My name is Steve Hemperly, and I am the executive vice president for CitiMortgage Real Estate Default Servicing.

Citi services approximately 7 percent of the loans in the United States. In this enormous difficult housing market, Citi has moved aggressively to help distressed borrowers. We have a high degree of success in keeping borrowers in their homes when we are able to make contact with them and they want to remain there.

Citi specifically focuses on finding long-term solutions for borrowers in need. In support of this, a key loss mitigation tool is loan modification. A modification agreement is typically used when a customer has a significant reduction of income that impacts his or her ability to pay and lasts beyond the foreseeable future. This agreement makes the mortgage more affordable for the customer. We have found modifications to be effective in helping borrowers manage through difficult times and avoid foreclosure.

Citi has a specially trained servicing unit that works with at-risk homeowners to find solutions short of foreclosure and tries to ensure that, wherever possible, no borrower loses his or her home. Citi continuously evaluates each of its portfolios to identify those customers who can save money and reduce monthly payments and offers them timely loss mitigation solutions. We also provide free credit counseling, make loss mitigation staff available to borrowers or counseling organizations, and provide work-out arrangements and other options.

In keeping with our commitment to help borrowers stay in their homes, we are implementing the FDIC streamline modification program for loans that we own where the borrowers are at least 60 days delinquent or where the long-term modification is appropriate even if the borrower is not yet delinquent.

In November of 2008, we announced the Citi Homeowner Assistance Program for families in areas of economic distress and sharply declining home values. For those borrowers who may be at risk although still current on the mortgages, we are deploying a variety of means to help them remain current on the mortgages and in their homes.

Citi's foreclosure prevention activities have good resolution rates for distressed borrowers whom we are able to reach. For example, for those going through the foreclosure process with whom we are in contact, we are able to help approximately 70 percent of them. However, we are not able to reach every one, and in those circumstances, there are limits to what we can do.

To better meet the increased needs of the struggling borrowers we service regardless of delinquency status, we have dedicated significant resources to our loss mitigation area. We have stepped up our loss mitigation staffing by almost 3 times from last year, since last year's staffing levels, and we will be providing additional training to all of our staff.

Additionally, as promised by our CEO, Vikram Pandit, to the House Financial Services Committee on February is 11th, Citi initiated a foreclosure moratorium on all Citi-owned first mortgages that are the principal residence of the customer as well as all loans Citi services where we have reached an understanding with the investor. The moratorium became effective February 12th and will continue until March 12th, before which time we expect finalized details on President Obama's loan modification program.

Citi will not initiate any new foreclosures or complete pending foreclosures on eligible customers during this time. This commitment builds upon our existing foreclosure moratorium for eligible borrowers who work with us in good faith to remain in their primary residence and have sufficient income to make affordable mortgage payments.

In order for policy makers, regulators, consumers, and market participants to better understand the extent of the current situation and our efforts to ameliorate it, we think it is important to share what we know. To assist in this effort, for the past four quarters, we have produced and publicly released our mortgage servicing report, which provides specific detail on our originations, delinquency trends, ARM resets, loss mitigation efforts, loan modification, foreclosures in process, and new foreclosures initiated. Our soon-to-be-released fourth quarter report will also include detailed information on our modification redefault rates for the first time.

Our report will show that distressed borrowers serviced by Citi who received modifications, reinstatements or repayment plans outnumbered those who were foreclosed on by more than six to one in the fourth quarter. The number of borrowers who were serviced by Citi who received long-term modifications in that quarter increased by approximately 51 percent as compared with the third quarter.

Our redefault rates, meaning the percentage of borrowers who have become 60-plus or 90-plus days past due at a given period of time after the loans are modified, do not exceed 23 percent for loans modified over the past year. For example, of the loans modified in the second quarter of 2008. Only 14 percent were 90-plus days past due 6 months after the modification. The fact that these borrowers are delinquent does not mean that will result in foreclosure. In fact, we will continue to work with those borrowers to make sure that we are able to find some kind of a long-term solution to keep them in their homes.

I want to assure the committee that we share your interest in helping homeowners, and we strongly support this committee's leadership in foreclosure prevention and its tireless efforts to solve the housing crisis.

Thank you, I will be happy to answer any of your questions.

[The prepared statement of Mr. Hemperly can be found on page 120 of the appendix.]

Chairwoman WATERS. Thank you very much.

I would like to start with Mr. Erbey.

Mr. Erbey, you are an independent loan modification—a servicer, servicer, I am sorry. Who do you contract with? Who do you do business with?

Mr. ERBEY. Our customers are the securitization—

Chairwoman WATERS. I can't hear you.

Mr. ERBEY. Our customers are the securitization trust. When Wall Street put together securities, they would contract with servicers to service those loans. That was our main line of business.

Chairwoman WATERS. And how do the customers who are in trouble find you?

Mr. ERBEY. We are a servicer much like the other bank-owned servicers. In other words, we send out bills and statements. We have call centers. We are not affiliated with the bank, and we do not originate mortgages, but we actually, whenever you take over a portfolio, you send out hello letters and you call the people up and verify the information with regard to that. So there is extensive contact with our customer base much like any other servicer would have.

Chairwoman WATERS. Have you found any claims of fraud by complaining mortgage holders that they were tricked, they were misled, that they did not sign certain documents, that they did not falsify, but it was done by a loan initiator?

Mr. ERBEY. Yes.

Chairwoman WATERS. And what do you do?

Mr. ERBEY. We try to basically, in all those cases, we try to basically re-underwrite that loan specifically to the person's ability to pay that for that loan and to get them on to a modification plan that is sustainable and get them going in a stabilized situation going forward.

Chairwoman WATERS. We don't have anything in the system to go after those loan initiators who appear to be guilty of some kind of fraudulent operation, do we?

Mr. ERBEY. Unfortunately, we do not.

Chairwoman WATERS. Do you think that is needed?

Mr. ERBEY. Yes, I certainly do.

Chairwoman WATERS. I appreciate that, thank you.

Ms. Coffin, I thank you for being here today. You know of my experience with Wells Fargo. And I am appreciative for your CEO who sent us a letter apologizing for any inconveniences, saying this is not typical of the way your servicing operation works.

Now let me understand that the Wells Fargo home mortgage servicing is separate from the bank; this is a separate institution or business, is that right?

Ms. COFFIN. Well, we are part of Wells Fargo.

Chairwoman WATERS. I cannot hear you.

Ms. COFFIN. Is the microphone on?

Chairwoman WATERS. Pull it closer.

Ms. COFFIN. We are definitely a part of Wells Fargo bank, so any customer who is in need of our services can either call our centers, can walk into any of our branches, can look through our Web sites. We are very connected with the banks.

Chairwoman WATERS. So you are only servicing Wells Fargo loans, is that right?

Ms. COFFIN. No, that is not correct.

Chairwoman WATERS. What other loans do you service?

Ms. COFFIN. We also service loans under ASE, which stands for America's Servicing Company, or to the loans, just like the gentleman from Ocwen just mentioned—

Chairwoman WATERS. So you have contracts with investors also.

Ms. COFFIN. Right.

Chairwoman WATERS. The contracts you have with the investors, do they have clauses that prevent you from doing loan modifications? Do they set that out in the contracts with you that you sign sometimes?

Ms. COFFIN. There are a few.

Chairwoman WATERS. What percentage?

Ms. COFFIN. A very small percentage.

Chairwoman WATERS. I have run across this where I am told, sorry, there is nothing we can do, because we signed a contract with this investor where we said we would not use loan modifications as a way of servicing the customers.

Ms. COFFIN. When we do have those contracts today, in the current environment that we are operating under, we still reach out to those issuers and ask, based upon the net present value that we have calculated, if they would like us to do the modification.

Chairwoman WATERS. How many say, go ahead and do it?

Ms. COFFIN. Some do, and some don't.

Chairwoman WATERS. What do you think we should do about that? Should we support those kinds of contracts that will not give the servicer the opportunity to do a reasonable, credible loan modification?

Ms. COFFIN. As I stated in my testimony, what I think is most important right now is the Administration's plan that provides a standardized modification program that all investors should follow.

Chairwoman WATERS. All right.

Now have you reduced the wait time on customers calling in to get some help? I waited over an hour or more. You know, that is a deterrent To people trying to get loan modifications.

Ms. COFFIN. I do understand.

Chairwoman WATERS. Have you increased the employment, so that you have more servicers?

Ms. COFFIN. Yes, we are. We continuing to hire all the time because of what is before us. And we strive for an 80 percent, which means within 3 to 4 rings, we hope to answer 80 percent of our calls, at all times, every day of the week.

Chairwoman WATERS. Who trains your servicers?

Ms. COFFIN. We do.

Chairwoman WATERS. There is no licensing of servicers. This is kind of an unregulated part of the industry. Is that right?

Ms. COFFIN. That is correct. We train them in-house.

Chairwoman WATERS. Describe their training. Do they train for 1 month, 2 months, a year? What kind of training do you give them?

Ms. COFFIN. 6 to 8 weeks, and what we normally do—

Chairwoman WATERS. What kind of background do they have to have?

Ms. COFFIN. In our default shop, it is a collections background. What we are looking for is people who have understood how to solve problems for people who are stressed, who are in these type of situations with affordability issues. When we bring them first on and they are trained, we do a buddy system. We make sure that they are sitting—

Chairwoman WATERS. What is a typical job they would have had prior to coming to your businesses?

Ms. COFFIN. A collections job or loss mitigation, which is people who help borrowers through modifying the terms of their loan.

Chairwoman WATERS. Any particular education?

Ms. COFFIN. No.

Chairwoman WATERS. Any particular requirement that they would have worked in a bank or worked with loans, mortgages?

Ms. COFFIN. What is most important to us is what we train them on in—

Chairwoman WATERS. Yes, but that is not the question I asked you. I am asking about qualifications. I am trying to determine how you select and identify these people that you train for 6 to 8 weeks. Do they have to have any background in finance or in working with mortgages or anything like that?

Ms. COFFIN. We will always look for people with a background in finance.

Chairwoman WATERS. But they don't have to have one, is that right?

Ms. COFFIN. No.

Chairwoman WATERS. So you are training people who may come from almost anywhere for 6 to 8 weeks. Do you think they are able to take every aspect of this mortgage and make decisions about whether or not or what kinds of loan modifications? They have a lot of flexibility there.

Ms. COFFIN. We normally don't bring people straight in as we hire them and bring them straight into a loss mitigation area of our operation. What we will often do is bring them in, train them, put them in a buddy system, which means they will first answer what we call the easier questions, and what we do is continually move our well-trained people who now have had months, sometimes years, of experience and continue to move them to our area which takes more skill and is more complicated, which is actually working through the loan modifications.

Chairwoman WATERS. Thank you.

Mr. Gross, we have talked about this before, and you know, it is a particular little problem with me. Your loss mitigation, you still have some offshore?

Mr. GROSS. Yes, we do.

Chairwoman WATERS. Why?

Mr. GROSS. Because we find that the job responsibilities that we have assigned to that staff, which is primarily customer-service oriented, answering questions that homeowners may—

Chairwoman WATERS. Give us an example of where these offshore operation are? India?

Mr. GROSS. In India and Costa Rica.

Chairwoman WATERS. In India, we have people who are helping Americans who are in trouble who understand the system and what we are doing and are able to make decisions?

Mr. GROSS. No, that is not what I said. The people in India will receive calls from homeowners who are typically—the homeowner is calling in to make a promise to pay or to say a date specific on when a payment will be received. If they say, I am not able to make this payment this month and I am going to need long-term help, that call is immediately transferred back to State-side and will be worked by one of our State-side loss mitigation staff members.

Chairwoman WATERS. Well, what if I said to you, if you are going to get TARP money, you have to hire people in this country to do loss mitigation? Would you agree with that, since we are trying to create jobs?

Why are you smiling?

Mr. GROSS. That was probably more of a grimace. I understand the question, but that is really outside my frame of reference.

Chairwoman WATERS. No, you have been here long enough to know that you were going to get this question from me. You always do. And I am sure you anticipated it.

Mr. GROSS. The—

Chairwoman WATERS. It seems to me you would have come here today and said: You know, we appreciate the American citizens having given us so much money. We are coming back to ask you for more. We are going to take all of our offshore operations and bring them home and create jobs for the taxpayers who are underwriting us. Well, I have said that.

The other thing about Bank of America, you talk about this home retention program. I discovered in doing loan modification implementation work with my constituents that you have several departments. Have you merged them all, or do I need to go through with you the different ways you can end up in several different departments at Bank of America when you are trying to get help?

Mr. GROSS. They have not yet been merged, but we are actively working on our phone systems to make sure that when you call in or a homeowner calls in, that they are immediately connected with the appropriate individuals.

Chairwoman WATERS. Well, how long is that going to take you? This has been going on for an awfully long time. If you call in and you say, I am late on my payment, you go one place. If you call in and say, I am not late on my payment, but I went to talk to somebody so I don't get in default, you go another place. If you call in and you say, I have a loan modification, but I may reach a default on it, you go to another place. So what is this home retention consolidation that you have when you still have all of these different departments that you send people to.

Mr. GROSS. The process that you described, when a homeowner calls in and they are current on their mortgage, they are automatically routed to our customer service environment, since the vast majority of those calls do not deal with delinquent payments; they deal with other questions.

So when a homeowner calls in and reaches the customer service staff and says, I am not going to be able to make a future payment, and they need in-depth assistance, then that call will then be transferred to the home retention department, and that staff member will then work with that current homeowner on what their issues are. That process I do not envision changing.

Chairwoman WATERS. Well, let me just say this, the system that you use is confusing to constituents. I was on the phone with Bank of America for hours, and your people sent me all over the country to different departments. And nobody seemed to understand what I was asking.

And if you have something called home retention, it seems to me it would be consolidated so that when someone called, they would not be transferred around to several different departments and that the people who were directing them to supposedly the correct department would know exactly what to do.

So would you consider it fair for us to say to the President, you must do something to force the Bank of America to have a consolidated effort to help homeowners in trouble before they get any more TARP money?

Mr. GROSS. I am not prepared to comment on the TARP funds.

What I will commit to is that within a very short period of time, we will deliver back to the committee an in-depth description of what we do and how we do it, so that you have a complete written understanding of our processes.

Chairwoman WATERS. Thank you very much.

Ms. Sheehan, you—well, before I leave Mr. Gross, are you doing all of Countrywide's loan modifications?

Mr. GROSS. Yes, we are. There is still the Countrywide mortgage servicing operation that in April will be changing over to the Bank of America name.

Chairwoman WATERS. But right now, Countrywide is still doing some of its own servicing, is that right?

Mr. GROSS. They are, yes.

Chairwoman WATERS. Okay, and Ms. Sheehan, you also contract with other entities to do their servicing, is that correct?

Ms. SHEEHAN. Yes, we do service our own loans as well as loans for third parties, including Fannie and Freddie.

Chairwoman WATERS. Would you give me an example of those third parties?

Ms. SHEEHAN. Well, it is Ginnie Mae for FHA loans, obviously for our GSE loans, which the bulk of the portfolio is Fannie and Freddie. And then there are other private investors for whom we service—

Chairwoman WATERS. So GSEs, Fannie and Freddie, are not doing their own?

Ms. SHEEHAN. No, we do the servicing for them. They are the investor in the loan.

Chairwoman WATERS. Okay, all right.

Mr. Hemperly, do you do servicing for anyone else other than Citigroup?

Mr. HEMPERLY. We do. Our answer is very similar to Ms. Sheehan's that she gave for Chase. We do a substantial amount of servicing for GSEs, Fannie and Freddie, in addition to loans we service for the FHA and also our loans that we hold on balance sheet.

Chairwoman WATERS. My last question is, for those of you who do loan initiation and then sell those mortgages to Fannie and Freddie, you do the loan initiation, you sell it to Fannie or Freddie, then they give it back to you to do the servicing?

Mr. HEMPERLY. Yes. We originate the loan. We deliver it to Fannie or Freddie, and we bore the loan on to our servicing system. So the loan is actually what we call servicing retained by us, and then we are responsible for all the servicing activities that occur on those loans.

Chairwoman WATERS. Fine, we need to take a look at that.

And I would like to thank my members for indulging me. I appreciate it so much.

Ms. Capito.

Mrs. CAPITO. Thank you, Madam Chairwoman.

Mr. Erbey, in your testimony, you mentioned that in your modifications, that you did a write down of the loan balances. Does that mean you write down the principal in some?

Mr. ERBEY. On 18.7 percent, yes.

Mrs. CAPITO. 18.7 percent of your loan modifications you are writing down the—

Mr. ERBEY. The principal.

Mrs. CAPITO. Does anybody else here in their loan modifications write down the principal?

Mr. HEMPERLY. We write down principal on occasion, not 18.7 percent of the time, though.

Mrs. CAPITO. Like how many?

Mr. HEMPERLY. It is a minority of the time. I don't have the percentages. It I think is probably less than 1 percent of the time.

Mrs. CAPITO. Mr. Gross, you said you do?

Mr. GROSS. Yes, it is on a small amount, and if I could expand on that answer. We are contractually bound in most cases to present the investor for whom we service the loans the best return or smallest loss that we can. And in most cases, we can achieve a smaller loss or better return to the investor by doing an interest rate reduction, having an affordable and sustainable payment for the homeowner without having the principal reduction.

Mrs. CAPITO. I understand that, but you were looking at a program here in the next—first of all, let me ask another question. Of all of you all on the panel, who has used or worked with the HOPE for Homeowners Program?

Ms. COFFIN. We have.

Mrs. CAPITO. And how has that worked?

Ms. COFFIN. We have set up a separate segmented group who were fully educated on the HOPE for Homeowners program. We dedicated and analyzed our portfolios to look for those borrowers who looked like they were eligible. We proactively reached out with letter campaigns and calls to those borrowers, and then we began the screening process to find those borrowers who would actually be eligible. Unfortunately, we found very few under the current requirements of HOPE for Homeowners who met the standards.

Mrs. CAPITO. My understanding is when you came, I am generalizing here, institutions have come before this committee before, showing great hope for the HOPE for Homeowners products as a way to help people who are in trouble. And it hasn't turned out that way, and that is deeply troubling to all of us here.

I think part of it, and correct me if I am wrong, is part of it the write-down on the balance has prevented, maybe contractually, but otherwise because it is considered financially to your disadvantage to go this direction, so now the President's program is going to incent your institutions to do what Mr. Erbey's does 18 percent of the time? Am I interpreting the new program correctly?

Mr. HEMPERLY. The new program, as I understand it relative to loan modifications, is not going to be very different from the program that we are headed towards currently with our commitments to the FDIC modification program. The FDIC program is essentially an affordability-based model, which is not terribly different than what we have done in the past. So we are headed down that path where we are going to try to get customers with affordable payments and they prove to us how much they make, and then, as a percentage of that, 31 percent, as a housing ratio, we give them an affordable payment to keep them in their home. That program is not terribly different at all from what we have done historically, and our redefault rates, we believe, are quite good.

Mrs. CAPITO. And on the FDIC program, is there a fee when you write down principal?

Mr. HEMPERLY. No, there is not a fee.

Mrs. CAPITO. I mean, a reward payment of $1,000; I believe that is the program we are looking at.

Mr. HEMPERLY. Well, on the Administration's program, my understanding is that there is an incentive fee to the servicers for booking loan modifications.

The FDIC program is basically going to be for, our commitments there are for balance sheet held assets. There is no fee that we will collect under our current commitment to that program. The benefit that we get is, hopefully, we will get the kind of performance through that program that we have seen on our redefault rates that I shared in my testimony, that we believe keeping homeowners in their home is great for communities, and also we believe that it is the best way to minimize our own losses.

Mrs. CAPITO. Let me ask you just a question out of the air, it just kind of hit me. You are talking to people every day who have mortgages who either are in trouble, anticipating being in trouble, and I am sure you are talking to your folks who are scrimping, saving, paying those mortgages everyday, are you hearing anything about what we are hearing in some fashion, is this fair? Is there a fairness quotient here? And I don't know if I am asking too much of an opinion here, but I would like to see if you have one on that and if you are hearing from your customers on that, who obviously are not going to qualify for any of these loan modification categories.

Mr. GROSS. I would say, yes, that we do hear this from our customers, the questions about the fairness issue.

On the flip side of that coin, we hear from the same customers regarding the trauma that is caused in their communities and in their neighborhoods with the foreclosure events. And ours is a balancing act to try and make sure that we are as fair to all parties as we can possibly be.

Mrs. CAPITO. Does anybody have—

Ms. SHEEHAN. I would say, we have had a similar experience in terms of hearing from current customers, but I also agree with Michael that we need to be focused on customers and communities. And I think we are concerned, all of us are concerned, about the impact of the foreclosed property destabilizing neighborhoods.

Mrs. CAPITO. I share that concern as well. I think, and it is, as Mr. Gross said, it is a balancing act. It is difficult for the homeowner on the verge. It is difficult for the neighborhood. It is difficult for the family. And so we are trying to weave a solution here, and I appreciate you all coming here and testifying.

Thank you very much.

Chairwoman WATERS. Thank you very much.

Mr. Cleaver.

Mr. CLEAVER. Thank you, Madam Chairwoman.

I would like to follow up on the Chair's questioning.

If I could start with you, Mr. Erbey, and move down, do all of you have operations offshore?

Mr. ERBEY. Yes.

Ms. COFFIN. No, not for customer-facing.

Mr. GROSS. Yes.

Ms. SHEEHAN. Not for customer-facing and loss mitigation.

Mr. HEMPERLY. We have offshore operations, but we do not do any loss mitigation work offshore.

Mr. CLEAVER. I don't know if you realize how utterly disgusted the voters are with that. And it is ineffable, but I have to just say, it really creates a problem.

Do you save money? Is this what the goal is?

Ms. COFFIN. I will make a comment to this. Wells Fargo has always been very strong about creating American jobs. The place that we do have offshore is in some of the technological areas where we could not find the appropriate number of people to help us with some of the automation of our systems.

Mr. CLEAVER. Like the dumb Americans couldn't—

Ms. COFFIN. No, sir. Not at all.

Mr. CLEAVER. The stupid Americans?

Ms. COFFIN. No.

Mr. CLEAVER. I am not sure I understand.

Ms. COFFIN. It was a supply and demand.

Mr. CLEAVER. The demand was greater than the supply?

Ms. COFFIN. And we don't have it now, sir, but this was previously when there was a lot of infrastructure that we were rebuilding and looking for a lot of technological expertise, and everyone was in the demand for that at the same time. Many of our systems were all being retooled.

Mr. CLEAVER. So it is not a financial issue where you save money?

Ms. COFFIN. We do not use it for that.

Mr. CLEAVER. Is everybody else the same?

Mr. GROSS. If I could comment, the global operations for essentially the Countrywide service portfolio, this operation has been in existence for 3 to 4 years now, I believe. It might be a little bit longer. The size of the operation is actually a little bit smaller than it was a year ago. And in terms of staff that we have added during the subsequent period has all been added State-side.

Mr. CLEAVER. Okay.

Mr. GROSS. But, yes, the initial motivation when we opened these call centers a few years ago was based upon cost.

Mr. CLEAVER. Okay.

I am going to tell Lou Dobbs on you people.

But let me go back to the program as laid out by President Obama, the Administration, is herculean. What kind of beefing-up of the servicers will you need to accommodate this program? Has there been any look at the size of the staff that will be needed? I am thinking a part of this whole thing that we are doing is creating jobs. And I am wondering if jobs can be created also as we try to reduce this new burden on neighborhoods all over the country by hiring people to do the modifications. And obviously, based on what Chairwoman Maxine Waters is experiencing, there is a need for a larger staff. So has there been any time spent in trying to come up with an estimate on when the staffing needs will be?

Mr. GROSS. If I could, as far as what the staffing needs will be, will be somewhat difficult to determine until the final rules are published on March 4th, but I would also suggest to you that in the mortgage servicing loss mitigation process, this home retention process that we are all engaged in, under the President's plan, we should become much more efficient and effective than we are today because we are going to have a single standardized plan that we will be able to use across all different portfolios.

Right now, we have a modification plan for FHA, a different one for Fannie Mae, a different one for Freddie Mac, and a different one for privately-issued securities. So this standardization should enable us to process many more modifications and workouts using the same staff, hopefully in a much faster timeframe.

Mr. CLEAVER. Thank you, Madam Chairwoman.

Chairwoman WATERS. Mr. Marchant.

Mr. MARCHANT. My question is about the whole standardization of modification. It seems like Chase, have you gone to your biggest investors and gotten pre-authority to authorize, to do modifications, so that you don't have to handle it on a case-by-case basis?

Ms. SHEEHAN. We have spent a lot of time working with our investors to make sure that they understand the modifications options that we wanted to be able to make available. Two of our biggest investors are Fannie and Freddie. They have recently come out with a new streamlined modification program, very similar to what many of us offer for our own portfolio. That was sort of the first step towards standardization.

I do agree with Mary, though, that we still have situations, not that many, but we still have situations where individual, you know, pooling and servicing agreements may hamper our ability, and in those instances, we have to go out for permission on a case-by-case basis.

Mr. MARCHANT. And the way I read the President's proposal is that this will only affect the GSEs, and it well affect your private label investors, so it is going to force the private investors to accept these modifications. Mr. Erbey?

Mr. ERBEY. That is still an open issue that was being discussed this morning. In our portfolio, more than 90 percent, we have no limitations on modification at all. There is about say 5 percent that it is affected by, you have to get approval by the related agencies; another 5 percent that you have to get individual investor approval. But the issue becomes one of, in terms of the implementation of the plan, are you required to apply it across your entire portfolio? And if so, what impact does that have on the contractual obligations that you have, no matter how small they may be?

Mr. MARCHANT. So 90 percent of your investors or REMICs have already given you authority to modify?

Mr. ERBEY. The structures in our part of the market, they have migrated over time, so that the standard pretty much for any of the modern ones would be that it is the servicer's discretion to maximize that present value on the portfolio.

Mr. MARCHANT. So, in your case, you have more discretion. Do you service any portfolio loans that you own?

Mr. ERBEY. Nominal, I mean very, very insignificant to our balance sheet.

Mr. MARCHANT. Well, it sounds to me like the question is still, that I have about the modification process, is the hit of principal and whether you are allowed, whether in the new plan, the President's new plan, whether there will be a substantial write down in principal, or will all the modification be towards the 38, 31 percentages? Do you understand it could be a stepped process? You go to 38 first, you go to 31, then you go to the principal reduction? Is there any kind of a look-back provision if one of the spouses is unemployed, and then a year later, that spouse becomes re-employed, is there then a recertification at some point where that person will call and say, "I have a job now, I no longer need this 31 percent or 38 percent?" Is there a look-back, or is this a once-in-a-lifetime snapshot that will be taken?

Ms. COFFIN. There are, like Michael just spoke of, there are details of the program that still need to be completed. But there is—you don't do a look-back, that if somebody then gets back a job, you kind of unwind the modification—

Mr. MARCHANT. That is the way I read it.

Ms. COFFIN. We don't do that. But what we do in some cases is we may have to mod originally to a lower interest rate or other things to get to affordability, but then you can step that rate back up over a period of time.

Mr. MARCHANT. So in the proposed, another piece of legislation that has the cramdown in it, how much more success—under what kind of a situation then would you put a person in a situation where they would not go this route instead of going to a bankruptcy route and put them in a position where they would make the decision to go the bankruptcy cramdown route as opposed to trying to go this route?

Ms. COFFIN. I would only tell someone they should go to bankruptcy as a last resort. What I applaud that the Administration has done is the standard modification program that should hold all of us accountable and provides expectations that say, if a borrower who is at risk comes to us, we now have the standard modification program. If, for some reason, that borrower cannot find a solution through that, then their final resort may be to go to bankruptcy, and this same standard modification program should be applied.

Mr. MARCHANT. And this is an opinion question. Is a person who gets a modification at a greater risk of destroying long term their credit than a person who goes into bankruptcy?

Mr. GROSS. No, I think the modification approach is actually to the homeowners' benefit, that very quickly they will be showing current on their mortgage and that their credit score will improve dramatically. I think the bankruptcy option provides very serious negative implications for the homeowner on a long-term basis.

Mr. MARCHANT. So if you were trying to prevent there from being a generation of borrowers who are forever doomed to be subprime borrowers in a world where there are no more subprime loans, would you go—if you were the government trying to push somebody towards a direction, you would push them more towards a modification, extended amortization instead of towards an easier route.

Mr. GROSS. Absolutely, we would hope that whatever legislation is enacted would in fact require homeowners to seek these modifications and to, in fact, prove that the modification was not attainable before the bankruptcy reduction was allowed.

Mr. MARCHANT. Thank you.

Chairwoman WATERS. Mr. Green.

Mr. GREEN. Thank you, Madam Chairwoman.

Mr. Gross, let's continue with what you were just addressing, the cramdown. Is that something that can work in concert with what you are currently doing or, is it at odds with what you are doing?

Mr. GROSS. There are aspects of the current legislation which we find troubling. I would say that it can work as long as we put in sufficient safeguards that the homeowner works with their servicer and that the homeowner seeks available modifications before they do the bankruptcy cramdown route.

