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FORECLOSURE MEDIATION PROGRAMS: CAN BANKRUPTCY COURTS LIMIT HOMEOWNER AND INVESTOR LOSSES?

HEARING

BEFORE THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

FEBRUARY 1, 2011

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FORECLOSURE MEDIATION PROGRAMS: CAN BANKRUPTCY COURTS LIMIT HOMEOWNER AND INVESTOR LOSSES?

TUESDAY, FEBRUARY 1, 2011

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, DC

The Committee met, pursuant to notice, at 10:01 a.m., in room SD–226, Dirksen Senate Office Building, Hon. Sheldon Whitehouse, presiding.

Present: Senators Whitehouse, Klobuchar, Franken, Blumenthal, and Grassley.

OPENING STATEMENT OF HON. SHELDON WHITEHOUSE, A U.S. SENATOR FROM THE STATE OF RHODE ISLAND

Senator WHITEHOUSE. The hearing will come to order. I am delighted to be joined by the Judiciary Committee's Ranking Member, Hon. Chuck Grassley, who I am very much looking forward to working with on these issues as we go forward.

I want to welcome all of the witnesses who are here today: Mr. Britt, Judge Drain, Mr. Rao, Dr. Sanders, Dr. Grossman.

What we will do is do some opening statements. Welcome, Senator Blumenthal. I know that it is not official yet that you are on this Committee, but for purposes of this hearing, I intend to treat you and our new Republican member, Senator Lee, should he come, as if they were because I think it is a fait accompli, and we might as well yield to common sense. So welcome, Senator Blumenthal.

Last October, I convened a Subcommittee hearing in Providence to examine a sensible approach to reducing foreclosures that has been adopted by the bankruptcy court for the District of Rhode Island, as well as a number of other districts. Under the foreclosure loss mitigation program, the court, at the request either of the homeowner or the servicer, will order the parties to sit down with each other and see if a settlement would be mutually beneficial. The settlement must be consensual and none is required, but the mere act of sitting the homeowner down with someone who has the authority to modify the mortgage or agree to another commonsense settlement often is enough to avoid a costly and painful foreclosure. It is often the first time that the homeowner has had that opportunity. The Rhode Island program is modest, but I believe that it has the potential to help many thousands of homeowners, and help is definitely needed.

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As the foreclosure crisis continues in Rhode Island and across the Nation, the administration's Home Affordable Modification Program, while well intentioned, has not succeeded in producing anywhere near enough modifications to stem the tide of foreclosures. The Congressional Oversight Panel recently estimated that the HAMP is on pace to modify 700,000 to 800,000 mortgages—far short of the 3 to 4 million that was the original goal of the program and nowhere near the 8 to 13 million foreclosures expected through 2012. Even the relatively few homeowners that manage to get HAMP modifications must endure a disorganized and often harrowing process.

Members of Congress hear frequently from our constituents being ignored and abused throughout the modification process: documents repeatedly lost over and over again, inconsistent advice from one person and then another, hours trapped on the phone waiting to find someone to talk to, and common sense frequently turned on its head to reject fair modifications or even short-sale requests in favor of foreclosure. Too often the left hand does not seem to know what the right hand is doing, and the homeowner is caught in the middle.

We have likely all heard from our mayors about the terrible collateral cost to communities from foreclosure. We have seen the big loan servicers drag their feet in the HAMP. And we have learned that these companies were playing fast and loose in the foreclosure process, carrying out foreclosures in the cheapest manner possible, often outsourcing the process to "foreclosure mill" document-processing companies. Tragically, these foreclosures are often unnecessary, indeed often not even in the mortgage holder's best interests, but they are driven forward by conflict-ridden bureaucratic machinery that lacks the most basic American failsafe: the chance to talk to a responsible human being who can make an actual decision in your case.

The bankruptcy court loss mitigation programs will not save every home, but they can help countless frustrated homeowners cut through that bureaucratic nightmare and get answers to their modification requests. Because foreclosures can trash the value of a house, loss mitigation programs can save investors money, too. Servicers too often act in their own fee-driven interests and not in the interests of the investors who actually hold the mortgages. A court-supervised negotiation can ensure that servicers do not reject reasonable settlements that would benefit the investors. And that is one reason that the National Association of Mortgage Investors is supporting our efforts here.

Loss mitigation programs have important benefits even for servicers. Bankruptcy courts have the power to clear title questions that have been raised by faulty paperwork with respect to mortgages. Court-approved settlements can protect servicers against future investor litigation. Pooling and servicing agreements often leave servicers unsure if they should modify mortgages or foreclose. A court can help to alleviate this uncertainty by signing off on the reasonableness of a settlement.

Ultimately, I believe that giving bankruptcy court judges the power to reduce the principal on primary residence mortgages would be the most efficient and least costly way to keep families

in their homes, but that is not the topic of today's hearing. This morning we are focusing on far more modest loss mitigation programs, which, without conferring any new substantive powers on bankruptcy courts, have proven effective in avoiding unnecessary foreclosures, mostly because it is the first time the homeowner has actually had a chance to talk with a human being from the bank who has the authority to make a decision in his case and to look at the file.

Thank you very much. I look forward to hearing the witnesses. We will hear from Senator Grassley, and then we will—I do not know if Senator Blumenthal cares to make an opening statement. If he does, we will do that. And then I will swear in the witnesses, and we will proceed with the hearing.

Senator Grassley.

STATEMENT OF HON. CHUCK GRASSLEY, A U.S. SENATOR FROM THE STATE OF IOWA

Senator GRASSLEY. Obviously, I thank you for holding this hearing. It is important to study the relationship between bankruptcies and foreclosures and whether there is, in fact, a need for change in the Bankruptcy Code.

The Committee also needs to study how the President and administration is responding to foreclosures, whether that response is working, whether the $75 million that the administration is spending is a proper use of the taxpayers' money; and if so, whether that money is being used in the most effective manner.

This hearing has a chance to have some of the facts come out and to have the issue fully and fairly examined, and I am open to listening to proposals that can make a difference. And I had an opportunity before the holidays to have such a discussion in my office with Senator Whitehouse, and I appreciate very much your coming to discuss your legislation.

The Nation is experiencing some difficult times. Our fellow citizens are hurting, and we must get the economy moving in the right direction. That means helping spur job creation and wisely spending taxpayers' money. But our effort must be fully thought out. As part of our responsibilities to our fellow citizens, we must carefully examine how relief proposals will impact the whole economy and how the money spent will impact future generations.

The issue of mortgage modification is not a simple one. There are significant and real concerns about the mortgage loan modification program being run by bankruptcy courts. There are questions about how these programs are being administered and their impact on the economy.

For example, the concerns also include questions about whether judges will use these programs to mandate cramdown, which obviously, you know, is a reduction in the principal amount of a loan, something that even the Obama administration program does not condone.

I also know that there are questions about whether the discussion on loan modification programs being run by bankruptcy courts is just ignoring the real problem. If you review the written materials and procedures for programs run by the bankruptcy court in Rhode Island, you see multiple references to the Home Affordable

Modification Program. The Treasury Department currently operates a number of foreclosure mitigation programs. The Home Affordable Modification Program is a $75 million program which began 2 years ago. However, the Home Affordable Modification Program has come under severe criticism even from Obama administration officials.

Although homeowners have applied to the program and received trial modifications, the number of modifications that are converted to permanent agreements that enable homeowners to permanently avoid foreclosure is, in fact, low. Particularly disturbing is the fact that Treasury still has not established performance goals or benchmarks for the Home Affordable Modification Program, meaning that there is no effective way for us to know whether the $75 million program has accomplished its intended purpose. That is not accountability. It is not transparency. That is just more taxpayer money going out the window.

In July of last year, as Ranking Member of the Finance Committee, I participated in a hearing examining the failures of the Home Affordable Modification Program. A few days after the hearing, I sent a letter to Treasury Secretary Geithner urging him and his Department to establish specific goals and benchmarks. Remarkably, the letter I received back from the Treasury defended the program as a success and confirmed that the Department does not and apparently refuses to set permanent goals for the program.

My concern is shared by the Special Inspector General for TARP. Just 6 days ago, the Special Inspector General issued a report that continues to confirm the failures of the Home Affordable Modification Program. That report also continues to call for the Treasury Department to establish specific goals and benchmarks just as I asked the Treasury Secretary to do.

As the Special Inspector General's report reveals, the numbers for the programs are "remarkably discouraging." The number of permanent mortgage modifications under the Home Affordable Modification Program remain anemic. There were just under 522,000 ongoing permanent modifications as of December 31st. A combined total of more than 792,000 trial and permanent modifications have been canceled, with more than 152,000 trial modifications still in limbo.

These permanent modification numbers pale in comparison not only to foreclosure filings but also to the Treasury's initial prediction that the Home Affordable Modification Program would "help up to 3 to 4 million at-risk homeowners avoid foreclosure by reducing monthly payments to sustainable levels."

In particular, the Special Inspector General's report confirms my concerns by describing Treasury's steadfast refusal to adopt meaningful goals and benchmarks as perhaps the most fundamental of the causes of the program's failure to have material impact on preventing foreclosures. And the report also outlines disturbing conduct of the Treasury Department: "Rather than develop meaningful goals and metrics for the program which would allow meaningful oversight, program accountability, and provide guidance for useful change, Treasury instead has regularly changed its criteria for success, citing at different times a total number of trial modifications, offers extended to borrowers, regardless of whether they were ac-

cepted, and then the total number of trial modifications, regardless of whether or not they became permanent, which far fewer than half already have done."

I agree with the Special Inspector General's conclusions that, "Given the current pace of foreclosures, achievements of the program look remarkably modest, and hope that this program can ever meet its original expectation is slipping away."

Now, in light of the documented problems with the program and its continued failure to provide real relief, the question becomes why are taxpayers paying $75 million for a program that does not work. The next question then, and appropriate here, is: Will another Government program, this time in the bankruptcy courts and this time without any Congressional oversight, really work to turn things around?

We also must be mindful that there will be limited Congressional oversight over judges within the bankruptcy court program. Accordingly, we must always be very careful before we grant judges who are not elected, and in the case of bankruptcy judges not subject to Senate review through the confirmation process, new powers without a thoughtful approach to it. I look forward to that thoughtful approach, as was evidenced by the Chairman's discussion with me back before Christmas.

Senator WHITEHOUSE. Thank you very much, Senator Grassley. And for opening statements in order of arrival, I would begin with Senator Blumenthal.

STATEMENT OF HON. RICHARD BLUMENTHAL, A U.S. SENATOR FROM THE STATE OF CONNECTICUT

Senator BLUMENTHAL. Thank you, Senator Whitehouse, and thank you for organizing and holding this hearing on a subject that I know is of huge importance to a lot of homeowners as well as to the industry. Having come from an office where we have seen daily and weekly and year after year the heart-wrenching consequences of homeowners being given the runaround, confronting this problem of red tape and the mortgage servicers and often losing their homes as a result, we know from our experience that mediation and intervention of this kind really works, and the numbers show it.

In Connecticut, we have had a program that actually has saved thousands of homeowners in this situation, a State-run, judicially operated mediation program that has stopped foreclosures, modified loans, to the benefit of the lenders as well as the homeowners. And the numbers in the Rhode Island program within the bankruptcy court I think further add evidence to the importance and potential practical consequences beneficial to all sides of this kind of mediation program.

We are here for the very limited purpose, as Senator Whitehouse pointed out, of clarifying the law to enable these mediation programs to take place under the auspices and authority of the bankruptcy court. But I think that in their potential for encouraging State-operated programs, they also have great significance.

So I want to thank you for being here. Thank you for your innovative work. I know Judge Drain, for example, has been very important in encouraging innovative solutions to these kinds of needs

and challenges, and they are very definite challenges. But I am looking forward to your testimony and learning more about what needs to be done and how these programs can be expanded.

Thank you.

Senator WHITEHOUSE. Thank you.

For an opening statement, Senator Klobuchar.

STATEMENT OF HON. AMY KLOBUCHAR, A U.S. SENATOR FROM THE STATE OF MINNESOTA

Senator KLOBUCHAR. Well, Senator Whitehouse, I just want to thank you for your early and clear leadership on this issue. From the very beginning, you have identified the foreclosure issue and have worked in many, many different areas. So I want to thank you for that. I am looking forward to hearing from the witnesses.

Senator WHITEHOUSE. And also of Minnesota, the junior Senator, Senator Franken.

STATEMENT OF HON. AL FRANKEN, A U.S. SENATOR FROM THE STATE OF MINNESOTA

Senator FRANKEN. Thank you, Mr. Chairman, for leading on this issue so steadfastly, and for so long, and for holding this important hearing on foreclosure mediation programs in bankruptcy courts to better protect consumers. You just have been a real leader on bankruptcy issues, and I applaud you for your work in this area.

I want everyone to forgive me. I am bouncing between here and the Energy Committee hearing, so I will be back and forth.

Many problems have come to light since the beginning of the foreclosure crisis. Most recently we have seen mortgage servicers fraudulently signing affidavits to execute foreclosures when they have zero personal knowledge of the individual borrower's situation. This problem, known as "robo-signing," is particularly troubling to me.

Last year, I wrote letters to Ally Financial and JP Morgan Chase calling for a suspension of all foreclosure proceedings until this issue had been resolved. I got a form letter from Ally touting their efforts to complete HAMP and non-HAMP loan modifications, and it is nice to see that they do not treat the homeowners they are servicing any worse than they treat a Senator.

I also joined with Senator Menendez in asking GAO to investigate the role of Federal regulators in overseeing foreclosure proceedings. While some mortgage servicers have taken action on this issue, I worry that it is a day late and a dollar short.

Borrowers are at such an extreme disadvantage in these foreclosure proceedings that I fear robo-signing is only one of many ways that servicers have been able to take advantage of vulnerable families and homeowners. And because most homeowners do not have access to legal advice or even basic counseling, most of these abuses never come to light.

Some of you may have heard me tell the story of Tecora, a Minneapolis homeowner who fell behind on her mortgage when her payments went up. She entered the Home Affordable Modification Program, or HAMP, but was told by her mortgage servicer that her file was closed because she had "declined a final modification of her mortgage." The problem was that she actually had not done that.

Tecora is working with the Twin Cities' Habitat for Humanity, a wonderful nonprofit that is helping her fight this mistake and stay in her home. Every homeowner deserves this type of assistance. Unfortunately, not everybody gets it.

Minnesota has taken important first steps to address this matter by requiring mortgage service providers to provide homeowners with pre-foreclosure notices that include foreclosure prevention counseling resources. Every state needs to adopt this and other services to help give homeowners a fighting chance.

I am pleased that Judge Drain could join us today to tell us about the innovative foreclosure mediation program that was developed in the Southern District of New York. In Minnesota, more than 22,000 people filed for bankruptcy this year. This is a record number, and it is more than 87 percent higher than the bankruptcy rate in 2007 before the recession occurred. Although I realize bankruptcy reforms will not help all families going through devastating foreclosures, these types of mediation programs are one important way we can help families in Minnesota and elsewhere to stay in their homes.

Thank you, Mr. Chairman. I look forward to hearing the witnesses' testimony.

Senator WHITEHOUSE. Thank you, Senator Franken.

I will now ask all of the witnesses to please stand and be sworn. Do each of you affirm that the testimony you are about to give before the Committee constitutes the truth, the whole truth, and nothing but the truth, so help you God?

Mr. BRITT. I do.

Judge DRAIN. I do.

Mr. RAO. I do.

Mr. SANDERS. I do.

Mr. GROSSMAN. I do.

Senator WHITEHOUSE. Please be seated.

I think I will ask for each—I will introduce each witness and ask them to make their statement. I will remind them that that little red light that comes on means your time is up and you need to wrap so that there is time for questioning by the Senators. And at the end of the testimony of the entire panel, we will then do questions.

Let me begin with Larry Britt, who is a homeowner from Riverside, Rhode Island, who will discuss his struggles over the past 2 years in getting a mortgage modification from his loan servicer. Mr. Britt teaches English as a second language to adults for the Rhode Island Family Literacy Initiative and holds a B.A. from the Harvard Extension School, and I am delighted that he has come down from Rhode Island to share his experience with us today.

Mr. Britt, please proceed.

STATEMENT OF LARRY BRITT, HOMEOWNER, RIVERSIDE, RHODE ISLAND

Mr. BRITT. Thank you, Senator Whitehouse and Committee members, for taking part in this important hearing.

My name is Larry Britt, and I have owned my home in Riverside, Rhode Island, since 2003. I bought my home as a permanent residence in which to spend my final working and future retirement

years. My home purchase was not an attempt to get in on the crazy real estate boom of the times. I work in metro Providence and, as the Senator said, I am an adult educator teaching workplace readiness, English proficiency, and U.S. citizenship preparation skills.

One month from now, I will be entering my third year of the mortgage modification process.

When I started the process in March of 2009, I had never been late paying any bills to any creditors, and my credit score was near perfect. Since entering into a modification process with Bank of America, the bank has ruined my credit rating and has been the major contributor of uncertainty about my future. As of November 2010, my credit score had dropped 160 points as a consequence of improper credit reporting by Bank of America. During the process I subscribed to a credit report service, and I received weekly e-mail notifications of continuing negative impacts to my credit score. Also during that time, two creditors closed my accounts, and three radically lowered my available credit limits. Equally, I am concerned about rescinded and denied credit that my elderly mother and other family members have suffered as a consequence of their financial relationships with me.