Mr. GREEN. Is it your understanding that the current proposal has that language in it?

Mr. GROSS. I believe that the current proposal, and I apologize, I am not an expert on this, but I believe that the current proposal does contain some reference to it. I don't think that the requirements in there are as strong as we would like. There are probably a few too many holes in there that would allow homeowners to seek the bankruptcy option with minimal resistance.

Mr. GREEN. If that aspect of it can be satisfied, would it then meet with your approval, "your," meaning your company's approval, not your personal approval?

Mr. GROSS. Thank you.

I think it would go a long way to that, because I think at that point what we would find is that we can effectively, especially under the President's new plan that we are all working on desperately right now to write the rules for or to assist in that effort, we want to have this new plan have a chance and to show the

American public and to you that we can perform under this new plan and that the bankruptcy cramdown provisions that are currently being contemplated largely should not be needed.

Mr. GREEN. Is your moratorium still in effect?

Mr. GROSS. It is.

Mr. GREEN. Let me just ask the other participants. Do you have a moratorium in effect? If so, would you kindly extend a hand into the air? Anyone. So we only have—and you would not have one, is that right Mr.—is it Erbey?

Mr. ERBEY. It is Erbey.

Mr. GREEN. You don't have one?

Mr. ERBEY. We don't have our own loans. Under the contracts that we have, we don't feel that we could have a moratorium.

Mr. GREEN. Let me pause for a moment and thank all of you for the moratorium. It is something that I think is going to be a benefit to your businesses as well as to the consumers, so I thank you for the moratorium.

How long will it stay in effect, Mr. Gross?

Mr. GROSS. It will stay in effect until the rules are published, which should be March 4th. From that point, what we would do is take the final rules, evaluate our portfolio to determine which homeowners who are at risk of foreclosure would in fact qualify, and then we will actively seek out those homeowners, offering them this plan, and we would reinstitute foreclosure proceedings after we either hear from the homeowner and determine that they are not eligible, that we cannot do it, or if the homeowner does not respond.

Mr. GREEN. Ms. Coffin, how does yours measure up?

Ms. COFFIN. Our moratorium is in place until at least the 13th of March. We have announced that to our borrowers. And we have, as I said in my testimony, already proactively began to analyze our portfolio with the information and the data that we have about the program for both the refinance opportunities and the modifications. And what we will turn to first, once we understand more of details after the 4th of March, is we will first turn to the borrowers who are most seriously delinquent or on the verge of foreclosure sale and proactively reach out to them.

Mr. GREEN. Mr. Hemperly?

Mr. HEMPERLY. Our moratorium started on February 12th, and it will extend for 30 days through March 12th. We are also eager to see the Administration's plans. Hopefully, we will see them on March 4th, which should give us time to understand them before we would schedule any additional foreclosure sales.

Mr. GREEN. Ms. Sheehan?

Ms. SHEEHAN. We also announced our moratorium on February 12th. At that time, we announced it would be extended through March 6th. That was before we knew when the details of the program were going to come out. So we will this week reconvene and consider, based on the information we know now, what is the next step we should take to be fair to our homeowners.

Mr. GREEN. Thank you.

I yield back.

Chairwoman WATERS. Thank you very much.

Mr. Clay.

Mr. CLAY. Thank you, Madam Chairwoman.

Let me start with Mr. Erbey.

Mr. Erbey, in your testimony, you propose two solutions for advanced financing to servicers. One proposal is to provide a $1 billion government infusion to minority-owned Robert Johnson Urban Trust Bank to establish a new operating division to provide advanced financing to servicers who commit to aggressive foreclosure prevention and loan modification measures. Currently, how many communities does the UTB service, or do you know?

Mr. ERBEY. I know of a handful, but I can't accurately describe that.

Mr. CLAY. Okay, give me examples of some.

Mr. ERBEY. They are in Florida, in the Orlando area.

Mr. CLAY. How would Mr. Johnson assist servicers with homeowner outreach to minority communities hardest hit, do you have any idea of how we he would pull that off?

Mr. ERBEY. I believe Mr. Johnson thinks he has quite a well-known name and reputation within the communities and that by being able to get out there and get the message out, that he would assist in that manner.

Mr. CLAY. Okay, all right. Thank you for that response.

Ms. Coffin, when considering your total number of modifications, what percentage of them are modifications that produced a decrease in monthly payment of at least 10 percent? Can you give us that percentage in your reported modifications that fit that category?

Ms. COFFIN. I don't have that data directly here in front of me, but to state I think what is important about these modifications, and I heard the discussions earlier today, what is important to understand about whether the payment reduces or not are the circumstances of each of the borrowers that we work with. We have cases of borrowers where they come to us, and if you take the President's, the Administration's plan that they just announced and the affordability targets they have set, I tell you today we have many borrowers who have come to us who are already below those targets. What we still try to do is help them. And sometimes that is taking those payments. Sometimes it is the taxes that they have not paid on their homes. Sometimes it is payments they are in arrearage, and we do capitalize those, we re-amortize the loan and try to get them back into a performing loan. So I think, more than just stating the numbers, it is important to understand when and why we do that particular type of modification.

Mr. CLAY. So that may include making the terms longer?

Ms. COFFIN. It could make the term longer, but it could actually increase their payment if they have not paid their real estate taxes and they have significantly missed many payments. If they made no payment on their homes for 8 months, lets say, and not paid their real estate taxes, to get them back in a performing loan and have them stay in that home, we he have to do something with those missed payments and those missed taxes.

Mr. CLAY. Which means these people have to have employment, of course.

Ms. COFFIN. That is correct.

Mr. CLAY. Given the size of the program being proposed by the Administration, and the need to look at the ability of homeowners to sustain a modification, how large of an increase in manpower do you believe would be needed to get this job done? Do you have any idea?

Ms. COFFIN. I would support what Mr. Gross stated. We actually see the standard modification program, as laid out and what we know of it so far, will actually be much more efficient for us. We have never stopped and we didn't just because of the plan decide then to start hiring. We are continually in this kind of environment reforecasting and preparing months ahead. As you heard, you don't just hire these people and put them on the phone tomorrow. You have to go through the hiring and training phase. You want to make sure they have the expertise to actually help our borrowers. So we are forecasting months and months in advance, and we will continue to do that.

But this actual plan, we believe, will make us more efficient for the reasons Mr. Gross stated. If we get a standard modification program, as we too serve Fannie, Freddie, FHA, multiple privates, if we got to one program and there was an accountability of what we were to move to a target of, it would be much more efficient for us.

Mr. CLAY. Anyone else on the panel?

Ms. Sheehan.

Ms. SHEEHAN. I would agree with what Mary just said. I think we do have 8 to 10 flavors right now of loan modification programs that are very complex. We have to go into databases, it complicates the training we talked about earlier, to be sure that the individuals understand all the different programs. So I believe it will be a tremendous benefit to servicers.

I also would like to say on behalf of Chase that we are trying to look at different ways to deal with our borrowers, which is why we have started to set up our homeownership centers around the country. Not everybody is going to work well in a call center. In some cases, you need to do face-to-face. And we actually have seen some very preliminary but very positive results from the centers that are opening right now.

Mr. CLAY. Thank you very much for your responses.

I yield back.

Chairwoman WATERS. Thank you very much.

Mr. Ellison.

Mr. ELLISON. Thank you, Madam Chairwoman.

And thank you to all of the witnesses.

Is your servicing process different between cases where the servicers own the mortgage and where they don't own the mortgage?

Can we start with you, Mr. Erbey?

Mr. ERBEY. Yes, certainly.

We have almost no mortgages that we own ourselves. So essentially, our process is exactly the same. Every loan is treated individually.

Mr. ELLISON. How about by you, Ms. Coffin?

Ms. COFFIN. Yes, I will try to give you the spectrum. We obviously on, let's take the Wachovia option ARMs that we just acquired, we are going aggressive. Those are loans that we own. We know the geography in which many of them are located is extremely distressed, and so we are going aggressive with modification programs. But as soon as we learn from the programs that we develop and implement on that, we reach out immediately to private investors and other investors to share our learnings and hope that they will deploy throwing programs also.

Mr. ELLISON. Mr. Gross?

Mr. GROSS. I would concur with what Ms. Coffin has just said. One of the standard provisions in service pooling and servicing agreements—

Mr. ELLISON. Mr. Gross, forgive me, but when you said you concur with Ms. Coffin, do you mean, when the servicer owns the loan, you are aggressive, and when you don't, you share the information because that is what I heard?

Mr. GROSS. Yes, and I was amplifying on that.

One of the standard provisions in a servicing contract generally is that we will service loans for that investor as we would for those in our own account, which means that we will not give loans in our own book of business, loans that we hold for investment, any preferential treatment over loans that we service for them.

Mr. ELLISON. Ms. Sheehan, how do you view this issue?

Ms. SHEEHAN. I would concur with both Mr. Gross and Ms. Coffin. Our core servicing processes are all the same. But when we come to loss mitigation and loan modification, we are more aggressive with our own portfolio loans for all of the reasons that we have been talking about today.

Mr. ELLISON. Sir?

Mr. HEMPERLY. A similar answer. We service for a lot of the same people that are our competitors do. And we also feel that we have more flexibility on our own portfolio.

I didn't get to answer the last question, but we also believe that a standardized approach that the Administration plan is proposing is also going to be a more effective way to deal with this situation, and it should be easier to train our folks on a standardized plan as well.

Mr. ELLISON. Can you tell me about what your outcomes have been when you have the loans that you own, loans that you don't, have you been able to—have you written down more or have you remodified more loans when you own them as opposed to the ones that you don't own? What has your experience been, is what I am asking?

Mr. Erbey, you only have one kind?

Mr. ERBEY. Correct, we have modified about 20 percent of all loans in our portfolio.

Ms. COFFIN. To answer your question, and as I just stated, we just acquired the Wachovia option ARMs, which is where we are going the most aggressive. I think what is important to a redefault, and I know there is a lot of analytics and a lot of speculation on redefaults, as was stated earlier, coming to a common industry definition of redefault, which we would stand by that any loan that has been modified, and seriously redefaults, which means 90 days delinquent within a year, is our definition of redefault. And because these are new procedures that we are developing and applying against this portfolio, it will take a while for us to determine what the true redefault is compared to historical redefault rates.

Mr. ELLISON. Do you have any numbers so far on the difference between the remodified loans that you own and the ones that you don't?

Ms. COFFIN. Well, I want to be cautious that Freddie and Fannie and many of the privates who have worked with us are very aggressive. I don't want to leave today that—

Mr. ELLISON. I am just trying to get a statistical understanding. Do you understand what I mean?

Ms. COFFIN. Between what we do in our portfolio, we are seeing a redefault rate that is probably lesser in our case that is lower than the 30 percent on average redefault, and you will so a little higher on those that do not go as significant in the modification terms.

Mr. ELLISON. Maybe I don't understand. Are you modifying more loans that you own than the ones that you don't?

Ms. COFFIN. I think the way I am interpreting this is we modify differently, not whether there is more or less; it is that we are modifying possibly differently.

Mr. ELLISON. But is there a numerical difference between the ones you own and the ones you don't?

Ms. COFFIN. No.

Mr. ELLISON. They are the same?

Ms. COFFIN. By numbers, just sheer volume?

Mr. ELLISON. Yes.

Ms. COFFIN. No. I mean, you would have to do that in relationship to the size of the portfolio. No. We are modifying. Like I stated earlier, there are very few of our contracts that don't allow us to modify.

Mr. ELLISON. So you modify the same number for the loans that you own and the ones that you don't?

Ms. COFFIN. The majority of the time, yes. On a ratio of how many loans we have, you still have to—if you want sheer numbers like 100 to 100, it would depend on the size of the portfolio and the number of loans that are in distress as a ratio.

Mr. ELLISON. All right. Well, do you have that information?

Ms. COFFIN. I don't have that right in front of me, but I can tell you that—I don't think there is a difference between that we can't modify. It is how we are modifying. What we are doing on the Wachovia loans is going more aggressive with the terms, such as principal forgiveness.

Mr. ELLISON. Okay. Mr. Gross.

Mr. GROSS. I apologize, I do not have the data that you are requesting at this time, but I would be glad to follow up with the committee afterwards.

Mr. ELLISON. Thank you, Mr. Gross.

And, Ms. Coffin, I am assuming you would supply the information?

Ms. COFFIN. Yes.

Mr. ELLISON. Ms. Sheehan.

Ms. SHEEHAN. Our servicer loans are much larger than our owned loans, so even if we are doing it proportionately the same, those numbers will be—the servicer numbers will be larger. But we would be happy to get that.

Mr. ELLISON. Thank you. We would request that. Thank you.

Sir?

Mr. HEMPERLY. We will pull the exact data for you as well. I believe that on a percentage basis, we do more deals on the loans that we hold on balance sheets than we do for others; and I think it is because we can do them earlier in the process in some cases than we can. And I think we have a little bit more flexibility to do that. But we will be happy to pull the numbers.

Chairwoman WATERS. Thank you very much.

Mr. Donnelly.

Mr. DONNELLY. Thank you, Madam Chairwoman.

Ms. Coffin, under Wachovia ARMs, when you look at them, what interest rate are you putting people—what product are you primarily putting folks into or trying to put folks into?

Ms. COFFIN. We are trying to get them into a fixed, but most importantly is when we see what the payment that they are currently able to afford, we are trying to keep them to that payment and modify the terms of the loan to get them to that payment.

Mr. DONNELLY. That is the ARM payment?

Ms. COFFIN. Yes.

Mr. DONNELLY. What is the average interest rate on those ARMs at the present time?

Ms. COFFIN. I am a little cautious in saying this because I don't have—

Mr. DONNELLY. Ballpark.

Ms. COFFIN. I will say ballpark, 2 percent, maybe slightly higher.

Mr. DONNELLY. So what you are doing is looking at that payment and saying, what kind of product can we produce that will keep them in the house at about that number?

Ms. COFFIN. That is correct.

Mr. DONNELLY. How many of those do you have, of these ARMs, of these mortgages, the Wachovia?

Ms. COFFIN. The Wachovia that we inherited was $122 billion.

Mr. DONNELLY. I am sorry, the total number of homes.

Ms. COFFIN. The total of the portfolio, I believe it is approximately 350,000, I believe, 400,000.

Mr. DONNELLY. And how long does it take you to get to all of them? I mean, how do you prioritize that? Is it you look and say, this one is in trouble, they missed a couple payments, we had better get together with them? How long will it be before you get that cleaned up? Is it, these ARMs go off next month, so we had better do those first?

Ms. COFFIN. Let me be clear that much of this portfolio is performing. If they are current, we continue to look at them. We are looking for imminent default. We want to make sure that we are proactively trying to predict those loans that will probably have imminent default. But we are starting with the most serious and those that are close to foreclosure. We are looking at those whose ARMs are ready to recast, those who are delinquent, and those who look like we would predict imminent default.

Mr. DONNELLY. So say the ARM goes off in another month or 2 months, but they are performing. Those ones you would already be working with to try to get into a new product.

Ms. COFFIN. We are working across that entire portfolio very aggressively.

Mr. DONNELLY. So there is not going to be folks who look up and their ARM is about to go off in a week, and they haven't heard from you yet?

Ms. COFFIN. That is correct.

Mr. DONNELLY. Mr. Erbey, when you look at the loans that you have in your portfolio, are there red flags that you look at to indicate to you, this is one we have to work on? For instance, somebody who has been put into a 10.5 percent rate at 20 years, is that something you would look at and say, how do we rework this? Are those important figures to you, or is it only you look and you go, who is in trouble this month?

Mr. ERBEY. Well, you certainly sort your portfolio based on characteristics to try to do imminent default, where you think somebody will try to default and try to deal with it ahead of time, such as a reset or a very high-interest-cost loans. So you would proactively be approaching those individuals. The vast majority of the work, however, because of the type of portfolio we have, is spent on basically people who are already in trouble.

Mr. DONNELLY. I know you use mathematical models. Do your models tell you, here is the income that they have? Here is the interest rate? This isn't going to—you know, they are paying it now, even people who are current; we have to get into this one and get this fixed?

Mr. ERBEY. Yes. We run models that look at the person's ability to pay over time. So it is not just a snapshot of what can they do today; what are they able to do in the future? You also look at redefault probabilities as well as prepay probabilities and future housing prices. And so you are looking at pretty much three-dimensional vectors on all those factors.

Mr. DONNELLY. And this next question would be to the whole panel. I met with some mortgage folks earlier today and spent some time with them, and one of them was saying that one of the biggest problems they are having with modifying loans is some of the servicers. And, you know, this was not any of you folks, but some of the servicers that they would call, the servicers said, "I have a pile 5-foot high on my desk; I am trying to get through them as quickly as I can. I haven't gotten to that one yet, and it may be a while."

Are you facing those kind of problems, where they are coming so fast, the requests for modification, or the screening that you are doing is indicating this should be modified, that timewise it is tough to get to all of them? Mr. Gross.

Mr. GROSS. In all candor, yes. Obviously, the volumes of homeowners who are approaching us today looking for modifications at times can be overwhelming. One of the significant issues that I think most servicers are confronted with today is the volume of homeowners who are current on their payments, but are coming to us and seeking a modification, and trying to determine which of those homeowners is doing it based upon a true financial hardship either now or in the near future based upon some event that may have taken place—unemployment, a rate increase, something has occurred—versus those people who have heard many statements in the media about all of the modifications and principal reductions that are coming forward. And, unfortunately, we have a lot of folks who are coming forward saying, where is my deal?

Mr. DONNELLY. So you would have a form or like almost a test?

Mr. GROSS. We would have to go through and perform the analytics on each loan, getting the income and expenses and trying to determine from the homeowner what is the hardship that causes you to make this request?

Mr. DONNELLY. And would something like, I started out in an ARM, I am now locked in at 10 percent over the next 20 years, and it is very tight every month; is that the kind of situation?

Mr. GROSS. Absolutely. Yes.

Mr. DONNELLY. Thank you, Madam Chairwoman.

Chairwoman WATERS. Thank you very much.

Ms. Kilroy.

Ms. KILROY. Thank you, Madam Chairwoman.

First, I would like to follow up on Ms. Coffin's answer regarding offshore employment and moving operations offshore, that Wells Fargo moved operations overseas because of a lack of qualified available IT personnel. I would like to suggest that Wells Fargo might want to take a look in my district in central Ohio where we have hundreds of IT persons, well-qualified, who have been laid off from various businesses, but including being laid off from major national banks; and before they were laid off, they were sent to India to train their replacements.

Ms. COFFIN. May I comment? I want to make sure that I am setting the right timeline of all this, and to be candid and honest with all of you, because I feel very strongly and I have known this, and have worked for Wells Fargo for over 11 years: It is one of their top principles that we create American jobs. And when I spoke, I wanted to make sure I was honest that it is that we do not go offshore. Where we have gone offshore in the past, not in this current unemployment environment—as a matter fact, I would probably have to state to you I would have to check whether we have anyone even in our technology today who is offshore. This was in our past, not maybe today. So I probably misstated that.

Ms. KILROY. I am glad to hear that correction, because what I heard and what I heard follow-up questioning was a comment that there weren't qualified people here.

I also want to find out your philosophy or the emphasis of quickly liquidating assets that are deemed to be maybe unproductive versus working out with those homeowners. Of course, in my opinion, working out helps the community, stabilizes prices, and, to me, not only being a good social policy, I think ultimately in the long run is a good business policy.

But I am concerned that Professor White at Vanderbilt recently told the New York Times that despite your testimony that you are aggressive on that, that Wells Fargo has modified few loans as a percentage of delinquent holdings. Would you like to comment on that?

Ms. COFFIN. Well, I am not sure if I remember that exact quote as you put it. I think you have to look at the nature of the makeup of our portfolio. Again, Wells Fargo's portfolio is predominantly investor owned; we do not own the loans. There is very little of our portfolio that we own as a balance sheet. And as I stated earlier today, I can give you this as fact, 8 percent of our portfolio is held by private investors, but they represent almost 70 percent of our serious delinquents, and they represent 50 percent of our foreclosures.

Ms. KILROY. And do you take a different approach to those loans than the loans that Wells Fargo has initiated?

Ms. COFFIN. I think it is not the approach we take to it. There is some because of the contractual obligations I spoke of earlier. But more importantly is how these loans were originated and who was put into these loans to begin with, which is the importance of responsible lending. These are loans that we did not originate; they are loans that we did not underwrite. These are loans where the companies reached out to us to do the servicing, and that is what we are doing. But many of these borrowers, we are not capable of finding an affordable situation.

Ms. KILROY. What period of time are you talking about for—let me strike that.

Are you aware that there were 31 complaints filed with the Ohio attorney general in 2007 alleging that Wells Fargo had refused to accept homeowners' offerings of their late mortgage payments?

Ms. COFFIN. You said 31?

Ms. KILROY. Thirty-one complaints filed with the Ohio attorney general.

Ms. COFFIN. That we were unwilling to accept?

Ms. KILROY. The late payments. That people were offering up their late payments, and Wells Fargo was refusing to accept their late payments.

Ms. COFFIN. I don't have the cases directly here in front of me, and I always love to state that it is very important, as I see in all the complaints that are brought to our attention, and I appreciate all of them that are, is that you have to look at the details case by case. Many of those that we find where if they are in a very serious or late stage of delinquency or foreclosure, and we are still looking at the income and expense analysis—every borrower that we look at is an income and expense analysis to find affordability. So just accepting late payments, if we still see that there is no chance of affordability with the modifications that we can do, we are avoiding the inevitable.

Ms. KILROY. Let me give you an individual situation reported in one of the local newspapers with respect to Wells Fargo for John and Sharon Vasquez, who bought a home in 1994 in Clintonville. And they had some ups and downs, once or twice fell behind, but they would typically get their payments back on track until they had a significant health issue. But even when the wage earner went back to work at the Postal Service, and they tried to work out a situation with Wells Fargo, initially the company refused the $5,000 that she offered. And then after that situation was worked through with the help of attorneys, they were required to pay—instead of $5,000, pay up $3,900 before the company would talk to them about restructuring the loan: A pre-payment of $3,900, and then we will talk to you about restructuring. They made that payment, and then the restructuring included terms that—included a balloon payment of $10,000 that was known that they can't pay. They are now in foreclosure proceedings.

Also, I just had a concern. We talked a little bit about some of the refinancings or modifications that ended up with lower principal, and also you mentioned many that ended up with higher principal. Of course, my concern is that a home modification with a higher payment is far more likely to end up back in a redefault situation.

Again, in the New York Times on February 19, Wells Fargo declined comment on increased principal charged to a Mr. Mitchell with back fees—fees, back payments, penalties. His principal was raised to above $300,000, his payments virtually unchanged, and he had to make an immediate $5,000 payment. He has now again fallen behind on his payments.

So I guess I am not sure what the—exactly the philosophy is here, but it seems it is not necessarily liquidating the assets quickly, it is not keeping the people in their homes, because the terms and conditions were such that people were not going to be able to keep up with them one way or the other. Is the philosophy more of maybe getting whatever you can out of the mortgagee before foreclosure is initiated?

Ms. COFFIN. No. I can make that very clear, it is not trying to just take as much cash as we possibly can. And that is one of the reasons we won't receive partial payments. We want to make sure that if we establish what a true modification that is sustainable with affordable payments, and that those payments are made, that is a performing loan. And we will not take just partial payments because, again, we could be taking payments on something that ultimately is going to end up in foreclosure.

In all of the cases that you mentioned, I want to be protective of privacy rights and what I can and can't say, so I would like to talk more generically. Any case that anyone brings to us, we will look under every detail and look at every piece of information. But until you understand the uniqueness of each of those cases, I think it is important to understand, for instance, there could be an example that the $3,900 being requested is for back real estate taxes. And if someone has not made a payment on their home in 6 months, and they have not paid their back real estate taxes, and we are looking at their income and expenses, it could be that we see they cannot afford the home.

Ms. KILROY. Let me ask you another question about refinancing and modifications, and that is, separate and apart from back taxes or penalty payments that were part of the mortgage, what kind of additional costs are there? We had some discussion of this with the earlier panel. What kind of additional fees are required of the home purchaser, the mortgager, in a refinancing in terms of title searches, title insurance, etc., things like that, appraisals? What requirements do you put on homeowners?

Ms. COFFIN. First of all, I am not an originator. I am on the servicing side of the business.

Ms. KILROY. But this would be for refinancing or modification.

Ms. COFFIN. I don't know that I can quote every last fee that is done on a refinancing, but I think what is more important is, I want to make this clear, that on a modification there is never a fee, ever. And I want to make sure our borrowers understand. There are some for-profit companies out there starting to charge them to get modifications for them, and they should avoid those. There is never a charge. I think I can say that for myself and my colleagues sitting here at the table.

Number two, I think it is important that when working on a modification, if—I can state this for us, if there are late fees that are part of the back, those are waived.

Ms. KILROY. Is there a differentiation that you make in terms of a modification or refinancing in terms of those kind of fees?

Ms. COFFIN. Yes. Because a modification is taking the current loan in the state that it is in, it is usually a customer who is in a distressed situation, and you are trying to modify the terms of the loan to reach affordability for them. A refinance is usually a customer who has good credit and who wants to refinance to a lower rate, and they are trying to get out of the current loan they are in to get into a lower-interest-rate loan.

Ms. KILROY. So somebody who is working hard, playing by the rules, may be suffering some issues financially, but not in the foreclosure situation, not in the delinquency situation would be asked to pay these fees?

Ms. COFFIN. And that is also where I believe the Administration's plan is providing new guidelines to help more people to refinance into that program. And I believe the program in the Administration's plan is a streamlined plan that has very few costs associated with it. I don't believe it is even going to require an appraisal.

Ms. KILROY. The situation that I was referencing was somebody who e-mailed me what they said was a Wells Fargo streamlined plan, and the closing costs that were associated with the loan which would increase their principal slightly, lower their monthly payments slightly, shorten the years left on the mortgage, but the closing costs were 9 percent of the value of the house. That seemed to me a little bit extreme.

Ms. COFFIN. I would like—if you could, I would love to know the details of that e-mail and send it to us. I can have our staff look into it. That seems like something I would need to check with the group that does that. I am in charge of servicing.

Ms. KILROY. Thank you, Madam Chairwoman.

Chairwoman WATERS. Thank you very much.

I would like to thank all of our witnesses for participating today.

I guess one thing that I heard was that everybody—you are all happy with the President's proposal, and you are glad that standards are being set for loan modifications. Is that correct? And let me just close by asking this question: How many of you or your companies were involved with the HOPE NOW program that was originated, what, a year-and-a-half ago? How long ago was that voluntary program put together?

Ms. SHEEHAN. That really started coming together in mid-2007. We kicked off initially that fall.

Chairwoman WATERS. And the idea of that program was that instead of trying to impose upon you rules, regulations, laws, that you would voluntarily get together and deal with this foreclosure problem; is that right?

Ms. SHEEHAN. Yes.

Chairwoman WATERS. That was the idea?

I may be a little bit naive, but given your expertise and everything that you know about this industry, why has it taken so long and why has it taken the President's initiative to get you all happy about standards? Why didn't you come up with something? Why didn't you propose standards? Why didn't you all tell us how this should be done? That was the whole idea putting together HOPE NOW. Did HOPE NOW fail?

Mr. HEMPERLY. The President's plan encompasses the GSEs, and up to this point, we hadn't had any kind of standardization where the GSEs were participating. And I think all of us probably served—the largest percentage of our servicing portfolios are Fannie and Freddie loans.

Chairwoman WATERS. I don't get the answer, because what I am asking is, you were at the table, and you were there to deal with this problem of foreclosures. What happened was you came up with a very, very weak program of using these HUD-approved counselors and nonprofits to counsel people and to help people, and that is about all you did. Why didn't you use your expertise and your talent to shape and form a response to the foreclosure meltdown that we were having? I am trying to figure out why the voluntary effort didn't work?

Ms. COFFIN. I would like to comment on that. I think one thing—and many of us have worked together outside of HOPE NOW and with HOPE NOW, and when this program began and when we launched it in 2007, the most prominent problem—the problem was subprime ARMs that you spoke about earlier today, and also getting borrowers to call us. And where HOPE NOW was very successful in its initial efforts was a streamlined ASF which allowed us to proactively go after and modify those ARM loans into fixed products before their ARMs reset.

Chairwoman WATERS. Let me say this, because our representative here representing Citi talked about having adopted Sheila Bair's program that she put together after she took over IndyMac, which really for the first time showed us what you can really get done. And so Sheila Bair basically took the IndyMac portfolio without your input, without your help, and came up with standards and ways by which—and one of the things that she did was she constructed letters that went out to the homeowners that said, this is what we can do for you, you know, under these conditions. Some other attempts, I am told, were letters that went out and said, come in and talk to us. And people said, I am not going in there; they are going to take my home. But she constructed letters that basically said, if you are in this kind of situation, here are the kind of things that we can do to help you.

So I guess I point that out to you, because we have struggled with this problem far too long, given you were all at the table under a voluntary program called HOPE NOW. I want to abolish HOPE NOW. And I know, even though the President may be relating to it in his plan, I think that HOPE NOW did very little to deal with this crisis. And I would just like you to think about how you can get in front of these problems that is going to affect the entire industry and come up with resolutions if you are truly interested in helping the homeowners.

I know that many of you can give me a lot of responses to that, but of course, we don't have any more time. And because I am chairing, I get a chance to do this. So I thank you for having been here today, and I am hopeful that as the President unveils his program, we are going to have the kind of cooperation and input to implement something that is truly going to deal with what is the problem facing our entire economy at this time. Thank you all very much.

I am reminded that I should tell you again 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.

Now, the panel is dismissed.

[Whereupon, at 6:10 p.m., the hearing was adjourned.]

APPENDIX

February 24, 2009

MAXINE WATERS
Member of Congress
35th District, California

CHIEF DEPUTY WHIP

COMMITTEES:
FINANCIAL SERVICES
Subcommittee on Housing and Community Opportunity
RANKING MEMBER

JUDICIARY
Subcommittee on Courts, the Internet and Intellectual Property
Subcommittee on Crime, Terrorism and Homeland Security
Subcommittee on Immigration, Border Security and Claims

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Opening Statement of the

Honorable Maxine Waters, D-35th CA

Chairwoman, Subcommittee on Housing and Community Opportunity

Hearing on "Loan Modifications: Are Mortgage Servicers Assisting Borrowers with Unaffordable Mortgages?"

Tuesday, February 24, 2009

2128 Rayburn House Office Building

2:30 p.m.

I would like to thank the Ranking Member and the other Members of the Subcommittee on Housing and Community Opportunity for joining me today for this hearing on "Loan Modifications: Are Mortgage Servicers Assisting Borrowers with Unaffordable Mortgages?"

Today's hearing is the first in a series of hearings to provide Congress with an in-depth understanding of loan modifications, including their benefits and challenges. In the next few months, the Subcommittee plans to hold further hearings on this issue, including an examination of the White House plan to modify loans and an investigation of the for-profit loan modification industry. Today, we have before us several key regulatory agencies and mortgage servicers who are going to tell us about their efforts to assist borrowers with unaffordable mortgages.

In addition to learning about their loan modification efforts, I hope that this hearing will also serve to educate Members about some of the fundamentals of the mortgage servicing industry, including how servicers are licensed, what kinds of contracts they have with investors, and how they receive their payments for servicing loans. I believe that this basic information is critical to understanding how the number of loan modifications can be increased. I hope that our witnesses will be able to educate the Subcommittee in this regard.

Loan modifications—changing the terms of the loan—are essential to ending the foreclosure crisis. According to Realty Trac, in 2008, 2.3 million households were in some stage of the foreclosure process, an 81 percent increase from 2007 and a 225 percent increase from 2006. The foreclosure crisis shows no signs of slowing down with Credit Suisse estimating that 8.1 million homes will enter foreclosure over the next four years.

However, while the pace of loan modifications has increased, repayment plans—which simply tack the missed payments onto a loan, thereby delaying the inevitable foreclosure until a later date—are still offered more than loan modifications. According to the Office of the Comptroller of the Currency and the Office of Thrift Supervision, in the third quarter of 2008 new loan modifications increased by more than 16 percent to 133,106, while new repayment plans increased by 11 percent to 154,649.

I am concerned that mortgage servicers simply aren't doing enough loan modifications. I am interested to hear the mortgage servicers before us today discuss what barriers or capacity issues are preventing them from performing more loan modifications and preventing foreclosures. And if capacity is an issue, I'd like to hear about how we can streamline the modification process so that we can prevent foreclosures quickly and efficiently. Since day one, I have been a supporter of enacting a systematic modification program. On the first day of the 111^{th} Congress, I introduced legislation—H.R. 37, the Systematic Foreclosure Prevention and Mortgage Modification Act of 2009—to put such a plan in action.

I am also concerned about some of the re-default rates on modified loans. According to OCC and OTS, modified loans have been re-defaulting at rates of 37 percent within three months after modification and 55 percent within 6 months after modification, with the rates of re-default seeming to vary by the type of loan and the entity servicing it.

In modifying loans, servicers must ensure that the new loan is more affordable to the borrower than it was before the modification. It makes little sense and benefits no one to modify a loan and to have it still be unaffordable for the borrower. It also makes little sense to do a slight modification—such as lowering the interest rate by a quarter of a point, for example—that makes the loan slightly more affordable but still out of reach for the borrower.

The type of loan modification being offered is also important to ensuring that the modified loan is affordable for the borrower. Credit Suisse has found that principal reduction modifications have lower re-default rates than other kinds of modifications. If this is the case, I would expect for mortgage servicers to perform more of these kinds of modifications. I am aware that principal reductions come with a significant cost for the investor, however, that cost is substantially less than letting the loan enter foreclosure.

Before I close, I would like to comment on the modifications that have yet to occur. There are millions of families out there who are struggling with their mortgages. They have tried to contact some of the servicers who will be testifying today. And they have not been able to get through or to reach the right person.

I have experienced first hand the challenges faced by borrowers who want to stay in their homes and who want to get current on their mortgages, but they either can't get their servicer to pick up the phone or they get wrong, misleading, or unapproved information. I have called the servicers myself and waited hours for someone to answer. I have been misdirected and disconnected and I understand the frustration borrowers have. It's unacceptable and I think homeowners deserve better.

I am very interested in hearing from today's witnesses on how they plan to improve their capacity and their outreach to ensure that the borrowers reaching out to them for help are able to receive the help they need.

I'm looking forward to hearing from our two panels of witnesses on the benefits, the challenges, and expenses involved in modifying loans. I would now like to recognize our Subcommittee's Ranking Member to make an opening statement.

CONGRESSMAN KEITH ELLISON

STATEMENT BEFORE HOUSING AND COMMUNITY OPPROTUNITY SUBCOMMITTEE: LOAN MODIFICATIONS: ARE MORTGAGE SERVICERS ASSISTING BORROWERS WITH UNAFFORDABLE MORTGAGES?

February 24, 2008

I want to thank the Chairwoman Waters and Chairman Frank for their leadership on this issue, an important one at the front line of our current economic crisis. Mortgage foreclosures devastate families and blight neighborhoods. And in many parts of our country, they are rising at an alarming rate.

In fact, a recent report by Credit Suisse estimates that 16 percent of all mortgages will enter foreclosure in the next four years. In Hennepin County, the home of my district, foreclosures increased by 32% in the past year.

I am therefore anxiously awaiting to hear from our witnesses, both from government and industry, regarding what is being done to stem this tide.

Last week, the Obama Administration unveiled its Homeowner Affordability Plan, the centerpiece of which was a modification plan for at-risk homeowners with conforming mortgages. This is a promising plan, and I am interested in hearing from our witnesses about what legislative and regulatory actions might be taken to apply it to an even wider universe of home mortgages.

Testimony of

Mary Coffin
Executive Vice President
Wells Fargo Home Mortgage Servicing

Before the

Subcommittee on Housing and Community Development
Financial Services Committee
United States House of Representatives

February 24, 2009

Chairwoman Waters, Ranking Member Capito and Members of the Subcommittee, I'm Mary Coffin, head of Wells Fargo Home Mortgage Servicing.

Throughout this crisis, the mortgage industry and the government have collaborated on ways to reduce foreclosures and stabilize the economy. We believe the spirit in which the Homeowner Affordability and Stability Plan was designed is yet another positive step forward in addressing these challenges. In the coming weeks as details of the plan are defined, we fully support striking the delicate balance between providing aggressive solutions for those in need and guarding against moral hazard.

From the beginning, Wells Fargo has been committed to doing what is right for our customers and our country by making homeownership achievable and sustainable for millions of Americans.

Last year, we made it possible for half a million families to purchase a home, and we refinanced another half a million families into lower mortgage payments. At the end of 2008, for the 8 million mortgage customers Wells Fargo services, 93 of every 100 were current on their mortgage payments. And, for the 7 who were not, we have worked hard at keeping them in their homes. Since our servicing portfolio is predominantly held by other investors, this has required gaining consensus to honor our contracts.

Over the past year and a half, through our *Leading the Way Home®* program, we have delivered more than 706,000 foreclosure prevention solutions. We work with all our customers – including those not yet in default – to determine if they qualify for a modification. They simply need to prove they have experienced a hardship that significantly changed their income and/or expenses. When we do modify a loan, about 7 of every 10 customers remain current or less than 90-days past due, one year later. We connect with 94% of our customers two or more payments past due. To be responsive to requests for help, we have more than doubled our staff to 8,000 team members – all U.S.-based.

These times are unprecedented, and we certainly are not perfect. But we do our best, and thank the members of this committee for taking your personal time to reach out to us when our service does not meet the standards we have set, so we can immediately work to correct the situation.

When we are unable to find a solution for a customer, we believe we can lessen the impact on the community by accelerating the sale of the foreclosed home. This includes maintaining the property and paying utility and tax bills. We discount foreclosed properties for sale to government or tax-exempt organizations, and provide financial support when our team members volunteer to rehabilitate foreclosed homes for low-to-moderate income families. Over the past two years, Wells Fargo has made $33 million in grants to non-profits to sustain neighborhoods.

When the foreclosure crisis began two- and a half-years ago, the first customers challenged were those with subprime ARM loans, and the primary challenge our industry faced was contacting at-risk customers. Wells Fargo was instrumental in addressing these issues by recommending an industry-wide streamlined process to modify ARM resetting loans into fixed products, and creating the HOPE NOW Alliance which has greatly improved our ability to connect with and work with our at-risk borrowers. But clearly as the housing and economic crisis has compounded, servicers have needed to keep pace with emerging trends and go deeper with modification tools to provide sustainable solutions. In the fourth quarter of 2008 alone, we provided 165,000 solutions – or three times what we provided in the same quarter of 2007 – including term extensions, interest rate reductions and/or principal forbearance. As another example, given the unique nature of the Wachovia Pick-a-Payment option ARM loans, we are using more aggressive solutions through a combination of means including permanent principal reductions in geographies with substantial property declines. In total, 478,000 customers will have access to this program if they need it.

The impact of the deteriorating economy has created additional challenges for borrowers. This evolving landscape has required us, as a leading servicer, to provide ongoing insights and recommendations that address the ever-changing trends. As the number of customers in need rises, Wells Fargo has advocated the creation of a standardized modification process that is aligned across all investors. The one described in the Administration's plan will significantly improve our ability to serve more customers and to set appropriate consumer expectations for a modification. According to third quarter 2008 Federal Housing Finance Agency (FHFA) statistics, 56% of the nation's 55 million mortgage loans are owned by Fannie and Freddie – who are already aligned with this new process. But most critical are the 16% held by private investors, which represent 62% of seriously delinquent mortgage loans.

In the modifications we do today, loan terms are adjusted to achieve at least a 38% affordability target. By bringing borrowers who need more help to a 31% target – as defined in the Administration's plan – we further increase the odds they can better manage their overall debt, lessening the likelihood of re-default.

Importantly, the plan does not overlook providing solutions for those responsible borrowers who continue to make their payments but find themselves in an upside-down mortgage. We applaud the balance created in providing them with refinancing solutions, as well as the commitment to keeping rates low and providing incentives for first-time homebuyers.

Even though the details of the Administration's plan are not final, Wells Fargo has already begun to operationalize the proposed standard modification program. Immediately after the President's announcement, we were ready to assist our customers with information through our web sites, voice response units, and team members. And, our analysis to find customers who may qualify is well under way.

While the measures we have discussed today will go a long way in addressing our nation's housing challenges, even more can be done through our continued collaboration. For instance, FHA should be granted the authority to expand the 601 Accelerated Claims Disposition program to allow the assignment of mortgages to FHA and the payment of claims upon modification of the FHA loan. We also have recommended changes to Hope for Homeowners that we believe will make this program a more attractive alternative for at-risk customers.

When asked what makes it difficult for us to help more borrowers, it is simply that their challenges are complex. Income disruption is at the root of the issue. Many customers are in variable or commissioned income situations that began destabilizing in the early part of the crisis. The full impact of unemployment and under-employment is still unknown. There are many unfortunate hardship cases but there are also people who got caught up in the excess of the growing economy and real estate values who can no longer sustain the lifestyles to which they have become accustomed. No loan modification, alone, can solve this dilemma. In certain circumstances, counseling which considers full debt restructuring is required.

We look forward to continuing to work with you on ways to turn the housing and mortgage industries around, and will assist in any way possible to advance the issues we have addressed today. Thank you for your time.

STATEMENT OF

William C. Erbey Chairman and Chief Executive Officer
Of
Ocwen Financial Corporation

BEFORE THE
Subcommittee on Housing and Community Opportunity Hearing

HEARING ON

Loan Modifications:
Are Mortgage Servicers Assisting Borrowers with Unaffordable Mortgages?

February 24, 2009

Introduction

Chairwoman Waters, Ranking Member Capito and distinguished Members of the Subcommittee -- my name is William Erbey and I am Chairman and CEO of Ocwen Financial Corporation, an independent mortgage loan servicer.

First, let me thank you for the opportunity to participate in this hearing today. I share your sense of urgency to find a lasting solution to our daunting foreclosure crisis – a crisis that lies at the very heart of our nation's economic problems and threatens millions of families with the loss of their American Dream – their home.

I applaud the leadership of the Chairwoman and Subcommittee Members in relentlessly advocating – ever since the inception of the crisis – the need for bold action to assist homeowners with unaffordable mortgages and to prevent avoidable foreclosures.

Ocwen Supports the President's Homeowner Affordability and Stability Plan

I also applaud President Obama, Secretary Geithner and the President's economic team for answering the call for bold action – in a matter of just a few weeks into the new Administration -- by launching the **Homeowner Affordability and Stability Plan**. This Plan includes a substantial loan modification component, the subject of today's hearing.

Prior government-sponsored loan modification initiatives were all good first steps in the right direction, but the President's new Plan is exactly the kind of **insightful and decisive action** that is needed to make a material impact on the foreclosure crisis.

Ocwen's Commitment to Foreclosure Prevention Through Loan Modifications – A Win/Win/Win Solution for Homeowners, Lenders and Servicers

As one of the few remaining independent mortgage servicers, Ocwen is very proud of our achievements in foreclosure prevention through loan modifications. We are not a loan originator -- we do not make mortgage loans. Rather, Ocwen is engaged as loan servicer under contract with mortgage investor-owners, i.e., the securitized REMIC trusts in which loans have been pooled by the mortgage-backed securities industry. Currently, our servicing portfolio contains approximately 325,000 mortgage loans, of which approximately 85% are subprime.

Beginning in early-2007, we pro-actively prepared for an increase in mortgage delinquencies by increasing our Home Retention Consultant staff by 50%. When the mortgage meltdown hit with full force later that year, we increased staff by another 35% and were the first in the industry to adopt an aggressive and comprehensive **loan modification program**. Our program re-engineers lower mortgage payments that are both **(a) affordable by the homeowner and (b) will return greater cash flow to investors than the net proceeds that would otherwise be realized in a foreclosure.**

Loan modifications crafted in this way are consistent with our contractual obligations and result in a **win/win/win** solution for all involved. The homeowner keeps their home; the loan investor avoids a substantial loss; and the loan servicer retains the loan in its servicing portfolio. Since the inception of the crisis, we have saved **over 90,000 homes** from foreclosure. And for investors, Ocwen's loan modification program returns **the highest cash flows** by any servicer on 90+ days delinquent loans – an amount that is **twice the industry average** – according to a Credit Suisse industry report. *See* "Mortgage Servicing Update," Credit Suisse, September, 2008.

Ocwen has been recognized by industry participants, regulators, community advocacy groups and the media as a leader in foreclosure prevention through loan modifications. *See, e.g.*, "Forestalling Foreclosure," TIME Magazine, December 31, 2008; "Modifying Mortgages Can Be a Tricky Business," New York Times, February 19, 2009 (copies attached).

Ocwen's success in sustainable loan modifications – "re-default" rate is less than half the OCC/OTS reported average

If loan modifications are to have an enduring impact, the reduced mortgage payments must be **sustainable** by homeowners. The salient measure of success, therefore, is the "re-default" rate, i.e., the percentage of loans that go into default again after modification. We are pleased to report that loan modifications engineered by Ocwen have a re-default rate of **19.4% compared to an industry average 42.9%** according to the most recent report issued by the OCC and OTS.

"Customized" loan modifications including Principal Reductions coupled with Early Intervention are the key to minimizing re-defaults

The superior sustainability of Ocwen's loan modifications is the result of our **customized approach** that addresses homeowner delinquencies on a loan-by-loan basis. By combining our proprietary loan analytics technology with behavioral science research, we:

- **First**, comprehensively re-underwrite each delinquent loan we service (i.e., the way it should have been done by the broker or lender at origination);

- **Second**, we determine whether modification is both affordable by the homeowner on a sustainable basis and maximizes net present value (or "NPV") for the loan owner as compared to a foreclosure; and

- **Third**, we provide one-on-one financial counseling to the homeowner, aided by interactive scripting engines incorporating proven psychological principles of persuasion and commitment, to maximize the likelihood of keeping current on the modified terms.

Another key to sustainability is **principal reductions** where necessary to achieve affordability. **18.7% of our loan modifications include writing down the loan balance** – this allows us to help more distressed homeowners with more solutions. An authoritative industry report noted that Ocwen leads the industry with **70% of the industry's principal reduction modifications.** *See* "Subprime Loan Modifications," Credit Suisse, October 1, 2008.

Early intervention is critical to foreclosure prevention. Prevailing industry standards, as confirmed by the American Securitization Forum, make clear that it is permissible to modify loans not only when the borrower is actually in default, but also when default is **imminent or reasonably foreseeable** in the good faith judgment of the servicer. Adopting this standard, our Early Intervention unit has successfully avoided upwards of **9,000 foreclosures** through pro-active modifications.

Resolving delinquencies in the best interest of the investor/taxpayer – the net present value calculation

The NPV model typically employed by loan servicers is limited to a static "point-in-time" approach that makes no attempt to account for the likely borrower behavior post modification (e.g., re-default, prepayment probability) or the likely value of property over time. Nor does the typical NPV model have the ability to analyze the *joint* probabilistic impact of several variables such as interest rate, step period and term.

In contrast, Ocwen utilizes a proprietary NPV model based on a **more dynamic "continuum" approach** -- one that incorporates a robust suite of cash flow models, statistical models and optimization algorithms that together produce truly optimal resolutions for investors/taxpayers. Our NPV calculations are based on the following:

- **Probability of Success Post Mod Model**
    - Assesses probability over time of staying current post modification

- **Probability of Prepayment Post Mod Model**
    - Assesses probability over time of pre-paying post modification

- **Case Shiller Home Price Index Prediction Model**
    - Time series and regression models that predict HPI for next 5 years

- **Optimization Algorithm**
    - Non-linear mixed integer models that can evaluate multiple vectors to determine the optimal combination of modified loan terms to maximize NPV

Scaleable technology is needed to meet the heavy volumes of delinquencies

If a loan modification program is to have a **material impact** to redress the national foreclosure crisis, it must be **scalable**. We have invested over **$100 million in R&D** in building an automated large scale system that incorporates artificial intelligence, decisioning models and scripting engines. This robust technology allows us to take on **many multiples** of the volumes of delinquencies we have already cured in our portfolio.

Consumer advocacy groups have been instrumental in enhancing borrower outreach

I would be remiss if I didn't recognize the critical assistance provided to us by our **non-profit consumer advocacy partners**. When for whatever reason a homeowner in distress does not respond to our letters or phone calls, we are unable to help them. Through grass roots outreach and educational initiatives, community groups such as the National Training and Information Center, HomeFree-USA, National Fair Housing Alliance, National Association of Neighborhoods, National Council of Laraza, St. Ambrose Housing Aid Center, East Side Organizing Project, South Brooklyn Legal Services, Homeownership Preservation Foundation, Neighborhood Assistance Corp. of America, Homes on the Hill, Neighborhood Housing Services of Chicago, Dominion Community Development Corp., Pittsburgh Community Reinvestment Group, Project to End Predatory & Deceptive Real Estate Practices at the Community Law Center and so many others have greatly assisted us in making that key communication link with our customers. We have also recently established a relationship with the National Community Reinvestment Coalition to broaden our homeowner outreach, and we will continue to support the foreclosure prevention efforts of HOPE NOW Alliance.

Enhancement to the ***Homeowner Affordability and Stability Plan****: Assisting Loan Servicers With Advance Financing*

A key aspect of the current credit crisis is the absence of financing for servicer "advances" that servicers are required to make to the MBS Trusts holding loans they service when borrowers miss P&I payments. Advances are paid back to the servicer from the top of the waterfall (i.e., ahead of the AAA bondholders) and are well collateralized by the value of the housing stock securing the mortgages in the Trust. At any point in time, the amount of advances due to the servicer is less than 5% of unpaid principal balance of the Trust. Even though advances have zero credit risk and financing them is the equivalent of a 5% LTV loan, the large commercial banks who have traditionally provided this financing have all but withdrawn from the market, including those who have received tens of billions in TARP money.

Perverse incentives are created due to lack of advance financing. For a servicer to work out a modification for a delinquent borrower, the foreclosure timeline must be extended. But this means the servicer must make additional advances during the workout period. Further, advances previously made on a foreclosed home are often not reimbursed to the servicer until the REO is sold. The incentives for the servicers are therefore to expedite, rather than forestall, the foreclosure process and then to dump the REO on the market by slashing price to ensure a quick sale. This puts more families out of their homes and exacerbates the decline in home prices which in turn precipitates more delinquencies, more foreclosures, and the vicious cycle continues unabated.

Two Proposed Solutions for Advance Financing

There are at least two currently proposed initiatives to provide servicer advance financing. Each can be funded and implemented simultaneously – they are not mutually exclusive.

1. **Independent Mortgage Servicers Coalition:** Various proposals to the Federal Reserve, Treasury and FHFA to provide up to $8 billion in a short-term financing facility and/or a related guarantee for to independent loan servicers who, combined, service in excess of $600 billion in mortgages (over four million homes).

2. **Robert Johnson/Urban Trust Bank ("UTB"):** Proposal for government infusion of up to $1 billion in minority-owned UTB to establish a new operating division to provide advance financing to servicers who commit to aggressive foreclosure prevention and loan modification measures. UTB would repay the entire investment over time, along with a 5% annual dividend. Mr. Johnson would assist servicers with homeowner outreach to minority communities hardest hit by the foreclosure crisis.

Conclusion

Let me conclude by saying that, as the President and Congress work together to combat the economic crisis, **Ocwen is ready, willing and able to help**. We are delighted to have been selected by Freddie Mac to pilot a special loan modification program, and we have additional capacity to assist in similar programs. Ocwen and other independent loan servicers are the front line of the fight against home foreclosures, and we have the most potent ammunition to win the battle – customized, scaleable loan modifications.

I thank you again for inviting me to testify today. I will answer any of your questions and I ask that my full written statement be entered into the record.

TIME
MAGAZINE

REAL ESTATE

Forestalling Foreclosure

A subprime servicer has devised a plan for modifying loans to keep people in their homes

BY BARBARA KIVIAT

IF YOU THINK SUBPRIME LENDERS ARE the loan sharks of real estate, then loan servicers—the outfits that collect mortgage money and run the books—are the enforcers. Their job is to keep the dough coming, no matter what. Yet Ocwen, one of the nation's largest servicers of subprime loans, has rewritten its role as the heavy and may have an approach to modifying delinquent loans that could slow the wave of foreclosures undermining the economy.

Last year, nearly a million houses were lost to foreclosure. That number could easily rise by millions over the next few years, promising more economic pain. The big problem is that no one has figured out a systematic way to stop the rot. Federal agencies and private lenders have rolled out one loan modification program after another—scattershot and largely timid attempts to make existing mortgages more affordable and keep neighborhoods intact.

Then there is Ocwen, which has already revised 16% of its 340,000 mortgages, in many cases cutting monthly payments 20% to 40%. Based in West Palm Beach, Fla., the company handles some of the worst loans Wall Street kicked up during the housing boom and isn't about to win any popularity contests among consumers—in the past, it's been the target of complaints about unresponsiveness and excessive fees. Nevertheless, good ideas can come from unlikely places, and as more borrowers—including a growing number with prime loans—fall behind on payments, there are lessons to be learned from the firm that has done more than almost anyone else to keep struggling homeowners in their houses.

Executives at Ocwen used to think, as those at any mortgage servicer would, that the solution to a delinquent loan was to create a plan for homeowners to catch up on past payments. When house prices were rising and refinancing was easy, that generally worked, even though it often meant higher monthly payments. But in early 2007, as housing values plateaued, then plummeted, Ocwen saw the percentage of homeowners defaulting a second time climb from 25% to 36%. "We realized we were going to have to make some adjustments," says Ocwen president Ron Faris.

So the company reprogrammed its computer models, which determine how to extract the most value from each loan, to allow much more substantial changes—lowering a mortgage's interest rate, docking its principal balance, converting an adjustable rate to a fixed one, stretching out the life of a loan. With many mortgages "upside down" (when the loan is larger than the home's current value) and the economy sagging, changes often have to be drastic to make the math work, but Ocwen has largely found a way, devising an affordable payment plan 9[illegible] of the time.

What really sets Ocwen apart, though, is its vigor. From doing just a couple of hundred modifications a month in the first half of 2007, Ocwen was up to [illegible] a month by the beginning of 2008, with [illegible] involving a reduction of the interest rate and [illegible] including a permanent write-down of the principal balance. Is it working? Six months after receiving an Ocwen modification, 21% of homeowners have again fallen behind on their payments by 60 days or more. That compares with a [illegible] redefault rate nationally, according to data from federal regulators—a figure that also includes much more stable prime loans.

Principal write-downs are practically unheard of elsewhere—even though they might very well be the best long-term solution for people who owe more than their mortgage is worth, and they help the broader picture too. "That debt overhang is a big drag on the economy," says Alan White, a Valparaiso University professor who studies loan modifications.

The motivation for modification isn't so much social responsibility as the pursuit of profit: when loans go delinquent, the servicer makes less money. Most of Ocwen's business is in collecting on subprime loans, so its portfolio has been hit hard. Nearly a quarter of the loans it services were behind in November, up from just 8% at the end of 2006. And while Ocwen doesn't own those loans, it still loses out when people don't pay on time, since the company has to temporarily front money to investors to make up for the shortfall. "Despite the fact that they're doing it in their own interest, you can't dismiss it," says Rod Dubitsky, head of asset-backed securities research at Credit Suisse, whose assessments show that aggressive modifications keep people in their homes longer.

Ocwen has also answered a key question for other would-be modifiers: whether it's possible to pass major losses to investors without getting sued. Paul Koches, Ocwen's general counsel, holds that the company is not only permitted to take such steps but obligated to—if that's what

Doing the Math on Loan Modifications

If you're struggling to make your mortgage, getting a break on payments probably sounds great. But will your servicer want to help? Here's how it all plays out.

1 A homeowner misses a payment. As the economy flags, people have less income. [illegible]

2 The mortgage servicer notices. [illegible]

John and Susan Archon [illegible]

Ron Faris, president of the loan servicer Ocwen, keeps foreclosures down. The Archons, right, fell behind on their mortgage after John's paycheck — he's a manager at a roofing company — took a major hit. Ocwen calculated that foreclosing on them would be less lucrative than lowering the interest rate on their mortgage, thus dropping their payments by $500 a month — enough to keep them in the house

it takes to squeeze the most money out of a loan for the long term. That's the case executives make when angry investors call — and they do call, especially when a principal reduction chokes off cash flow in a particular month.

Make no mistake: Ocwen has a nearly messianic focus on the goal of maximizing returns for investors. "In most cases, that means keeping people in their homes and getting them to pay their mortgages," says Ocwen CEO Bill Erbey. In foreclosure, investors typically recoup only 60¢ on the dollar.

In a way, Ocwen was uniquely situated to jump ahead on modifications. Erbey, who used to run General Electric's mortgage insurance operation, started buying nonperforming loans with his partners in the early 1990s. Ever since, Ocwen has been refining its computer models — we're talking sophisticated stuff, like vectors and artificial intelligence — to better whip delinquent loans into shape. When the housing slump hit and defaults started to rise, Ocwen wasn't some afterthought unit of a mortgage originator caught with its pants down; it was in its element, in a position to immediately scale up.

That's why, unlike a lot of loan-modification programs, such as those rolled out by Citigroup and IndyMac Bank, Ocwen's doesn't use broad guidelines — for instance, assuming that homeowners should be able to contribute 38% of their income to paying their mortgage. When Ocwen rewrites a loan, it starts from scratch, with an agent at one of its four call centers — two in Florida, two in India — following an adaptive script to reconstruct a borrower's financial data. (The script changes, based on not only what a borrower says but also how he says it; since hiring a director of consumer psychology last summer, Ocwen has been handling embarrassed callers differently than, say, angry ones.)