Bank of America told me that I was told my credit score would be adversely impacted but could not provide documentation that proves I was told of this consequence when I started the modification process. I received documentation from the bank that contradicts what I assert after I contacted Senator Whitehouse as well as the Office of the Comptroller of Currency.

Because of legitimate financial hardships that I have documented, I entered into Bank of America's mortgage modification program hoping I could avoid prospective financial problems. In the past 24 months, I have immediately replied to all Bank of America inquires and requests for documentation. If we have the time, I could read through a chronology of my interactions with Bank of America from March 2009 to May 2010. But it sounds like I have a time limit, so, in short, I will say the chronology lays out a repeated cycle of applications, providing documentation, approvals, denials, mixed messages, and multiple departments and customer service representatives that left me unsure about my modification status. I am going to skip the details of that period of time, Senator.

Kind of at the end of that time period, in May 2010, I received a letter from Bank of America stating that I had been denied a mortgage modification because all requested documentation had not been received by the bank.

In May of 2010, I called Bank of America and was told to disregard the letter dated May 7th. The customer service representative stated that, according to Bank of America records, "all documentation was complete and received as of March 29, 2010."

At that time, I became truly frightened at the prospect of losing my home. I had mailings from Bank of America stating that I was about to go into foreclosure and that I was not eligible for mortgage modification. Two Bank of America customer service representatives had told me to ignore the letters, yet I had nothing in writing from them that assured my case was still under review.

That is when I contacted the Senator Whitehouse's office, and gratefully, I got an immediate response from Karen Bradbury, a case worker in the Senator's Providence office.

Karen's efforts resulted in a connection for me with the Department of Treasury's HAMP Solution Center. At first, my HAMP case worker sounded like the answer to my ongoing problems. The HAMP representative told me that he would be an advocate for me with Bank of America. At that time, the HAMP representative told me that he had learned from Bank of America that I was "under review for the Making Home Affordable Second Look" program. Throughout July and August of 2010, I contacted the HAMP Solution Center seven times. Each time, the HAMP Solution representative told me that his updates directly from Bank of America said that my modification was still under review and that I had complied with all requests for documentation as well as honored my agreement to make on-time modified monthly payments.

Honestly, after a few months with HAMP, I felt like they were reading from the same script as the banks. When I checked in with them, there was never any update; there were never any outstanding bank requests for documentation from me. Yet once a month or so over this same period, I received additional requests from the bank for repeat documentation.

I continued to make on-time mortgage modification payments, and the bank continued to report me as delinquent on payments. Consequently, my credit score and available credit continued to go down.

Last September, I started to work on filing forms with all three credit reporting agencies in an attempt to get BofA modified payments reclassified as modified payments rather than delinquencies. The credit reporting forms strongly encouraged trying to get the creditor in question to correct the problem. So I called Bank of America on October 4th of last year. I asked the Bank of America representative to review my account and confirm that I had made my modified payments that I had agreed to.

The customer service representative told me that my mortgage was in default as of May 7, 2010, and that I had been sent a letter saying I was not eligible for the Making Home Affordable Modification program because I did not provide Bank of America with requested documents. The representative also said that I had been sent a letter requesting the documentation. I never received this letter, and I explained the following to the representative.

This next testimony is just a rehash of what I have already said.

Senator WHITEHOUSE. Why don't you go ahead and summarize then. The time has expired.

Mr. BRITT. OK. Finally, I talked to that representative's supervisor. She would not give me her name. She told me she had no time for me and hung up on me.

So, to wrap up, I would say that since my first modification agency with the bank in October of 2009, I have been paying my modified monthly payment on time. However, since the bank considered my payments to be incomplete, the most recent modification agreement states that my modified principal balance has been increased by over $11,000. As the bank told me in a prior mailing, the modification agreement states that this amount includes unpaid and de-

ferred interest, fees, escrow advances, and other costs. The agreement also states that interest will now accrue on the unpaid interest that is added to the outstanding principal balance, which would not happen without this agreement.

Had the bank honored its terms of the October 2009 modification agreement with me and permanently modified my loan after I had made the agreed-upon trial modification payments, my principal loan balance would include 3 months of deferred interest and fees rather than the 16-month total of $11,000.

As with past modification agreements, I have once again provided all of the same paperwork and once again made three on-time trial modification payments. Unlike past modification agreements with Bank of America, I now have a customer advocate from the bank's Office of the CEO and President. She has a first name and a last name, and I can talk to her when needed. But, sadly, I believe it took the advocacy of my Senator to receive the level of customer service that all consumers deserve.

So I should be happy and I am truly grateful to the Senator's office and Rhode Island housing for what I hope is a final resolution. However, given the past 24 months of misinformation, can I be sure that Bank of America's "approval" is for real? Does another Bank of America division have me slated for foreclosure? I just cannot be sure, and the 24-month process has forced me into deeper financial trouble and emotional distress.

I know this story is hard to follow. It has taken me untold hours to keep track of and compile the scores of interactions I have had with the bank and HAMP Solutions Center.

If needed, I can document all of my activities, phone calls, documents sent, and the names of customer service representatives.

I want to thank you again for your time and consideration, and I would be happy to answer any questions or elaborate on any points that I have made.

[The prepared statement of Mr. Britt appears as a submission for the record.]

Senator WHITEHOUSE. Thank you very much, Mr. Britt. Your story provides an important backdrop against which the testimony of our next witness I think it is important to be seen.

Judge Robert Drain has been a bankruptcy judge in the Southern District of New York since 2002. Prior to his appointment to the bench, Judge Drain practiced bankruptcy law at the renowned New York law firm of Paul, Weiss, Rifkind, Wharton & Garrison. He is a fellow of the American College of Bankruptcy and a member of the American Bankruptcy Institute, the International Insolvency Institute, and the National Conference of Bankruptcy Judges. Judge Drain holds a B.A. from Yale University and a J.D. from Columbia University, and we are delighted that he has taken the trouble to join us today and share his experience.

Judge Drain.

STATEMENT OF HON. ROBERT DRAIN, UNITED STATES BANKRUPTCY JUDGE, SOUTHERN DISTRICT OF NEW YORK

Judge DRAIN. Thank you, Senator Whitehouse, Senator Grassley, Senator Blumenthal. Thank you for inviting me to testify on the loss mitigation program implemented on January 1, 2009, by the

United States Bankruptcy Court for the Southern District of New York.

Senator Whitehouse briefly summarized my biography. I should note that since I started practicing bankruptcy law in 1984, I dealt exclusively with large corporate bankruptcies and reorganizations, the types of cases for which the Bankruptcy Court for the Southern District of New York is well known.

However, like our colleagues around the country, we also preside over thousands of consumer bankruptcy cases, where the fate of the home is of central importance.

When confronted in late 2008 with the mortgage foreclosure crisis, my colleagues and I saw a set of problems that cried out for a formal mediation structure. And I would like to believe that our experience led us to see the issues as much from the lenders' perspective as from the homeowners'. In fact, it was creditors' lawyers—I want to emphasize that, creditors' lawyers—representing mortgage lenders and servicers who first asked the court to consider such a mediation program.

The problem was, and is, I think, basic. Increased defaults and the drop in home prices rendered the "autopilot" servicing model applied to the vast majority of home mortgage loans inadequate. A model premised on collecting payments in the ordinary course for all but a tiny percentage of mortgages and foreclosing on the few defaulted ones in the context of a rising market all too often simply did not work anymore. In the present market, to maximize their recovery, lenders actually would have to decide between adding to their stock of foreclosed homes or, alternatively, engaging in a workout with their borrower; either course could be preferable in the right circumstances.

However, this process simply was not happening with loan after loan after loan. Instead, loan servicers were leaving enormous amounts of money on the table simply because they continued to press the foreclosure button rather than respond to their borrowers' calls to renegotiate defaulted loans. The lenders' lawyers saw this, as did we. Moreover, whether because of fears about breaching the automatic stay under the Bankruptcy Code, constraints in their governing documents, or perceptions about the risk of liability to their beneficiaries if they negotiated with their borrowers, servicers wanted a court order setting a framework for such negotiations. Finally, and importantly, the lenders wanted structure imposed on the negotiations to make sure that the homeowners would not simply waste the lenders' time.

Of course, these lender goals almost completely overlapped with the borrowers'. Nothing, I believe, has been more frustrating to homeowners than loan servicers' refusal or inability to address their defaulted loans directly, banker to borrower, on a businesslike basis. Mr. Britt has just testified to this at today's hearing. From my experience, such testimony does not describe merely isolated instances of lender deafness but a widespread and pervasive problem.

To develop the mediation guidelines that eventually became the loss mitigation program in our district, we opened the discussion from the creditors' lawyers to consumer lawyers, and then to a wider group of creditor and consumer lawyers, and finally put the proposal out for public comment. We reached out to the creditor

and consumer bar again after the program had been operating for about a year and a half and have modified it somewhat in the light of their comments. However, remarkable consensus continues in its support. We did not, frankly, have anyone object to it.

The loss mitigation program is embodied in two general orders of the court, as well as model forms of commonly used documents that can be found on our website.

In summary, it applies in all cases under the Bankruptcy Code to loans secured by an individual debtor's primary residence. It may be invoked, on notice and with an opportunity to object, by either the homeowner or the lender. If there is no objection, the court enters an order establishing deadlines for the exchange of contact information for representatives with authority to negotiate; requests for and exchange of relevant information, such as the debtor's financial information and appraisals of the house; and the filing of affidavits disclosing the information that has been submitted, which, after about a year and a half, we found to be necessary to obviate disputes over whether information was, in fact, provided to the lender, since a frequent homeowner complaint is that the lenders often ask for the same information after it has already been sent. The guidelines also provide for a conference between the parties, a conference, if necessary, with the court, as well as an outside date to conclude the mediation. While the parties are negotiating, all litigation between them is put on hold, although either party can request that negotiations be terminated and litigation resume.

Lender objections to the invocation of loss mitigation—and requests to terminate it—are granted if, taking into account the homeowner's financial circumstances and the value of the house, it is not reasonable to expect that the parties, negotiating in their own self-interest, will reach an agreement. As best we can tell—and we are trying to improve our statistics—there have been over 2,000 requests for loss mitigation, only 90 of which drew an objection by the lender. We have entered 75 orders granting such objections. Of the remaining 15, based on my experience, most of the creditors actually, once they met with the lender—I am sorry, with the debtor—agreed to have the mitigation continue in their own interests. With the experience under the program, it became clear that it would not be invoked simply as a delaying tactic but actually to get something done, and objections to loss mitigation have almost ceased.

The program facilitates consideration of a homeowner's eligibility for the Government-sponsored HAMP program, but it is not limited to HAMP modifications. Indeed, although the program most often results in some form of loan modification, it is expressly not limited to loan modification. The parties may consider, for example, negotiating a "graceful exit" in which the homeowner has a specified time to leave the house—perhaps coinciding with the end of the school year—parameters for a short sale, or a deed in lieu of foreclosure.

The loss mitigation program has two primary benefits. It ensures, first, that there is a responsible lender representative with whom to discuss the loan. I cannot emphasize this enough: without the structure imposed by the program, most of the time this simply would not happen. Second, the program's structure, under the ulti-

mate supervision of the court, ensures that the parties deal with each other in good faith.

Most of the program's corollary benefits relate to its bankruptcy context. In a bankruptcy case, the lender can see how the homeowner is resolving his or her entire financial predicament, often freeing up income to pay the mortgage. For example, the Bankruptcy Code lets a debtor resolve wholly underwater junior mortgages and judgment liens that have been placed on the home and otherwise clear title, and the bankruptcy case provides a forum for dealing with tax liens and claims. Moreover, lenders with document problems—which today is not a negligible concern—can settle these issues on notice to interested parties and with the approval of the bankruptcy court.

The court's supervision is critical but limited. Our role is to ensure that the parties deal with each other in good faith. We may not impose an outcome on the parties, either directly or by, for example, refusing to relieve them of the loss mitigation procedures until they reach an agreement. We are there to enforce the deadlines imposed by the order and to resolve complaints that a party is acting arbitrarily, capriciously, or otherwise to the detriment of good-faith negotiations.

For example, we might ask a lender representative if the lender has considered whether the debtor is offering to pay more, on a present value basis, than the value of the house in foreclosure, but it would be inappropriate to insist that the lender reconsider a valuation that was done in good faith. At times we may make a suggestion about how to cross an impasse, but only on a basis to which the parties are prepared to agree.

About one-half of the loss mitigations that have concluded have resulted in some form of an agreement—usually a loan modification reducing the interest rate and stretching out payments.

We often hear that the loss mitigation mediations that did not result in an agreement also had a good effect: the homeowners saw, after actually engaging with their lender, the dollars and cents reasons why they could not keep their house. At a time when many homeowners cannot even get their letters and phone calls returned—often by banks that homeowners are acutely aware have themselves been rescued by the Federal Government—this is no small achievement.

Obviously, before we implemented the loss mitigation program, we assured ourselves of our legal authority to do so. The program is consistent with Congress and the Federal courts' general encouragement of mediation, as well as specifically with section 105(d) of the Bankruptcy Code, Bankruptcy Rules 7016 and 9014, and the courts' inherent power to manage their own docket. The legal basis for our loss mitigation program has never been challenged, although I am aware of such a challenge to a similar program in the Bankruptcy Court for the District of Rhode Island that has recently been denied by that court.

One reason for legislation in this area would be to make the courts' authority absolutely clear. There is another reason as well, however. By passing legislation expressly recognizing the benefits of home mortgage mediation programs, Congress would endorse a

solution to one of the most vexing problems of the financial crisis by encouraging bankers to return to being bankers.

Since I am not testifying today on behalf of any group, I can tell you that my personal view of legislation is that less is best. Even if you share that view, however, and perhaps especially if you share it, facilitating homeowners and lenders to negotiate the resolution of their loans is a good idea.

Thank you again for inviting me to testify on this important topic, and I am happy to try to answer any questions that you have about it.

[The prepared statement of Judge Drain appears as a submission for the record.]

Senator WHITEHOUSE. Thank you, Your Honor. I am very grateful to you for coming here and sharing your experience.

Our next witness is John Rao. He is an attorney with the National Consumer Law Center, focusing on consumer credit and bankruptcy issues. He has served as a panelist and instructor at numerous bankruptcy and consumer law trainings and conferences. He has served as an expert witness in court cases and has testified in Congress on consumer matters. He is a contributing author and editor of NCLC's Consumer Bankruptcy Law and Practice, co-author of NCLC's Bankruptcy Basics; Foreclosures; and Guide to Surviving Debt; and contributing author to NCLC's Student Loan Law; Stop Predatory Lending; and NCLC Reports: Bankruptcy and Foreclosures Edition. He is also a contributing author to Collier on Bankruptcy and the Collier Bankruptcy Practice Guide. Mr. Rao serves as a member of the Federal Judicial Conference Advisory Committee on Bankruptcy Rules, appointed by Chief Justice John Roberts in 2006. He is a conferee of the National Bankruptcy Conference, a Fellow of the American College of Bankruptcy, Vice President for the National Association of Consumer Bankruptcy Attorneys, and former board member for the American Bankruptcy Institute. He is an adjunct faculty member at Boston College School of Law. Before coming to NCLC, Mr. Rao served as a managing attorney of Rhode Island Legal Services and headed the programs Consumer Unit. His practice included a broad range of cases dealing with consumer, bankruptcy, and utility issues, requiring representation of low-income clients before Federal, State and bankruptcy courts, and before administrative agencies. And I can assure everyone listening that both from being with him and against him on some of those cases, he was an excellent advocate. Mr. Rao is a graduate of Boston University and received his J.D. in 1982 from the University of California-Hastings.

Mr. Rao, thank you.

STATEMENT OF JOHN RAO, ATTORNEY, NATIONAL CONSUMER LAW CENTER, BOSTON, MASSACHUSETTS

Mr. RAO. Senator Whitehouse, Senator Grassley, Senator Blumenthal, thank you for holding this hearing——

Senator WHITEHOUSE. May I just note you have done this before and you know the rules, and I know you have got a lot of testimony that is in the record, and I hope you will confine yourself, as best you can, to the times that are scheduled. As a former practicing attorney, I am still sufficiently intimidated of judges that I did not

gavel Judge Drain. But I would urge the other witnesses to try to make it within the time frame if they can.

Mr. RAO. Thank you, Senator. I testify today on behalf of the low-income clients of the National Consumer Law Center, as well as on behalf of the National Association of Consumer Bankruptcy Attorneys.

The Treasury Department's HAMP program will not reach its goal of 3 to 4 million permanent loan modifications because it has relied upon the voluntary efforts of servicers, and no effective method of enforcement was incorporated into the program's design. Treasury has used various incentives to encourage servicer participation, but these carrots have not resulted in servicer compliance.

In response to the very basic problem of homeowners who cannot get servicers to promptly consider their requests for loan modifications in a timely manner or, for that matter, to even get a simple yes or no answer, numerous foreclosure mediation programs have been adopted nationwide by State and local courts.

At their core, these programs are a procedural device to bring homeowners and mortgage servicers together to consider alternatives to foreclosure. They do not compel a particular outcome, as Judge Drain mentioned. They do not force a servicer or investor to modify their contracts or to cram down a loan. All they compel is that the parties designate someone with settlement authority to participate and that the parties negotiate in good faith. In that respect, these programs are consistent with the many court-annexed alternative dispute resolution and mediation programs that have become commonplace in both Federal and State courts.