"I had to show why I was making less money," says John Archon, a manager at a roofing company in Florida, whose paycheck took a major hit in the housing bust. He and his wife now share a car, are energy conscious and "eat a whole lot more hamburgers than steak." Ocwen knocked the interest rate on their 30-year fixed-rate mortgage from 9.5% to about 6.0%, saving the couple $500 a month. Getting those new terms was a stressful process, says Archon, but he "took the standpoint that they were weeding out the people who were not that serious."

Ocwen also breaks ranks with industry practice by modifying loans for people who bought houses as investments. Again, that's in Ocwen's self-interest: those loans account for 17% of its portfolio. In bucking the general disdain for bailing out investment properties, Ocwen realizes that cash is cash, whether it comes from an owner-occupied mortgage payment or one fed by rent, and that a foreclosure displaces a family and blights a neighborhood whether the occupants are owners or tenants.

Which just goes to show that moneymaking and good economic policy aren't necessarily incongruous. As much as capitalism — especially in the mortgage industry — has gotten a bad rap of late, it might just prove useful yet. ■

The secret formula. If your ability to pay has truly changed, your servicer might consider a modification. That depends on whether it can get more money out of you or from a foreclosure

Keeping payments coming. Changes to your loan — like an interest-rate reduction — will be designed to get as much money from you as possible without causing you to default

The investors must be happy. Most recent mortgages were packaged and sold to investors. As long as the servicer keeps cash flowing from the loan [illegible]

"All the News That's Fit to Print"

The New York Times

Washington Edition

Today, some sun, blustery, turning colder, highs around 50. Tonight, clear, colder than usual, lows near 25. Tomorrow, sunny, seasonable, highs in low 40s. Details, Page A12.

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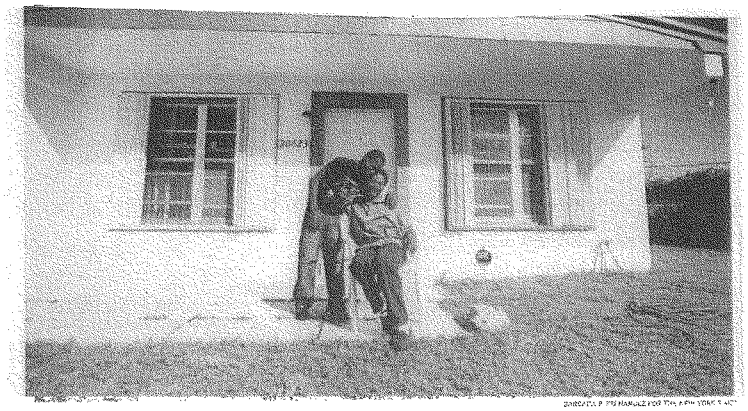


BARBARA P. FERNANDEZ FOR THE NEW YORK TIMES

Luzetta Reeves, with her grandson Donnie Howard, now makes a lower monthly payment on her house in Miami Gardens, Fla.

Modifying Mortgages Can Be a Tricky Business

By VIKAS BAJAJ and JOHN LELAND

MIAMI GARDENS, Fla. — When her brother could no longer help support her, Luzetta Reeves asked her small mortgage company to cut her monthly payments. It did — by 11 percent — making it possible for her to afford her house here on her modest fixed income.

In Miami, Jeffrey Mitchell saw his family income drop just as real estate taxes and insurance premiums increased, making his monthly mortgage payments crushing. He got a lower interest rate, too. But with the added fees and penalties, his monthly payment remained the same. He is now back in foreclosure.

As the Obama administration steps up efforts to help troubled homeowners modify their mortgages, it might consider the experiences of these two South Florida borrowers and their mortgage companies, one small, one large.

National statistics on mortgage modifications suggest that what happened to Ms. Reeves, a disabled 54-year-old, and Mr. Mitchell, a 42-year-old union representative, is fairly typical.

The nation's 14 largest banks reported that more than half of the loans they modified last year were delinquent again after just six months, according to the federal bank regulator, the comptroller of the currency. But several small mortgage companies like the one that helped Ms. Reeves, which have been pursuing modifications longer, say that less than 25 percent of their modified loans became delinquent again.

"It's becoming more and more clear to us that if you do real modifications the default rate is significantly lower," said Tom Miller, the attorney general of Iowa, who has led a group of state officials pushing the industry to modify more loans. "They shouldn't be called modifications if people pay more or approximately the same."

Two years into the foreclosure crisis, many borrowers say they still have trouble reaching anyone at their bank or mortgage company to discuss loan modifications.

Banks and investors absorb huge losses in foreclosures, but some mortgage companies may view foreclosure as more profitable and expedient than modifications because they can levy extra fees and they do not have to wait to see if a homeowner will continue to make payments.

Bankers counter that they pro-

Continued on Page A16

Modifying Mortgages Can Be Tricky Business

From Page A1

sue options that minimize losses, but add that it is often hard to reach delinquent borrowers because many hide from their creditors.

While both arguments appear to have merit, reports by analysts at Credit Suisse and a law professor, Alan M. White, show that when mortgages are renegotiated, borrowers often face higher monthly payments or balloon payments at the end of the term.

Rod Dubitsky, a mortgage analyst at Credit Suisse, found that modifications that result in lower payments tended to re-default at half the rate as plans under which payments were higher or remained roughly the same.

The performance of individual companies varies greatly. Some, like Wells Fargo, one of the nation's largest servicers of home loans, have modified few loans as a percentage of their delinquent mortgages, said Mr. White, an assistant professor of law at Valparaiso University.

Other companies like Ocwen Financial and Litton Loan Servicing, a subsidiary of Goldman Sachs, have modified a big portion of their delinquent loans, according to Credit Suisse. (The studies cover only loans packaged into securities, not those held on the books of banks.)

In the case of Ms. Reeves, Ocwen cut the interest rate to 5.6 percent, from 8.9 percent, lowering her payments by $125, to $1,027. Officials at the company said the reduction would cost less than seizing and selling Ms. Reeves's modest two-bedroom house near Dolphin Stadium.

"Ocwen was very patient with me, and they really worked with me," said Ms. Reeves, who has back problems and breast cancer.

The company said its modifications were not acts of charity but were based on calculations of whether changing loan terms was in the best interests of investors. Using home price data, estimates of legal costs and the time it takes to foreclose, the company determines how much it will recover in foreclosure. It compares that with estimates of what borrowers can afford based on income, family size and expenses.

"Our biggest hurdle is reaching out and talking to people," said Margery A. Rotundo, Ocwen's senior vice president for residential loss mitigation. "If a borrower has a desire and the ability to stay in the home, we can help them."

Ms. Rotundo said the company's decades-long experience with borrowers with blemished credit histories informed its approach.

Ocwen, which is based in West Palm Beach, Fla., modified half of the delinquent loans it resolved last year. It foreclosed on a third, and most of the rest were sold before foreclosure for less than what was owed on them.

But many more people appear to have the experience of Mr. Mitchell, the other Florida borrower.

Mr. Mitchell bought his Miami home four years ago for $282,000. In 2007, his wife had to work less to care for a sick child, and the family was hit with higher tax bills and insurance premiums, raising monthly payments to $2,700 from $2,200.

When Mr. Mitchell told Wells Fargo he could not keep up, he said, "It fell on deaf ears for a while."

Wells Fargo ultimately cut Mr. Mitchell's interest rate to 6.1 percent, from 6.5 percent. But it added fees, back payments and penalties to his principal, raising it above $300,000. His payments were virtually unchanged, and he was asked to make a $5,000 payment to get out of foreclosure. He fell behind again right away. His house, he estimates, is worth only $199,000.

"The arrangements they come up with are not really in your best interest," he said. "You feel like you're trapped."

Wells Fargo declined to comment for this article.

Analysts say it is hard to know exactly why different mortgage companies handle delinquent loans so differently.

Smaller companies like Ocwen that are under more financial pressure and have more experience in dealing with higher-cost loans have been most aggressive in lowering payments, said Mr. Dubitsky, the Credit Suisse analyst. Big banks like Wells Fargo, which would need to be retooled to emphasize modifications over foreclosures, appear to favor modifications that do not lower payments or debts very much.

A spokesman for the comptroller, Bryan Hubbard, said that many banks began focusing on lowering monthly payments last year and that it would be premature to say they had not done enough to help borrowers.

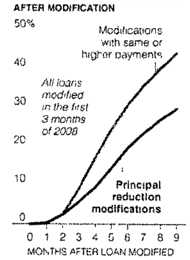
Lowering payments is becoming more important as the economy weakens, Mr. Dubitsky said, because more borrowers are likely to lose jobs or encounter expenses they cannot afford.

"If the borrower is spending every last dollar on their debt," he said, "that leaves them vulnerable to unexpected expenses."

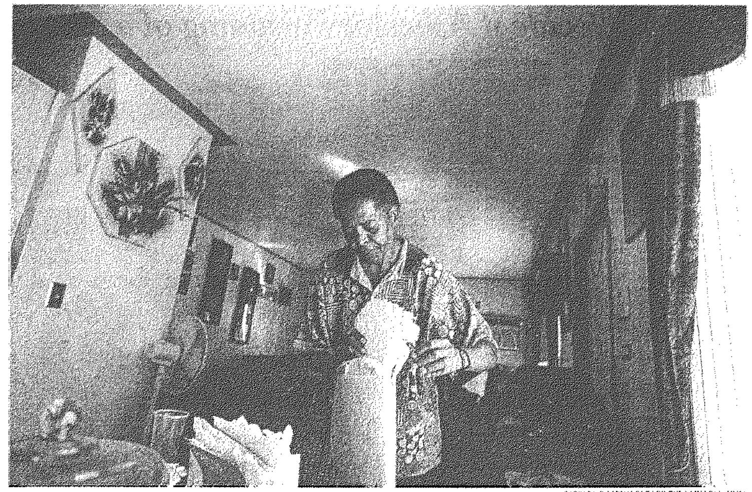
Vikas Bajaj reported from Miami Gardens, and John Leland from New York.

Not All the Same

Lenders have been modifying delinquent home loans but the borrowers making the same or higher monthly payments fall behind again faster than those who pay less after their principal has been reduced.



Source: Credit Suisse THE NEW YORK TIMES



BARBARA P. FERNANDEZ FOR THE NEW YORK TIMES

Luzetta Reeves was able to remain in her home by modifying her mortgage, which cut her interest rate to 5.6 percent from 8.9.

For Release Upon Delivery
2:30 p.m., February 24, 2009

TESTIMONY OF

JOSEPH H. EVERS

DEPUTY COMPTROLLER FOR LARGE BANK SUPERVISION

OFFICE OF THE COMPTROLLER OF THE CURRENCY

BEFORE THE

SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

OF THE

COMMITTEE ON FINANCIAL SERVICES

OF THE

U.S. HOUSE OF REPRESENTATIVES

FEBRUARY 24, 2009

Statement Required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

INTRODUCTION

Chairwoman Waters, Ranking Member Capito, and members of the Subcommittee, on behalf of the Office of the Comptroller of the Currency (OCC), I thank you for holding this hearing and inviting the OCC to testify on this important topic. As Deputy Comptroller for Large Bank Supervision, I am responsible for large bank data and analytics and have been charged with developing more comprehensive and timely mortgage metrics to support the OCC's supervision of large bank mortgage banking operations.

The OCC has always encouraged banks to work with troubled borrowers to prevent avoidable foreclosures and meet the needs of creditworthy borrowers as reiterated in news releases over the past few years.[1] Since then, the OCC has joined other regulators on numerous occasions to urge banks to continue to implement effective programs to prevent avoidable foreclosures and minimize potential losses. Today, the number of foreclosures facing this country and the underlying problems facing the mortgage industry remain a significant challenge for homeowners, their communities, the banks that service those loans, state and federal financial regulators, and policy makers. Clearly, more must be done to address this challenge, and the OCC supports the Administration's Homeowner Affordability and Stability Plan, which takes significant steps toward addressing these issues.

As the regulators of the largest mortgage servicers, the OCC and the Office of Thrift Supervision (OTS) also are uniquely positioned to provide key information about the performance of mortgages and loan modifications, about trends in foreclosures, and about approaches to loss mitigation activities undertaken by national banks and federally regulated

[1] See Interagency News Release, "Federal Financial Regulatory Agencies Propose Guidance on Nontraditional Mortgage Products," December 20, 2005.

thrifts. This information, in turn, helps to encourage and incent modifications that are affordable and sustainable.

Last year, we established a process for collecting and reporting on mortgage performance data and partnered with the OTS to apply this process, based on loan-level data and using standardized definitions and data elements, to report on some 60 percent of all first-lien mortgages in the country. This information is validated, and then communicated to the public in our quarterly *OCC and OTS Mortgage Metrics Report.*

We have made much progress in the last year to develop and refine our data collection, validation, and reporting efforts, and our work in this area continues to evolve in response to supervisory needs and changing market trends. We currently are working to provide additional data at a more granular level on the affordability of loan modifications as well as the types of loan modifications being implemented by the largest mortgage servicers. We continue to improve these efforts and to enhance the information we obtain, and we look forward to making the additional information available in future issues of our *Report.*

This written statement addresses specific issues raised in your Letter dated February 17, 2009, by providing details of: (1) our efforts to improve the understanding of loan modification performance through our mortgage metrics data collection effort; (2) findings from our most recent *Mortgage Metrics Report* including what we have learned about loan modifications; (3) current challenges facing effective loan modifications; and (4) our ongoing efforts to encourage responsible lending, foreclosure prevention, and appropriate loss mitigation activities, including loan modifications.

I. BACKGROUND AND EVOLUTION OF THE OCC AND OTS MORTGAGE METRICS EFFORTS

As part of the OCC's ongoing efforts to address mortgage delinquencies and options for achieving sustainable and affordable mortgage loan modifications, the OCC recognized the need for more comprehensive and timely mortgage data to better understand, assess, and monitor loan performance, loss mitigation activities, and foreclosure trends within the national banking system. In beginning to undertake this large data collection effort in late 2007, we decided to collect data at the loan level from the largest federally regulated mortgage servicers using standard data elements and definitions. We determined basic definitions and standard elements so the information from all the servicers would be comparable—so we could make apple-to-apples comparisons. We also shared our data elements and definitions with the HopeNow Alliance, Treasury, and other federal and state regulators. We chose to employ widely used metrics for terms like "prime," "Alt-A," and "subprime,"[2] as well as "payment plan" and "modification." We also applied a standard approach to reporting loan delinquencies and foreclosure actions.

Our use of standard metrics, consistent definitions, and reporting approaches ensures that mortgage loan performance and loss mitigation activities, including loan modifications, are reported in a consistent and uniform manner by all participating national bank mortgage servicers. For example, we found some servicers count any contact with a borrower about payment reduction or relief as a mitigation in process, while others did not count mitigation efforts until a particular mitigation plan had been formally implemented. Standardized definitions make comparisons across different servicers easier and support the use of this data for our supervisory purposes.

[2] See "Definitions and Methods" presented in the *OCC Mortgage Metrics Report*, October 2007-March 2008.

Collecting data at the loan level has the advantage of allowing us to drill down to individual loans and source systems. In addition, the OCC and OTS subject monthly data collections to a standardized data validation process and subjective review by mortgage banking experts. This approach to validation requires submitted data to pass our validation checks and controls before it can be accepted into our database for use. In some cases, servicers are required to resubmit their monthly data in order to meet our validation standards.

On February 29, 2008, the Comptroller issued a letter to the nine largest national bank mortgage servicers requiring them to submit data on each of the first-lien mortgages they service for others, service for themselves, and hold on their balance sheet according to our standard definitions. These large mortgage servicers also were required to report this data on a monthly basis within 30 days of month end, using the OCC data schedule.[3]

The scope of the data collection was unprecedented, and the effort to validate the data extensive. The initial data request included 64 data elements on each of the 23 million loans held or serviced by national banks for each month from October 2007 through March 2008. The results of this first data call were published in June 2008 in the *OCC Mortgage Metrics Report*, October 2007-March 2008.[4] The *Report* presented new loan-level data on the performance of first-lien mortgages, trends in foreclosure, and banks' loss mitigation efforts. However, we recognized limitations to this initial *Report* and saw opportunities to improve reporting.

Even before completing this first *Report*, the OCC began to work with the OTS[5] to issue a joint *Report* the following quarter. By combining our efforts, the joint *Report* by the OCC and

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[3] See OCC News Release, "OCC to Require Data from Large Bank Mortgage Servicers," February 29, 2008, and Letter to National Bank Mortgage Servicers, February 29, 2008.
[4] See OCC Mortgage Metrics Report, October 2007-March 2008, released on June 11, 2008.
[5] The OTS separately issued its first report on mortgage metrics on July 3, 3008.

OTS covers more than 60 percent of the first-lien mortgages in the industry, or roughly 35 million loans with principal balances exceeding $6 trillion.

The OCC and OTS worked to further refine data definitions and elements and to ensure data collection and validation efforts produced comparable data that could be reported in aggregate form. The OCC and OTS released their first joint *Report* on mortgage metrics on September 12, 2008.[6] That *Report* followed the same format and included much the same data as the previous reports but on a larger scale. The *Report* showed the continued rise in mortgage delinquencies, the shift in emphasis from payment plans to loan modifications, and the use of loss mitigation more frequently than initiating new foreclosure proceedings.[7] The next step for the agencies was to expand the data to answer questions about the performance of loan modifications.

In December 2008, the OCC and OTS released their second joint *Report* on mortgage metrics covering the first three quarters of 2008.[8] This *Report* presented the first available information on the performance of mortgages following modification based on loan-level data covering a broad portion of the mortgage industry.[9] We found that an unexpectedly high percentage of loan modifications made in the first and second quarters of 2008 resulted in re-defaults. This could be the product of several factors. Early loan modifications may not have been structured in a manner that resulted in affordable and sustainable mortgage payments. Other factors, such as excessively high debt burden, negative equity position, and increasing levels of unemployment and underemployment, also may be contributing to high re-default rates.

[6] See OCC and OTS News Release, "Agencies Release Joint Mortgage Metrics Report For the Second Quarter of 2008," September 12, 2008.
[7] See, the *OCC and OTS Mortgage Metrics Report*, January-June 2008.
[8] See OCC and OTS News Release, "Agencies Release Joint Mortgage Metrics Report For the Third Quarter of 2008," December 22, 2008.
[9] See the *OCC and OTS Mortgage Metrics Report*, Third Quarter 2008, December 22, 2008.

Based on the findings of our December *Report*, the OCC and OTS decided to expand the scope of the mortgage performance data gathered from national banks and thrifts to examine more closely the affordability and sustainability of loan modifications to be released in the next *Report* due out in March.

The additional data we are obtaining will show how modifications changed the total amount of borrowers' monthly principal and interest payments for loans modified during 2008. The next edition of the agencies' joint *Mortgage Metrics Report*, scheduled for release next month, will present information for categories of loan modifications that:

- Increased borrowers' monthly principal and interest payments.
- Brought no change to payments.
- Reduced payments by 10 percent or less.
- Reduced payments by more than 10 percent.

Importantly, for loans modified in the first and second quarters of 2008, the *Report* will also show the percentage of modifications in each of the four categories that are 60 or more days past due at six months after modification. This will help gauge how changes in monthly payments resulting from modifications make mortgages more sustainable and help keep borrowers in their homes.

The OCC and OTS announced this effort to expand data collection and reporting on February 13, 2009.[10] At the same time, the agencies released their most current dictionary of definitions and standard elements, expanded from the original 64 elements to 99.[11] This data dictionary was provided to the State Foreclosure Prevention Working Group, the Conference of

[10] See OCC and OTS News Release, "OCC and OTS Expand Data Collection on Mortgage Performance," February 13, 2009.
[11] See OCC/OTS Mortgage Metrics – Loan Level Data Collection: Field Definitions, McDash Analytics, January 7, 2009.

State Bank Supervisors (CSBS),[12] and as part of the OCC and OTS coordinated response to the data request by the Congressional Oversight Panel.[13]

II. FINDINGS FROM MORTGAGE METRICS INITIATIVE TO DATE

In the *OCC and OTS Mortgage Metrics Report*, Third Quarter 2008, the agencies collected data from the nine national banks[14] and the five thrifts[15] with the largest mortgage servicing portfolios. At the end of September 2008, the 34.6 million first-lien mortgage loans serviced by these institutions totaled more than $6.1 trillion in principal balances. The combined servicing portfolio constituted more than 60 percent of all mortgages outstanding in the United States. About 88 percent of the mortgages in the total servicing portfolio were held by third parties as a result of loan sales and securitization by government-sponsored enterprises (GSEs), the originating banks, and other financial institutions. The *Report* presents a number of significant findings about the quality of first-lien mortgages held and serviced by national banks and federally regulated thrifts, foreclosure trends and loss mitigation efforts, the use of loan modifications versus other loss mitigation tactics, and the performance of loans modified in the first and second quarter of 2008.

In brief, the data through the third quarter of 2008 showed that delinquencies, foreclosures in process, completed foreclosures, and other actions leading to home forfeiture all continued to rise, but that newly initiated foreclosures had declined while new payment plans

[12] See OCC and OTS response to letter from State Foreclosure Prevention Working Group, February 13, 2009.
[13] OCC and OTS response to Congressional Oversight Panel request, February 20, 2009.
[14] The nine banks are Bank of America, Citibank, First Horizon, HSBC, JPMorgan Chase, National City, USBank, Wachovia, and Wells Fargo.
[15] The five thrifts are Countrywide, IndyMac, Merrill Lynch, Wachovia FSB, and Washington Mutual. Washington Mutual was acquired by and merged into JPMorgan Chase in September 2008. IndyMac has been operated by the Federal Deposit Insurance Corporation since July 2008. Countrywide has been purchased by Bank of America. Wachovia has been purchased by Wells Fargo.

and modification actions increased. The third quarter data also showed that loan modifications were associated with high levels of re-default.

Key findings included:

- Credit quality declined during the third quarter across all loan categories, continuing the trend reported in the first to the second quarters of 2008. The percentage of current and performing mortgages in the portfolio declined to 91.47 percent at the end of the third quarter from 93.33 percent at the end of the first quarter.[16]

- Early stage delinquencies (30-59 days past due), seriously delinquent mortgages (60 or more days past due plus loans to bankrupt borrowers who are 30 or more days past due), and the number of foreclosures in process increased in the third quarter.

Delinquency and Foreclosure Rates (% of all mortgage loans in the portfolio at the end of each quarter)			
	First Quarter	Second Quarter	Third Quarter
30-59 days delinquent	2.59%	2.85%	3.20%
Seriously delinquent	2.66%	2.94%	3.54%
Foreclosures in process	1.41%	1.59%	1.78%

- The number of loan modifications completed in 2008 steadily increased, and loan modifications surpassed payment plans as the primary loss mitigation tool used by servicers.[17]

Newly Initiated Home Retention Actions			
	First Quarter	Second Quarter	Third Quarter
Loan modifications	72,877	114,439	133,106
Payment plans	136,874	139,186	154,649
Total	209,751	253,625	287,755

[16] As noted in the *OCC and OTS Mortgage Metrics Report*, the portfolio of first-lien mortgages serviced by national banks and thrifts, while large, is unique and not necessarily representative of the total industry. As a result, numbers presented by the OCC and OTS may not track national averages or numbers extrapolated to represent the total industry.

[17] OCC and OTS are currently unable to determine the performance of various types of loan modifications. The agencies are working to expand the data collection effort to include this data in the future.

- Loan modifications completed in first quarter 2008 and second quarter 2008 had high re-default rates at three months after loan modification and re-default rates did not level off over time.

- For loans modified in the first quarter of 2008, more than 37 percent of modified loans were 30 or more days delinquent or in the process of foreclosure after three months. After six months, that re-default rate was more than 55 percent. For loans modified during the second quarter, the three-month 30+ day delinquent re-default rate was more than 40 percent.

Modified Loans 30+ Days Delinquent (30+ Re-default Rate)		
	Three Months After Modification	Six Months After Modification
First quarter 2008 loan modifications	37.44%	55.14%
Second quarter 2008 loan modifications	40.52%	--

- For loans modified in the first quarter, more than 19 percent were 60 or more days delinquent or in process of foreclosure after three months. That rate grew to nearly 37 percent after six months. For loans modified in the second quarter, that re-default rate was more than 21 percent after three months.

Modified Loans 60+ Days Delinquent (60+ Re-default Rate)		
	Three Months After Modification	Six Months After Modification
First quarter 2008 loan modifications	19.18%	36.90%
Second quarter 2008 loan modifications	21.38%	--

- Re-default rates were lower for loans held by the servicing banks and thrifts, compared to loans serviced for others. This may suggest greater flexibility to modify loans in more sustainable ways when loans are held on a servicer's own books than when loans are securitized or otherwise held by third parties. However it may also reflect other factors including stronger underwriting or a deeper relationship between the borrower and the bank.

First Quarter 2008 Loans by Investor	Three Months After Modification (30+ Days Delinquent)	Six Months After Modification (30+ Days Delinquent)
On-book portfolio (loans held by servicers)	35.06%	50.86%
FHLMC (Freddie Mac)	39.09%	57.87%
FNMA (Fannie Mae)	38.34%	57.11%
Private Investors	42.28%	60.76%

- The number of completed foreclosures and other home forfeiture actions (short sales and deeds-in-lieu-of-foreclosure) increased by 11 percent from the second to the third quarter.[18] Short sales and deeds-in-lieu-of-foreclosure remained a small fraction of loss mitigation activities. The number of home retention actions—loan modifications and payment plans—was more than twice the number of completed foreclosures and other home forfeiture actions. The number of newly initiated foreclosures fell from 288,689 during the second quarter to 281,298 during the third quarter—a drop of 2.6 percent.

Completed Foreclosures and Other Home Forfeiture Actions	First Quarter	Second Quarter	Third Quarter
New short sales	5,834	8,222	13,254
New deed-in-lieu-of-foreclosure actions	1,074	807	843
Completed foreclosures	107,134	118,316	127,738
Total	114,042	127,345	141,835
New home retention actions relative to completed foreclosures and other home forfeiture actions	183.92%	199.16%	202.88%

Additional Information Reported to the Congressional Oversight Panel

[18] Completed foreclosures, short sales, and deed-in-lieu actions require the borrower to give up the home to pay (partially or in whole) the mortgage debt.

The OCC and OTS reported additional information beyond what was presented in the December *Mortgage Metrics Report* in their February 20, 2009, response to a request from the Congressional Oversight Panel. The additional information provided to the Congressional Oversight Panel was based on the same data collected as of September 30, but further detailed the data to show items such as the number of government-insured mortgages, the number of jumbo mortgages, the number of mortgages for 2-4 family residences, the number of owner occupied homes at origination, the total monthly debt-to-income ratio for borrowers, loan-to-value ratios in excess of 90 percent, loans with current negative equity, the type of loan (adjustable rate mortgage, interest only, or negatively amortizing), and differences between loans serviced for others and loans on the banks' books.[19]

Planned Improvements to the Mortgage Metrics Initiative

Our findings reported on data through September 30, 2008, did not yet fully address important questions about loan modification affordability, the types of loan modification actions, or payment sustainability as it relates to affordability. These questions led to our decision that more detailed information was required to enhance our analysis. Since the publication of the latest *Report* in December 2008, we have been working to gather additional details on the types of modifications and changes in monthly principal and interest payments resulting from modifications. On January 7, 2009, we met with the largest mortgage servicers to detail the new reporting requirements. On February 13, 2009, the OCC and OTS announced their efforts to expand the mortgage metrics data collection activities.[20] We plan to present the substantially

[19] OCC and OTS Response to request by Congressional Oversight Panel, February 20, 2009.
[20] See OCC and OTS News Release, "OCC and OTS Expand Data Collection on Mortgage Performance," February 13, 2009.

expanded information on actual changes in monthly principal and interest payments resulting from loan modifications in the next quarterly *Mortgage Metrics Report* due out in March 2009.

To support this effort, the OCC and OTS updated the definitions and the data elements used to collect data from mortgage servicers. We have significantly expanded the number of data elements we are collecting from the servicers to obtain more detailed information on borrowers' monthly principal and interest payments before and after the modification, and the loan terms being modified. As described above, we will report the number of modifications resulting in increased payments, unchanged payments, reduced payments by 10 percent or less, or reduced payments by more than 10 percent. For loans modified in the first and second quarters of 2008, the next *Report* will show the percentage of modifications in each of the four categories that are 60 or more days past due at six months after modification. This will help determine whether significantly lower payments is the major factor in reducing loan re-default, or whether other factors are at work, such as other debt, negative equity, or income loss.

The OCC and OTS have also begun to collect other data on the type of modifications, including interest rate reduction or freeze, principal write down or deferral, capitalization of delinquent amount, term extension, or a combination of these features. While this information will not be available until the June 2009 *Report*, we continue to further our analysis and understanding of mortgage modification actions and effectiveness. Collectively, such information will result in better assessments of loan performance, modifications, and re-defaults.

III. THE VALUE OF QUALITY MORTGAGE METRICS AND REPORTING

The OCC and OTS mortgage metrics initiative provides rigorously validated data for bank supervisors, policy makers, and mortgage servicers to work with in understanding the performance of loan modifications and making consistent comparisons across federally regulated national banks and thrifts.