I would like to outline the reasons why bankruptcy courts, too, can play an important role in avoiding unnecessary foreclosures. As was mentioned, homeowners routinely encounter numerous bureaucratic barriers. Mr. Britt mentioned he was required to submit the same documentation over and over again. The New York and Rhode Island loss mitigation programs attempt to break this logjam by requiring the homeowner and servicer to designate contact persons for the exchange of information. Importantly, the loss mitigation programs provide for the entry of an order which specifies time deadlines for those requests for information to be exchanged.

Also, too often homeowners wait under the HAMP program for over a year for a decision to get a modification request. These delays occur despite the fact that HAMP guidelines require a decision within 30 days after an application has been submitted.

Contrary to Mr. Grossman's statement in his testimony, the reality is that HOPE NOW does not help homeowners get through to a decisionmaker. The advantage of mediation programs is that they require each of the parties to designate a person having authority to resolve the matter.

A major failing of HAMP is also that homeowners are often never told the reason why their modification request has been denied, even though Treasury requires them to provide those reasons. Under the Rhode Island and New York loss mitigation programs, the servicer who wishes to terminate the program must state those reasons clearly in a request to the court, and the information about denials can be obtained.

HAMP-participating servicers are under contractual obligations to consider homeowners for loan modifications before they foreclose. If a homeowner is found eligible, they are supposed to stop the foreclosure. However, the HAMP guidelines do not provide the same protection for homeowners while their application is under consideration. In a bankruptcy loss mitigation program, that protection to avoid the foreclosure from proceeding while the application is considered would be available because of the automatic stay.

More troubling than servicers not making decisions is that they are often providing proprietary workout agreements on less favorable terms. Recently, the Congressional Oversight Panel reported that almost 70 percent of loan modifications have not been under HAMP and that these proprietary modifications have a much higher re-default rate.

In a loss mitigation program in a bankruptcy court, all the parties can look and see what was done and make sure that the homeowners was properly evaluated for HAMP.

The loss mitigation programs in bankruptcy also deal with the Second Mortgage Program. Many homeowners have other second mortgages which prevent the first mortgage holders from modifying the loans. The laws of bankruptcy allow for that to be dealt with.

Finally, a modification in a bankruptcy proceeding also permits the court and the homeowner to address all of the debt—the consumer's entire debt load, all of the other debts they are dealing with—car loans and credit card debts—and that, too, has a way of increasing the possibility of avoiding re-default on these modifications.

Thank you again for holding this hearing, and I am happy to answer any questions that you may have.

[The prepared statement of Mr. Rao appears as a submission for the record.]

Senator WHITEHOUSE. Thank you very much, Mr. Rao. I appreciate you being here.

Our next witness is Dr. Anthony B. Sanders. He is a distinguished professor of finance in the School of Management at George Mason University. His research in teaching focuses on housing, financial institutions, and real estate finance and investments. Professor Sanders earned his Ph.D. and M.A. from the University of Georgia, and we welcome him here today.

STATEMENT OF ANTHONY B. SANDERS, PROFESSOR AND SENIOR SCHOLAR, THE MERCATUS CENTER, GEORGE MASON UNIVERSITY, FAIRFAX, VIRGINIA

Mr. SANDERS. Mr. Chairman and members of the Committee, my name is Anthony Sanders, and my research focuses on real estate finance, securitization, and housing economics. Thank you for the invitation to testify before you today.

When President Obama was elected in November 2008, the Case and Shiller Composite-10 housing index was 165.95, down from its peak in June of 2006 of 226.29. The unemployment rate in November of that same year was 6.5 percent, up from 4.8 percent at the peak of the housing bubble in June 2006. According to the most recent releases, the Case-Shiller index has declined further to 157.28 while unemployment has risen now to 9.1 percent.

While housing and unemployment numbers are disturbing at a national level, they are far worse in many States. House prices haven fallen substantially in the "sand States" of Florida, Arizona, Nevada, and California—each over 40 percent from peak to recent. Other States such as Rhode Island, Maryland, and Michigan have experienced a decline of over 20 percent in housing prices. And in terms of unemployment, Nevada, California, and Florida have unemployment rates far higher than the national average of 9.1 percent.

Thus, until unemployment starts to shrink dramatically and housing prices began a serious recovery, successful loan modifications will be very difficult to achieve. The forecast for unemployment is not positive, so difficulties in loan modifications are likely to continue.

A number of alternative proposals to HAMP and voluntary, privately initiated current servicer programs for loan modifications have been proposed. They range from the dramatic principal reductions—the Hubbard-Mayer proposal—to loan modifications for the unemployed.

Whatever proposal Congress pursues, it will be a steep hill to climb. Lenders filed 3.8 million foreclosures in 2010, and even more are expected to be filed in 2011. It is projected that the foreclosure wave will subside in 2012, but not before several million foreclosures have been filed. And we can only hope that housing prices have started to rise again in 2012 and unemployment begins to decrease.

The Hubbard-Mayer proposal highlights the difficulty of a Government solution to the problem. Essentially, Hubbard and Mayer advocate having Freddie and Fannie reduce borrower loan principal through refinancing on mortgages they insure or hold. The borrower's principal would be reduced to local house price levels, thus negating the negative equity problem and partial income curtailment problems.

While it is true that their plan would lower mortgage payments and may reduce future foreclosures, the costs are staggering. Hence, the difficulty with trying to implement a Government solution trying to fix the negative equity problem.

One of the objectives of the Government loan modification program is home preservation. Home preservation is achieved when loan modifications are used to keep borrowers in their home. The desire to keep borrowers in their home must make economic sense to both the investor and the servicer.

What do I suggest? Well, first, having a mandatory mediation assumes that a borrower would be better off in their home as an owner rather than as a renter. Given the prevalence of negative equity and the large supply of vacant and rental property—a story today said 11 percent nationwide—it is likely that many borrowers would actually be better off renting.

Second, a mandatory mediation adds additional costs and delays to the process, a process that is already severely strained. The average time to liquidation of a house averages 17 months already—costing the investor/lender lost interest and asset value declines. If bankruptcy becomes more appealing to borrowers because of the mandatory mediation, we would expect rather onerous delays in

moving borrowers to foreclosure. Furthermore, the mandatory modification may result in borrowers bypassing HAMP.

Third, Fannie and Freddie, the mortgage giants, have expansive databases and models regarding the likelihood of a borrower surviving with a loan modification. If Fannie and Freddie are having trouble with serious delinquencies and foreclosures, what are the odds that a bankruptcy court can intervene with a sensible loan modification solution that Fannie and Freddie could not direct its servicers to accomplish?

Fourth, any requirement of mediation between a borrower and a servicer must be made explicit when the mortgage loan is originated and the securities are created. As of now, there is no understanding by borrowers or investors that mandatory mediation in bankruptcy is required or that it is even possible. This represents another surprise to investors and other market participants which are in all cases viewed negatively. Creating more surprises may further decrease the interest in mortgage market investment, resulting in less available mortgage credit and funds.

Finally, while mediation may result in more loan modifications being made, we know that the failure rate on loan modifications is about 50 percent and could be higher if house prices continue to be soft and unemployment does not improve. Stated differently, if the standards for getting a loan modification are lowered, the more likely it is that the failure rate for modifications would increase.

In summary, the housing market needs to recover, and persistent attempts at delaying foreclosure—whether through mediation or moratorium—only adds additional uncertainty to the housing market and slows any recovery.

Thank you for your willingness to let me share my thoughts with you.

[The prepared statement of Mr. Sanders appears as a submission for the record.]

Senator WHITEHOUSE. Thank you, Professor Sanders.

Our last witness is Andrew Grossman, who is a visiting legal fellow in the Center for Legal and Judicial Studies at the Heritage Foundation. His research focuses on law and finance, bankruptcy, and the constitutional separation of powers. Mr. Grossman is also a litigator at the law firm of Baker & Hostetler in Washington, DC. He received his J.D. from the George Mason University School of Law, a master's degree in government from the University of Pennsylvania, and a B.A. from Dartmouth College.

Welcome, Mr. Grossman.

STATEMENT OF ANDREW M. GROSSMAN, VISITING LEGAL FELLOW, THE HERITAGE FOUNDATION, WASHINGTON, DC

Mr. GROSSMAN. Mr. Chairman and members of the Committee, the Committee is to be commended for holding this hearing today to consider the promises and pitfalls of bankruptcy courts' loss mitigation programs. These programs are a recent innovation, and while there is some anecdotal evidence on their operations, there has yet to be the kind of formal study or statistical evidence that could drive sound policymaking with respect to them.

As to whether these loss mitigation programs are, in the broadest possible sense, successful, I can offer no firm opinion today be-

cause I do not believe that anyone at this time could say with any degree of certainty that these programs are having a positive impact on our housing market or on homeowners in distress overall.

There are, however, good reasons to doubt that loss mitigation programs stand to make a positive net contribution. I will discuss three.

First, it seems unlikely that, absent some form of coercion, these programs will provide a significant marginal benefit over the myriad of programs that already exist to aid responsible homeowners who find themselves in financial distress. Bankruptcy should be an option of absolute last resort, not a front-line tool to achieve broad policy results. It is unlikely to succeed in achieving such results when pre-bankruptcy interventions have proven unsuccessful. That is probably the case here.

As you know, home mortgage modification programs to date have had mixed records of success. HAMP, for example, will never achieve the 3 to 4 million permanent modifications that its backers promised, and indeed it has a record of failed modifications that should be troubling to any observe and give pause.

The mortgage industry's proprietary modification efforts, which they have organized under the acronym HOPE NOW, have a better record, with over 1.5 million modifications completed in 2010. These efforts are not a panacea by any means. Foreclosure rates remain high and foreclosure starts are growing in many areas of the country. The primary reason for this is a stubborn reality, one that has taken policymakers and Government actors some time to grasp. Many individuals have little equity in and are unable to afford the payments for the homes in which they are currently living. Because prices collapsed, refinancing is not available in many of these cases. Solving this problem takes money—lots of it—not legal tweaks.

This explains in large part the failure of HAMP. To alter the incentives of servicers and convince mortgage investors to write down in part bad loans, HAMP offers subsidies to servicers and lenders to undertake the modification process and reduce monthly payments. Nonetheless, tens of billions of dollars remain on the table.

The avowed premise underlying bankruptcy courts' loss mitigation programs is that there are informational barriers between borrowers and servicers and lenders that hamper mutually beneficial loan modifications. This ignores the enormous progress that it has made in getting reliable information to at-risk homeowners and the many avenues of contact that now exist. Not all homeowners may take advantage of these resources, but they do indicate that the time when information on modification was hard to come by and modification decisions were made slowly through opaque processes has long passed.

Loss mitigation also assumes that in a large number of cases it is possible to reach a mutually beneficial negotiated settlement, especially a mortgage modification. The debtor and the lender are merely made to confer. This is a questionable premise. As experience with HAMP has shown, the low-hanging fruit is gone. Most modifications that are obviously win-win have been done, or could be done, without any intervention by a bankruptcy court. They are off the table. Modifications that fall slightly outside the band of

mutual benefit either have been evaluated for HAMP eligibility, or could be at any time, again without action by the bankruptcy court. And modifications that fall outside of that band—that is, where even the HAMP subsidies are insufficient to enable the parties to make a deal—are likely to be unworkable. Payment that is acceptable to the lender is likely to be more than the borrower can afford to pay. So there is no good reason to believe that, absent coercion, loss mitigation during the bankruptcy process will cause deals to emerge that were previously impossible or unavailable. To believe otherwise would be to expect a free lunch: Without putting any additional money on the table, bankruptcy courts can somehow bridge the gap between a borrower's ability to pay and what the lender is willing to accept.

There are, however, situations in which that might superficially be the case, and that is my second point. There is a real risk that these programs, as legally structured, could function in a manner that is coercive, that places undue burdens upon mortgage investors, and that upsets legitimate investment-backed expectations.

The loss mitigation programs differ in their terms. They share several features intended to push the parties toward settlement. First, a party objecting to the loss mitigation process or seeking to terminate it must usually provide the court with specific reasons why loss mitigation would not be successful. Second, the creditor must be represented by an individual with full decisionmaking authority to enter into a loan modification or take other action. This is in itself a burden. Third, the parties must negotiate in good faith and are subject to sanctions for failure to do so and to follow this amorphous requirement. Fourth, when the period allotted for negotiation has run its course without any agreement, any party—usually the debtor—may seek an extension to continue negotiations, and a party—usually the creditor—opposing the extension must, again, show cause as to why an extension would be inappropriate. Taken together, these features effectively place the burden on the lender to demonstrate why the debtor is not eligible for relief. This represents a reversal of the normal bankruptcy practice. Instead, the creditor must make a separate and additional showing to enforce what is on paper itself a legally enforceable right. This tilts what had been a level playing field in bankruptcy practice.

It is troubling in this context that several bankruptcy courts have candidly discussed their loss mitigation programs in the absence of their—in the context of the absence of their authority to order changes to the terms of loan agreements securing debtors' primary residences. The implication is that although bankruptcy judges are without power to cram down a mortgage securing a debtor's principal residence, they may through requiring the direct participation of high-ranking officials heavy-handedly enforcing the good-faith requirement and placing the burden on servicers and lenders to show cause why a modification could not be reached, effectively achieve the same result. In these ways, loss mitigation programs can coerce creditors—repeat players who recognize the necessity of remaining on good terms with bankruptcy courts—to make concessions that compromise their rights.

Third, and finally, there is a real risk that loss mitigation programs will in some instances cause harm to those they are meant

to aid. As with HAMP, homeowners may enter into modifications that ultimately prove unworkable and result in additional financial distress without preserving their home. This is, if anything, a greater risk in loss mitigation programs because of their ad hoc approach to making modifications without any of the safeguards and strict eligibility criteria that are embedded into HAMP and proprietary programs or the generous subsidies in HAMP that may serve to reduce payments.

Unfortunately, the bankruptcy courts lack the facilities to undertake the kind of data collection that would be necessary to chart the subsequent performance of mortgages modified in this manner. Not only do we not know whether these modifications are injuring a substantial proportion of those whom they are intended to benefit—which has been the case with HAMP—but we will have no way of knowing that even in the future.

The fact that loss mitigation may drive some homeowners to file for bankruptcy who would otherwise have not done so is also harmful. Bankruptcy is an expensive, disruptive, and potentially damaging process. One-third of all Chapter 13 filers complete the process successfully and get a fresh start. The rest, two-thirds, pay court fees, pay attorneys' fees, pay fees to the bankruptcy trustee, invest time and money to restructure their financial affairs, and then wind up with nothing more than temporary relief.

These statistics suggest that holding out the promise of significant relief from mortgage debt to encourage more individuals to file for bankruptcy is bad policy. At best, bankruptcy would serve only to delay foreclosures in most cases, while imposing enormous costs and harmful delay on those who are already financially vulnerable and limiting their future access to credit.

I thank you again for the opportunity to testify and look forward to answering your questions.

[The prepared statement of Mr. Grossman appears as a submission for the record.]

Senator WHITEHOUSE. Thank you, Mr. Grossman.

Judge Drain, let me ask you, you have done, according to your testimony, 2,000 of these—more than 2,000 of these loss mitigation mediations in your courtroom. Only 90 of them drew an objection. The original process was one that was first requested by creditors' lawyers, correct? And the backdrop to it, as I understand it, is loan servicers' refusal or inability to address their defaulted loans directly, banker to borrower, on a businesslike basis.

In your experience of the 2,000 loss mitigations that you have been through, in how many of those, approximately, would it have been the first time that the homeowner, the debtor, actually had a face-to-face conversation with somebody who had full settlement authority and that they were able to negotiate with in good faith?

Judge DRAIN. Well, first let me be clear. The 2,000 requests for loss mitigation are court-wide. I myself have probably presided over, oh, I would say, about 400. But you have accurately summarized my testimony. This program was developed first at the request of creditors' lawyers who were appearing in court and not having the data really to get the relief that their client wanted, and also in addition were telling their clients that they were leaving a lot of money on the table by foreclosing.

Second, it was developed with creditor and consumer lawyer support, posted for public comment, and did not receive negative comments as some sort of coercive program.

But as far as how many people had not spoken with a businessperson, my belief is that the distinct majority had not gotten a response.

Senator WHITEHOUSE. Ever.

Judge DRAIN. Ever.

Senator WHITEHOUSE. Do you have any guesstimate on how long these negotiations between the homeowner and the servicer or the bank customarily have gone before it comes to your court?

Judge DRAIN. Well, they are not really negotiations. One of the issues with HAMP——

Senator WHITEHOUSE. Participation in the program. Let us put it that way.

Judge DRAIN. One of the issues with HAMP is that there are not people there to implement it. It is a very haphazard process of taking information, often losing it, passing it on to someone else, and it is not really premised ultimately on a business assessment of what is good for the lender in the first place.

So I mentioned this. Of the 15 objections by lenders to the invocation of loss mitigation, the ones that I have dealt with, except with one expectation, the lenders, when they actually come to court and see the facts, say, "Well, you know, this actually makes sense. We will talk with this person. He or she has been basically getting the runaround."

So I think that the main benefit of any formal mediation program is to put decisionmakers together.

Senator WHITEHOUSE. So to the extent that Professor Sanders believes that this is another surprise to investors and other market participants which is almost always viewed negatively, your answer would be actually this is a surprise that they sought, welcome, and are happy to work with?

Judge DRAIN. I think that is right. What is not in the record, frankly, is opposition by lenders, and particularly those whose real money is at stake. A servicer may find it inconvenient, and servicers sometimes do have different incentives. But if your money is really at stake as a lender and your borrower can pay you more than the house is worth, clearly more, it is really kind of a no-brainer.

Senator WHITEHOUSE. And that may explain why the Association of Mortgage Investors is working with me on this and seems excited about it. So I think that is a good thing.

My time has expired. Our Ranking Member, Senator Grassley.

Senator GRASSLEY. Thank you.

I think it is legitimate, as we have done already, to raise the question—we have HAMP—whether or not that should not be fixed before we look at something else, or do we need to do both. And I said in my opening statement how the Special Inspector General raised questions about not having meaningful goals and then not having transparency and accountability that comes from transparency. And he repeated that to our Committee last July and now again 6 days ago. So I am going to direct some questions to Mr. Sanders and Mr. Grossman, but I have got two questions that are

about HAMP, but I want to get to a couple questions about the bankruptcy process, so just a short answer.

Mr. Sanders and Mr. Grossman, do you agree with the Special Inspector General's assessment? And, more importantly, do you have any insights into why the Treasury Department's refusal to set goals for the HAMP program? Mr. Sanders, then Mr. Grossman.

Mr. SANDERS. I am sorry. I did not hear the last part of your question.

Senator GRASSLEY. Why the Treasury Department might be refusing to set goals, as I have asked them to do and as the Special Inspector General said they should do.

Mr. SANDERS. Well, I have some light I can shine on that. When President Obama first came into office, I met with Treasury and gave them a presentation, which I will be glad to share with everybody, pointing out, saying in the next few years you are going to have horrendous problems in terms of loan modifications because I know what you are thinking of, you are thinking of doing means-testing for loan modifications, which means we are going to pick an income group and give them loan modifications, but if you are in too high of an income group or you suffered property loss, we are not going to do anything about it.

And I said, OK, those are policy decisions based on economics and other things, but your program is not going to work. It is not going to target enough people, and it will not be effective enough. That is all the servicing issues aside.

I think what Secretary Geithner in terms of that response is saying is that, you know, the problem is that any target we set, we do not know what we can meet. I think literally it is because, as I said, housing prices are still falling; unemployment is not getting any better. How do you set targets for successful loan modifications when the economy is still in complete disarray? That is a tough one. So on that one I kind of—I wish you would set targets. You can still do it. But, again, what targets would they set to make any sense?

Senator GRASSLEY. Mr. Grossman, and only if you have got another point of view on that.

Mr. GROSSMAN. I would just say the entire policymaking community on every possible side of this issue shares your frustration with the lack of transparency that has accompanied these efforts. It has made it very difficult for many people to make positive contributions.

Senator GRASSLEY. Mr. Sanders, Mr. Grossman, one of the concerns with the loan modification program being run by bankruptcy courts is that judges, directly or indirectly, might force lenders to cram down home mortgages. Cramdown is a reduction of principal, as everybody knows. A further concern is that because most mortgages are held by the Federal Government, taxpayers will ultimately be left holding the bag, and the national debt and economy would be further damaged.

Could you elaborate further on the potential damages that cramdown might have on the economy? Mr. Grossman and then Mr. Sanders.

Mr. GROSSMAN. Well, I think a lot of people have come to realize over the past 2 years that the largest problem we have is the fundamental disconnect in many instances between a debtor's ability to pay and the amount of money that would need to be paid to rescue that person's home. It is a financial question. It is an economics question.

To the extent that it is possible in a large number of circumstances to bring those two numbers together, it is going to have to be through some type of coercion. That is the way that a modification will have to be achieved.

To the extent that that happens, that upsets legitimate investment-backed expectations, and one would reasonably expect that that would stifle investment in the mortgage sector.

One also expects that it would upset the contractual agreements between mortgage investors and servicers, and that would have a similar effect.

Senator GRASSLEY. Mr. Sanders.

Mr. SANDERS. Again, in my testimony I mentioned Fannie Mae and Freddie Mac, the mortgage giants. They are not disposed toward cramdowns. In fact, they are very much scared of them, for the following reasons: No. 1, it would be very harmful toward taxpayers; it would be very harmful toward investors in mortgage-backed securities, because, again, it is the moral hazard problem. Once somebody realizes there is a potential for a cramdown, writing off some principal—maybe not all the principal but some principal—they are worried about the fact that that would open Pandora's Box and you could actually have a flood of people rushing into bankruptcy just to try to get a massive principal writedown.

Now, again, I realize there would be safeguards in place for that not to happen. I just do not know what those safeguards are. But, again, it terrifies Fannie and Freddie and it terrifies other investors out there.

Now, there are investors in the market—that one trade organization you are talking about wants to see principal writedown, so not everyone is against them. But Fannie and Freddie clearly are.

Senator GRASSLEY. At 11:30 I have got to go, and I would submit some questions to be answered in writing. And I would also like to have some testimony from trade associations put in the record.

Senator WHITEHOUSE. Without objection, the trade association's testimony, timely received, will be put in the record. Your questions will be put in the record as questions for the record.

[The testimony appears as a submission for the record.]

Senator WHITEHOUSE. While we are doing this, I have a statement from Chairman Leahy that will also be made a part of the record.

[The prepared statement of Chairman Leahy appears as a submission for the record.]

Senator WHITEHOUSE. I will turn to Senator Blumenthal, but before I do, I want to exercise the prerogative of the Chair to ask Judge Drain one question.

Judge Drain, is cramdown a part of your program?

Judge DRAIN. Absolutely not.

Senator WHITEHOUSE. OK.

Senator Blumenthal.

Senator BLUMENTHAL. Thank you, Mr. Chairman. You have just asked and elicited an answer to my first question.

Clearly, this entire program is voluntary, is it not, Judge Drain?

Judge DRAIN. Yes.

Senator BLUMENTHAL. Let me address the two objections or concerns that I think have been very thoughtfully raised by Professor Sanders and Mr. Grossman: first, that the unintended consequences of this kind of program can enable or encourage people to stay in homes they really cannot afford and thereby just delay a day of reckoning and maybe even hurt people as a result. I think that concern is belied by the experience in Connecticut where we have a mandatory mediation program, not a voluntary one, and out of 7,700 cases in foreclosure, some 4,400 families have been enabled to stay in their homes and are in their homes.

So I would like to ask you, Judge Drain, and perhaps Mr. Rao, whether you have any practical experience or statistical evidence—Mr. Grossman has said that the evidence is only anecdotal so far—that would address that concern?

Judge DRAIN. Well, I think that one of the benefits that the lenders saw in our program is that the court would supervise it and cut it off if the debtor's expectations were unrealistic, and that happens. Most people in our district are represented by counsel, and so they are advised by counsel in advance what they can achieve and what they cannot achieve. But there are times with pro se's and also sometimes with individual debtors, their expectations are just not realistic. This resolves that promptly. It does it in an objective way so that they can at least get the sense that they were not getting a runaround. So my belief is that at least once they are in the loss mitigation program, the ability to succeed or not gets flagged pretty quickly.

Mr. RAO. Senator, there are obviously concerns about the lack of transparency with HAMP, but one thing we do know and we have seen from the reports that have been coming out of Treasury is that it proves the point that if you do actually modify the mortgage and give the homeowner an affordable payment, they will pay. The statistics are showing that 1 year after the program with homeowners who have been on permanent modifications, 85 percent of those homeowners are staying on the program. The re-default rates on HAMP modifications are considerably lower than any other modifications that have been attempted, and I specifically refer to the proprietary mortgages that servicers are doing outside of the HAMP program which have re-default rates which are twice as high as HAMP modifications.

The final point is even within that category of homeowners who are staying on the program, the re-default rate, when you lower their monthly payment more, often more than 30 percent, the re-default rates are even lower. So the more you reduce the monthly payment, the more the homeowner will continue to make ongoing payments which will contribute to investor gains.

Senator BLUMENTHAL. I thank you for those answers, and perhaps I can ask Mr. Grossman and Professor Sanders, the reference to this program as "coercive"—and I respect your point that very often the mere request by a judge to reach a settlement can impose some degree of pressure as someone who has been in that position

as a practicing attorney. Is there something special about this program that is more coercive, exerts more pressure? Because in the course of almost any litigation, a judge will say at some point, "Can't you folks reach an agreement?" And those lawyers very often appear frequently before that judge and so may feel some pressure. But is there something about this program that is different from the ordinary litigation, Mr. Grossman?

Mr. GROSSMAN. With respect to the normal bankruptcy process, I think the primary difference is that in some cases this would serve to effectively shift the burden from the debtor to the creditor to justify why it is in a particular instance that a modification or some other type of settlement could not be reached.

Now, it depends entirely on the courts and it depends entirely on the judge. In some cases, these are going to go forward, and it is not going to be done in a coercive manner, and I think that in many cases has been the experience. And from what Judge Drain has described, I think his court has done an exemplary job of implementing this program and working through what is a very difficult situation.

That said, by shifting the legal burdens and putting on a party a burden to enforce a property right that they otherwise would be able to enforce free and clear, that is necessarily in some instances going to have an effect on the out; otherwise, you would not do it. I think that stands the potential of being coercive in some instances.

Senator BLUMENTHAL. I realize my time has expired, but if it were made clear that there is no shift in legal burden, I gather that concern would be addressed.

Mr. GROSSMAN. I fear that that would really cut to the heart of these programs, because the way to effect that would be necessarily to remove from them the mandatory nature of the mediation, to remove the mandatory nature of the negotiation. It would require a significant change. I think voluntary mediation programs are wonderful, and I think that is something that judges should move forward on. I think that this creates a very good template for that sort of model.

Senator BLUMENTHAL. So if it were made clear that this program is completely voluntary, that objection, again, would be addressed.

Mr. GROSSMAN. If the participation in the program itself were entirely voluntary and it did not abrogate any other rights or responsibilities that are specified in the Bankruptcy Code, that would be a very different beast.

Senator BLUMENTHAL. Thank you.

Thank you, Mr. Chairman.

Senator WHITEHOUSE. Save that question, Judge Drain. We will be back to it, but I do not want to interrupt Senator Franken.

Senator FRANKEN. Well, I want to continue with this because, Mr. Grossman, I am a little confused because in your previous answer you had said it would require coercion for this to be done. That this kind of settlement would require coercion is what you said. And so now it seems like your answer is very different when confronted with the reality—when taken out of your theoretical framework, in answering the Ranking Member, you said it would

require coercion. But now what I see from Judge Drain's court, as you just acknowledged, is that there is no coercion there.

Let us get to the reality of this and what has really happened as opposed to some theory. We have heard, Judge Drain, the concerns raised by the other witnesses that lenders are coerced to negotiate better terms for the loan. Can you tell me what percentage of loan modifications in your program involve reduction in principal of the loan?

Judge DRAIN. Not that many. Most of them involve significant reductions in interest rate, 12 percent down to 3, 4, 2, percent; waiver of fees; waiver of default interest; and rolling defaulted principal payments into the back end of the loan.

Where there has been a principal reduction, it is usually on a second mortgage where the second mortgage holder realizes that in a foreclosure they would get nothing, so they are getting a better deal by having a principal reduction. Or where the mortgage holder has significant document problems and might not ever succeed in foreclosing. In that case, I have approved very significant settlements where the principal was reduced a lot, but that was really a different—that was a legal issue as opposed to an economic issue.

Senator FRANKEN. All this is to me pieces of a whole. During Mr. Grossman's testimony, he talked about all the opportunities that people have on the way there and why we shouldn't need this in addition. But in your testimony and in response to questions, you said this is very often the first time that the homeowners have gotten this information.

Mr. Rao, Senator Grassley very rightly said we need to fix HAMP as part of this.

Now, I proposed legislation that actually passed the Senate last year—in fact, Senator Grassley voted for it, along with quite a few Republicans—to create an office within HAMP to provide assistance to homeowners navigating the system, the Homeowner Advocate Office. And, unfortunately, it did not get passed by the House. My experience with people in Minnesota is the servicers do not provide them with information, and the servicers either are incompetent or lie to them. The idea of a Homeowner Advocate Office is that there is some place in the Treasury to have a Homeowner Advocate. And we paid for this with Treasury funds; it did not cost a thing.

So given your experiences working with homeowners in foreclosure proceedings, would you see the value of having a homeowner advocate involved in the proceeding?

Mr. RAO. Well, Senator, I think something obviously is required. A homeowner advocate could potentially fill that role of providing the impetus for servicers to be accountable for their actions and, most importantly, as we keep saying over and over again today, for them to simply make decisions, which they are required to do under the HAMP guidelines.

Mr. Grossman referred to these loss mitigation programs as imposing a burden on servicers to have a decisionmaker. That is their requirement under—as a participating servicer, they are required to make decisions and to do it within 30 days.

So, yes, I believe a Homeowners Advocate Office could help enforce, for example, that requirement. I think the other legislation

passed by Congress as part of the Dodd-Frank bill requiring disclosure of information such as the results of the net present value test will also be helpful for achieving accountability with the HAMP program, so that the parties, especially the homeowners and their advocates, can know whether there has been a proper denial of their application.

Senator FRANKEN. Thank you, Mr. Chairman.

Senator WHITEHOUSE. Thank you.

Mr. Britt, you said at the end of your testimony that you now have a customer advocate from the bank's Office of the CEO and President. She has a first and last name, unlike a lot of the names on the phone that you had to deal with beforehand, and you can talk to her when needed rather than just calling an 800 number and getting whatever first name picked up the phone.

Mr. BRITT. Yes.

Senator WHITEHOUSE. You believe that it took the advocacy of a Senator's office to get you that. My specific question is: In the 2 years that you have been wrestling your way through this program and with this bureaucracy, how long was it before that connection with the CEO's office, customer advocate, existed? For how long were you on your own fighting against this bureaucracy?

Mr. BRITT. Twenty months.

Senator WHITEHOUSE. Twenty months. And Judge Drain has testified that that is the—20 months might not be the exact number, but it is a commonplace for the people who are coming into the loan mitigation program to have never yet had a chance to talk to a human being who has authority to make a decision in their case. So the context in which I see this, Mr. Grossman, is a little bit different than yours. The context in which I see this is that we have a highly imperfect, bureaucratic system that is grinding away and never taking a good, hard look at these cases because you are always dealing with somebody who is hired to answer the phone and who is hired to move paper, but has no decisionmaking capacity. And you can imagine the frustration of an ordinary American like Mr. Britt whose home is at stake and for 20 months cannot find something as simple and American and basic as a human being to talk to on the other end. And you see the same thing work out—this judgment is confirmed, in my opinion, by what you see working out with local banks, community banks, banks who hold their mortgages.

I can assure you—and I bet you that Senator Franken and Senator Blumenthal can do the same—that the foreclosure problem does not exist in anywhere near the dimensions that it does in the general market when the bank is still there. And it is for that simple, American reason that you have the chance to go into your bank and talk to a human being, and if there is a solution to be found that is in everybody's best interests, you get it.

I really believe that you should reconsider whether or not you want to put your credibility behind the notion that the system that led to the loss mitigation program deserves the credit that you give it at having sorted out those problems beforehand, and that the only residual value that the loss mitigation program can present is coercion. It is inconsistent with the judge's experience. It is inconsistent with our experience, with our case in Rhode Island. And I

think what is really happening here is that people who have never had somebody to talk to—it is always "John," and he is always giving you information; then somebody else writes a letter, and it is terrifying because your home is at stake, and the paperwork has to be filed over and over again to the point where you feel you are being harassed because you are being asked for the fifth or sixth time to file the same damned paperwork that you have already filed, that you have the Federal Express certificate that you filed, you have the fax receipt that you filed, and they still make you do it again because they have got the whip hand to take your home away if you do not go ahead and file it again.

After 19 or 20 months of that, it is pretty frustrating, and when that can be broken by simply getting two people in a room—you are a litigator, are you not?

Mr. GROSSMAN. Yes.

Senator WHITEHOUSE. You have seen situations in which in front of a judge the two parties come together, and suddenly they are willing to be a lot more reasonable, and suddenly a deal is worked out. And judges do that all the time, do they not? Yes, you are saying. They do that all the time.

Let me ask you specifically: Of the three elements of this proposal, one is that somebody has to show up in the court with full settlement authority for the bank. That is one. Two is that they have got to show up during the loss mitigation program. And three is that they have to negotiate in good faith. Which one of those three specifically do you object to? Do you object to them having to show up with full settlement authority? Do you object to them having to show up during the loss mitigation process? Or do you object to them having to negotiate in good faith?

Mr. GROSSMAN. It is my concern that if—the problem at root here that you are discussing, the ability to sit down in a room and hash things out person to person, to the extent that that is what is lacking, an individual should not need——

Senator WHITEHOUSE. Let us assume that that is what is lacking——

Mr. GROSSMAN.—should not be forced to file for bankruptcy——

Senator WHITEHOUSE. No, no——

Mr. GROSSMAN.—to achieve that result.

Senator WHITEHOUSE. I agree with you. But here we are dealing with people who are required to file for bankruptcy. They are at that stage. Nobody does it because they love it. They are at that stage. Why in that forum, once they are there, should a rule that somebody has to show up with full settlement authority, that person has to be present during the loss mitigation program, and they have to negotiate in good faith, which one of those three is objectionable to you in that circumstance that you are now in bankruptcy court with a foreclosure in the offing?

Mr. GROSSMAN. Again, the problem—and I think I stated this previously—is the mandatory nature of this program. It effectively rewrites the contractual obligations of either the creditor and/or the servicing agent.