For bank supervisors, the data will help us develop risk-based supervision strategies. Examiners will use the information for a wide range of activities, including identifying anomalies, comparing national bank trends to the industry, evaluating asset quality and loan-loss reserve needs, and assessing the effectiveness of loss mitigation actions. Over time, it will allow us to look at trends in performance based on origination channels and other key credit characteristics. This will help us more fully assess underwriting policies, loss mitigation (e.g. loan modifications and payment plans), losses, and recovery efforts.

The data collection effort itself is an important bank supervision tool. By requiring more and better data, the OCC and OTS are spurring servicers to modify their systems to provide both themselves and bank supervisors with higher quality information upon which to base their decisions.

For policy makers, the data raise important questions about the delinquency rates of loans after loan modification that require more investigation. Understanding the current re-default rates of modified loans can better inform how best to structure systematic loan modification programs to be successful in preventing avoidable foreclosures and in minimizing loss. By bringing standardization to definitions and a common set of elements to the discussion, the mortgage metrics effort provides policy makers the ability to look across a large portion of the mortgage industry and be confident that they are comparing apples to apples. Such standardization leads to greater transparency across the industry.

For mortgage servicers, the data collection effort pointed out gaps in loss mitigation data that had previously prevented a more comprehensive and timely understanding of loss mitigation activities within the industry. Before the current crisis, loan modifications were few and focused strictly on mitigating the losses to banks and investors. As the crisis unfolded, loan modification and other loss mitigation actions became issues of systemic importance and the need for more comprehensive and timely mortgage data became much greater. The mortgage metrics initiative resulted in increased efforts by mortgage servicers to improve their systems and data reporting capabilities, which not only allowed them to respond to regulator requirements, but also produced better data for their own internal decision making and use. Better visibility of this data over time will result in more robust loss mitigation plans and risk management strategies. Standardized definitions and common elements also allow mortgage servicers to better compare their performance across the industry.

IV. IMPROVING LOSS MITIGATION AND FORECLOSURE PREVENTION

With the large number of foreclosures and the increasing numbers of serious delinquencies, actions to prevent avoidable foreclosures and effectively minimize loss continue to be critical to homeowners, mortgage servicers, and the economy as a whole. While many of the largest mortgage servicers regulated by the OCC have independently taken action to expand and enhance their loan modification and foreclosure prevention efforts, more action is needed.

However, challenges to effective foreclosure prevention and loan modification remain, including:

- Working with investors of securitized mortgages to accept loan modifications and their terms when demonstrated as preferable alternatives to foreclosure. The OCC supports using a consistent net present value (NPV) model to assist servicers in estimating loss severity rates on modifications relative to foreclosures.

- Working with borrowers to obtain current income and total debt information to determine the capacity of borrowers to meet monthly mortgage payments under modified terms. This requires a level of effort by both borrowers and servicers since total debt information is not always readily available to servicers. However, we find promise in results from efforts by servicers, and nonprofit consumer and foreclosure counseling organizations to increase borrower contact with their lenders and servicers.
- Negotiating with second-lien holders to agree to a loan modification. This takes time and slows down the process for implementing loan modifications.
- Targeting borrowers who are presently current on their mortgage for loan modifications when there currently is not a clear standard or definition in securitization pooling and servicing agreements for determining a "foreseeable default."
- Declining home prices that result in borrowers having no equity in their homes may serve as an economic disincentive to make mortgage payments under modified loan terms. In addition, borrowers who have lost their jobs and have no income will not be in a position to make mortgage payments, even under modified loan terms.
- The need for consistent, comparable, and additional data to better understand the effectiveness of loan modifications across the industry. Since the publication of our first *Mortgage Metrics Report* less than nine months ago, we have made progress to improve available data on mortgages, loan modifications, and foreclosures.

Suggestions to Address these Challenges and Other Issues

To address these challenges it will be necessary to have loan modification programs that can be understood, implemented, and will result in mortgages that are affordable and sustainable for the borrower. This will require loan modification programs to define eligible borrowers and underwriting criteria that can be consistently applied for determining affordability. In addition, a uniform and consistently applied NPV model will be important to determine the cost of loan modifications versus foreclosure, and servicers and nonprofit consumer credit counseling organizations should continue to coordinate and work closely together to reach out and assist borrowers in need of loan modifications.

V. ENCOURAGING RESPONSIBLE LENDING, FORECLOSURE PREVENTION, AND LOSS MITIGATION

While much has been done in the past year to assist troubled borrowers and stem the tide of foreclosures, much more needs to be done to effectively address problems facing homeowners and the mortgage markets. In this regard, the OCC strongly supports the Administration's Homeowner Affordability and Stability Plan and will work with the Administration, Treasury, and mortgage servicers to ensure it is properly implemented. The plan, which was announced by President Obama on February 18, includes a number of elements designed to assist homeowners making a good faith effort to stay current on their mortgage obligations in avoiding foreclosures. A central tenet of this plan is to provide consistent guidance to lenders and borrowers to solve for mortgage payments that are affordable and sustainable when making loan modifications. As we obtain additional information and gain insights into what is working and what is not working, we will work to ensure adjustments are made to implement loan modifications that are effective.

The OCC has been at the forefront in calling for prudent and responsible underwriting and requiring fair, non-predatory lending practices. As early as 2003, the OCC warned against predatory and abusive lending practices.[21] In one of his first speeches, Comptroller Dugan warned banks against risky, nontraditional loans, expressed concern about features of these loans that result in negative amortization and a high rate of defaults, and announced that the federal banking agencies planned to release guidance on underwriting and disclosures for nontraditional mortgages.[22] That guidance was proposed in December 2005[23] and finalized in 2006.[24] The OCC later championed the application of these standards throughout the entire mortgage industry[25] and joined other federal regulators in promoting the consumer awareness of the risks of these loans.[26] Subsequent to the issuance of this guidance, the OCC conducted a horizontal review to ensure that large banks properly implemented the nontraditional mortgage guidance.

Since then the OCC has actively promoted banks' responsibility to work with troubled borrowers to avoid unnecessary foreclosures and meet the needs of creditworthy borrowers. In 2006, the Comptroller spoke out on nontraditional mortgage products and praised banks' efforts to work with borrowers through community groups and nonprofits.[27] Later that year we issued a newsletter educating banks on foreclosure prevention programs,[28] and the Comptroller

[21] See OCC News Release, "Comptroller Hawke Urges New Approach to Combating Predatory Lending," July 24, 2005 (http://www.occ.gov/toolkit/newsrelease.aspx?Doc=92PAMG4.xml) and Interagency Brochure, "Putting Your Home on the Loan Line is Risky Business," October 7, 2003 (http://www.occ.gov/predatorylendingbrochure.pdf.)

[22] See Remarks by the Comptroller of the Currency before the Consumer Federation of America, December 1, 2005.

[23] See Interagency News Release, "Federal Financial Regulatory Agencies Propose Guidance on Nontraditional Mortgage Products," December 20, 2005.

[24] See Interagency News Release, "Federal Financial Regulatory Agencies Issue Final Guidance on Nontraditional Mortgage Product Risks," September 29, 2006.
(http://www.occ.gov/toolkit/newsrelease.aspx?JNR=1&Doc=M3ZM5FQW.xml)

[25] See OCC News Release, "Comptroller Dugan Urges Key Principles of Federal Nontraditional Mortgage Guidance Apply to All Mortgage Originators," October 17, 2006.
(http://www.occ.gov/toolkit/newsrelease.aspx?Doc=4DTXZX3L.xml)

[26] See Interagency News Release, "Agencies Provide Consumer Information on Nontraditional Mortgage Loans," October 18, 2006. (http://www.occ.gov/toolkit/newsrelease.aspx?JNR=1&Doc=8WZDEM4.xml)

[27] See OCC News Release, "Comptroller Dugan Expresses Concern about New Types of Mortgages That Offer Low Initial Monthly Payments, but Higher Payments Later," April 20, 2006.
(http://www.occ.gov/toolkit/newsrelease.aspx?Doc=ZL7ERCCB.xml)

[28] See the OCC's Community Developments Online -- *Homeownership Preserving the America Dream, Spring 2006.* (http://www.occ.gov/cdd/spring06b/cd/index.html)

underscored banks' responsibilities to serve the credit needs of all community members.[29] In 2007, the OCC joined other federal regulators to encourage financial institutions to work with borrowers unable to make their payments.[30] One week later, the Comptroller re-emphasized these points during a speech to the National Foundation for Credit Counseling.[31] Later in 2007, the OCC unveiled public service advertisements to increase awareness of foreclosure prevention efforts[32] and a newsletter providing additional information to assist banks in their foreclosure prevention work.[33] The OCC then joined other federal regulators to issue a statement on subprime lending, reinforcing previous statements to work with borrowers in a safe and sound manner who are financially unable or reasonably expected to be unable to meet contractual payment obligations on their home loans,[34] and in a separate statement, the agency encouraged federally regulated financial institutions and state-supervised entities that service securitized residential mortgages to review and make full use of their authority under pooling and servicing agreements to identify borrowers at risk of default and pursue appropriate loss mitigation strategies designed to preserve homeownership.[35]

[29] See OCC News Release, "Comptroller Dugan Underscores Banks' Responsibility To Serve Credit Needs of All Community Members," May 3, 2006 (http://www.occ.gov/toolkit/newsrelease.aspx?Doc=ZL7ERCCB.xml)
[30] See Joint Release, "Federal Regulators Encourage Institutions to Work with Mortgage Borrowers Who Are Unable to Make Their Payments," April 17, 2007. (http://www.occ.gov/ftp/release/2007-41.htm)
[31] See OCC New Release, "Comptroller Dugan Expresses Concern over Subprime Mortgage Foreclosures; Receives "Making-the-Difference" Award from Credit Counseling Foundation," April 24, 2008. (http://www.occ.gov/ftp/release/2007-44.htm)
[32] See OCC News Release, "Comptroller Dugan Unveils Public Service Announcements Encouraging Delinquent Borrowers to Contact Lenders for Help to Avoid Foreclosure," June 25, 2007. (http://www.occ.gov/ftp/release/2007-61.htm)
[33] See OCC Community Developments Insights: Foreclosure Prevention: Improving Contact with Borrowers. June 26, 2007. (http://www.occ.gov/cdd/Foreclosure_Prevention_Insights.pdf)
[34] See Joint News Release, "Federal Financial Regulatory Agencies Issue Final Statement on Subprime Mortgage Lending," June 29, 2007. (http://www.occ.gov/ftp/release/2007-64.htm)
[35] See Joint News Release, "Federal Financial Regulatory Agencies and CSBS Issue Statement On Loss Mitigation Strategies for Servicers of Residential Mortgages," September 4, 2007. (http://www.occ.gov/ftp/release/2007-91.htm)

In 2008, the OCC reiterated the guidance to national banks to work with troubled borrowers to meet the needs of creditworthy borrowers and their communities,[36] and most recently joined other federal regulators to once again encourage mortgage servicers to work with existing borrowers to avoid preventable foreclosures, which can be costly to both the institutions and to the communities they serve, and to mitigate other potential mortgage-related losses.[37]

CONCLUSION

In conclusion, more needs to be done on foreclosure prevention and to ensure sustainable mortgage credit. The OCC supports the Homeowner Affordability and Stability Plan, and we will continue to encourage national bank servicers to work with troubled borrowers and to develop and implement effective—affordable and sustainable—loan modification programs that prevent avoidable foreclosures. In addition, we will continue to refine our mortgage metrics and collect additional data to help us, as well as policy makers and the public, to better assess the effectiveness of loan modifications implemented by federally regulated institutions. You can expect to see additional information on modification performance in our next *Mortgage Metrics Report* due out in March.

[36] See OCC News Release, "Comptroller Dugan Urges Action to Help Communities Suffering from Effects of Mortgage Foreclosure Crisis," February 12, 2008. (http://www.occ.gov/ftp/release/2008-14.htm)
[37] See Joint News Release, "Interagency Statement on Meeting the Needs of Creditworthy Borrowers," November 12, 2008.

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Statement of

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Managing Director for Corporate and International Activities
Office of Thrift Supervision

concerning

Loan Modifications:
Are Mortgage Servicers Assisting Borrowers with Unaffordable Mortgages?

before the

Subcommittee on Housing and Community Opportunity
United States House of Representatives

February 24, 2009

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Statement required by 12 U.S.C. 250: The views expressed herein are those of the Office of Thrift Supervision and do not necessarily represent those of the President.

Testimony on Loan Modifications: Are Mortgage Servicers Assisting Borrowers with Unaffordable Mortgages?

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Grovetta N. Gardineer
Managing Director for Corporate and International Activities
Office of Thrift Supervision

I. Introduction

Good afternoon, Chairwoman Waters, Ranking Member Capito and Members of the Subcommittee. Thank you for the opportunity to offer testimony on behalf of the Office of Thrift Supervision (OTS) on loan modifications and what strategies will work best to keep more Americans in their homes. The importance of the topic of this hearing is hard to overemphasize. Turning back the tide of home foreclosures is an essential element in combating the economic crisis confronting this nation and much of the rest of the world. Foreclosed homes spell tragedy for the uprooted American families, harm neighborhoods by driving down property values and add downward pressure to already depressed home values.

Although about 92 percent of all home mortgages in this country are being repaid on time, the remaining eight percent that are delinquent or in foreclosure represent a historically high number and a contagion in our economic system.

In my testimony today I will discuss interagency guidance by the federal bank regulatory agencies on helping troubled borrowers and encouraging mortgage servicers to take action to preserve homeownership. I will also explain the details of a foreclosure prevention plan that the OTS developed a year ago to provide incentives for avoiding foreclosures among homeowners who are "underwater," owing more on their mortgages that their homes are worth. Lastly, I will describe in some detail the work by the OTS and the Office of the Comptroller of the Currency (OCC) to produce detailed reports that provide validated, loan-level data on loan modifications and other foreclosure-prevention measures among about 60 percent of all outstanding mortgages in the nation. These reports provide valuable insight into how well foreclosure prevention efforts are working and what strategies offer the greatest promise for providing sustainable solutions over the long term.

The OTS has had a long standing commitment to affordable and sustainable mortgage modification efforts and has repeatedly encouraged its institutions to work constructively with their troubled borrowers. After proposing its OTS Foreclosure Prevention Proposal a year ago, agency leaders have been testifying on Capitol Hill about foreclosure prevention alternatives, discussing approaches with industry trade groups and working with other bank regulators to help keep American families in their homes.

Just last week, Director Reich urged OTS-regulated institutions to suspend foreclosures on owner-occupied homes until the Administration's Financial Stability Plan "home loan modification program" is finalized. As he stated, "OTS-regulated institutions would be supporting the national imperative to combat the economic crisis by suspending foreclosures until the new Plan takes hold."

The Plan unveiled by President Obama last Wednesday commits $75 billion to prevent avoidable foreclosures by reducing monthly payments for homeowners. OTS officials participated in the interagency effort led by the Treasury Department to develop the Plan and we look forward to continuing to participate in interagency initiatives to address this national dilemma.

II. Background and History

OTS's efforts to encourage servicers to work with troubled borrowers are not recent. For example, in April 2007, OTS and the other Federal banking regulators issued a statement that encouraged financial institutions to work with homeowners who are unable to make mortgage payments. Because prudent workout arrangements consistent with safe and sound lending practices are generally in the long-term best interest of both the financial institution and the borrower, institutions were assured that they would not face regulatory penalties if they pursued reasonable workout arrangements with borrowers.

The statement advised borrowers who are unable to make their mortgage payments to contact their lender or servicer as soon as possible to discuss available options. The advice remains sound today, although we have refined our notion of what a constructive workout arrangement looks like. Examples of constructive workout arrangements included modifying loan terms, and/or moving borrowers from variable-rate loans to fixed-rate loans.

In the summer of 2007, OTS coordinated with the FDIC to convene several meetings with servicers to better understand the issues they faced. The servicers identified several stumbling blocks they had already encountered, including the direct expense of loan modifications, unresponsive borrowers, the requirement to maximize value to the servicing trust, and legal and accounting impediments in servicing agreements associated with securitized loans.

In September 2007, the OTS joined the other Federal banking regulators and the Conference of State Bank Supervisors in issuing a statement "encouraging federally regulated financial institutions and state-supervised entities that service securitized residential mortgages to review to determine the full extent of their authority under pooling and servicing agreements to identify borrowers at risk of default and pursue appropriate loss mitigation strategies designed to preserve homeownership."

The statement noted that many subprime and other mortgage loans had been transferred into securitization trusts governed by pooling and servicing agreements. The agreements could allow servicers to contact borrowers at risk of default, assess whether default was reasonably foreseeable and, if so, apply loss mitigation strategies to achieve sustainable mortgage obligations. Servicers could have the flexibility to contact borrowers in advance of loan resets.

As the August 2007 statement said, appropriate loss mitigation strategies could include loan modifications, conversion of an adjustable rate mortgage into a fixed rate, deferral of payments, or extending amortization. In addition, institutions were asked to consider referring appropriate borrowers to qualified homeownership counseling services to work with all parties to avoid unnecessary foreclosures.

Finally, bank and thrift programs that transition low- or moderate-income homeowners from higher-cost loans to lower-cost loans have long been able to receive favorable consideration under the Community Reinvestment Act (CRA), provided the loans are made in a safe and sound manner. Building on this principle, the OTS joined with other regulators to issue expanded CRA guidance in January 2009. These "questions and answers" encourage financial institutions to participate in foreclosure prevention programs that have the objective of providing affordable, sustainable, long-term loan restructurings or modifications for homeowners who are facing foreclosure on their primary residences.

III. Developing Standardized Reporting Templates

In March of 2008, OTS issued a statement that encouraged its regulated mortgage servicers to use a standard template developed by HOPE NOW to report information on modifications of subprime adjustable rate mortgage loans.

In a memorandum to Chief Executive Officers of OTS-regulated thrift institutions, the agency pointed out that the use of a standard template would support monitoring of foreclosure prevention efforts and provide transparency for investors in loan securitization trusts.

IV. OTS Mortgage Metrics Report

In support of this effort, the OTS worked closely with the OCC to design a standardized reporting template that included more that 60 data fields for each loan. The result of this initiative was the publication of the first OTS Mortgage Metrics Report in July 2008.

The report was based on a data collection process that covered 64 data elements for each of the 11.4 million first-lien residential mortgages held or serviced for the period January 2008 through March 2008 by the five largest OTS servicers. This was the first report to gather and analyze standardized information of this scale and detail on mortgage delinquencies, loss mitigation actions, and foreclosures. OTS used a data vendor to aggregate, validate, store and generate reports, but retained ownership and control of the data. OTS used the same standard data elements and definitions as the OCC and the Hope Now Alliance to promote standard data collection and analytic consistency across the mortgage industry.

V. Joint Report with OCC

The second Mortgage Metrics Report was a joint report by the OCC and the OTS. By joining together, the agencies presented a more comprehensive picture of mortgage performance, loss mitigation and foreclosures among federally regulated banks and thrifts.

The combined report reflects the activities of many of the industry's largest mortgage servicers, and incorporates information on all types of mortgages serviced, not just subprime. The report presents loan-level data on each of the 34.7 million loans in this portfolio. Because we have access to the individual loans, the results we report are not based on estimates or on inferences from surveys, but rather reflect the servicers' actual experience.

The decision to issue a joint report also extends the effort of creating a common reporting framework by using standardized reporting terms and data elements. In particular, the report uses standard definitions for prime, Alt-A, and subprime mortgages, relying on credit score ranges that are common across the industry. A common reporting framework allows for better comparison across the industry and over time.

The agencies collected data from the nine national banks and the five savings associations with the largest mortgage servicing portfolios. At the end of June 2008, the first-lien mortgage loans serviced by these institutions totaled more than $6.1 trillion in principal balances. The combined servicing portfolio constituted more than 90 percent of all mortgages serviced by national banks and thrifts, and approximately 60 percent of all mortgages outstanding in the United States. Approximately 88 percent of the mortgages in the total servicing portfolio were held by third parties via securitization by government-sponsored enterprises and other financial institutions.

Key findings of the second quarter joint report include:

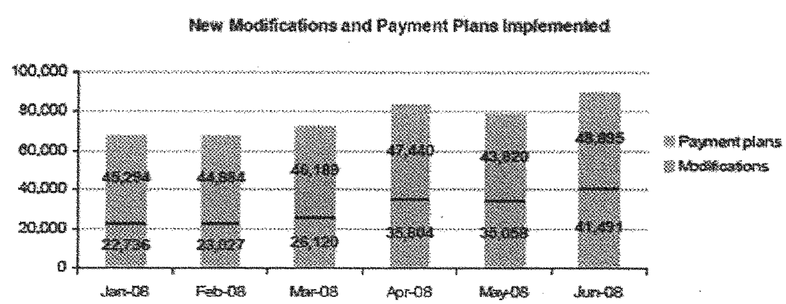
- New loan modifications increased by more than 80 percent from January 2008 to June 2008 and increased by 56 percent from the first quarter to the second quarter. By comparison, new payment plans grew only 8 percent from January to June 2008 and increased more than 2.7 percent from the first quarter to the second quarter. (A payment plan is a short- to medium-term change in scheduled terms and payments, while a loan modification is a permanent change in the contractual elements of the mortgage, such as the interest rate or other loan terms.)

- As a result, the mix of loss mitigation shifted toward loan modifications from the first quarter to the second quarter with the share of loan modifications increasing from 34.5 percent to 44.5 percent.

	First Quarter Total	Second Quarter Total
Loan modifications	71,883	112,353
Payment plans	136,367	140,155
Loss mitigation actions	208,250	252,508

- There were increases in early stage delinquencies (30-59 days past due) and seriously delinquent mortgages, defined as mortgages that are 60 or more days past due plus loans to bankrupt borrowers who are 30 or more days past due.
- Foreclosures in process also increased in the second quarter from 1.40 percent (or about 483,000) in the first quarter to 1.60 percent (or about 556,000).
- New loss mitigation actions increased more quickly than new foreclosures during the second quarter.
- Overall, new loss mitigation actions relative to new foreclosures averaged more than 87 percent during the second quarter, about 12 percentage points higher than the first quarter (from 75.68 percent to 87.45 percent).
- Total new loss mitigation actions (loan modifications and payment plans) totaled 252,508 during the second quarter, an increase of more than 21 percent over the first quarter. Total monthly loss mitigation actions reached more than 90,000 in June.

New Modifications and Payment Plans Implemented	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08
Loan modifications	22,736	23,027	26,120	35,804	35,058	41,491
Payment plans	45,294	44,884	46,189	47,440	43,820	48,895
Total loss mitigation actions	68,030	67,911	72,309	83,244	78,878	90,386



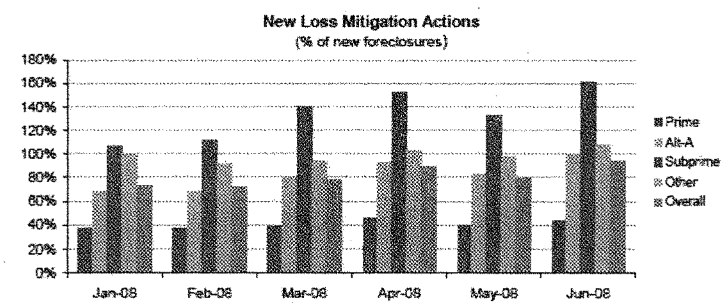
New Loss Mitigation Actions Relative to New Foreclosures

The following data show new loss mitigation actions as a percentage of foreclosures initiated during the month. For any given risk category, a percentage exceeding 100 percent means there were more new loss mitigation actions than new foreclosures during the month. New loss mitigation actions increased faster than new foreclosures during the second quarter. Overall, new loss mitigation actions relative to new foreclosures averaged more than 87 percent during the second quarter, about 12 percentage points higher than the first quarter. Subprime mortgages consistently had the highest percentage of new loss mitigation actions to new foreclosures, well above 100 percent throughout the period.

Prime mortgages consistently had the lowest percentage, averaging 43 percent over the last three months of the reporting period. (These findings are illustrated in the following charts.)

New foreclosures consist of all mortgages on which servicers commenced formal foreclosure proceedings during the month (e.g., public notice, judicial filing). New foreclosures do not always result in a foreclosure sale or loss of the borrowers' homes because banks simultaneously pursue other mitigation strategies, or borrowers take action to return their mortgages to a current and performing status.

New Loss Mitigation Actions (% of new foreclosures)	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08
Prime	36.85%	37.30%	38.79%	46.29%	40.03%	44.06%
Alt-A	68.01%	68.01%	78.80%	92.73%	82.77%	99.12%
Subprime	106.07%	112.16%	139.56%	152.96%	132.10%	160.53%
Other	100.81%	92.21%	94.20%	102.96%	98.11%	108.20%
Overall	73.01%	72.40%	78.70%	89.24%	79.39%	94.04%



The second quarter data showed that servicers were increasingly using loan modifications relative to payment plans as well as engaging in more loss mitigation activity, especially as measured relative to new foreclosures initiated.

VI. Third Quarter Mortgage Metrics Report

The joint third quarter report on mortgage performance showed continued increases in delinquencies and foreclosures in process. The key results include:

- Delinquencies, foreclosures in process, and other actions leading to home forfeiture continued to rise.
- Loan modifications continued to grow more quickly than other loss mitigation strategies, as banks and thrifts worked with borrowers to keep them in their homes while minimizing losses. The number of new loan modifications increased 16 percent in the third quarter to more than 133,000.
- For the first time, this report included re-default rates on modified loans. The number of loans modified in the first quarter that were 30 or more days delinquent was more than 37 percent after three months and more than 55 percent after six months. The number of loans modified in the first quarter that were 60 or more days delinquent was more than 19 percent at three months and nearly 37 percent after six months.
- The number of delinquent loans increased during the third quarter across all loan categories—prime, Alt-A, and subprime. More than nine out of 10 mortgages remained current, but the percentage of current and performing mortgages fell from 93.33 percent at the end of the first quarter to 91.47 percent at the end of the third quarter.
- Banks and thrifts continued to work with borrowers to mitigate losses and help borrowers retain their homes. The number of newly initiated home retention actions—loan modifications and payment plans—increased by 13 percent from the second quarter to the third quarter.
- Loans held on the books of servicing banks and thrifts had the lowest re-default rates at 35.06 percent after three months, and 50.86 percent after six months, compared with loans serviced on behalf of third parties. The lower re-default rate for loans held by servicers may suggest that there is greater flexibility to modify loans in more sustainable ways when loans are held on a servicer's own books than when loans have been sold to third parties.

VII. Fourth Quarter Mortgage Metrics Report

For the fourth quarter report, scheduled for release in March, the OCC and the OTS have expanded the scope of the mortgage performance data gathered from national banks and thrifts to include additional information on the affordability and sustainability of loan modifications.

The additional data will show how loan modifications changed the total amount of borrowers' monthly principal and interest payments in 2008. The fourth quarter report will review categories of loan modifications that:

- Increased borrowers' monthly principal and interest payments.

- Brought no change to payments.
- Reduced payments by 10 percent or less.
- Reduced payments by more than 10 percent.

Importantly, for loans modified in the first and second quarters of 2008, the report will show the percentage of modifications in each of the four categories that are 60 or more days past due at six months after modification. This will help gauge the effectiveness of the four categories of changes in monthly payments in making mortgages more sustainable and in keeping borrowers in their homes.

Future reports covering all of 2008 and subsequent periods will also show trends in the types of modifications undertaken by loan servicers.

VIII. Summary of Results

Our experiences with servicers, our data collection efforts, industry analyses, academic research, and internal analyses suggest the following:

- Incenting the servicer and borrower to make affordable, sustainable modifications, as measured by prompt payments over time, serves a useful purpose to properly align behavior.
- The significant difference in performance between bank-owned modified loans and those serviced for others suggests certain impediments exist (legal, accounting) in securitization structures that inhibit successful loan modifications.
- Loan modifications are costly for the servicer. We believe that providing additional incentives to servicers for loan modifications will likely result in more modifications.
- Analyses by Merrill Lynch, Amherst Holdings, Fitch, and others suggest that three major factors affect the performance of loan modifications:
    - A decrease in the monthly payment. Larger decreases are associated with lower post-modification delinquencies.
    - The extent to which the borrower is underwater (owes more than the home is worth) after the loan modification. Borrowers who are still underwater after a loan modification are more prone to delinquencies.
    - The length of time the borrower has been in the home. In general, the longer the borrower has been in the home, the more likely the modified mortgage will perform.

IX. Evaluation Framework

Successful modification plans avoid unnecessary foreclosures by making changes that address affordability issues within the framework of aligning appropriate short and long-term incentives.

With these objectives in mind, almost a year ago, Senior Deputy Director Scott Polakoff testified before the Senate Banking Committee concerning a proposed expedited loan modification effort that addressed the three most important aspects of successful loan modification program: an expedited process, an affordable monthly payment and an approach to dealing with "underwater" mortgages, in which the borrower owes more than the current market value of the home.