Senator WHITEHOUSE. That is what bankruptcy courts do. Right? That is where you go to get contracts renegotiated, and it is the American way that it is in everybody's best interests to get that

done. And how mandatory is it when you have done 2,000 and there have been—Judge Drain, do you want to respond to that?

Judge DRAIN. Well, I would respond in two ways. First, again, the vast majority do not view it as being coerced into doing it. We have had 15 people who objected whose objections either were retracted or denied out of 2000.

Second, you cannot just walk into bankruptcy court as a lender and snap your fingers and say, "I want the house back." It does not happen that way. That is not the law. The lender has to make a motion for relief from the automatic stay, and the response often to that motion is, "We have sought out the HAMP program." And courts, as recently described in Judge Votolato's decision from Rhode Island, are faced with a lawyer standing up in court and you ask that lawyer for the bank, "Well, did they invoke the HAMP program?" And the lawyer says, "I do not know," because they do not know. It is on autopilot.

And so then you say, "Well, you better find out, and we are going to adjourn the hearing until you do," because obviously the HAMP program puts you on one path and foreclosure puts you on another. So it is just a fallacy to say that the law gives a lender the ability to snap its fingers and get stay relief.

But, more importantly, economically, the lenders want court supervision of this process because that is how it works. It keeps the debtors in line, and it forces them the lenders to have a client. There is nothing worse than not having a client, appearing before a judge and not really having a client. And, unfortunately, the way the large securitized or packaged loans operate, they do not have clients.

Senator WHITEHOUSE. In the same way that homeowner——

Judge DRAIN. That the local bank——

Senator WHITEHOUSE. —has nobody to talk to.

Judge DRAIN. Right.

Senator WHITEHOUSE. The lawyer for the organization——

Judge DRAIN. Or the local bank. You know, if you represent a local bank, you know who your client is, and you get directions from him or her.

Senator WHITEHOUSE. Senator Blumenthal, second round, if you wish.

Senator BLUMENTHAL. Thank you, Mr. Chairman. Again, I must say, as an Attorney General recently in this business, so to speak, one of my frustrations has been, in fact, for our attorneys and personally that finding someone who was the real party and was in a position to negotiate and modify a mortgage was one of the real travails, most frustrating aspects, often to the detriment of, in fact, the real party in interest whose real concern or interest would have been well served by being present and being involved in the process.

But since it is, in essence, consensual in my view, not coercive, and since everyone the program itself would be optional for the bankruptcy court, I would like to ask perhaps, Judge Drain, whether you have an indication that more bankruptcy courts would, in fact, engage in this kind of program if their authority were clarified under section 105.

Judge DRAIN. I think that is the case. Since we enacted it, half of the court in the Eastern District of New York said they would do it. I am told by one of my colleagues there that one of the judges who did not do it was somewhat concerned that he would be overreaching his authority.

As I think you said, Senator, in your opening remarks, by enacting legislation in this area, the Congress would also be telling courts, not just Federal courts but State courts, that you should think about this. And, you know, we are public servants, and I think that is an important message.

Senator BLUMENTHAL. Thank you.

Thank you, Mr. Chairman.

Senator WHITEHOUSE. Senator Franken.

Senator FRANKEN. I really have enjoyed listening to the Chairman, who really has bored into this subject and has been on this for so long, and I have enjoyed listening to the former Attorney General of Connecticut for—what was it? About 50 years?

[Laughter.]

Senator FRANKEN. I would actually like an answer to the Chairman's question from Mr. Grossman. Which of the three requirements do you object to: that someone with the fully authority for the lender in the loss mitigation program be there; that they show up during the loss mitigation program, two; and that they act in good faith? Which if those three do you object to?

Mr. GROSSMAN. Senator, as I stated, my objection is with the mandatory nature of the program. I suppose you could take that as being all three, although I do not think that would be strictly an accurate way of describing it. But it is the mandatory nature of the program.

Senator FRANKEN. OK. The mandatory nature in a bankruptcy court where—as a bankruptcy judge, Judge Drain, do you—you have the authority—your job is to resolve all these claims on someone when they go bankrupt, right?

Judge DRAIN. Yes.

Senator FRANKEN. And you have authority to do these things, right?

Judge DRAIN. Yes—well, I will give you the—I have forced one lender to continue loss mitigation. One. That was as lender that has a $200,000 equity cushion, so they would not have gotten relief from the automatic stay, and they simply were not paying any attention to the borrower. I said, "I am not going to terminate loss mitigation until you look at this borrower's financial information." I think I have the authority to do that because they were not going to get relief from the stay anyway for months because they had an equity cushion, $200,000.

But that was an exception. I mean, most of the time—and by "most of the time," like 99 percent of the time, they want the structure because that is why you do mediation. You want someone there to keep the parties focused and to not let them throw hogwash up at you and to get the deal done.

Senator FRANKEN. Thank you.

Mr. Rao, one last question. I have been very concerned with the issue of robo-signing in which employees of mortgage servicers have improperly signed affidavits executing foreclosures without

having actual firsthand knowledge of the facts of the mortgage. Would loss mitigation programs in bankruptcy courts have prevented this problem or at least mitigated the problem? Or could it prevent a similar issue in the future by ensuring that more attention is paid to each individual case?

Mr. RAO. I think that definitely could mitigate the problem, primarily because bankruptcy courts have been addressing this issue for some time. In my written testimony, I listed a number of cases dating back 10, 15 years in which bankruptcy courts have encountered problems with false affidavits and false documents being filed and have sanctioned parties for filing them. So although it has become sort of popular in the press right now and there has been a lot of coverage of it, it is actually not at all new to bankruptcy courts, and bankruptcy judges have done a very good job of ensuring the truth and veracity of the documents that get filed in the courts. So having it be part of a loss mitigation program would only improve that.

Senator FRANKEN. Thank you. And I thank all of you for your testimony.

Thank you, Mr. Chairman.

Senator WHITEHOUSE. Thank you, Senator Franken.

I think we will call the hearing now to a conclusion. I want to first of all thank our Ranking Member, Senator Grassley, who is an extraordinarily distinguished member of this body, for the time that he took here with us today, and I look forward to working with him and to have my staff work with his staff on helping to resolve the issues about whether this is a secret cramdown program of some kind, which I hope the judge's testimony helped dissipate, but to make sure that that is clear to all concerned and to make sure that the investors' voices are heard in this, because they are another party that benefits from these types of programs. And with any luck, we will be able to get to a resolution that allows us to go forward.

In order particularly to facilitate the questions that come from Senator Grassley, he has additional written questions that we have accepted into the record, and I would urge all of you, to the extent that they are directed to you, to respond as rapidly as you can. We close the record of the hearing after one week, ordinarily, so obviously the quicker Senator Grassley's questions can get to you, the more that week that remains for you to answer and get them back. But I think it would be very helpful, and I would urge you to be as punctual as possible in getting those answers back.

The record of this hearing will be kept open for one week in order to accommodate your answers and any other materials that any members of the Committee may wish to add. And I just want to particularly thank those who have traveled some distance for being here. Mr. Grossman, I think you are actually nearby, but it appears that Professor Sanders has come from Georgia, and I am grateful to you for that. Maybe not. Maybe you are from nearby. I thought you were——

Mr. SANDERS. Fairfax, Virginia.

[Laughter.]

Senator WHITEHOUSE. Oh, you were easy then, even though there is a fair amount of snow on the ground by Washington standards.

Mr. Rao has come down from New England. I appreciate that very much. Judge Drain has come down from New York. I appreciate that very much. Mr. Britt has come from Riverside, Rhode Island, where he is successfully hanging on to his home after at least 20 months of a bureaucratic nightmare. And I am grateful for the testimony of all of you. You have each contributed to this hearing, and I appreciate it. But, again, as a former practicing attorney, I cannot help but extend a particular appreciation to Judge Drain, who I know has a very busy schedule in his court, and to have you with us, sir, I think is particularly significant and much, much appreciated on my part, Your Honor.

So thank you all very much. The hearing is adjourned subject to the week for providing of answers.

[Whereupon, at 11:48 a.m., the Committee was adjourned.]

[Questions and answers and submissions for the record follow.]

QUESTIONS AND ANSWERS

February 26, 2011

Dear Senator Leahy,

It was my pleasure to testify before your Committee at its February 1, 2011, hearing on "foreclosure mediation programs" in bankruptcy courts. These programs raise important questions with respect to the vitality and recovery of the housing market and with respect to the proper enforcement of property rights and the rule of law. The Committee deserves credit for inviting witnesses to present a balanced view of these programs, their promises, and their pitfalls.

My primary purpose in writing today, however, is to respond to the thoughtful written questions submitted by Senators Sessions and Grassley which you sent to me by letter dated February 9, 2011. I will present each question, in italics, as it was provided to me. My responses are in roman text.

QUESTIONS FOR THE RECORD FROM SENATOR JEFF SESSIONS

1. *At the hearing, you testified:*

> *It's troubling in this context that several bankruptcy courts have candidly discussed their loss mitigation programs in the context of the absence of their authority to order changes to the terms of loan agreements securing debtors' primary residences. The implication is that, although bankruptcy judges are without power to cram down a mortgage securing a debtor's principal residence, they may, through requiring direct participation of high-ranking officials, heavy-handedly enforcing the good faith requirements in placing the burden on servicers and lenders to show cause why a modification cannot be reached, effectively achieve the same results. In this way, loss mitigation programs can coerce creditors who are repeat players and recognize the necessity of remaining on good terms with bankruptcy courts to make concession that compromise their rights.*

Later in the hearing, Senator Whitehouse asked Judge Drain "is cram down a part of your program?" In response to Senator Whitehouse's question, Judge Drain testified "absolutely not."

If I understand your testimony, you were not arguing that this proposal gives judges the legal authority to order cram downs of home mortgages. Rather, you

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were testifying merely that these programs could give courts the authority to pressure creditors to submit to cram downs. Is that correct?

Yes, it is clear that the effect of bankruptcy court "loss mitigation programs" ("LMPs") will be, in many cases, to pressure creditors to write off some portion of their legal claim on the estate, whether by reducing the principal amount of the loan or waiving certain fees, penalties, or other charges to which they have a legal right.

Judge Drain's response that his court's LMP does not involve "cram down" was correct but incomplete. "Cram down" is a term of art in bankruptcy practice that refers to splitting a secured claim into secured and unsecured portions based on the value of the security; typically, the unsecured portion of the claim is discharged. The effect is to reduce the principal amount of the loan to the value of the underlying asset, thereby reducing indebtedness and loan payments. This occurs at the immediate expense of the lender,[1] who is forced to write-down the value of the loan notwithstanding his contract and property rights under law. Long-term, cram downs are at the expense of borrowers, who face reduced access to credit, higher required down payments, higher interest rates, and other changed terms that increase the cost and difficulty of borrowing. It is for these reasons principally that Congress has barred bankruptcy courts from cramming down mortgages secured by debtors' primary residences.

Yet all of the same negative consequences may result from legal actions that are similar to, but fall short of, cram down, and that is one of the risks presented by mandatory LMPs. Without ordering a cram down or ordering a lender to reduce the principal value of a loan, a bankruptcy court may still, under the guise of mediation, coerce principal reductions and other loan modifications that compromise lenders' lawful rights. This pressure may be overt, such as suggesting a specific modification—for example, one in line with the modifications completed under the HAMP program. It may also be subtle or procedural in nature, such as the judge hinting that the court would look favorably upon a modification, questioning the lender's "good faith" when it declines to propose a modification, or requiring the lender to incur legal expenses and delay during the mediation process. Lenders are repeat players in bankruptcy courts and place great value in remaining in the good graces of those courts and their judges. For that reason, even subtle cues by the court may suffice to coerce a lender to abandon, in part, its substantive rights. The result is to reduce the anticipated value of mortgage loans, increase the risk of loss on such loans, and increase the transactional expenses associated with mortgage lending. In a dynamic market, such as that for mortgage lending, loan criteria will tighten, borrowing costs will increase, and overall lending will fall. So while the cause of these things is not, strictly speaking, "cram down," both the general mechanism (coercing creditors to abandon some portion of their legal rights) and the results are identical.

2. *At the hearing, Judge Drain testified that, in the Bankruptcy Courts for the Southern District of New York, "this entire program is voluntary." As I read the orders establishing the New York program, a judge has the authority to order a debtor or creditor to attend mediation prior to allowing foreclosure on the*

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[1] For brevity's sake, I use "lender" to refer to mortgage lenders, mortgage investors, and mortgage servicers.

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mortgage. A judge may even order a debtor or creditor to attend such mediation after an objection to the request for mediation has been filed, if the court overrules that objection. Indeed, Judge Drain testified that there were 15 cases in which a party had been ordered into mediation over his objection.

a. Is an order of a Bankruptcy Court requiring a party to a mortgage agreement to attend mediation enforceable through contempt proceedings?

b. If an action is taken in compliance with a court order, would you characterize that action as "voluntary?"

Judge Drain was incorrect to state that his court's "entire program is voluntary," because the program is, by its own terms, mandatory. The Loss Mitigation Program Procedures adopted by the United States Bankruptcy Court for the Southern District of New York on December 29, 2010, provide that, while a lender may object to the court's entry of a loss mitigation order, the court may nonetheless enter its order over that objection. *See* § V. The entry of this order alters the lender's right to lift the automatic stay and foreclose on the property, *see* § VI.C.2, and requires that the lender "shall negotiate in good faith," § VII.A. Not only is this burden stated in mandatory terms, but the LMP Procedures also expressly state, "A party that fails to participate in loss mitigation in good faith may be subject to sanctions." *Id.* Even absent sanctions and the possibility of contempt proceedings, it would be incorrect to deem LMP participation "voluntary" because the LMP Procedures speak in expressly mandatory terms.

A party which fails to comply with an LMP order may also be subject to civil or possibly criminal contempt. A bankruptcy court has the power to hold parties in contempt of court for failure to follow its directives. *See* Fed. R. Bankr. P. 9020; *Brown v. Ramsay (In re Ragar)*, 3 F.3d 1174 (8th Cir. 1993) (criminal contempt); Clifford J. White III, Civil and Criminal Contempt in Bankruptcy Court, *USA Bulletin*, Vol. 47, No. 4 (August 1999), *available at* http://www.justice.gov/ust/eo/public_affairs/articles/docs/contempt.htm. Participation is therefore by no means "voluntary."

3. One of the reasons Judge Drain characterized his program as non-coercive was that creditors have the ability to object to a request for mandatory mediation. You expressed some doubts about whether the ability to object to mediation was a meaningful safeguard, testifying that the programs could place the burden on the lender to show that a successful settlement cannot be reached.

a. Between the debtor and the creditor, who, in your opinion, has the most accurate and complete information concerning the debtor's financial condition?

Especially in the current market, the ability to achieve a successful loan modification depends almost entirely on the debtor's willingness and ability to pay. For that reason, an accurate statement of the debtor's finances is essential. Forming a complete picture of a debtor's finances can require extensive documentation, involving all of the debtor's sources of income, assets, liabilities, and cost of living expenses. A lender, in general,

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will have no more than a piece or two of this puzzle—for example, details on loans that may be in its own portfolio. The borrower, however, has the whole puzzle, or at least the ability to assemble it. For that reason—and in addition to the damage it does to their legal rights—lenders are poorly positioned to bear the burden of demonstrating that successful modification is impossible or even unlikely.

b. *Most debtors file bankruptcy only once in their life, whereas most servicers manage many mortgages within a bankruptcy court's jurisdiction. Do you think that fact may have some effect on the willingness of servicers to object to debtors' requests for referral to mediation? Please explain your answer.*

As described above, mortgage lenders are "repeat players" in the bankruptcy process. While an individual may file for bankruptcy only once or several times in his or her life—and indeed, the law contains provisions to discourage or bar repeat filings—a mortgage lender with a portfolio of home loans may reasonably expect to come to bankruptcy court as a creditor with some frequency, especially at a time when the economy remains weak and unemployment high. Accordingly, mortgage lenders, like all repeat players to litigation, recognize the value of remaining in judges' good graces. This may manifest itself in any number of ways, from going along with mediation orders even when they are unlikely to result in a successful modification to proposing modifications that compromise their rights and to which they would not otherwise voluntarily accede. In such a situation, coercion may be subtle, but from the point of view of the lender, still quite tangible.

c. *Judge Drain responded to your concern by pointing out that motions to lift the stay are not automatically granted. Would it be fair to say that, in consumer cases, the stay is usually lifted if the amount owed on the mortgage exceeds the fair market value of the home?*

While a bankruptcy court has a duty to consider all motions and responses in opposition fairly against the requirements of the law—with the result that few motions are "automatically" granted—in many circumstances the automatic stay is lifted in response to requests by mortgage lenders in bankruptcy, especially where the debtor has little or no equity in the home. At the very least, LSMs greatly increase the burden on the lender to lift the automatic stay and may categorically bar such relief for an arbitrary period of time, thereby compromising the lender's rights under law.