The proposal based its analysis of "affordable" monthly payment on sound underwriting criteria that assessed the borrower's capacity to meet mortgage obligations based on a principal deferral of the present mortgage, if warranted by a current appraisal, and monthly payments lowered by a below-market interest rate (such as 4.5 percent) on a 30-year, fixed-rate mortgage. Borrowers that qualified under the new principal, term and rate would be offered such a loan. Thus, the extent of the loan modification would be based both on market factors and the borrower's income.

To address underwater mortgages, the loan would be refinanced at the current market value of the property into a new Federal Housing Administration (FHA) insured loan. A key aspect of the OTS proposal was that the original loan holder would receive a negative equity interest (as a non-interest bearing second position claim) equal to the amount of the discount between a new FHA loan and the unpaid balance on the original mortgage. However, this amount could be reduced by a designated percentage, e.g., 15 percent, paid to the borrower upon sale to maintain borrower incentives to preserve the property and maximize its value at sale. The negative equity interest also could be adjusted to provide for a designated percentage to be paid out to an existing second mortgage loan holder to recognize the write-off necessary to permit the FHA refinancing to proceed.

Upon a later sale of the property by the borrower, any appreciation in the value of the property (reflected in the sale price) above the discounted payout (i.e., the amount paid to the original loan holder with the proceeds of the FHA loan) would be payable to the holder of the negative equity interest up to the full amount of that interest (less any prior second mortgage holder allocation and/or borrower offset to preserve the value of the property), with any sale proceeds beyond the amount of the negative equity interest accruing to the borrower.

The OTS Plan provided a market-driven solution that would not "bail out" investors or borrowers. It would allow qualifying borrowers to avoid foreclosure and stay in their homes; it would allow lenders to underwrite mortgages based on acceptable "loan to value" ratios while utilizing current appraised values; and it would allow servicers to maximize proceeds for the securitization.

The plan would provide an incentive for the original loan holders (including the opportunity for participation by existing second lien holders) and the borrowers to participate in the program. The plan would also avoid a windfall to borrowers by requiring any appreciation in a subsequent sale to be paid to holders of the negative equity interest up to the amount of the discount that the original loan holders took when the original loan was modified (again, less any allowance to a prior second lien holder and any borrower incentive to maintain and maximize the value of the property). And the plan would rely on an existing framework – including FHA-insurance – for addressing problem loans in securitizations. Finally, the OTS Plan would create a potentially marketable financial instrument in the negative equity interest.

X. Conclusion

As mentioned earlier, the OTS has been participating in the interagency effort led by the Treasury Department to develop the Financial Stability Plan's "home loan modification program." We are continuing these efforts as the interagency group works out the details of the modification plan scheduled to be announced in early March.

Some of the issues and solutions we have identified are being addressed, such as providing incentives to servicers and borrowers to make modifications and keep payments current. Others, such as how to standardize the terms of loan modification, remain unsettled. Still others, such as the legal and other impediments to modifying loans in a securitization structure, have yet to be addressed.

We continue to encourage our financial institutions to work with homeowners who are unable to make mortgage payments in a prudent way. We believe that prudent workout arrangements that are consistent with safe and sound lending practices are generally in the long-term best interest of both the financial institution and the borrower. We remain committed to continuing to focus on these problems in the weeks and months ahead and we look forward to continued cooperation with our fellow regulators, Members of Congress and others in this important endeavor.

Bank of America

TESTIMONY OF
MICHAEL GROSS
MANAGING DIRECTOR, LOAN ADMINISTRATION LOSS MITIGATION
BANK OF AMERICA
Before the
HOUSE SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY
UNITED STATES HOUSE OF REPRESENTATIVES
WASHINGTON, DC
FEBRUARY 24, 2009

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Good afternoon, Madame Chair, Ranking Member Capito and subcommittee members. I am Michael Gross, Bank of America's Managing Director of Loan Administration Loss Mitigation. Thank you for the opportunity to appear again to update you on the efforts of Bank of America to help families prevent avoidable foreclosures and stay in their homes. As the country's leading mortgage lender and servicer, Bank of America understands and fully appreciates its role in helping borrowers through these difficult economic times. We are committed to being a responsible lender and servicer and facilitating home ownership and retention. We want to ensure that any borrower who has sufficient income and the intent to maintain homeownership has the ability to do so using any and all tools we have available.

Support for the President's Foreclosure Relief Efforts

Bank of America applauds the Obama Administration's Homeowner Affordability and Stability Plan's focus on assisting financially distressed homeowners with their mortgage payments through their refinancing and loan modification program. Ken Lewis, our Chairman, has assessed the plan as very thoughtfully constructed and believes it has a very good chance to make a significant and positive impact. We strongly support the Administration's focus on affordability in the loan modification and refinance processes in order to achieve long-term mortgage sustainability for homeowners. Bank of America recently announced a moratorium on foreclosure sales that is in effect until guidelines for implementing the Homeowner Affordability and Stability Plan are released. Bank of America's foreclosure sales moratorium includes first lien owner-occupied mortgage loans owned and serviced by Bank of America, Countrywide and subsidiaries of Merrill Lynch, as well as those owned by investors who have agreed to the terms of the moratorium. Simply put, we want to have every opportunity to help homeowners who can be assisted by these new initiatives.

The Administration's focus on affordability and sustainability is consistent with the approach we have successfully developed with our customers, which has led to more than 230,000 loan modifications for our customers in 2008, and another 39,000 customers in January 2009 alone. In 2008, Bank of America committed to offer loan modifications to as many as 630,000 customers over the next three years to help them stay in their homes, representing more than $100 billion in mortgage financing. We appreciate the opportunity to work with the Administration in developing guidelines for the uniform implementation of its modification and refinance initiatives to ensure success of the Homeowner Affordability and Stability Plan.

Bank of America is "Open for Business"

I also want to provide a brief update on our mortgage business. We understand that the focus of this hearing is on loan modifications, but we strongly believe that long-term recovery in the economy and housing markets relies upon lenders responsibly and effectively providing loans to creditworthy borrowers. To that end, we are making great progress toward fully integrating Countrywide Financial Corporation into Bank of America. In April we will unveil "Bank of America Home Loans," which will bring together the Bank of America and Countrywide mortgage products and brands under the Bank of America banner and standards. Bank of

America Home Loans brand will confirm our longstanding pledge to all of our customers and associates that we will only offer helpful, understandable and affordable mortgage products. We have a simple, compelling brand promise: to be a responsible lender, and to help our customers achieve successful, sustainable homeownership.

We understand the leadership role we play in stimulating the country's economic activity. We are in fact making new mortgage loans available to eligible customers for buying homes and refinancing their current mortgage loans, as evidenced by the following:

- In the fourth quarter of 2008, we originated more than $60 billion in new loans for consumers, including $45 billion in mortgages and $5 billion in home equity.
- As part of this activity in the fourth quarter of 2008, we originated more than $11 billion in mortgages for more than 77,000 low-to-moderate income borrowers.
- In January 2009, we produced $21.9 billion in mortgages, including $6.3 billion in home purchase originations and $15.6 billion in refinance transactions.

In addition to being America's largest home lender in 2008, Bank of America is one of the nation's largest financial institutions. With over 6,100 banking centers, 59 million consumer households and over $800 billion in deposits, Bank of America has the strength and stability to continue helping people realize and maintain their dream of homeownership. We also are now routinely publishing public updates on our lending volumes at: www.bankofamerica.com/progress.

Bank of America's National Homeownership Retention Program

Bank of America is leading the mortgage industry out of today's challenging economic environment. We know that many consumers are experiencing financial hardships, but they ultimately have the ability and willingness to repay their loans. We are hard at work helping them do just that.

Since I last appeared before Congress, Bank of America launched the National Homeownership Retention Program. The ambitious new program was announced on October 6, 2008 and was developed together with several state Attorneys General. Today Attorneys General from more than 30 states have joined in the program. It is designed to achieve affordable and sustainable mortgage payments for borrowers who financed their homes with subprime loans or payoption adjustable rate mortgages serviced by Countrywide and originated by Countrywide prior to December 31, 2007. Our home retention division of nearly 6000 professionals began serving eligible borrowers on December 1, 2008.

The centerpiece of the program is a streamlined loan modification process designed to provide relief to eligible subprime and pay option ARM customers who are seriously delinquent or at risk of imminent default as a result of loan features such as rate resets or payment recasts. The program's goal is the same as that of President Obama's Homeowner Affordablility and Stability Plan: to reduce monthly mortgage payments to affordable and sustainable levels. We are targeting first-year payments of principal, interest, taxes and insurance to equate to 34 percent of the borrower's income. Modification options for qualified homeowners include:

- Unsolicited streamlined interest rate reductions to the introductory rate for five years for borrowers facing interest rate resets or payment recasts;
- Interest rate reductions to as low as 2.5% for qualified borrowers making fully amortized payments;
- Ten-year interest-only periods with interest rate reductions to as low as 3.5% for interest only payments;
- Gradual step-rate interest rate adjustments to ensure annual principal and interest payments increase at levels with minimal risk of payment shock, subject to interest rate caps;
- Elimination of the negative amortization provision in payoption ARM loans; and
- Principal write-downs on certain payoption ARMs that restore lost equity for certain borrowers.

Our program applies to eligible mortgage loan customers serviced by Countrywide who occupy their home as their primary residence. Under the program, Countrywide does not charge eligible borrowers loan modification fees, it waives late fees associated with the borrower's present default, and it waives prepayment penalties for subprime and payoption ARM loans originated between 2004 and 2007 that it or its affiliates own. Loan modifications are made in full compliance with investor servicing contracts and, where servicing contracts limit modification, Countrywide seeks consent from investors, rating agencies, and mortgage insurers.

Bank of America's Home Retention Operations

I also would like to update the Subcommittee on additional progress we have made to date on our home retention operations beyond the Countrywide loan portfolio. We have added more staff and improved the experience, quality and training of the professionals dedicated to home retention. Since early last year, as the housing and credit markets have struggled, the combined home retention staff for Bank of America and Countrywide has more than doubled, to nearly 6000. We will continue to increase home retention staffing levels to ensure that we are responsive to our customers.

At the core of our combined operations are the substantial commitments we made to engage in aggressive home retention efforts to help customers avoid foreclosures and remain in their homes. In addition to the new loan modification program for Countrywide subprime and payoption ARM borrowers I described earlier, Bank of America is devoting significant resources to modifying and working out loans of all types for its customers who are facing default and possible foreclosure. We are tailoring our workout strategies to a customer's particular circumstance by using a range of home retention options to assist those who are struggling to make their monthly loan payments, such as:

- Formal and informal workout arrangements, repayment plans and forebearance agreements that allow customers additional time to bring their loans current;
- Loan modifications that may significantly reduce interest rates, extend maturity dates or otherwise modify loan terms, including the new Streamlined Modification Program created jointly by Fannie Mae, Freddie Mac, FHFA, Department of Treasury, and the Hope Now Alliance;

- Partial claims that involve unsecured, no-interest or low-interest loans to customers to cure payment defaults; and
- Targeted strategies for customers facing interest rate resets that include automatic rate reductions for up to five years.

Bank of America begins evaluating and working on these options to assist at-risk borrowers as soon as we become aware they are having difficulty making mortgage payments. We also continue to educate customers about the options available to them and the workout solutions they may be able to employ to stay in their homes.

The qualifications for a loan modification depend on whether the loan is owned by an investor and the terms of a particular Pooling and Servicing Agreement (PSA). Generally, we have more flexibility with loans directly held by the bank. With these loans we do not have to wait until someone is 60 or 90 days delinquent. The loans we service on behalf of investors, including the GSEs, are subject to PSAs. In some instances there is flexibility to consider loan modifications early in a borrower's state of delinquency, but some PSAs have very strict limits. It is important to note that even where we have flexibility for early intervention, a distressed borrower still must meet basic ability to repay requirements. We were pleased to see that the Presidents new foreclosure assistance initiative will provide further guidance and support for earlier intervention with borrowers in financial hardship.

Key to successful loss mitigation initiatives undertaken by national servicers such as Bank of America are our partnerships with financial counseling advocates and community based organizations such as Hope Now, NeighborWorks, NACA and the Homeownership Preservation Foundation. Given the impact national and local nonprofits have had in reaching and assisting families, Bank of America also is collaborating with the National Urban League, National Council of La Raza and National Coalition of Asian Pacific American Community Development to address the disproportionately high foreclosure rates among minority communities. As part of this, Bank of America made a $2.5 million grant. In March we will kick off this national effort, beginning with a home rescue fair in Chicago, followed by fairs and outreach in cities across the US throughout 2009 and 2010, including Los Angeles. We are also actively engaged in foreclosure prevention outreach programs with both governmental and community organizations around the country. We will continue to work with investors, insurers, the government-sponsored enterprises (GSEs), HUD and VA, regulators and community partners to further identify ways to improve our ability to reach customers with affordable home retention solutions.

As we have learned through experience, early and open communication with customers is the most critical step in helping prevent foreclosures. In 2008, we participated in more than 350 home retention outreach events across the country, including foreclosure prevention and "train the trainer" events. We are proactively reaching out to customers by:

- Making more than 10 attempts per month to contact delinquent homeowners through phone, mail and other means.
- Seeking to contact customers through outbound calls, including nearly 12 million outbound calls in January. These outbound calls resulted in approximately 1 million conversations with at risk homeowners in January.

- Mailing, on average, 700,000 personalized letters and cards each month that offer customers the choice to contact Bank of America, a HUD-approved housing agency, or a nonprofit housing organization.
- Sending company workout counselors to branch offices and events all over the nation to meet directly with homeowners who need assistance.

In general, the costs for a loan modification are lower than the costs of the full foreclosure process. However, there are several variables that influence costs for each scenario, including state foreclosure law requirements, authority under Pooling and Servicing Agreements, and the complexity of the loan modification. Among the significant costs that servicers incur for loan modification are personnel and information technology. We believe the President's inclusion of financial support to servicers for loan modifications generally will be helpful for servicers as they strive to pursue every loan modification contemplated by the plan. Once a loan is successfully modified there are no unique or specific challenges for servicing that loan.

Bank of America's Home Retention Results

In 2008, our Home Retention Division completed over 230,000 loan modifications, a 198% increase over 2007. I would emphasize here that these are workouts in which the customer enters into a plan to *keep their homes*. It does *not* include deeds in lieu of foreclosures or short sales.

In addition to sharply increasing the pace of workouts, we have also become more aggressive in the types of workout plans completed. Loan modifications are now the predominant form of workout assistance. In 2008, loan modifications accounted for approximately 75% of all home retention plans. Of these loans, interest rate modifications accounted for approximately80% of all the loan modifications. This past January, loan modifications accounted for approximately 87% of all home retention plans. Of these loans, interest rate modifications accounted for 88% of all the loan modifications. Importantly, the vast majority of these rate relief modifications have durations of at least 5 years.

In a significant majority of our loan modifications over the last year, the monthly principal and interest payment level has stayed the same or decreased. In some instances, the best solution for a customer with an ARM is simply to freeze the interest rate at the current lower level. For others, the amount of the decrease depends on factors such as the financial situation of a customer and the amount of flexibility we have to modify the loan under any applicable Pooling and Servicing Agreements. In those situations where a monthly payment may have increased it is usually the result of needing to structure the repayment of delinquent amounts and overdue taxes payments.

The Subcommittee also asked that we address redefault rates. Upfront it is important to emphasize that continued economic decline is driving changes in borrower income and that, in turn, is a major contributor to redefault. The purpose of modifications is to assist borrowers from losing their home to foreclosure. In this regard we measure redefault in terms of borrowers who have, since modification, fallen victim to foreclosure or have returned to a state where we have initiated foreclosure proceedings once again. By this measure, we believe that 25-40% of our modifications have redefaulted. Certainly many of our customers who have obtained modifications continue to struggle. Some are seriously delinquent once again (60 days delinquent or even 90 days delinquent). These are very volatile times and economic and unemployment uncertainty are placing increased stress on all borrowers, including those with recent modifications. Try as we might to find the appropriate long-term solution for distressed borrowers it is impossible to measure the true definition of success or failure in this environment. The way we look at it, these efforts will allow more people to stay in their home than not, so it is a positive.

Recommendations for Expanding Loan Modifications

I would like to highlight a few continuing impediments to loan modifications for the Subcommittee's consideration. Importantly, I must note that despite our best efforts, it is changed circumstances of the borrower, such as unemployment, divorce, illness or dissatisfaction with the property that may make a loan modification unattainable. As a baseline, we can only modify loans where the borrower has the ability and willingness to repay. Our studies show that such "unresolvable" borrower issues represent the largest impediment to modifications, and this could worsen without economic growth and housing market stability.

Bank of America today services approximately 15 million loans. Some of these loans are held for investment in our own portfolio, but others are serviced on behalf of investors, including GSEs (the largest category of investors), government entities (such as FHA and VA), and private investors. The manner in which we service these loans is governed by the underlying pooling and servicing contracts and related rules of these investors. For loans that are held for investment, we have broad flexibility to modify the loans. For other categories, however, investor rules and underlying servicing contracts with respect to modifications are not uniform and may prevent us from making modifications that would benefit borrowers and investors. Under some arrangements, for example, servicers have express or implied authority to make loan modifications - while under other arrangements, loan modifications are expressly disallowed. Even within categories of investors, such as the GSEs, there is significant variation in the rules that apply. Servicers are frequently unable to effect loan modifications because of contractual prohibitions.

Another challenge is lack of uniformity in approaches to loan modifications. Examples include voluntary loan modification programs like ours and our peers, as well as government programs, like the one the FDIC adopted in connection with its acquisition of IndyMac. Servicers are employing usual and customary loan modification techniques, such as interest rate and principal reductions or deferrals; and they are developing underwriting and other guidelines -- frequently imbedded in models -- to determine when and what type of loan modification is appropriate and benefits borrowers and investors. Bank of America supports government and industry efforts to develop greater consensus regarding these elements of loan modification programs. In the fall we supported the announcement by the Treasury Department, Federal Housing Finance Agency, HUD and other government entities to adopt systematic loan modification programs that will help drive uniformity among these entities in the approach to loan modifications. Last week's annoucement by the President took another very important step in this direction by calling for the creation of standardized loan modification processes by March 4. We believe that nationwide modification standards are needed and that this is the best solution to keeping borrowers in their homes and ensuring that borrowers receive consistent treatment regardless of who owns their loan.

We have been working with investors and servicers to achieve these standards, and there has been good momentum towards achieving this goal. Some of the important components for a national standard are that:

- It applies a net present value model so that we achieve the goal of assisting distressed borrowers while at the same time retaining investor confidence that they also benefit from these decisions;
- It is streamlined to maximize effectiveness but also addresses moral hazard concerns through requirements such as verification of borrower hardship and income; and
- It includes a variety of modification solutions, including interest rate reductions, interest only payment options, and principal forbearance and forgiveness.

We support proposals that would provide a guarantee for a portion of the losses if a modified loan redefaults. We believe that such a guarantee will increase the number of loan modifications made since this would reduce the amount of loss that the holder of a loan would absorb if there was a redefault. The guarantee could be incorporated into a servicer's net present value model to increase the number of modifications that are made because it would reduce expected loss severities for the investor. We would also support other alternatives such as subsidizing interest rates and principal reductions as part of loan modifications.

Importantly, servicers need protection from litigation when applying modification solutions. We would request that Treasury and the Federal Reserve support legislation currently before Congress that would provide such a safe harbor.

I also want to take this opportunity to reaffirm Bank of America's support of the Hope for Homeowners (H4H) program contained in the Housing and Economic Recovery Act of 2008. We believe the legislative improvements recently approved by the House Financial Services Committee and that may be forthcoming in the Administration's guidelines for the Homeowner Affordability and Stability Plan will increase the viability of the program. The servicing industry needs as many tools as possible, such as H4H, as possible to maintain homeownership. Furthermore, we believe that legislative changes are needed to enhance the ability of servicers to help FHA borrowers. Today, the regulations that provide loss mitigation tools for servicers to assist FHA borrowers often impede our ability to modify these loans. While FHA offers insurance to lenders to pay claims associated with defaulted loans, FHA cannot exceed its statutory authority to pay loan modification costs incurred when a loan is bought out of a Ginnie Mae pool at par, modified, and then repooled. In this economic environment, Congress should arm the FHA with the tools to allow a servicer, who does not own the loan, to modify it and be reimbursed the costs of maintaining that borrower's full FHA insurance protection and the opportunity for ongoing sustainable homeownership.

Finally, we also need to ensure that lenders and servicers subject to federal regulation are not hampered in their ability to modify previously modified loans by restrictions and limitations imposed by the Federal Financial Institutions Examination Council ("FFIEC"). We appreciate the federal agencies' concern with financial institutions disguising their distressed assets through multiple modifications for defaulting borrowers. Nevertheless, the foreclosure crisis and rising concerns not only about consumers losing their homes but also neighborhood blight from vacant properties call into question whether such limits on modifying previously modified loans are justified in this environment. We believe the needs of families and communities outweigh regulator concerns in this context, or at least warrant exceptions or new alternatives to these FFIEC provisions. Servicers and mortgage holders must not worry that their efforts to provide more manageable loan payments to borrowers will result in regulator criticism or penalties. We must be able to provide whatever relief we can to homeowners who are willing and able to make reasonable, affordable payments to maintain homes for their families. We hope to work with the Obama Administration in addressing this issue through the forthcoming guidelines to the Homeowner Affordability and Stability Plan.

Conclusion

I want to thank you for the opportunity to describe our ongoing home retention efforts. We recognize there is still much more to be done. Today's foreclosure crisis demands expedient, affordable loan modifications that help borrowers, within the framework of our contractual obligations to investors. This is a critically important undertaking that must be done right if we as a country are going to preserve the flow of mortgage credit to support sustainable homeownership and at the same time protect communities and neighborhoods from avoidable foreclosures. We look forward to working with Congress and the Administration to accomplish these goals. I would be happy to answer any questions you might have.

Testimony of

Steven D. Hemperly
Executive Vice President, Real Estate Default Servicing
CitiMortgage, Inc.

Before the

Committee on Financial Services
United States House of Representatives
Subcommittee on Housing and Community Opportunity

February 24, 2009

Chairwoman Waters, Ranking Member Capito and Members of the Subcommittee on Housing and Community Opportunity, thank you for the invitation to appear before you today to discuss Citi's loan modification efforts.

My name is Steve Hemperly and I am the Executive Vice President for CitiMortgage Real Estate Default Servicing. As a top five servicer with more than $800 billion dollars in our loan servicing portfolio, Citi services approximately 7% of the loans in the United States. We believe this gives us a considerable understanding of the scope and dynamics related to the foreclosure crisis confronting the nation and the work that needs to be done to keep borrowers in their homes.

In this enormously difficult housing market, Citi has moved aggressively to help distressed borrowers. We have a high degree of success in keeping borrowers in their homes when we are able to make contact with them, and they want to remain in their homes.

Citi specifically focuses on finding long-term solutions for borrowers in need. In support of this, a key loss mitigation tool is loan modification. A modification agreement is typically used when the customer has a significant reduction of income that impacts his or her ability to pay and will last past the foreseeable future. This agreement makes the mortgage more affordable for the customer. We have found modifications to be effective in helping borrowers manage through difficult times and avoid foreclosure.

Citi has a specially trained servicing unit that works with at-risk homeowners to find solutions short of foreclosure and tries to ensure that, wherever possible, no borrower loses his or her home. Citi continuously evaluates each of its portfolios to identify those customers who can save money and reduce monthly payments, and offers them timely loss mitigation solutions. Among other efforts, we provide free credit counseling, make our loss mitigation staff available to borrowers or nonprofit counseling organizations acting on behalf of borrowers, and provide work-out arrangements and other options.

In keeping with our commitment to help borrowers stay in their homes, we are implementing the FDIC's streamlined modification program for loans we own, where the borrower is at least 60 days delinquent or where a long-term modification is appropriate, even if the borrower is not yet delinquent.

In November 2008, we announced the Citi Homeowner Assistance Program for families, particularly in areas of economic distress and sharply declining home values, whose mortgages Citi holds. For those borrowers who may be at risk, although still current on their mortgages, we are deploying a variety of means to help them remain current on their mortgage and in their homes.

Citi's foreclosure prevention activities have good resolution rates for distressed borrowers whom we are able reach; for example, for those going through the foreclosure process with whom we are in contact, we are able to save approximately 70 percent. However, we are not able to reach everyone, and in those circumstances, there are limits to what we can do.

To better meet the increased needs of struggling borrowers we service, both pre and post delinquency, and reach as many of them as possible, we have dedicated significant resources to our loss mitigation area. We have stepped up our loss mitigation staffing by almost three times over last year's staffing levels, and have provided additional training for our existing staff.

Additionally, to reiterate the commitment made by our Chief Executive Officer Vikram Pandit to the House Financial Services Committee on February 11, 2009, Citi initiated a foreclosure moratorium on all Citi owned first mortgage loans that are the principal residence of the customer as well as all loans Citi services where we have reached an understanding with the investor.

The moratorium became effective February 12, 2009, and will continue until March 12, 2009, before which time we expect finalized details on President Barack Obama's loan modification program. Citi will not initiate any new foreclosures or complete pending foreclosures on eligible customers during this time.

This commitment builds upon our existing foreclosure moratorium for eligible borrowers with Citi-owned mortgages who work with us in good faith to remain in their primary residence and have sufficient income to make affordable mortgage payments.

In order for our efforts to have the broadest possible impact, Citi has also worked with investors and owners of more than 90 percent of the mortgages we service – but do not own – to make sure that many more qualified borrowers will also benefit from this moratorium.

In order for policymakers, regulators, consumers and market participants to better understand the extent of the current situation, and our efforts to ameliorate it, we think it is important to share what we know. To assist in this effort, for the past four quarters we have produced and publicly released the *Citi U.S. Consumer Mortgage Lending Data and Servicing Foreclosure Prevention Efforts* report. The Report, available at www.Citigroup.com, goes into specific detail on our originations, delinquency trends, ARM resets, loss mitigation efforts, loan modifications, foreclosures in process, and new foreclosures initiated. Our soon to be released fourth quarter report will also include detailed information on our re-default rates for the first time.

Our report will show that distressed borrowers serviced by Citi, who received modifications, reinstatements or repayment plans outnumbered those who were foreclosed by more than six to one in the fourth quarter of 2008. The data demonstrate that our commitment to long term solutions is yielding results; the number of borrowers serviced by Citi who received long term solutions, in the form of loan modifications, in the fourth quarter of 2008 increased by approximately 51% as compared with the third quarter of 2008.

Our re-default rates, by which we mean the percentage of borrowers who became 60+ or 90+ days past due at a given time period after their loans were modified, do not exceed twenty-three percent for loans modified over the past year. For example, of the loans modified in the second quarter of 2008, only 14% were 90+ days past due six months after modification. The fact that these borrowers are delinquent does not mean that the result will be foreclosure, and in fact, we continue to work with these borrowers after re-default to find long term solutions to help keep them in their homes.

In keeping with the actions I have described and our desire to do more, Madam Chairwoman, and members of the Committee, I want to assure you that we share your interest in helping homeowners, and we strongly support this Committee's leadership in foreclosure prevention and its tireless efforts to solve the housing crisis.

In closing, I want to again emphasize Citi's commitment to keeping borrowers who we service out of foreclosure and in their homes whenever possible. Thank you again, and I would be pleased to answer questions.

Statement of

Patrick J. Lawler, Chief Economist

Federal Housing Finance Agency

Before the House Financial Services Committee

Subcommittee on Housing and Community Opportunity

Loan Modifications:
"Are Mortgage Servicers Assisting Borrowers with Unaffordable Mortgages"

February 24, 2009

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February 24, 2009

Chairwoman Waters, Ranking Member Capito and members of the Subcommittee, thank you for the opportunity to testify on behalf of the Federal Housing Finance Agency (FHFA). My name is Patrick Lawler and I am Chief Economist of FHFA.

Today, the country faces an enormous challenge to stabilize the housing market. FHFA and the housing GSEs are actively working on foreclosure prevention to help homeowners in trouble. This is a major component of FHFA's four-pronged strategy to ensure the housing GSEs fulfill their mission of providing liquidity, stability, and affordability to the housing market. The other crucial components of this strategy are:

- Ensuring that Fannie Mae, Freddie Mac, and the Federal Home Loan Banks support the market in a safe and sound manner, with special emphasis on affordable housing;
- Strengthening confidence in Fannie Mae and Freddie Mac, which should improve mortgage rates; and
- Working with the Enterprises to set best practices for the whole mortgage market.

The housing plan outlined last Wednesday by President Obama highlighted an even more prominent role for Fannie Mae and Freddie Mac. My testimony today will summarize recent initiatives and activities already underway to promote effective loan modifications, and discuss the even larger Enterprise role announced last week.

Since its inception, FHFA has provided supervision and oversight of the Enterprises' credit risk profile and default management activities including loss mitigation programs. During the last 24 months, that oversight heightened with the rise in defaults, serious delinquency rates and foreclosures. During 2008, FHFA worked closely with Treasury, HUD, the FDIC, other regulators, and the Enterprises to enhance and expand loss mitigation activities in general, and loan modifications in particular. FHFA implemented monthly and quarterly Foreclosure Prevention Reports to monitor and publicly disclose the Enterprises' efforts to assist "at risk" borrowers.