4. *At the hearing, you also expressed the concern that mandatory mediation programs might give bankruptcy judges the de facto ability to modify mortgages on primary residences. Judge Drain testified at the hearing that, under mandatory mediation programs, judges "may not impose an outcome on the parties, either directly or by, for example, refusing to relieve them of the loss mitigation procedures until they reach an agreement. We are there to enforce the deadlines imposed by the order and to resolve complaints that a party is acting arbitrarily, capriciously or otherwise to the detriment of good faith negotiation."*

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a. *Under Senator Whitehouse's bill, S. 222, is there any specific provision that would limit the bankruptcy judge to the role Judge Drain describes?*

No, S. 222, by giving bankruptcy courts carte blanche to enact LMPs, does not limit in any way their discretion or prevent them from using such programs to coerce modifications that the parties would not, on a purely voluntary basis, enter into.

b. *Mr. Rao testified that "under the Rhode Island and New York loss mitigation programs, the servicer who wishes to terminate the program must state those reasons clearly in a request to the court." Based on your experience as a litigator, do you think it is likely that servicers will not wish to make such an explanation in open court or in publicly-available court filings?*

Lenders may find such filings to be problematic for several reasons. First and foremost, under the loan agreement and generally applicable law, the lender has no legal obligation to make such a showing to achieve relief from the bankruptcy court. In this way, LMPs effectively alter the terms of the loan agreement, placing a burden on the lender that was not part of the bargain thatit struck with the debtor. Understandably, lenders would not wish to shoulder this expense. Second, in some instances, the showing described by Mr. Rao may require lenders to divulge proprietary materials—for example, the precise manner in which they evaluate loans for modification. This would become, in general, part of the public record, and thereby available to competitors. This information would also be available to attorneys who might solicit other homeowners in the area whose homes are subject to mortgages held by the lender. In this way, homeowners could abuse the bankruptcy process to achieve mortgage modifications that are unnecessary, such as write-offs of loan principal where the homeowner is able to make the current mortgage payments. Lenders who balk at making such modifications may be subject to sanctions for "bad faith"—after all, their internal modification procedures would be a matter of public record. The result would be "modification mills," widespread write-downs on loans, further contraction in mortgage lending, and further harm to the housing market.

c. *Is there a defined, universally accepted legal standard by which bankruptcy judges will evaluate servicer behavior to determine if the servicer is "acting arbitrarily, capriciously or otherwise to the detriment of good faith negotiation?" If not, would you characterize that determination as being a discretionary one with the court?*

With respect to negotiations over mortgage modifications, there is no single, clear standard for "good faith" participation. For that reason, such a determination is largely at the discretion of the bankruptcy court and would be difficult or impossible to overturn on appeal—keeping in mind that such determinations are extremely unlikely to be appealed.

5. *Senator Whitehouse commented at the hearing that mandatory mediation programs "have important benefits even for servicers. Bankruptcy courts have the power to clear title questions that have been raised by faulty paperwork with respect to mortgages." Do bankruptcy courts obtain that power through the*

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establishment of mediation programs, or is that a power that bankruptcy courts have irrespective of such programs?

Loss Mitigation Programs, as they have been implemented to date, provide bankruptcy courts with no additional legal authority to resolve title defects. Indeed, such programs, implemented through standing orders, could not confer on the court any additional authority. Nor would S. 222, as introduced, provide any such additional authority. If LMPs have benefits to lenders—which is a doubtful proposition—resolving title defects is certainty not among them.

QUESTIONS FOR THE RECORD FROM SENATOR CHARLES GRASSLEY

1. *One of the concerns with the loss modification programs ("LMPs") being run by bankruptcy courts is that they could potentially produce a de facto moratorium on foreclosures, which could have an adverse impact on our already suffering economy and housing market.*

   Please elaborate on the potential damage to the housing market and credit systems if LMPs produced a de facto moratorium on foreclosures? More specifically, what is the potential damage to the housing market and credits systems if the average time for all foreclosures is increased by any significant amount of time, for example, six months to one year?

While it is unlikely that LMPs would produce a moratorium, they do inevitably delay the foreclosure process, which has many of the same effects as a moratorium. However, passage of S. 222 could, in fact, result in temporary regional moratoriums due to the uncertainty that it would inject into the foreclosure process, especially as bankruptcy courts move to adopt and revise LMPs.

Even temporary foreclosure moratoriums of this sort would be enormously damaging to the housing market and mortgage lending. First, a moratorium would delay the bottoming out of the housing market by keeping a large inventory of homes of the market for the duration of the moratorium, with the expectation that these homes would be put on the market later. Second, a moratorium would directly impose large costs on mortgage lenders, who would be unable to enforce their legal rights for the duration of the moratorium. Third, a moratorium could increase mortgage defaults by driving the prices of many homes further underwater and by reducing the disincentive to default—the threat of imminent foreclosure. Fourth, depending on its duration, a moratorium could harm or even cause the failure of many community banks and credit unions that have significant mortgage holdings in their communities. Fifth, a moratorium would impose costs on taxpayers through Fannie Mae and Freddie Mac. Sixth and finally is the potentially permanent damage that would be done to credit markets by demonstrating to lenders that the federal government is willing to upset settled contractual rights for short-term political gain. If investor confidence were damaged in this way, the cost of borrowing could rise across the economy, and particularly for mortgage loans. This would, in the end, injure all Americans who depend on credit. For these reasons, even a temporary foreclosure moratorium caused by widespread adoption of LMPs would have extremely negative consequences for the U.S. economy.

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2. *According to some supporters of the bankruptcy court loss modification programs, one of the purported benefits of the programs is that they allow the servicers of mortgages to enter into modifications below the guidelines established by the ultimate holders of the mortgages. In other words, a greater amount of the debt will be written off or deferred than would otherwise be possible under the programs run by the federal government or private institutions. There is a perception that the entry of a court order requiring mandatory mediation and an order approving a settlement that results from the mediation, gives servicers some immunity or "cover" to violate contractual and fiduciary obligations. However, the ultimate holder of the overwhelming number of mortgages, one way or another, is the federal government via Freddie Mac and Fannie Mae. So really the ultimate holders of these mortgages are American taxpayers.*

   (a) Should courts be helping mortgage servicers violate their contractual and fiduciary obligations to taxpayers or any other third parties?

The rule of law includes the enforcement of lawful contractual rights and obligations. When courts arbitrarily modify contractual rights—or, equivalently, decline to enforce lawful contractual rights—to the benefit of one party and detriment of another, the rule of law is undermined. This is inconsistent with the generally accepted role of the courts, which is to uphold and faithfully apply the law.

   (b) If not, what are the economic and policy ramifications?

The consequences are those I identified above in response to Senator Sessions's first question. Particularly serious would be the blow to investor confidence, which could effect lending throughout the economy.

   (c) Under the Bankruptcy Code, when a principal residence is involved, is it the proper function of a bankruptcy judge to "re-write" the mortgage and/or the contract between the servicer and the ultimate holder of the mortgage, as is suggested by supporters of the loss mitigation programs?

No. As discussed above, Congress has, for good reasons, declined to give bankruptcy courts the authority to alter the terms of mortgages securing debtors' principal residences. When a bankruptcy court attempts to achieve such a result in an indirect manner, such as through a LMP, it risks the negative consequences that Congress sought to avoid in denying courts that power.

3. *At the conclusion of its January 28, 2011 decision overruling the challenge to its loss mitigation program, the Rhode Island Bankruptcy Court stated that the program "was conceived as a case management tool designed to encourage the resolution of differences between residential mortgage lenders and their borrowers, and to provide a way for them to access the various federal housing programs available outside of*

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bankruptcy, such as the Home Affordable Modification Program (HAMP)." The decision further maintains that "[t]he Loss Mitigation Program is intended to start a dialogue, giving the parties nothing more than the opportunity to discuss their respective positions."

Similarly, during the hearing before the Committee, multiple supporters of the programs repeatedly indicated that the most beneficial aspect of the programs was that they provided borrowers the first chance to communicate with a fully authorized representative of the lender.

However, given the extremely negative credit implications that flow from filing for bankruptcy, it would appear to be a very high price to pay to receive the most beneficial aspect of the loss mitigation programs.

Generally, what are the negative ramifications of a homeowner's filing bankruptcy and how do you evaluate the claim that these programs should be expanded in order to provide homeowners with the programs' most beneficial aspect? In other words, do the negative consequences of filing bankruptcy outweigh what is described as the biggest benefit of participating in a loss mitigation program run by a bankruptcy court?

As to whether the negative ramifications of filing for bankruptcy outweigh the potential benefits of LMP participation for an individual that would otherwise not file for bankruptcy, the answer is almost certainly yes.

Filing for Chapter 13 bankruptcy is an expensive and disruptive process. While the total fees for filing are only about $300, guideline attorney's fees range from about $2,500 to $5,000 in simple cases, depending on the district; in complex cases, the fee can be much higher.

In addition, filings are included on credit reports immediately upon filing and remain there for seven years. Thus, Chapter 13 bankruptcy damages credit scores and impairs access to credit for a significant period of time.

Many Chapter 13 bankruptcies fail; that is, the filer never obtains a discharge of his debts. Nearly 20 percent of Chapter 13 cases fail before the court has confirmed the filer's plan. Another 55 percent fail between confirmation and discharge because the filer has been unable to carry out his plan. This means that only one-third of all Chapter 13 filers complete the process successfully and get the fresh start that bankruptcy promises. The rest—two-thirds of all filers—pay court fees, pay attorney's fees, pay fees to the bankruptcy trustee, invest time and money to restructure their financial affairs, and then wind up with nothing more than temporary relief. It is therefore not surprising that a substantial number of Chapter 13 filers—nearly one-third—go on to file for bankruptcy again.

These statistics suggest that holding out the promise of significant relief from mortgage debt to encourage more individuals to file for Chapter 13 bankruptcy is bad policy. At

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best, Chapter 13 would serve only to delay foreclosures in most case where the home is at risk while imposing enormous costs on those who are already financially vulnerable and losing their access to credit.

Moreover, LMPs may undermine more promising approaches to preventing foreclosures. The bulk of outstanding mortgages are controlled or owned by Fannie Mae and Freddie Mac, private banks, and portfolio lenders, all of which have the power to renegotiate mortgages and face strong incentives to do so to preserve the value of homes. By holding out a false hope of major modifications, LMPs may undermine their efforts by eliminating homeowners' incentives to accept modification offers, even ones that are targeted to their situation and less disruptive than bankruptcy is likely to be. In this way, LMPs may only delay foreclosures while blocking more promising alternatives that better protect consumers' financial security.

4. *Some supporters of the loss mitigation programs maintain that the programs can produce better modifications than those under HAMP or private/proprietary programs. How is that possible? What direct or indirect forces or factors would produce a better modifications resulting from the bankruptcy court programs?*

HAMP, of course, relies on government subsidies to encourage lenders to alter mortgages to reduce monthly payments. This allows the parties to complete modifications that fall slightly outside the band of mutual benefit, due to the borrower's inability to make payments that would provide the lender a reasonable stream of payments. Modifications that fall farther outside of that band—that is, where even HAMP subsidies are insufficient to enable the parties to make a deal—are likely to be unworkable; a fair payment to the lender is likely to be more than the borrower can afford to pay.

Therefore, the contention that LMPs could result in more aggressive modifications than under HAMP implies that the bankruptcy court overseeing the LMP is able to wield some additional tool or power that is unavailable in HAMP. One such tool that could be used to further reduce monthly payments is money—simply provide more subsidies. But LMPs do not provide additional money. The only other possible tool is coercion—that is, pushing lenders to accept deals that they would, in a purely voluntary circumstance, reject as disadvantageous. To believe that LMPs do not rely on coercion to achieve such results would be to expect a free lunch: without putting any additional money on the table, bankruptcy courts can somehow bridge the gap between a borrower's ability to pay and what the lender is willing to accept.

5. *No law prevents lenders and borrowers from negotiating to modify a mortgage, before or after a borrower files bankruptcy. Under the Bankruptcy Code, the deadlines governing the adjudication of a motion for relief from the automatic stay can be extended by the mutual agreement of the parties. Moreover, during the hearing, there was testimony that there have been only a limited number of objections to cases being referred to the loss mitigation program in the Southern District of New York.*

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So, what, if anything, does the "mandatory" nature of the loss modification programs run by bankruptcy courts really add? Based on the statements made at the hearing by supporters of the programs, shouldn't a voluntary program produce the same results? And if so, why is any legislation needed?

What the mandatory nature of LMPs adds to the programs is subtle coercion, as described above. This, supporters seem to believe, will be enough to result in modifications that would otherwise be unachievable. To the extent that those who support LMPs dispute this point, they necessarily accept that a voluntary mediation program would achieve the same results as a mandatory LMP. And, to be sure, voluntary mediation is a valuable service that reduces litigation expenses and helps resolve disputes in an expedient and often amiable manner. No additional legislation is needed for parties to a bankruptcy proceeding to participate in voluntary mediation.

6. *A few days prior to the hearing, a bill, S.222, the "Limiting Investor and Homeowner Loss in Foreclosure Act of 2010," was introduced. Do you believe that the proposed legislation should be enacted? Why or why not?*

Though I take no position on S. 222, the policies underlying it are troubling and should give any Member of Congress pause. As described in my written testimony, the bill appears designed to authorize and encourage bankruptcy courts to adopt mandatory LMPs that serve to coerce lenders to agree to loan modifications that they would not accept voluntarily. Further, these programs, even when they do not result in such modifications, burden the exercise of lenders' lawful contractual rights. These programs threaten many severe and negative consequences, which I describe in my written testimony and elsewhere in these answers. S. 222 is a bill that would slow recovery of the housing market and housing prices, while making it more difficult for responsible families to obtain mortgage loans in the future. A Congress that does not share those goals and that seeks to speed recovery and expand homeownership would not enact S. 222.

7. *The loss mitigation programs run by bankruptcy courts and HAMP are inextricably intertwined. The failures of HAMP are well documented. According to a March 2010 report prepared by the Office of the Special Inspector General for the Troubled Asset Relief Program, the failures of HAMP are likely because:*

   (1) the Treasury Department has revised the program regulations and guidelines repeatedly since its creation, causing confusion and delay;

   (2) the Treasury Department approved and encouraged the grant of trial modifications without proper documentation of the homeowner's eligibility, resulting in a large number of trial modifications being granted where the homeowner had no hope of saving the mortgage through modification; and

   (3) the Treasury Department has failed to properly advertize and market the program to homeowners.

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The Special Inspector General also concluded that a number of design elements of the Home Affordable Modification Program make it unlikely to result in permanent foreclosure avoidance.

Do you agree with the conclusions reached by the Special Inspector General in his March 2010 report?

I do agree with the conclusions reached by the Special Inspector General. HAMP, though well-intentioned, has been a failure and has actually harmed many of the families it was intended to help. At this date, it is extremely unlikely that the program will achieve anything near its goal of three to four million permanent mortgage modifications.

8. *During the hearing, John Rao testified that:*

> *"... -- there are obviously concerns about the lack of transparency with HAMP. But one thing we do know and we have seen from the reports that have been coming out of Treasury is that it proves the point that if you do actually modify the mortgage and give the homeowner an affordable payment, they will pay.* ***The statistics are showing that one year after the program with homeowners who have been on permanent modifications 85 percent of those homeowners are staying on the program.****"*
>
> *"****The redefault rates on HAMP modifications are considerably lower than any other modifications that have been attempted. And I specifically refer to the proprietary mortgages that services are doing outside of the HAMP program which have redefault rates which are twice as high as HAMP modifications****. And the other final point is even within that category of the -- of homeowners in the -- who are staying on the program the redefault rate when you lower their monthly payment more and often more by -- than 30 percent the redefault rates are even lower. So the lower the monthly -- the more you reduce the monthly payment the more the homeowner will continue to make ongoing payments, which will contribute to investor gains."*

(Emphasis added).

Do you agree with Mr. Rao's testimony? Why or why not?

Mr. Rao's testimony is, at best, highly misleading, but it is also revealing. It is misleading because, in fact, a huge number of HAMP modifications fail. Since its inception, HAMP has facilitated about 1.5 million trial modifications, about half of which have been canceled due to the inability of borrowers to make modified payments or for other reasons. Mr. Rao implies that this is not the case by referring only to the universe of permanent modifications. But the program has been unsuccessful in achieving significant numbers of permanent modifications. Examined as a whole, rather than cherrypicking narrow portions of its work, HAMP is a failure.

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But Mr. Rao's testimony serves the useful purpose of revealing his hope for LMPs that they will result in mortgage modifications that achieve reductions even greater than those made under HAMP alone. As described above, such modifications could only be achieved through the application of coercion on lenders. Mr. Rao's testimony very nearly concedes this point.

9. *On January 25, 2011, legislation was introduced in the House of Representatives to terminate HAMP. Do you believe that HAMP should be ended? If so, why? If not, what has to be done to get HAMP to work? And what is the timeframe within which those changes have to be implemented?*

HAMP is a failure and should be ended. I direct the Committee to the comments of my Heritage Foundation colleagues Ronald Utt and David John, whose criticisms of HAMP at the time it was introduced proved unfortunately and eerily prescient. They predicted at the time that most modifications made under HAMP would fail. As they explained, in a weak economy and weak housing market, even significant government interventions and subsidies would not "save" many homeowners. They were right. *See* Ronald Utt, Ph.D. and David John, 12 Problems with the Obama Mortgage Stability Initiative Plan, Heritage Foundation Webmemo No. 2311, February 25, 2009, available at http://www.heritage.org/Research/Reports/2009/02/12-Problems-with-the-Obama-Mortgage-Stability-Initiative-Plan.

Worse than HAMP's ineffectiveness is the harm that it has caused many families. An unsuccessful modification under HAMP can have devastating consequences and actually accelerate home loss. It can also increase indebtedness and lead the way to bankruptcy. In HAMP, the Obama Administration has ignored the admonition *primum non nocereto*: "First, do no harm."

Accordingly, Congress could actually help homeowners by requiring the winding down of the HAMP initiative in a way that does not penalize those who are currently undergoing trial modifications but sets a firm end-date for the program.

10. *In March of last year, Mark Calabria, the Director of Financial Regulation Studies of the CATO Institute, testified before the House Committee on Oversight and Government Reform about why government efforts have not stemmed the foreclosure tide. The CATO Institute is a nonprofit, non-partisan public policy research institute. In his testimony, Mr. Calabria explained that:*

> *"The short answer to why previous federal efforts to stem the current tide of foreclosures have largely failed is that such efforts have grossly misdiagnosed the causes of mortgage defaults. An implicit assumption behind former Treasury Secretary Paulson's HOPE NOW, FDIC Chair Sheila Bair's IndyMac model, and the Obama Administration's current foreclosure efforts is that the current wave of foreclosures is almost exclusively the result of predatory lending practices and 'exploding'*

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adjustable rate mortgages, where large payment shocks upon the rate reset cause mortgage payment to become 'unaffordable.'"

"The simple truth is that the vast majority of mortgage defaults are being driven by the same factors that have always driven mortgage defaults: generally a negative equity position on the part of the homeowner coupled with a life event that results in a substantial shock to their income, most often a job loss or reduction in earnings. Until both *of these components, negative equity and a negative income shock are addressed, foreclosures will remain at highly elevated levels. ..."*

"Before discussing specific policy proposals, Congress should bear in mind that as approximately 50 percent of foreclosures are currently driven by job loss, the most significant way to reduce foreclosures is to foster an environment that is conducive to private sector job creation. Accordingly, the worst thing Congress can do is to insert uncertainty into the job market, pushing employers to the sides-lines."

Do you agree with Mr. Calabria's testimony? Why or why not?

I do agree with Mr. Calabria's testimony because he accurately diagnoses a primary cause of the foreclosure crisis. The fundamental problem driving high foreclosure rates is unaffordability, and unaffordability is often caused by job loss and unemployment. In that circumstance, unless the federal government is willing to provide enormous subsidies to homeowners who cannot afford their mortgage payments or whose homes are underwater—subsidies far larger than those available under HAMP—tinkering with existing mortgages will not provide significant benefit.

I also agree with Mr. Calabria's prescription that, to reduce foreclosures, Congress should focus on pro-growth policies and avoid enacting barriers to job creation. Unfortunately, the previous Congress chose the opposite approach, enacting bills such as the misnamed Patient Protection and Affordable Care Act that will raise the cost of hiring, impose financial burdens on businesses and individuals, and result in job loss. To help economic recovery, the Senate would do well to follow the lead of the House of Representatives in passing legislation to repeal the PPACA.

Along similar lines, my Heritage Foundation colleagues James Sherk , Karen Campbell, and John Ligo have identified a series of economic and regulatory reforms to "unleash entrepreneurs to create jobs." *See* James Sherk , Karen Campbell, Ph.D. and John Ligo, A Free Enterprise Prescription: Unleashing Entrepreneurs to Create Jobs, Heritage Foundation CDA Report No. 10-09, December 14, 2010, available at http://www.heritage.org/Research/Reports/2010/12/A-Free-Enterprise-Prescription-Unleashing-Entrepreneurs-to-Create-Jobs. The pro-growth policies that they identify would do far more to help American homeowners than all of the Obama Administration's housing-directed efforts taken together.

Sincerely,

Andrew M. Grossman
Visiting Legal Fellow
The Heritage Foundation

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QUESTIONS FOR THE RECORD FROM SENATOR CHARLES GRASSLEY

TO

DR. ANTHONY B. SANDERS

FOLLOWING THE SENATE JUDICIARY COMMITTEE HEARING:

"FORECLOSURE MEDIATION PROGRAMS: CAN BANKRUPTCY COURTS LIMIT HOMEOWNER AND INVESTOR LOSSES?"

HELD ON FEBRUARY 1, 2011

1. One of the concerns with the loss modification programs ("LMPs") being run by bankruptcy courts is that they could potentially produce a *de facto* moratorium on foreclosures, which could have an adverse impact on our already suffering economy and housing market.

   Please elaborate on the potential damage to the housing market and credit systems if LMPs produced a *de facto* moratorium on foreclosures? More specifically, what is the potential damage to the housing market and credits systems if the average time for all foreclosures is increased by any significant amount of time, for example, six months to one year?

   Loss modifications programs (LMP) are a dangerous animal. Once the public understands that a LMP is attainable AND they get to stay in their homes will (dramatically) lower principal, it could actually lead to an avalanche of bankruptcy requests. In Arizona, it is estimated that 70% of the households are "under water" and would like relief, even if they will continue to make loan payments. This is bad economic policy and the unintended consequences could be severe.

2. According to some supporters of the bankruptcy court loss modification programs, one of the purported benefits of the programs is that they allow the servicers of mortgages to enter into modifications below the guidelines established by the ultimate holders of the mortgages. In other words, a greater amount of the debt will be written off or deferred than would otherwise be possible under the programs run by the federal government or private institutions. There is a perception that the entry of a court order requiring mandatory mediation and an order approving a settlement that results from the mediation, gives servicers some immunity or "cover" to violate contractual and fiduciary obligations. However, the ultimate holder of the overwhelming number of mortgages, one way or another, is the federal government via Freddie Mac and Fannie Mae. So really the ultimate holders of these mortgages are American taxpayers.

   (a) Should courts be helping mortgage servicers violate their contractual and fiduciary obligations to taxpayers or any other third parties?

   No. For the United States to be trusted in the global economy, we should stay with our laws and understood contracts. Violating the law and existing contracts is very dangerous and will result and costly borrowing for future borrowers.

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(b) If not, what are the economic and policy ramifications?

As I state before, it is bad economics to write down principal since there is little evidence that it prevents default (except in the extreme where 100% write-down means that the borrower is given a free house).

(c) Under the Bankruptcy Code, when a principal residence is involved, is it the proper function of a bankruptcy judge to "re-write" the mortgage and/or the contract between the servicer and the ultimate holder of the mortgage, as is suggested by supporters of the loss mitigation programs?

No, global capital markets understand what laws and rules governing loan writedowns and having bankruptcy judges rewrite the mortgage is dangerous and would expose fatal flaws with a good intent.

3. At the conclusion of its January 28, 2011 decision overruling the challenge to its loss mitigation program, the Rhode Island Bankruptcy Court stated that the program "was conceived as a case management tool designed to encourage the resolution of differences between residential mortgage lenders and their borrowers, and to provide a way for them to access the various federal housing programs available outside of bankruptcy, such as the Home Affordable Modification Program (HAMP)." The decision further maintains that "[t]he Loss Mitigation Program is intended to start a dialogue, giving the parties nothing more than the opportunity to discuss their respective positions."

Similarly, during the hearing before the Committee, multiple supporters of the programs repeatedly indicated that the most beneficial aspect of the programs was that they provided borrowers the first chance to communicate with a fully authorized representative of the lender.

However, given the extremely negative credit implications that flow from filing for bankruptcy, it would appear to be a very high price to pay to receive the most beneficial aspect of the loss mitigation programs.

Generally, what are the negative ramifications of a homeowner's filing bankruptcy and how do you evaluate the claim that these programs should be expanded in order to provide homeowners with the programs' most beneficial aspect? In other words, do the negative consequences of filing bankruptcy outweigh what is described as the biggest benefit of participating in a loss mitigation program run by a bankruptcy court?

The costs to bankruptcy are generally well known. It is a devastating process that borrowers should avoid if possible, Then why dangle a carrot (principal writedowns) to entice more borrowers into a painful process? The government already oversubsidized housing in the US leading to a housing bubble that has destroyed the life savings of millions of households. Why do we keep wanting to destroy America's households through government actions?

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4. Some supporters of the loss mitigation programs maintain that the programs can produce better modifications than those under HAMP or private/proprietary programs. How is that possible? What direct or indirect forces or factors would produce a better modifications resulting from the bankruptcy court programs?

   That is false. The loan mods available in the programs may be better for the borrower, but not for the lender or investors. Remember, the borrower has likely defaulted already and should be in a less stressful environment such as renting. How is allowing borrowers to continue in a housing they can't afford as "Better?"

5. No law prevents lenders and borrowers from negotiating to modify a mortgage, before or after a borrower files bankruptcy. Under the Bankruptcy Code, the deadlines governing the adjudication of a motion for relief from the automatic stay can be extended by the mutual agreement of the parties. Moreover, during the hearing, there was testimony that there have been only a limited number of objections to cases being referred to the loss mitigation program in the Southern District of New York.

   So, what, if anything, does the "mandatory" nature of the loss modification programs run by bankruptcy courts really add? Based on the statements made at the hearing by supporters of the programs, shouldn't a voluntary program produce the same results? And if so, why is any legislation needed?

   The bankruptcy court LMP is redundant and is an example of "If you don't succeed, try try again." Many households failed HAMP for reasons of insufficient income (if any) for the payment. Even a temporary payment decline wouldn't work. With all the programs available, the only carrot that the bankruptcy courts offers is writing down principal that investors have chosen not to do. In other words, granting a "Get Out of Jail Free" card.

6. A few days prior to the hearing, a bill, S.222, the "Limiting Investor and Homeowner Loss in Foreclosure Act of 2010," was introduced. Do you believe that the proposed legislation should be enacted? Why or why not?

   Absolutely not. The bill is redundant at best, bad economic policy and sends a terrible signal to the world economy about our willingness to stand by contracts.

7. The loss mitigation programs run by bankruptcy courts and HAMP are inextricably intertwined. The failures of HAMP are well documented. According to a March 2010 report prepared by the Office of the Special Inspector General for the Troubled Asset Relief Program, the failures of HAMP are likely because:

   (1) the Treasury Department has revised the program regulations and guidelines repeatedly since its creation, causing confusion and delay;

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(2) the Treasury Department approved and encouraged the grant of trial modifications without proper documentation of the homeowner's eligibility, resulting in a large number of trial modifications being granted where the homeowner had no hope of saving the mortgage through modification; and

(3) the Treasury Department has failed to properly advertize and market the program to homeowners.

The Special Inspector General also concluded that a number of design elements of the Home Affordable Modification Program make it unlikely to result in permanent foreclosure avoidance.

Do you agree with the conclusions reached by the Special Inspector General in his March 2010 report?

First, I agree with the conclusions of the SIG's March 2010 report. Second, I think it didn't go far enough. Loan modifications (HAMP) were bogged down in politics rather than sound economic policy (e.g., means testing) and were doomed to failure. Massive housing price declines and surging unemployment are very difficult problems to solve in a patchwork program like HAMP. The same applies to the bankruptcy legislation.

8. During the hearing, John Rao testified that:

"... -- there are obviously concerns about the lack of transparency with HAMP. But one thing we do know and we have seen from the reports that have been coming out of Treasury is that it proves the point that if you do actually modify the mortgage and give the homeowner an affordable payment, they will pay. ***The statistics are showing that one year after the program with homeowners who have been on permanent modifications 85 percent of those homeowners are staying on the program***."

"***The redefault rates on HAMP modifications are considerably lower than any other modifications that have been attempted. And I specifically refer to the proprietary mortgages that services are doing outside of the HAMP program which have redefault rates which are twice as high as HAMP modifications.*** And the other final point is even within that category of the -- of homeowners in the -- who are staying on the program the redefault rate when you lower their monthly payment more and often more by -- than 30 percent the redefault rates are even lower. So the lower the monthly -- the more you reduce the monthly payment the more the homeowner will continue to make ongoing payments, which will contribute to investor gains."

(Emphasis added).

Do you agree with Mr. Rao's testimony? Why or why not?

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I do not agree with Mr. Rao's testimony. In fact, I have no idea where he comes up with the redefault numbers he uses. I have seen the reports by Bank of America and others versus HAMP and I don't see the numbers he is talking about.

Having said that, remember, if you lower a mortgage payment or principal lower enough, HAMP could save homes. But at what cost to taxpayers? Even if HAMP was as successful as Mr Rao claims, he never asked whether we should be doing it, he only asked if we could.

If HAMP was so successful, then why does Treasury keep changing the terms? I side with the SIG inspector's report -- it is a dismal failure.

And once again, a bankruptcy judge could eliminate defaults by cancelling mortgage principal. This must be weighed against the enormous cost of doing so to the financial system and taxpayers.

9. On January 25, 2011, legislation was introduced in the House of Representatives to terminate HAMP. Do you believe that HAMP should be ended? If so, why? If not, what has to be done to get HAMP to work? And what is the timeframe within which those changes have to be implemented?

   HAMP should absolutely be terminated. It was expensive and a failure. Even worse, holding out the hope of modifications sends a bad signal to borrowers. I would go so far as to say that HAMP actually created false hope that resulted in borrower anger when servicers couldn't deliver the modification that was irrationally expected. Just as consumers were overly optimistic about house price growth, they were overly optimistic about the government solving their mortgage problems. The poor gentleman from Rhode Island who testified should have been angry with the Administration for what they implied would happen.

10. In March of last year, Mark Calabria, the Director of Financial Regulation Studies of the CATO Institute, testified before the House Committee on Oversight and Government Reform about why government efforts have not stemmed the foreclosure tide. The CATO Institute is a nonprofit, non-partisan public policy research institute. In his testimony, Mr. Calabria explained that:

    "The short answer to why previous federal efforts to stem the current tide of foreclosures have largely failed is that such efforts have grossly misdiagnosed the causes of mortgage defaults. An implicit assumption behind former Treasury Secretary Paulson's HOPE NOW, FDIC Chair Sheila Bair's IndyMac model, and the Obama Administration's current foreclosure efforts is that the current wave of foreclosures is almost exclusively the result of predatory lending practices and 'exploding' adjustable rate mortgages, where large payment shocks upon the rate re-set cause mortgage payment to become 'unaffordable.'"

    "The simple truth is that the vast majority of mortgage defaults are being driven by the same factors that have always driven mortgage defaults: generally a negative equity position on the part of the homeowner coupled with a life event that results in a substantial shock to their income, most often a job loss or

reduction in earnings. Until *both* of these components, negative equity and a negative income shock are addressed, foreclosures will remain at highly elevated levels. ..."

"Before discussing specific policy proposals, Congress should bear in mind that as approximately 50 percent of foreclosures are currently driven by job loss, the most significant way to reduce foreclosures is to foster an environment that is conducive to private sector job creation. Accordingly, the worst thing Congress can do is to insert uncertainty into the job market, pushing employers to the sides-lines."

Do you agree with Mr. Calabria's testimony? Why or why not?

I do agree with Mr. Calabria's testimony (I have given roughly the same testimony in the House). To quote President Clinton, "It's the economy ..." A housing bubble formed and blew up; unemployment shot through the roof (where it still remains).

To blame the bubble and its bursting on subprime lending is misguided and incorrect. To be sure, low down payment borrowers got burned terribly by the downturn (which is why I have pleaded with HUD/FHA to stop low down payment programs). Exploding ARMs (better known as "broken ARMs" was a red herring; it was low down payment ARMs that defaulted because of house price declines and increases in unemployment.

In fairness to everyone (see my Treasury Report from December 2008), house prices were rising and subprime borrowers were actually going delinquent quite a bit less during the bubble. Had the bubble continued, we would not be having this discussion; in fact, HUD would be congratulated for making "homes affordable" and even subprime borrowers got a share in the American dream. When house prices deflated rapidly, the American dream turned into a nightmare. So to blame ARMs and subprime lending is inappropriate and leads to the wrong policy conclusion – it was negative equity and unemployment surge as the root cause, low down payment and subprime borrowers got taken out first, but it has now bled into the prime borrower market as well.

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Senator Jeff Sessions
Hearing: "Foreclosure Mediation Programs: Can Bankruptcy Courts Limit Homeowner and Investor Losses?"
Written Questions for Dr. Anthony Sanders

1. At the hearing, Senator Whitehouse stated that "Servicers too often act in their own fee-driven interests and not in the interests of the investors who actually hold the mortgages. A court-supervised negotiation can ensure that servicers don't reject reasonable settlements that would benefit the investors." Could you briefly explain how servicers are paid for their work on home mortgages that are in default?

   Servicers (if different than the investor or lender) may act to maximize servicing fees at the peril of litigation and a loss of business. Investors, by and large, do NOT want principal writedowns since there are extraordinary moral hazard problems associated with them (very costly to perform and it could encourage a tidal wave of applicants).

   Servicers are paid through fees (did we expect them to work pro bono?) but those fees are only part of the compensation. If servicer A misbehaved and harmed investors through stringing out the process, two things will happen. A) they will not be hired again, so their fee income goes to zero and B),they will be sued for violation of the Pooling and Servicing Agreement (PSA) by not acting in the best interest of the certificate holders.

2. At the hearing, Judge Drain discussed the perceived need to establish mandatory mediation programs in the bankruptcy courts. Judge Drain testified:

   > the problem was and is, I think, basic. Increased defaults and the drop in home prices rendered the autopilot servicing model applied to the vast majority of home mortgage loans inadequate. A model premised on collecting payments in the ordinary course for all but a tiny percentage of mortgages and foreclosing on the few defaulted ones in the context of a rising market, all too often, simply didn't work anymore.

   a. Do you believe that, for most participants in the mortgage servicing industry, the collapse of the housing market in 2008 was sudden and unexpected? Please explain your answer.