As indicated in our Federal Property Manager reports, modifications have been rising steadily since the beginning of 2008. In 2007, loan modifications totaled 34,603 and averaged 2,884 per month. As of November 2008 year-to-date, monthly loan modifications have ranged from 3,971 to 8,291 per month, and averaged 5,311. In addition, Fannie Mae introduced the Home Saver Advance program which allowed borrowers to reinstate their accounts with an unsecured loan on the property. As of November 2008, Home Saver Advance loans reinstated 61,671 accounts.

Clearly, modifications can be very effective in reducing foreclosures. To maximize that effectiveness, servicers need to be able to establish meaningful contact with the borrower. Also, borrowers must provide information needed for the servicer to create a payment that is affordable, and that the borrower can consistently pay over time. The likelihood of a successful modification is increased when servicers and borrowers connect very early on – before the account is deeply delinquent.

Since the 1980s, the Enterprises have offered loan modifications as an alternative to foreclosure. A loan modification is simply a change to one or more of the mortgage terms – unpaid balance, term or interest rate – that creates a more affordable payment for the borrower. A standard loan modification requires the borrower to submit a personal budget, hardship statement, and verification of income. The servicer pulls an updated credit report. The borrower's ability to pay is calculated on his or her personal circumstances, and is based on the borrower's residual cash-flow. The approach is customized to the borrower's situation, requires extensive communication, and is very labor-intensive. In this environment with rapidly rising delinquencies, servicers are challenged by the sheer volume of borrowers requesting assistance and their ability to effectively and efficiently modify the loans. As a result, new programs have been designed with the goal of reaching more borrowers more quickly, and making it easier and faster to execute a loan modification.

In November, FHFA announced the "Streamlined Modification Program" (SMP) that was rolled out in December. To date, 90,000 letters (solicitations or modification offers) have been mailed to a targeted population of borrowers who had missed three payments. Responses to those letters are just starting to come in. Early indications are that several of the program guidelines should be liberalized to reach a broader population and to create a lower, more affordable payment. This feedback was shared with the Treasury Housing Team working on the Administration's Homeowner Affordability and Stability Plan.

In addition to the SMP announced in November, the Enterprises have taken many additional steps to help avoid preventable foreclosures. They suspended foreclosures and evictions and developed programs to protect renters living in foreclosed properties. They are pulling loan files for a second look before foreclosures, and they are working with credit and housing counselors.

Historically, under individually customized modifications, re-default rates have ranged around 25 – 30 percent. Because the SMP was just recently rolled out, there are no data to calculate re-default rates. It's important to note that when calculating and analyzing re-default rates, common definitions are required. There is much debate within the industry as to what those definitions are, how re-default rates should be measured and over what timeframes.

Private Label Securities (PLS)

As conservator of the Enterprises, FHFA has not only taken strong action to ensure the maximum effort by the Enterprises to modify loans to prevent foreclosures, but also has taken a leading role in efforts to address the foreclosure crisis in the private-label securities market. While Fannie Mae and Freddie Mac own or guarantee almost 31 million mortgages, about 56 percent of all single-family mortgages, the mortgages they own or guarantee represent just 19 percent of serious delinquencies. Private-label mortgage-backed securities (PLS) represent 16 percent of all outstanding mortgages but more than 62 percent of the serious delinquencies.

If we are going to stabilize the housing market, we must address that 62 percent. FHFA believes Fannie Mae and Freddie Mac must be leaders in improving, promoting, and enforcing industry standards and best practices for all mortgages.

The GSEs own the largest position of originally AAA-rated private-label residential and commercial mortgage-backed securities. Currently, Fannie Mae, Freddie Mac, and the 12 Federal Home Loan Banks own $255 billion unpaid principal balance in private-label residential mortgage-backed securities or 14 percent of single-family PLS outstanding. Fannie Mae and Freddie Mac have wrapped an additional $13 billion unpaid principal balance of such securities, which they now guarantee for third-party investors. Subprime and Alt-A mortgages constitute the overwhelming majority of mortgages backing these securities for Fannie and Freddie. The Federal Home Loan Banks have very little subprime but a substantial investment in Alt-A securities.

We have heard for almost two years that it is hard to modify PLS because of the constraining trust and pooling and servicing agreements. In December, FHFA convened a meeting with the major trustees and a group of high touch, independent servicers. Director Lockhart has met with American Securitization Forum representatives and private-label MBS servicers, investors, and trustees to strongly encourage rapid adoption of SMP as the industry standard. In light of the GSEs' large exposure to mortgages in private label MBS, on November 24, 2008, the Director sent to private-label securities servicers and trustees a letter urging their prompt action to support SMP. We have subsequently encouraged the Corporate Trust Committee of the American Bankers Association in the development of its letter encouraging all servicers to consider and pursue appropriate modifications in a proactive and timely manner, and providing information on how to best work within PLS pooling and servicing agreements. I am pleased to say that the Corporate Trustee Committee recently released a letter doing just that. We and the Enterprises are working with independent mortgage servicers to help them in their efforts to obtain financing of the advances they are required to make to PLS trusts.

FHFA began in September a Foreclosure Prevention Report, which is a transparent review of key performance data on foreclosure prevention efforts. These monthly and quarterly reports present data from more than 3,000 approved servicers on 30.7 million first-lien residential mortgages serviced on behalf of Fannie Mae and Freddie Mac, of which 84 percent are prime. The just released November report showed that for the first full two months of conservatorship, October and November, the number of loan modifications increased 50 percent from the previous two months.

FHFA understands the nation's deep concern over the personal hardships of the foreclosure crisis. We maintain that significant loan modifications are the best way to help both the people involved and the economy in the long run. Any legislative changes to existing bankruptcy laws should be approached in as careful and considered way as possible to avoid unintended consequences for individuals and for weakened financial institutions. We must do everything we can to give homeowners incentive to achieve an affordable mortgage payment through loan modifications rather than endure the hardships of bankruptcy.

Modification Costs and Process Improvements

The Committee asked about costs of modifications – to the servicer, the investor, and the GSEs and about how the modification process can be improved.

In the absence of any loss mitigation strategy, the delinquency and ultimate foreclosure on a residential property imposes substantial costs on all stakeholders. The borrowers end up with ruined credit records and the loss of their homes. The servicer absorbs the up-front responsibility of covering missed payments and the operational expenses of trying to work with the borrower. The investor ultimately absorbs the foregone payments, the process costs of the foreclosure, and the difference between the mortgage balance and the net realized value upon sale of the house. If the mortgage is in a MBS guaranteed by Fannie Mae or Freddie Mac, the Enterprise absorbs these losses instead of the investor as do private mortgage insurers and bond insurers, where applicable.

As the total costs of foreclosure can be sizeable in relation to the mortgage balance, servicers often will pursue less costly outcomes, ranging from loan modifications that reduce the income stream on the mortgage but keep the borrower paying on the mortgage to alternatives to foreclosure that result in the homeowner leaving the property. These alternatives include short-sales – the sale of a house at less than the mortgage balance – and deed-in-lieu transfers where the borrower surrenders the property to the lender without going through foreclosure.

The Homeowner Affordability and Stability Plan anticipates the use of a standard net present value (NPV) model. The purpose of that model is to compare the cost of the modification to the cost of foreclosure and to identify the least cost alternative.

Areas where improvements can be made are in borrower education and in servicer capacity. First, borrowers need to be educated to not immediately pack up and vacate the property when they hear the term "foreclosure." Foreclosure is a process that takes anywhere from 4 to 24 plus months to complete. During this period, any borrowers interested in retaining their homes can and should continue to work with the servicer to reinstate the account. Second, serious attention should be placed on assisting servicers in expanding their capacity to reach all borrowers who are in need of help. The Homeowner Affordability and Stability Plan substantially increases servicer incentives to modify loans. However, servicers should be encouraged to hire the required resources to do the job right. In addition, servicers' capacity can be expanded by leveraging off existing housing counseling agencies. Furthermore, the servicer workforce can be further expanded with training of professionals with a comparable skill set and experience; e.g., tax preparers accustomed to working one-on-one with clients. Finally, technology initiatives are being explored to make the process more accessible, timely and efficient; e.g., a web-based portal available to all borrowers nationwide.

Before I move on to the pivotal role to be played by the Enterprises in loan modifications under the Homeowner Affordability and Stability Plan announced by President Obama last week, I want to provide a brief update on Enterprise utilization of the support facilities created under the July 2008 HERA legislation, and under more recent Federal Reserve programs. These important sources of liquidity and financial backing allow the Enterprises to operate in conservatorship and to play a crucial role in helping to restart the housing market.

<u>Government support for the GSEs</u>

HERA gave the Treasury Department authority to support Freddie and Fannie and fund them in a variety of ways. We could not have put Fannie and Freddie into conservatorship without Treasury's $100 billion Senior Preferred Stock facility, which provides *an effective guarantee* of the Enterprises' debt and mortgage-backed securities by ensuring each Enterprise has a positive net worth. The amount of this facility, $100 billion, That is about *three times* the minimum capital the old law required. In return, Treasury received from each Enterprise a billion dollars in senior preferred stock and warrants for 79.9 percent of the common stock. At the same time, we eliminated the dividends on both the common and preferred stock.

This Senior Preferred Stock facility protects not only present senior and subordinated debt holders and MBS holders but also *any future* debt and MBS holders. It lasts until the facility is fully used or until all debt and mortgage-backed securities are paid off. To date, Freddie has accessed about $13.8 billion and indicated it needs another $30 billion to $35 billion to cover fourth quarter losses. Fannie only just recently announced that it will need $11 billion to $16 billion to cover its fourth quarter losses.

As Secretary Geithner and President Obama announced last Wednesday, Treasury has doubled the Senior Preferred Stock Facility to $200 billion each to remove any possible doubt from the minds of investors that the U.S. Government stands behind Fannie Mae and Freddie Mac.

Two additional facilities were also implemented when the conservatorships began. Under the first, Treasury has purchased $94 billion in mortgage-backed securities and has made it clear it will continue to be an active buyer. The second is an unlimited secured credit facility which acts as a liquidity backstop for Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, but this has not been utilized.

In November, the Federal Reserve announced two critically important programs to reduce mortgage rates. In the first, it will purchase $500 billion or more in Fannie Mae, Freddie Mac, and Ginnie Mae MBS over a period of six months. Since the beginning of January, the Fed has purchased $115 billion under this program. The second program is a purchase of up to $100 billion in Fannie Mae, Freddie Mac, and Federal Home Loan Bank debt. To date, the Federal Reserve has purchased $30 billion in Fannie, Freddie, and Federal Home Loan Bank notes. Both of these programs are a significant part of the government's overall efforts to restart the housing market.

These programs have had a very positive impact on mortgage rates, which have fallen more than 100 basis points. Rates on 30-year loans even dropped below 5 percent, but crept back up to 5.04 percent in Freddie Mac's latest weekly report. These lower rates provide an important opportunity to do two things—refinance and modify mortgages to help stabilize housing prices. If confidence is restored and the present large spread to Treasury rates is reduced, mortgage rates could move lower.

Although I have been concentrating on the single family market, the housing GSEs are very important players in multi-family housing. That market is extremely important in creating affordable housing. Fannie and Freddie remain committed to that market through Delegated Underwriting and Servicing, and Commercial Mortgage-Backed Securities. As the President indicated last week, we are working with the GSEs - and with private sector industry participants - on ideas to better support Housing Finance Agencies, especially in the tax credit and housing bond areas.

Homeowner Affordability and Stability Plan

Let me now turn to the new Homeowner Affordability and Stability Plan announced last week by President Obama, focusing particularly on elements of the plan relevant to the Enterprises. FHFA was pleased to work with the White House, the Treasury Department, and the Enterprises in the development of this plan. It is a major step forward in reducing preventable foreclosures and stabilizing the housing market. It aggressively builds on the FDIC's and our streamlined mortgage modification programs. While the Enterprises will receive less in monthly payments on the modified loans, this should be more than offset by the benefits of having far fewer defaults and foreclosures. The key elements of the plan are:

1. **Fannie Mae and Freddie Mac will provide access to low-cost refinancing for loans they own or guarantee.** This will help up to 4 to 5 million homeowners avoid foreclosure and reduce their monthly payments. This program is designed for current borrowers who seek to refinance at a lower rate or into a safer mortgage but who have experienced difficulties due to declining home values. They will be eligible for a refinanced mortgage with a current loan-to-value of up to 105 percent.

This refinance initiative covers only mortgages that Fannie Mae and Freddie Mac already hold in their portfolio or guarantee through their MBS. Thus, they already hold the credit risk on the mortgage. For those mortgages that at the time of origination had above 80 percent LTV ratios, there exists some form of credit enhancement, in most cases private mortgage insurance. For those that had LTVs below 80 percent at origination, no additional credit enhancement was needed.

The target beneficiaries of this initiative are those homeowners who are current on their mortgages. The initiative is premised on the unusual and exigent market circumstances that preclude such homeowners from refinancing to a lower rate mortgage because of the combined effects of the decline in house prices and limited availability of mortgage insurance.

The refinance initiative allows a borrower with a mortgage held or guaranteed by Fannie Mae (Freddie Mac) to refinance into a new mortgage that would be held or guaranteed by Fannie Mae (Freddie Mac). The key characteristic of this initiative is that the borrower need not obtain additional credit enhancement (such as private mortgage insurance) on the refinanced loan in excess of what is already in place for that loan. That is, the overall credit exposure of Fannie Mae (Freddie Mac) would not increase after the refinance. In fact, it would be reduced because, after the refinance, the borrower would have a lower monthly mortgage payment and/or a more stable mortgage payment.

There are several important limitations placed on the refinances permitted under this initiative. The refinance will not have a cash-out component, except for closing costs and certain de minimus allowances; the Enterprise will use its best efforts to continue existing mortgage insurance coverage; monthly principal and interest payments will be reduced or the borrower will be refinanced from a more risky loan (such as interest-only or a short-term ARM) to a more stable product; and this new authority extends only through June 10, 2010.

The refinance initiative is akin to a loan modification as it affects loans for which an Enterprise already holds the credit risk. By creating an avenue for the borrower to reap the benefit of lower mortgage rates in the market, the credit risk of that mortgage to the

Enterprise diminishes; thus, this is a loss-mitigation initiative in this very troubled time in housing finance. It has the added benefit of helping many households strengthen their own financial situation and enhance their commitment to their home and community. FHFA will maintain its oversight over the initiative as part of its safety and soundness responsibilities.

2. **A $75 billion loan modification plan, called the Homeowner Stability Initiative, will reach up to 3 to 4 million at-risk homeowners.** This program will help homeowners stay in their homes and protect neighborhoods. Importantly, there will be a national standard for loan modifications and the Treasury will partner with financial institutions to reduce borrowers' housing costs to 31 percent of their gross incomes through a combination of interest rate reductions, maturity extensions, principal forbearance, and/or principal forgiveness. The initiative will pay half the cost of the reduction from 38 percent to 31 percent. There will be "pay for success" incentives for servicers, incentives to encourage borrowers stay current, incentives to reach borrowers early, and reserve payments to encourage lenders to modify mortgages even though prices could fall further. For those loans owned or guaranteed by Fannie Mae or Freddie Mac, the Enterprise will bear the full cost of the modification.

3. **Treasury will support low mortgage rates by strengthening confidence in Fannie Mae and Freddie Mac.** The Treasury Department has doubled the size of its Preferred Stock Purchase Agreements to $200 billion each. This increase is to provide assurance to the markets that Fannie Mae and Freddie Mac will continue to fulfill their important mission of providing much-needed liquidity, stability and affordability to the housing market at this time.

Resetting these agreements from $100 to $200 billion each should remove any possible concerns that investors in debt and mortgage-backed securities have about the strong commitment of the U.S. Government to support Fannie Mae and Freddie Mac. In addition, the Treasury Department will continue to purchase Fannie and Freddie MBS, and is increasing the size of the GSEs' allowable mortgage portfolios by $50 billion to $900 billion, along with corresponding increases in the allowable debt outstanding.

Over the next several days, FHFA will be working with the Administration and the Enterprises to finalize the details and implement this program.

Thank you for the opportunity to offer this testimony. I will be happy to answer questions.

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February 6, 2009

James B. Lockhart III
Director
Federal Housing Finance Agency
1700 G Street, NW
Washington, DC 20552

Re: Mortgage Loan Modifications for RMBS Transactions

Dear Director Lockhart:

The American Bankers Association ("ABA")[1] has been working with our members to address the many issues arising out of the ongoing turmoil in the mortgage markets. Chief among these are the issues surrounding foreclosure mitigation and loan restructuring. ABA has been in the forefront of efforts to assist our members in their efforts to modify home loans. We have been a strong supporter of the private HOPE NOW coalition and have supported the framework of the FDIC's loan modification proposal as well as the Hope for Homeowners program.

Given the FHFA's role as the regulator of Fannie Mae and Freddie Mac and the efforts you are undertaking with these GSEs to encourage loan modifications, we are writing to set forth the position of our corporate trustee members with respect to the subset of residential mortgages that have been privately securitized.

Our corporate trustees seek to encourage servicers of RMBS transactions to consider loan modifications as an appropriate loss mitigation strategy on RMBS transactions where the servicer believes such loan modifications will provide a benefit to investors as a whole. In addition, the trustees encourage servicers to commence loan modification efforts where the servicer believes a loan default is imminent and a modification will result in a more favorable recovery than foreclosure.

[1] 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 two million men and women. ABA's corporate trust members represent the vast majority of banks who serve as trustee on residential mortgage-backed securitization transactions.

Over the past year, the trustee banks have been involved in discussions with the Federal Housing Finance Agency ("FHFA"), federal, state and local legislators, and various media outlets in an effort to educate government officials and the public about the unique challenges of modifying mortgages that secure RMBS transactions.

As a result of these discussions, the trustees believe that attempting to reduce the number of preventable foreclosures can be in the best interests of all of the parties to RMBS transactions, particularly given that increasing numbers of foreclosures drive down property values, which, in turn, diminishes the value of RMBS collateral.

ABA trustee banks are neither advocating nor advising servicers to adopt any specific loan modification program or framework promulgated by various industry groups, regulators or governmental agencies. Rather, ABA trustee banks are encouraging all servicers to consider and pursue appropriate modifications in a proactive and timely manner. We recognize that it is the servicer who must determine, in the exercise of its sound business judgment, whether a loan modification:

- Is appropriate for a particular borrower;
- Will be an effective long term solution;
- Is permitted under the applicable servicing agreement; and
- Maximizes the return to investors as a whole.

We believe that the general approaches discussed below can be adapted by servicers and subservicers to meet the requirements of the specific RMBS transactions for which they provide mortgage servicing services.

The servicing agreements for RMBS transactions are not uniform and may place limitations on servicers' ability to modify such mortgage loans. However, we believe that loan modifications when properly made in accordance with the underlying transaction documents can be in the best interests of all investors in RMBS transactions.

Types of PSA Provisions

The pooling and servicing or similar agreements (collectively "PSAs") in RMBS transactions specify the servicing standards to be followed, and the general provisions typically fit into one of three broad categories.

- *Discretionary PSAs.* Some PSAs allow a servicer to modify delinquent mortgage loans if, in its reasonable and good faith determination, such modification is in the "best interest" of securitization investors.
- *Industry Standards PSAs.* Other PSAs allow modifications so long as the servicer is acting in accordance with industry standards.

- *Restrictive PSAs.* A third category of PSAs can be more restrictive and either prohibit or materially limit loan modifications.

Thus, the type of PSA involved dictates the degree of discretion a servicer may exercise when entering into a loan modification for a delinquent or defaulted mortgage loan.

We believe that servicers must make an initial determination as to whether a particular loan modification protocol meets the existing standards of the applicable PSAs. Clearly this will be easiest to do with respect to Discretionary PSAs, since they specifically refer to modifications being made in the "discretion of the servicer," applying a specified standard (such as the best interests of investors).

Similarly, we believe that, as market participants, RMBS servicers are uniquely situated to determine whether a proposed protocol meets industry standards and therefore complies with Industry Standards PSAs.

If servicers make these determinations reasonably, in good faith, and in accordance with their PSAs, in many cases the outcome will benefit investors collectively. Where a servicer finds that a proposed protocol does not comply with a PSA as written, or that the PSA is sufficiently ambiguous to give rise to legal risks, trustees are willing to engage in multiparty discussions aimed at finding an appropriate solution. In some cases, the solution may mean seeking investor approval of PSA amendments.

<u>**Loan Modification When Default is Imminent**</u>

Trustees believe that if a servicer has a reasonable belief that a mortgage loan default is imminent, then the servicer should promptly analyze whether an appropriate and effective loan modification will result in a more favorable recovery than a foreclosure. Any analysis should consider the impact on the amount or timing of payments made by the borrower under any proposed modification versus the costs of foreclosure and anticipated recovery, based upon current market information. If the servicer determines that a loan modification will benefit investors in the RMBS transaction and is permitted by the PSA, the modification should be pursued *before* the borrower stops making loan payments. If servicers wait for missed payments, the borrowers may be so far behind in their payments that a solution is not achievable. By acting promptly before a default occurs, servicers can mitigate losses earlier and reduce the likelihood of foreclosure and the associated costs and expense.

<u>**Addressing Potential Liability for Loan Modifications**</u>

To address valid concerns that proposed modification procedures would expose servicers or trustees to liability, ABA's corporate trustees are working with servicers to seek the concurrence of legal and accounting authorities that the modification frameworks currently used in the industry are permitted by the PSAs and applicable law. This effort may include:

- Seeking the approval of the rating agencies for such procedures based on industry acceptance;

- Working to seek affirmation that the adoption of, or heavy usage of, the modification procedures will not affect the accounting treatment of the relevant RMBS transactions or other public reporting entities;

- Working with the Internal Revenue Service to ensure that such modifications will not affect the status of any Real Estate Mortgage Investment Conduits that are part of such RMBS transactions;

- Working with the American Securitization Form to identify ways that PSAs can be amended, to more easily allow loan modifications to take place or better clarify the standards that servicers have to comply with when making modifications (including guidelines and/or recommendations for any cost benefit analysis); and

- Exploring alternative legislative or regulatory sources of funding for servicer advances so that servicers can afford to take the time necessary to work with borrowers to fully consider effective loan modifications.

In addition, we will work with you and Fannie Mae and Freddie Mac to encourage support among investors for the application of the Streamlined Modification Program or similar programs.

Finally, ABA will work to have the U.S. Congress enact appropriate protections for servicers who use these foreclosure mitigation practices and for trustees who are named in such transactions. ABA strongly supports legislation passed by the House Financial Services Committee that includes a servicer safe harbor, and testified before the Committee that the safe harbor should be expanded to cover trustees. In addition, ABA will work to encourage the Senate to pass legislation including such protection for both servicers and trustees. We hope you and the RMBS servicer community will work with us to ensure passage of this legislation.

Conclusion

In conclusion, ABA's member trustees believe much can be done to enhance investor returns in RMBS transactions by increasing the pace and availability of loan modifications as an alternative to foreclosure. We would be interested in a forum to discuss loan modification proposals with the mortgage servicing community, industry trade associations, and other interested constituencies such as the FHFA, HOPE NOW, Fannie Mae and Freddie Mac., and would be pleased to assist. We look forward to working with you.

Sincerely,

Diane Casey-Landry

Diane Casey-Landry

Federal Housing Finance Agency

Federal Property Managers Report No.3

February 12, 2009

Streamlined Loan Modification Report
In 2008, I submitted to your attention the details of our streamlined loan modification program (SMP) and FHFA's *Plan to Maximize Assistance for Homeowners and Minimize Foreclosures.* Both Fannie Mae and Freddie Mac rolled-out the SMP on December 15th as scheduled. The SMP targets seriously delinquent borrowers and creates "affordable" monthly mortgage payments of no more that 38 percent of the household's monthly income. Through this program, Fannie Mae and Freddie Mac have a greater ability to quickly and efficiently create sustainable monthly mortgage payments for troubled borrowers. Potentially hundreds of thousands more struggling borrowers will be able to stay in their homes at an affordable monthly mortgage payment. The Enterprises' servicers have received hundred of thousands of calls. The Enterprises' have sent approximately 90,000 solicitations related to the SMP to homeowners since the program was implemented. The numbers of finalized SMP modifications to date are small. It's too early to predict the success of this current program, but we are continuing to evaluate options to improve it.

New Fannie Mae and Freddie Mac Activities
Since our last report, Fannie Mae announced that it will extend its suspension of evictions from Fannie Mae-owned single-family properties through February 28, 2009. The suspension applies to all single-family properties including owner-occupied properties that have been foreclosed upon as well as foreclosed properties occupied by renters. Fannie Mae began implementing its National Real Estate Owned (REO) Rental Policy that allows qualified renters in Fannie Mae-owned foreclosed properties to stay in their homes. The new policy applies to renters occupying any type of single-family foreclosed properties at the time Fannie Mae acquires the property. Eligible renters will be offered a new month-to-month lease with Fannie Mae or financial assistance for their transition to new housing should they choose to vacate the property. The properties must meet state laws and local code requirements for a rental property.

Freddie Mac also announced it will extend its suspension of evictions triggered by foreclosures on single family properties with Freddie Mac-owned mortgages through February 28, 2009. Freddie Mac is simultaneously launching a new strategy to offer leases to qualified owner-occupants and tenants' so they can rent the properties on a month-to-month basis after foreclosure. Under the REO Rental Option, leases will be offered to current renters on a month-to-month basis at market rents or the rent amount they were paying prior to foreclosure, whichever is less. The rent for former owner-occupants will be the market rent, which will determined by the property management firm Freddie Mac contracted to manage the program. Freddie Mac is piloting a new workout strategy for high risk loans designed to keep more at-risk borrowers in their homes by employing third party servicers that specialize in servicing Alt A and other types of higher risk mortgages. Under the new pilot, a selected portfolio of higher risk mortgages that are at least 60 days delinquent will be given to a specialty servicer for intensive attention using the full range of Freddie Mac workout opportunities, including the SMP developed with the FHFA, Fannie Mae and the HOPE Now Alliance.

FHFA Activities
As the housing GSEs are the largest holders of private label mortgage-backed securities ($255 billion), FHFA has been working with their trustees, servicers and investors to be more aggressive in modifying the loans in those securities, including adopting SMP. The American

Bankers Association recently responded to FHFA in a February 6th letter on behalf of their trustees' committee that they support modifications as a better alternative in many cases than foreclosure as they said "attempting to reduce preventable foreclosures can be in the best interest of all of the parties to the RMBS transaction, particularly given that increasing numbers of foreclosures drive down property values, which, in turn, diminishes the value of RMBS collateral!"

Foreclosure Prevention Report
In accordance with the reporting requirements of Section 110(b)(5), please find attached our FHFA monthly *Foreclosure Prevention Report*, which reports on loan modifications and foreclosure activities of the Enterprises as of November 30, 2008. FHFA also publishes a quarterly report with detailed analysis. The most recent quarterly report, dated September 30, 2008, is posted to our website at www.fhfa.gov. The FHFA *Foreclosure Prevention Reports* summarize data provided by Fannie Mae and Freddie Mac and gives a comprehensive view of their efforts to assist borrowers through forbearance, payment plans, and loan modification, and other alternatives to foreclosure such as short sales and deeds-in-lieu. The reports cover 30.7 million mortgages and focus on the delinquencies, loss mitigation actions, and foreclosure data reported by more than 3,000 approved servicers.

The attached November 30, 2008 *Monthly Foreclosure Prevention Report* indicates that of the Enterprises' 30.6 million residential mortgages:

- The loan modifications for October and November, which were the first two full months of the conservatorship, had increased by 50 percent from the previous two months. These data reflect the increased commitment of the GSEs and their servicers to help borrowers in trouble modify their loans to keep them in their homes.

- Loans 60+ days delinquent (including those in bankruptcy and foreclosure) as a percent of all loans increased from 1.46 percent as of March 31, 1.73 percent as of June 30, and 2.21 percent as of September 30 to 2.39 for October and 2.73 percent for November.

- Loans 90+ days delinquent (including those in bankruptcy and foreclosure) as a percent of all loans increased from 1.00 percent as of March 31, 1.73 percent, 1.19 percent as of June 30, 2.21 percent, and 1.52 percent as of September 30 to 1.67 percent for October and 1.88 percent for November.

- Loans for which foreclosure was started as a percent of loans 60+ days delinquent declined from 8.29 for the first quarter, 7.81 percent for the second quarter, and 7.20 percent for the third quarter to 6.44 percent for October 2008 and 5.25% for November 2008.

- Loans for which foreclosure was completed as a percent of loans 60+ days delinquent decreased from 2.41 percent for the first quarter, 2.55 percent for the second quarter, and 2.56 percent for the quarter to 2.33 percent for October and 1.73 percent for November.

- Modifications completed increased from a monthly average of 2,883 for 2007, 5,218 for the first quarter, and 5,129 for the second quarter and 4,497 for the third quarter to 5,600 for October and 8,291 for November. Compared to the monthly average of 4,948 for the first nine months of 2008, October modifications increased by 13.2 percent and November by 67.6 percent.

- The loss mitigation ratio for November was 61.7 percent – the highest since June which was reported at 64.8 percent. The year-to-date loss mitigation ratio is 55.2 percent. The loss mitigation ratio is calculated at the total mitigation activities (payment plans, delinquency advances, loan modifications, short sales, deeds in lieu, assumptions, and charge-offs) divided by the total of loss mitigation activities plus foreclosures completed and third-party sales. This ratio allows for comparison of loss mitigation performance over time – irrespective of delinquency rates.

FHFA Foreclosure Prevention Report
January through November 2008

	2007 Aver/Mo	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08	2008 YTD Aver/Mo
Number of Loans (at period end)													
Total		30,135,490	30,367,051	30,408,771	30,483,080	30,661,811	30,619,891	30,623,407	30,650,194	30,744,135	30,634,428	30,586,564	30,537,711
Prime		24,952,459	25,153,692	25,217,229	25,307,364	25,498,551	25,498,297	25,533,099	25,581,750	25,700,544	25,680,402	25,666,584	25,435,452
Nonprime		5,183,031	5,213,359	5,191,542	5,175,716	5,163,260	5,121,594	5,090,308	5,068,444	5,043,591	4,954,026	4,919,980	5,102,259
60 Days+ Delinquency (at period end)													
Total		431,310	433,613	444,902	470,139	497,316	528,764	565,919	621,061	678,474	730,971	834,831	567,027
Prime		193,930	203,069	214,262	228,667	245,311	263,699	284,498	313,496	345,376	379,785	438,630	282,793
Nonprime		237,380	230,544	230,640	241,472	252,005	265,065	281,421	307,565	333,098	351,186	396,201	284,234
60 Days+ Delinquency (percent of total loans)													
Total		1.43%	1.43%	1.46%	1.54%	1.62%	1.73%	1.85%	2.03%	2.21%	2.39%	2.73%	1.86%
Prime		0.78%	0.81%	0.85%	0.90%	0.96%	1.03%	1.11%	1.23%	1.34%	1.48%	1.71%	1.11%
Nonprime		4.58%	4.42%	4.44%	4.67%	4.88%	5.18%	5.53%	6.07%	6.60%	7.09%	8.05%	5.57%
90 Days+ Delinquency (percent of total loans)													
Total		0.92%	0.95%	1.00%	1.05%	1.12%	1.19%	1.27%	1.38%	1.52%	1.67%	1.88%	1.27%
Foreclosure Starts													
Total	22,545	32,583	39,980	35,957	39,031	37,887	39,925	47,770	44,170	40,969	47,086	43,827	40,835
Prime	10,604	16,096	21,832	20,021	21,965	21,579	22,374	27,998	25,082	22,495	26,808	25,456	22,882
Nonprime	11,942	16,487	18,148	15,936	17,066	16,308	17,551	19,772	19,088	18,474	20,278	18,371	17,953
Completed Foreclosure Sales													
Total	6,408	10,571	10,317	10,645	11,916	13,305	12,964	16,364	15,528	15,605	17,008	14,408	13,512
Prime	3,226	5,786	5,623	5,797	6,715	7,514	7,626	9,929	9,242	9,394	10,226	8,769	7,875
Nonprime	3,182	4,785	4,694	4,848	5,201	5,791	5,338	6,435	6,286	6,211	6,782	5,639	5,637
Completed Foreclosure Sales (Percentage of Starts)													
Total	28.4%	32.4%	25.8%	29.6%	30.5%	35.1%	32.5%	34.3%	35.2%	38.1%	36.1%	32.9%	33.1%
Prime	30.4%	35.9%	25.8%	29.0%	30.6%	34.8%	34.1%	35.5%	36.8%	41.8%	38.1%	34.4%	34.4%
Nonprime	26.6%	29.0%	25.9%	30 4%	30.5%	35.5%	30.4%	32.5%	32.9%	33.6%	33.4%	30.7%	31.4%
Completed Foreclosure Sales (Percentage of Starts with a 6-month lag)													
Total	n/a	n/a	n/a	n/a	n/a	n/a	n/a	50.2%	38.8%	43.4%	43.6%	38.0%	36.8%
Prime	n/a	n/a	n/a	n/a	n/a	n/a	n/a	61.7%	42.3%	46.9%	46.6%	40.6%	38.8%
Nonprime	n/a	n/a	n/a	n/a	n/a	n/a	n/a	39.0%	34.6%	39.0%	39.7%	34.6%	34.3%
HomeSaver Advance (Fannie Mae Only)													
Total	n/a	0	11	1233	2,052	2,881	11,725	10,599	7,914	8,764	6,800	9,692	5,606
Prime	n/a	0	3	343	545	856	4,459	4,285	2,747	3,134	1,998	3,113	1,953
Nonprime	n/a	0	8	890	1,507	2,025	7,266	6,314	5,167	5,630	4,802	6,579	3,653

FHFA Foreclosure Prevention Report
January through November 2008

	2007 Aver/Mo	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08	2008 YTD Aver/Mo
Borrower Workout Plans (Repayment Plans Initiated + Modifications Plans Completed)													
Total	52,188	28,912	24,696	25,803	25,808	24,622	31,400	30,351	33,957	34,955	35,082	34,579	30,015
Prime	16,976	10,263	9,106	9,498	9,775	9,431	12,031	12,012	13,648	13,848	14,209	14,098	11,629
Nonprime	35,212	18,649	15,590	16,305	16,033	15,191	19,369	18,339	20,309	21,107	20,873	20,481	18,386
Formal Repayment Plans Initiated													
Total	17,585	24,683	18,809	20,264	21,837	19,945	24,661	26,082	29,506	30,183	29,482	26,288	24,704
Prime	6,061	8,946	7,244	7,696	8,571	7,786	10,022	10,506	12,094	12,120	12,197	11,235	9,856
Nonprime	11,524	15,737	11,565	12,568	13,266	12,159	14,639	15,576	17,412	18,063	17,285	15,053	14,848
Modifications Completed													
Total	34,603	4,229	5,887	5,539	3,971	4,677	6,739	4,269	4,451	4,772	5,600	8,291	5,311
Prime	10,915	1,317	1,862	1,802	1,204	1,645	2,009	1,506	1,554	1,728	2,012	2,863	1,773
Nonprime	23,688	2,912	4,025	3,737	2,767	3,032	4,730	2,763	2,897	3,044	3,588	5,428	3,538
Modifications by Type (EESA Section 110)													
Interest Rate Reduction	NR	NR	NR	NR	NR	NR	NR	NR	NR	NR	3,269	6,151	9,420
Reduction in Loan Principal	NR	NR	NR	NR	NR	NR	NR	NR	NR	NR	-	-	-
Other	NR	NR	NR	NR	NR	NR	NR	NR	NR	NR	2,331	2,140	4,471
Modifications as a Percent of Workout Plans													
Total	66.3%	14.6%	23.8%	21.5%	15.4%	19.0%	21.5%	14.1%	13.1%	13.7%	16.0%	24.0%	17.7%
Prime	64.3%	12.8%	20.4%	19.0%	12.3%	17.4%	16.7%	12.5%	11.4%	12.5%	14.2%	20.3%	15.2%
Nonprime	67.3%	15.6%	25.8%	22.9%	17.3%	20.0%	24.4%	15.1%	14.3%	14.4%	17.2%	26.5%	19.2%
Borrower Workout Plans (Repayment Plans Initiated + Modifications Completed) as a Percent of Completed Foreclosure Sales													
Total	814%	274%	239%	242%	217%	185%	242%	185%	219%	224%	206%	240%	222%
Prime	526%	177%	162%	164%	146%	126%	158%	121%	148%	147%	139%	161%	148%
Nonprime	1107%	390%	332%	336%	308%	262%	363%	285%	323%	340%	308%	363%	326%
Short Sales Completed													
Total	335	516	556	704	850	1,056	1,156	1,492	1,465	1,717	2,103	1,828	1,222
Prime	172	303	341	425	525	677	754	1,000	1,033	1,200	1,489	1,323	825
Nonprime	163	213	215	279	325	379	402	492	432	517	614	505	398
Deeds-in-Lieu Completed													
Total	69	102	84	122	107	62	67	118	138	171	156	150	116
Prime	48	62	61	93	82	42	44	80	114	118	123	113	85
Nonprime	21	40	23	29	25	20	23	38	24	53	33	37	31

FHFA Foreclosure Prevention Report
January through November 2008

	2007 Aver/Mo	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08	2008 YTD Aver/Mo
Charge-Offs In Lieu of Foreclosure Completed													
Total	40	56	42	70	41	49	66	73	57	72	96	75	63
Prime	14	24	11	28	16	20	27	34	25	28	38	32	26
Nonprime	26	32	31	42	25	29	39	39	32	44	58	43	38
Total Loss Mitigation Actions Completed (# of Loans)													
Payment Plans Completed	4,531	5,024	6,777	6,314	5,595	5,504	5,294	4,897	4,720	5,093	4,927	4,147	5,299
HomeSaver Advance (Fannie Mae Only)	-	-	11	1,233	2,052	2,881	11,725	10,599	7,914	8,764	6,800	9,692	5,606
Loan Modifications Completed	2,884	4,229	5,887	5,539	3,971	4,677	6,739	4,269	4,451	4,772	5,600	8,291	5,311
Short Sales Completed	335	516	556	704	850	1,056	1,156	1,492	1,465	1,717	2,103	1,828	1,222
Deeds-in-Lieu Completed	69	102	84	122	107	62	67	118	138	171	156	150	116
Assumptions Completed	-	-	-	-	-	-	-	-	-	-	-		-
Charge-offs in Lieu of Foreclosure Completed	40	56	42	70	41	49	66	73	57	72	96	75	63
Total	7,858	9,927	13,357	13,982	12,616	14,229	25,047	21,448	18,745	20,589	19,682	24,183	17,619
Foreclosure Sales Completed	6,408	10,571	10,317	10,645	11,916	13,305	12,964	16,364	15,528	15,605	17,008	14,408	13,512
Third Party Sales	42	687	652	592	711	672	660	726	725	1,953	773	577	793
Total	6,450	11,258	10,969	11,237	12,627	13,977	13,624	17,090	16,253	17,558	17,781	14,985	14,305
Total Loss Mitigation Actions, Foreclosure Sales, and Third Party Sales	14,309	21,185	24,326	25,219	25,243	28,206	38,671	38,538	34,998	38,147	37,463	39,168	31,924
Loss Mitigation Performance Ratio	54.9%	46.9%	54.9%	55.4%	50.0%	50.4%	64.8%	55.7%	53.6%	54.0%	52.5%	61.7%	55.2%

WRITTEN STATEMENT OF VANCE T. MORRIS

Director for Single Family Asset Management
U.S. Department of Housing and Urban Development

Hearing before the Subcommittee on Housing and Community Opportunity
Committee on Financial Services
United States House of Representatives

"Loan Modifications: Are Mortgage Servicers Assisting Borrowers with Unaffordable Mortgages"

February 24, 2009

Madam Chair, Ranking Member Capito and members of the committee, on behalf of the Department of Housing and Urban Development I'd like to thank you for the opportunity to speak about FHA's loss mitigation practices and, in particular, loan modifications. I am Vance Morris, the Director for FHA's Office of Single Family Asset Management, and I am responsible for managing the Government's interest in FHA-insured mortgages including servicing and loss mitigation, as well as Real Estate Owned (REO) activities. My Office's responsibilities include establishing and updating general servicing guidelines for FHA lenders, helping homeowners retain homeownership while overcoming the financial difficulties that lead to the mortgage defaults, monitoring lenders for compliance with servicing and loss mitigation requirements, and managing and selling properties acquired by FHA. These activities are instrumental to maintaining the strength of FHA's insurance funds and its $534 billion portfolio.

I have been with the U.S. Department of Housing and Urban Development (HUD) for 12 years, and prior to serving in my present capacity, I served as the Director of Single Family Program Development where I developed credit and valuation policy. I also worked in the lender approval and quality assurance areas. Therefore, I am keenly aware of the need to ensure that FHA loans remain safe and affordable options for homeowners.

In 1996, HUD completed a study titled "Providing Alternatives to Mortgage Foreclosure: A Report to Congress", which formed the basis of HUD's Single Family Loss Mitigation Program. During the same year, the Department implemented its Loss Mitigation Program with the primary objectives of (1) maximizing the opportunity for borrowers to retain home ownership and cure delinquencies on their mortgages; (2) mitigating losses that would result from foreclosure by using alternatives to foreclosure; (3) providing lenders with performance-based incentives, and (4) minimizing paperwork and empowering lenders to work directly with homeowners to determine the most appropriate loss mitigation tool. It is important that lenders actively engage in loss mitigation solutions with borrowers, before four full monthly installments are due and unpaid as required by regulation. Lenders must evaluate each defaulted loan, consider all loss mitigation options, and determine for which of these (if any) the borrower may be eligible. In addition to loan modifications, FHA has the following home retention loss mitigation tools:

Special Forbearance is a payment plan that allows the mortgage company to accept less than the total delinquency due, which provides for an extension of time to bring the mortgage current beyond when foreclosure would otherwise be initiated. Instances where mortgagees might opt for this loss mitigation tool are (1) the borrower has recently experienced involuntary but temporary reduction in income, and (2) the borrower now has a reasonable ability to pay the arrearage under the terms of a repayment plan. To initiate a special forbearance payment plan, the mortgagee must execute the plan no earlier than 3 missed payments and no later than 12 missed payments. Special forbearances can be used in conjunction with Loan Modifications and Partial Claims. In Fiscal Year 2009, HUD projects a seventeen percent increase in Special Forbearance actions over FY 2008, where there were 22,144 such actions.

For Partial Claims, FHA will advance funds to the lender on behalf of the borrower to cure a default if the loan is at least four months due and unpaid and not more than twelve months due and unpaid. The amount of the partial claim must cure the delinquency and may also include legal fees from canceled foreclosures. In a partial claim, FHA effectively creates a subordinate mortgage from the borrower that is due when the borrower sells the property or at the time that the first mortgage is paid in full. Partial Claims may not be utilized when there are more than 12 months of full mortgage payments that are due and unpaid. In Fiscal Year 2009, HUD projects a 48 percent increase in Partial Claims actions over FY 2008, where there were 16,416 Partial Claims actions.

The most utilized loss mitigation tool is loan modification. Loan modifications account for nearly 60 percent of FHA's loss mitigation actions, annually. Loan modifications are intended to eliminate the past due amounts on the loan for the borrower who has recovered from financial distress. Lenders may re-amortize the loan up to 30 years, change the interest rate (up or down) within established ranges, and add the delinquency into the loan modification to bring the loan current. It is our understanding that the interest rate increase is to bring the loan up to a market rate in order to securitize the loan. Generally, the lender changes the term of the loan and maintains the same interest rate. It is also our understanding that lowering the interest rate affects the lender's profitability and is rare. Over the past 12 years, through January 31, 2009, FHA insured lenders have completed over 324,000 loan modifications. The number of loan modifications varies each year. In Fiscal Year 2008, over 57,900 loan modifications were completed or over 4,800 per month. HUD estimates that in FY 2009 loan modifications will increase by nearly 12 percent over FY2008 to nearly 65,000 loan modifications.

HUD measures the effectiveness of a loss mitigation action by determining if the loan ended in foreclosure 24 months following that action. By that measure, loan modifications are an effective tool because, historically, over 85 percent of the loans modified were not foreclosed in the 24 months following the action. This is not to say that the loans do not re-default. The modified loans have a re-default rate of 35%.

FHA delinquent borrowers are contacted in a variety of ways. Borrowers are sent a "How to Avoid Foreclosure" pamphlet that explains FHA's loss mitigation options and encourages borrowers to contact their lender. In addition, FHA supports housing counseling agencies that provide delinquency and loss mitigation counseling in their communities. FHA's National Servicing Center provides training to servicers in the Loss Mitigation Program and operates a help desk for FHA borrowers who need help making contact with their lenders. HUD also has on its website information for consumers on its Loss Mitigation Program.

Lenders are required to evaluate each defaulted FHA loan to determine which, if any, loss mitigation tools will help the borrower avoid foreclosure. Violation of this requirement can result in a penalty 3 times the amount FHA paid in a foreclosure claim to reimburse the lender.

The process to modify a loan is as follows:

> Under HUD's Loss Mitigation Program, the lender is required to review the borrower for loss mitigation qualification prior to the fourth full monthly installment due on the mortgage becoming unpaid (assuming the borrower cooperates). This process begins with the borrower providing financial information for the lender to perform a financial analysis of the borrower's financial condition and independently verify the information. If the lender determines from the financial analysis and title evaluation the borrower will qualify/benefit from a loan modification it then sets the terms of the proposed modification which may include a reduction in interest rate, capitalization of delinquent payments and if applicable legal fees from a canceled foreclosure, re-amortization or recast to extend the term back out to 360 months. The lender would draft the documents and send them to the borrower with new payment and term information, for execution and return, the modification is filed on record and the loan is brought current.

Costs to the servicers that FHA will reimburse for modifying the loans are title work and document preparation, HUD provides an incentive payment to lenders of $750 plus up to $250 for title work. If the lender has to foreclose the cost ranges from $2,500 up to $5,000 depending on the state the property is in. HUD reimburses the lenders up to 75 percent of the foreclosure costs. We understand that servicers could also lose or gain money when re-pooling these mortgages with interest rate changes, but FHA does not have analyses on these costs.

If a borrower does not qualify for any FHA loss mitigation home-retention tools (special forbearance, loan modifications or partial claims), the borrower would be evaluated for the non-home retention loss mitigation options of pre-foreclosure sale and deed in lieu of foreclosure.

Under a pre-foreclosure sale (PFS), which is a short sale, a borrower, under certain conditions, may sell their house for less than the outstanding debt. The lender preauthorizes the terms of the sale and the minimum sales price in accordance with FHA guidelines. For Fiscal Year 2009, HUD projects approximately 5,000 pre-foreclosure sales, an amount which represents no significant change from each of the prior three years.

Deed-in-Lieu of Foreclosure is a type of conveyance that occurs when the borrowers voluntarily transfer the property to the mortgagee. This loss mitigation tool should only be considered when the borrower is in default and does not qualify for any other loss mitigation options or upon failure of a pre-foreclosure sale. For Fiscal Year 2009, HUD projects less than 1,000 deeds-in-lieu, an amount which represents no significant change from each of the prior three years.

The charts below summarize FHA's loss mitigation actions and re-default and claim rates associated with the loss mitigation actions.

Loss Mitigation Data FY2006 – FY2009 as of January 31, 2009			
	Total Retention Tools	Total Non Home Retention Tools	Total Loss Mitigation
FYTD 09	38,704	2,027	40,731
FY 08	96,482	4,685	101,167
FY 07	86,527	4,480	91,007
FY 06	75,528	5,244	80,772

Source: US Dept of HUD Claims Branch reports.

FHA Single-Family Insurance FY2004 – FY2006 Re-Default and Claim Rates After Loss Mitigation Loan Workouts			
Year of Initial 90-day Defaults Subsequently Cured with FHA Loss Mitigation Tools	Re-Default Rate Within One Year	Claims Within One Year of Cure	Claims Within Two Years of Cure
2004	32.8%	9.3%	14.1%
2005	31.4%	7.8%	12.6%
2006	32.4%	6.2%	9.6%

Source: US Dept of HUD; Defaults are defined as 90-day delinquencies; Re-defaults are new 90-day delinquencies reported within 12 months after curing the initial default; Cures involve use of FHA loss mitigation tools by loan servicers; Insurance claims arise primarily from foreclosure actions. Data as of September 30, 2008

HUD is requesting new authority to enhance its partial claim program to enable FHA to buydown mortgage balances. The Administration is developing changes to the authority that will allow FHA to assist homeowners experiencing reductions in income that are more than just temporary in nature while considering the impact to program costs.

Again, I want to thank you for the opportunity to explain FHA's loan modification and other loss mitigation options. I am prepared to answer your questions.

TESTIMONY OF MARGUERITE SHEEHAN
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY
JPMORGAN CHASE

Chairwoman Waters, Ranking Member Capito and Members of the Subcommittee on Housing and Community Opportunity, we appreciate the opportunity to appear before you today on this most important topic of helping homeowners. We recognize that no one benefits in a foreclosure.

My name is Molly Sheehan and I work for the Home Lending Division of JPMorgan Chase as the Housing Policy executive. Chase is one of the largest residential mortgage servicers in the United States, serving more than 10 million customers located in every state of the country with mortgage and home equity loans totaling about $1.4 trillion. We are proud to be part of one of this country's pre-eminent financial institutions with a heritage of over 200 years.

Continuing to Lend

As one of the largest residential mortgage originators in the country, we also continue to make mortgage credit available, even in these difficult times. We provide loans directly to consumers and we purchase loans from smaller lenders so they can lend to their customers. In 2008, Chase made more than $105 billion in mortgage loans even though mortgage applications declined significantly.

Keeping families in their homes

At Chase we are not only continuing to lend; we are also doing everything we can to help families meet their mortgage obligations and keep them in their homes. Even before the current housing crisis began, our foreclosure prevention efforts were designed to do just that. We believe that it is in the best interests of both the home owner and the mortgage holder to take corrective actions as early as possible – in some cases even before default occurs. We apply our foreclosure prevention initiatives to both the $325 billion of loans that we own and service and the $1.1 trillion of investor-owned loans that we service. We expect to help avert 650,000 foreclosures – or a total of $110 billion of loans – by the end of 2010. We have already helped prevent more than 330,000 foreclosures, including modifying loan terms to achieve what we expect should be long-term, sustainable mortgage payments.

We are well under way to implementing the commitments we made in announcing this foreclosure prevention plan last October. In particular, we have:

- Commenced mailing proactive modification offers to borrowers of Chase-owned Option ARM loans at imminent risk of default.
- Selected sites for 24 Chase Homeownership Centers in areas with high mortgage delinquencies where counselors can work face-to-face with struggling homeowners. We will have 13 of these centers –in California and Florida – open and serving borrowers by the end of this week. The other 11 around the country will be open by the end of next month.
- Added 300 new loan counselors to provide better help to troubled borrowers, bringing the total number of counselors to more than 2,500.
- Initiated an independent review process to ensure each borrower was contacted properly and, if and as appropriate, offered modification prior to foreclosure.
- Developed a robust financial modeling tool to analyze and compare the net present value of a home in foreclosure to the net present value of a proposed loan modification; this tool allows Chase to modify loans as proactively as it can while still meeting its contractual obligations to act in the best interests of investors when making loan modifications.
- Worked to help establish a non-profit clearinghouse to join Chase and other lenders who want to donate or discount their owned real estate to non-profit and government agencies that can use these properties.
- Worked with Fannie Mae and Freddie Mac to implement their new Streamlined Modification Program for borrowers at least 90 days delinquent; we have mailed more than 28,000 letters in the past several weeks.

Our Loan Modification Programs

We have expanded the loan modification alternatives that Chase already offered as part of our Foreclosure Prevention program. The enhanced modification tools allow for more flexibility based on the borrower's current loan type and the borrower's specific financial situation. Chase is working to finalize the offers and strategy for both delinquent and current borrowers, but the offers are likely to include those described further below.

Chase-owned subprime hybrid Adjustable Rate Mortgages (ARMs) scheduled to reset for the first time will remain at the initial interest rate for life of the loan. Borrowers will qualify for this program if they have a clean payment history on a hybrid ARM whose interest rate adjusts after the first two or three years. Borrowers do not need to contact Chase to benefit from this program – the rate lock will happen automatically.

We will use the ASF Fast Track program to reduce payment shock for subprime hybrid ARMs serviced but not owned by Chase and scheduled to reset for the first time. Qualifying borrowers will have their initial ARM rate frozen for five years.
For owned Option ARM loans facing large increases in payments as a result of a recast and high loan to value ratios, Chase has begun to mail pre-approved modification offers. These offers allow borrowers to keep making their current, low payments for at least 3 more years before gradually moving towards a market rate. All the borrowers need to do is simply sign and return the modification agreement.

Chase will offer a pre-approved modification for borrowers whose loans are either owned or securitized by the GSEs and that meet the GSE's Streamlined Modification Program guidelines. Much like is done in the Chase program, term extensions, rate reductions and principal forbearance will be used to achieve an affordable monthly payment.

Borrowers not eligible for any of the systematic modification programs described above are reviewed on case-by-case basis to determine the suitability of a modification or other foreclosure prevention approach. For example, borrowers who are only in early stage delinquency may qualify for the Early Workout Program offered by Fannie Mae.

Loan modifications under the Chase programs are evaluated by developing an estimated target affordable payment of 31% to 40% of the borrower's gross income. We are using the lowest percentages for borrowers with the lowest incomes. Once the target payment is calculated for the borrower, we will test each modification option to see if it will get the borrower to an affordable payment. Concurrently, we apply the Net Present Value analysis to each option to determine whether the value of the modification exceeds the value expected through foreclosure. We will recommend as the modification the option that produces both an affordable payment and a positive Net Present Value to the loan.

Chase's modification hierarchy is currently being implemented for delinquent borrowers. Chase will be proactively reaching out to those borrowers to develop an appropriate offer. Components of any modification proposal may include the following:

- Eliminating negative amortization for pay option ARMs.
- Establishing a new loan term as long as 40 years.
- Reducing the interest rate to as low as 3%. This rate will be frozen for three years and then increase at a maximum of 1% per year until it reaches the prevailing market rate at the time of the modification.
- Reducing the principal on which payments are calculated to as low as 90% to 95% of the home's current value. The difference between that amount and the outstanding principal does not accrue interest but is due upon maturity or prepayment of the loan.
- Introducing a 10-year, interest- only period on the loan.
- Other rate reductions and principal forbearance as necessary to meet affordability standards as long as it is net present value positive.

The modification hierarchies will be the basis for a loan-by-loan review of our portfolio to develop an offer that can be proactively presented to the borrower. It is then the borrower's responsibility to contact us, discuss their financial situation and furnish the appropriate documentation so that we can verify their income. Our experience has clearly shown that modifications resulting from income verification result in the most sustainable loans with the best performance.

Other Foreclosure Prevention Options

Loan modifications are not the only tactic that Chase is pursuing. Chase believes that for a number of distressed homeowners, a refinance into a fully-amortizing FHA- or GSE-insured loan with lower payments may be a better alternative. So we will offer refinances for borrowers we believe are at risk of default or are already delinquent, as well as provide the economic incentives (such as principal forgiveness, principal forbearance or rate subsidization) required to refinance these borrowers.

In addition, Chase offers other foreclosure prevention options, such as

- Payment plans (where a borrower agrees to pay back arrearages over time),
- Deferments (where a borrower agrees to make late payments in the future),
- Borrower stipulations (where a borrower agrees to make a set of payments, often as a prelude to a modification), and
- Short-sales / settlements (a form of principal forgiveness where Chase agrees to accept less than the amount of the mortgage in exchange for the underlying property or the proceeds of the sale of the underlying property).

Although borrowers do not keep their homes in short sales and settlements, these may be appropriate solutions when the borrower has no interest in remaining in the home or simply cannot afford the home over the long term even if payments are reduced by a modification.

We believe that programs like ours are the right approach for the consumer – all consumers -- and for the stability of our financial system as a whole. We support the Administration's proposal to adopt a uniform national standard for such programs and to encourage all sensible modification efforts short of bankruptcy as much as possible. We are very pleased with the steps taken by the Administration to address this need.

We support the President's Plan

In particular, as our CEO, Jamie Dimon commented, "we believe that the Homeowner Affordability and Stability Plan announced last week by President Obama is good and strong, comprehensive and thoughtful. We think it will be successful in modifying mortgages in a way that's good for homeowners".

We applaud:

- The focus on making monthly payments affordable for borrowers
- The creation of uniform national standards for mortgage modification to provide consistent and fair treatment of customers across the industry. That standard will include the common-sense application of full income and debt verification
- The partnership with government to reduce interest rates – and payments -- for borrowers
- The expanded ability of borrowers to take advantage of today's lower rates through refinancing
- The inclusion of financially distressed borrowers even before they are delinquent
- The use of counseling for borrowers with the highest debt ratios

We look forward to working with the Administration, Congress, the agencies and other interested parties in implementing these initiatives to help families – and the U.S. economy.

As we advised Chairman Frank and the members of the House Financial Services Committee on February 12th, we have stopped adding loans owned by Chase into the foreclosure process where the properties are occupied by homeowners. We committed to this freeze through March 6th to afford the President and the Administration time to develop and communicate the details of the new Plan. This replicates our commitment on Oct. 31 to refrain from initiating new foreclosure actions so that Chase could review those mortgages for possible modification. That commitment delayed foreclosure commencement on over $22 billion of Chase-owned mortgages held by more than 80,000 homeowners.

Thank you for your attention and I would be happy to answer any questions you may have.

Respectfully submitted,
Marguerite Sheehan
February 23, 2009

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