      I have testified in the House on several occasions that the housing market literally fell off a cliff after subprime loan delinquencies were shrinking to very low rates. So, yes, the servicing industry was taken by surprise and deluged by loan mod, short sales and related requests. If it was so easy to predict, why were Fannie Mae, Freddie Mac, HUD, OCC, FDIC, Treasury and the Fed all caught by surprise?

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b. Do you believe that the staffing levels and logistical systems of the mortgage servicing industry were unprepared for the sudden collapse of the housing market? Please explain your answer.

I have a slide presentation that I presented at Treasury in 2009. It shows that it was like the Titanic –a glassy ocean surface then an ice berg came into view. Yes, the servicing industry wss caught unprepared. And then we heaped HAMP on top of them, an overly cumbersome, ineffective and expensive "cure" which, of course, failed.

c. Is it possible that the failure of mortgage servicers to effectively manage documentation and communication management in the HAMP program, which were extensively discussed during the hearing and have been well publicized in recent months, are the temporary result of a drastic and unexpected change in the needs staffing and logistical needs of mortgage servicers?

HAMP added unnecessary burdens to an already stressed servicing industry. As Herb Allison testified in a House hearing, they place Treasury agents at every servicer to monitor the effectiveness of HAMP. It would have been better if the agents had rolled up their sleeves and tried answering the phones.

3. At the hearing, you testified that mandatory mediation programs could create uncertainty for mortgage investors by making *ex post* modifications to the contracts under which mortgages are serviced and foreclosures are pursued. Later in the hearing, after Judge Drain testified that it was creditors' attorneys who first sought the establishment of mandatory programs in his court, Senator Whitehouse said that "actually, this is a surprise [mortgage investors] sought, welcome, and are happy to work with."

a. Are the mortgage investors you spoke of necessarily the same mortgage investors that own the mortgage in a particular bankruptcy proceeding? Please explain your answer.

Suppose I am a Dutch pension fund and I purchase MBS backed by mortgages. The Prospectus Supplement lays out in black and white how the process works, as does the Pooling and Servicing Agreement (PSA). Now, we want to change the rules and allow bankruptcy judges to do something that investors had no idea was possible – writendown principal outside the system of contracts. Even Fannie Mae and Freddie Mac (aka, the American taxpayer) would be stunned if bankruptcy courts can transfer wealth from investors to borrowers.

b. Is it possible that the creditors' attorneys, who are often employed by the servicers of mortgages, might have different incentives with regard to mandatory mediation and mortgage modification than the investors? Please explain your answer.

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Once again, the only party that wants to do a principal writedown is the borrower. There are some that believe that this will help stabilize the housing market, but Fannie Mae and Freddie Mac were also supposed to have stabilized the market and made it worse. Creditor's attorneys do not want principal writedowns unless it makes sense to investors.

4. You mentioned at the hearing that you gave a presentation to the Obama Administration's Treasury Department, explaining the pitfalls of attempting to use a means-tested mortgage modification program to address the housing crisis. Please take this opportunity to detail the substance of that presentation for the Committee.

I pointed out to the attendees (Treasury, Obama Transition Team and HUD) the magnitude of the problem, particularly in Arizona, California, Nevada and Florida. I pointed out that negative equity was a massive problem and so pervasive in those areas that it would be too expensive to fix. Furthermore, I pointed out that it hit both high and low housing price segments and if you don't resolve the high-price homes, they will collapse down on the middle income homes, and so on.

I was greeted by a snort (not from Treasury) and told that they only politically viable solution was a means test, meaning that only the lower income groups would qualify (but only if they had sufficient income). I then said "Why bother? You have doomed any loan mod program to failure since you are attacking political problems, not economic problems."

Fast forward to today. The high end market in those states has collapsed down on the middle income housing driving down their values. HAMP is an abject failure, all because the administration refused to understand the two major points: 1) house prices collapsed and 2) unemployment increased. So they decided to give loan mods to those who were employed, but refused to do anything about negative equity.

The answer is that it is the proverbial "Bridge too Far." Let servicers try to do loan mods that they feel are appropriate; otherwise, let the market work itself out.

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SUBMISSIONS FOR THE RECORD

Working for Alabama Banks
534 Adams Avenue • Montgomery, Alabama 36104
Telephone 334.834.1890 • Fax 334.834.4443
www.alabamabankers.org

November 30, 2010

Senator Jeff Sessions
335 Russell Senate Office Building
Washington, DC 20510-0104

Dear Senator Sessions:

The Alabama Bankers Association (ABA) has serious concerns about a legislative proposal by Senator Whitehouse (D-RI) that would provide a broad grant of authority to bankruptcy courts to establish mortgage "Loss Mitigation Programs" (LMPs) by local rule or order.

ABA member banks are highly sensitive to the consequences of foreclosure for bank customers and have supported efforts to foster voluntary work outs and loan modifications between home owners and lenders. Therefore, we are very concerned that LMPs would undermine voluntary loan modification efforts. In fact, there would be tremendous incentives for debtors to file for bankruptcy. By paying legal fees that total less than the cost of a single mortgage payment, the foreclosure process would be halted by the automatic stay and the claim holder would then be subjected to judicial pressure to agree to a loan modification. This could lead to major increases in bankruptcy filings in Alabama and throughout the country.

Further, because each LMP would be local in design, rather than established under a national rule, there could be wide variation in program details -- not just between different judicial circuits but between different bankruptcy courts within a given circuit. This would present serious administrative/compliance issues for claim holders involved in cases on a regional or national basis. We also have little doubt that most bankruptcy courts and judges in Alabama and elsewhere would be likely to use LMP authority aggressively, including using it to override the anti-cram down prohibition in Chapter 13 bankruptcy proceedings.

For instance, a claim holder could be ordered to participate in a LMP involuntarily in cases where the debtor has occupied (or even rented out) the property for months or years without making payment, where all delaying tactics under state and local law have been exhausted, and where the claim holder has knowledge and belief that the debtor is unable or unwilling to make reasonable future payments (much less cure past arrearages).

LMPs in bankruptcy could threaten the economic recovery, force mortgage cram downs and put in place an open-ended judicial foreclosure moratorium, and we urge you not to support Senator Whitehouse's proposal.

Sincerely,

Robert W. Dumas
President & CEO, AuburnBank
President, Alabama Bankers Association

Dan Bailey
CEO, Alabama Bankers Association

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New Hampshire Making Homes Affordable (MHA) Pilot Program •AAHMP• AAHMP	To: AAHMP Attention: S. Gillian Borrower: **David A Vanaskey** Address: **14740 N 150th Lane** **suprise, AZ 85379** Loan Number: **0** Date: **2/8/2010** From: Sol Klein Fax Number: (949)608-9126 Phone number for follow-up: 858-793-3780

The following application has been underwritten to determine the homeowner's eligibility for a Loan Modification under the Administration *Making Homes Affordable* program (MHA) guidelines.

Recommendation:

- ☒ **The applicant is eligible under MHA (analysis, application and supporting documentation is enclosed per your request).**
- ☐ **The applicant is ineligible for MHA for the following reason:**
  - ☐ **Inability to pay**
  - ☐ **Not in imminent default**
- ☐ **The applicant is eligible for a Modification other than MHA (analysis, application and supporting documentation is enclosed).**
- ☐ **The following recommendation had been made to the applicant:**
  - ☐ **Referral - Real Estate Agent**
  - ☐ **Referral - MHA Refinance**
  - ☐ **Referral - Deed in Lieu of Foreclosure**

Comments: Please see attached.

Please contact me should you require additional information.

Sincerely,
Sol Klein
(800)426-5626

Date: **2/8/2010**
From: Sol Klein
Phone Number: (800)426-5626

Borrower: **David A Vanaskey**
Address: **14740 N 150th Lane**
suprise, AZ 85379
Loan Number: **0**

F.A.S.T. MHA Modification Synopsis

	Original	Current	TARP	Modified
Rate	8.175%	8.175%	1.625%	**2.000%**
Term	360	328	480	**480**
P&I Payment	$1,246.42	$1,446.42	$1,369.85	**$1,095.94**
PITIA Payment	$1,363.51	$1,563.51	$1,486.94	**$1,213.03**
Housing Ratio	34.85%	39.96%	38.00%	**31.00%**
			Savings	**$350.48**
BE Ratio	62.55%	67.66%	65.70%	**58.70%**
		Refer borrower to Credit Counseling		

Calculations based on a total gross monthly income of: $3,913.00

Modified Loan Terms

Due Date:	3/1/2010
Maturity Date:	2/1/2050
Loan Type:	Fully Amortizing
Current UPB:	$474,282.95
Funds Due To Be Capitalized:	$5,000.00
Modified UPB:	$436,354.48
Interest Rate:	2
P & I:	$1,095.94
Escrow Payment:	$117.09
Total Payment:	$1,213.03
Term:	480
Amortized Term:	480
Estimated Value:	$113,000.00 *
LTV:	424.144%

Principle Forbearance/Reduction

Modified UPB Reduction $:	$42,928.47
Modified UPB Reduction %:	8.96%

* Data Source: Yahoo.com Real Estate valuator. (Zillow.com/eappraiser.com)
(Disclaimer- Current Estimate value is based on the above data source and may not be considered an accurate reflection of the current market values.)

American Alliance of Home Modification Professionals

Proposal
Settlement Conference

Mandatory Settlement Conference requires a new approach to deal with the statute. AAHMP is proposing to employ our personnel to assist courts and homeowners in this process.

The major benefit to a Settlement Conference is that the homeowner is engaged in finding a solution to the issue The current process of mandatory Settlement Conference has not been as successful as it could for a number of reasons;

1. Homeowners are unprepared when they attend the conference. Typically the homeowner does not have all the required documentation needed to reach a proper conclusion of eligibility for a HAMP or conventional modification. This causes further delay in the process due to time required to gather proper documentation. The lender/servicer has also lost the full attention of the homeowner. A trial modification can be given based on what information is available. However, under sd1001 a HAMP trial modifications will not be aloud prior to full underwriting.
2. Lender/servicer representation does not always have all information available to properly capitalize the UPB at the conference which makes a final offer, properly underwritten, difficult to be presented to the homeowner.
3. Lender/servicer representation may not always have the training required to properly determine eligibility under HAMP guidelines, or the tools present to make that determination; income verification, accurate calculation of DTI, back-end ration, etc…
4. Lender/servicer representation may not always have the training required to properly counsel the homeowner on other mitigation solutions if they do not qualify under HAMP.
5. If a conclusion is not agreed upon by both parties at the time, active engagement by the homeowner may be lost.
6. Help for the Homeowner may not always be available since many can not afford an attorney and most Housing Counselors already have to many cases.

AAHMP is proposing a different solution to the Settlement Conference. It addresses most of the shortfalls of the current process by determining eligibility prior to the conference by incorporating AAHMP full program. AAHMP is a **Neutral Third Party**; it is not an advocate for the Homeowner or the Servicer but rather professional

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processors and underwriters supported by state-of the-art technology to assure proper determination of eligibility.

1. Upon the ordering of a Settlement Conference the homeowner contact information would be provided to AAHMP along with a completed AAHMP "Information Request form" AAHMP Member Company LMC assigned will contact the homeowner and complete the "Front-end" operations. They will provide the homeowner with our Barcode Fax Cover Page technology for the gathering of all proper documentation. The Loan Modification Consultant* (LMC) will assist the homeowner and create the trust required to move the process forward. The LMC assigned will have the language skills required for the client. Once all documents are gathered the case will move through AAHMP's program of processing and underwriting to determine eligibility for HAMP or possibly more traditional modification. The recommendation is delivered at the conference to the bank representative and the court. An email address will be requested of the bank representative so a digital copy – with all documentation can be sent electronically.
2. The assigned LMC can work directly with the Homeowner or a processor will be assigned to work with the attorney or Housing Counselor to prepare a final "Recommendation" or Disposition Package. This package is a fully underwritten determination if the Homeowner **"does" or "does not"** qualify for a HAMP or a more conventional modification. This final Recommendation will be signed by a HUD Direct Endorsed Underwriter based on HAMP guidelines. The LMC, or Homeowner Representative acting on behalf of the client will have a fully completed "Recommendation" in hand to offer to the bank representative at the conference.
3. The LMC will be fully trained as per AAHMP requirements. If a modification is not possible the LMC will counsel the homeowner on alternatives options at the conference. The homeowner is engaged at this point therefore the LMC will be able to show the homeowner why they do not qualify. The goal is to create the trust between the LMC and the homeowner during step 1 which makes them more receptive to counseling at the conference.

For any successful loss mitigation effort, full engagement by the homeowner is key. Acting in the homeowners and lender/servicer's best interest is how AAHMP is designed. For the Settlement Conference AAHMP has made arrangements with one of the top ranker national franchised Organizations to have a designated number of their agents complete the requirements for membership in AAHMP. The reason this group was considered as LMC's with in AAHMP's structure is two fold, they are professionals in their field specially trained in distressed properties, thus know their specific market, and a determination can be made prior to the conference on a possible short sale option if the homeowner does not qualify for a modification.

Currently used Housing Counseling Agencies can be used if preferred by the court.

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As with all of AAHMP's modification programs, our ***F.A.S.T.*** platform would allow for full monitoring, control and transparency of the program by the court.

*Consistency in effort and procedures is one of the major shortcomings of the foreclosure efforts to date. It is one of the main complaints from homeowners, state and federal government representatives and the media. With the use of a national Real Estate Organization in the process, under the umbrella of a single structure, AAHMP, and its rules and procedures give that needed consistency. All agents used from this organization must complete AAHMP's process for membership with a background check and satisfactory completion of the online certificate training course. The agent would identify themselves to the homeowner as a Loan Modification Consultant (LMC) certified by AAHMP. For full disclosure the agent would further identify themselves as a local Real Estate agent. The integrity of the process is protected by AAHMP's structure. The LMC does not make the decision on modification eligibility, that function is completed by the processor and the HUD Direct Endorsed Underwriter therefore the LMC can not move the homeowner to a short sale option until modification eligibility has been denied. The LMC is getting paid for their efforts with Front-end operation and attending the Settlement Conference. However if the modification is not obtainable the best strategy is to provide alternatives immediately which includes a professional analysis for a possible short sale along with other alternatives. The goal for all parties is to avoid foreclosure and all associated cost to the lender if possible. Rules governing this process can be set by the controlling authority and enforced by AAHMP.

With the availability of HUD EHLP program professional trained LMC, processors and HUD Direct Endorsed Underwriters can be used in the process as an administrative cost to stop preventable foreclosures in the time frame required.

We would appreciate the opportunity to more fully explain how AAHMP member companies can help.

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American Alliance of Home Modification Professionals

Propose addition to Senate bill S.222

We propose the following addition to Senate Bill S.222 which would help in its process, implementation, monitoring and transparency of the Mediation effort;

- That a Neutral Third Party be used to deliver to the Court a "Recommendation of Eligibility" of the application for loss mitigation efforts. The Neutral Third Party must provide trained processors, no less than the level of HUD Direct Endorsed Underwriters and full monitoring and transparency of the process to the Court. This information is to be provided in "Real Time" to any controlling authority designated.

Reasons for proposed addition;

Ample evidence over the past two years has demonstrated short fall in the national modification efforts. We know that the servicer does not always act in good faith in regard to process. These problems may not be in all cases from purposeful intent but rather from the lack of trained personnel doing the underwriting. We also know from anecdotal evidence and testimony from the experts at many hearings, including Chairwomen of the FDIC that the servicers' financial interest is not always in line with the Homeowner and Investor. We hear this from SIGTARP, COP, GAO, Housing Counselors and Attorneys' representing Homeowners. The same problems that exist in HAMP in general also impact the mediation conference.

A neutral third party will provide the Court with an accurate analysis of eligibility under HAMP guidelines. It will give the Homeowner the confidence that their file has been underwritten properly regardless of outcome. This work can all be completed with in the 30 days for completion set forth in HAMP reducing backlog in the courts.

Attached please find a Mediation/Settlement Conference program we where asked to develop by Fannie Mae for Florida using our general program. We where confident Fannie was going to move in that direction but after nine months we where informed they decided to stay with their current structure of working with the servicers, now Florida has over 500k mediation cases pending.

With the cooperation and assistants of the Court in the Mediation Conference program the Neutral Third Party can help reduce the time required to complete the process by

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supplying a fully underwritten "Recommendation or Disposition Package" based on HAMP guidelines. Attached please see "Disposition Package" which would be the document delivered at the conference. As you will see a determination of eligibility will be handed to the Court and servicer representative. This program will accomplish the following;

- Only one, possible two conferences will be needed.
- Court will know that the servicer did in fact underwrite the file correctly according to HAMP guidelines. This will give the Court the Neutral Third Party information to make a final determination moving forward.
- All documentation will be digitally attached to the file and delivered electronically to the servicer (no lost docs)
- The Homeowner or their representative is prepared to act.
- If the Homeowner does not qualified they will understand the reasons why knowing that a neutral third party has completed the work.

Reporting;

Technology must provide monitoring, control and transparency in Real Time which is vital to any successful loss mitigation effort. These abilities perform many different functions to the Controlling Authorities';

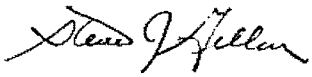
- Provides the ability to determine success/failure of the effort immediately and to implement changes requires for success
- Provides status of every file in Real Time
- Track servicer and homeowner performance
- Track cost to HAMP/taxpayer

Unfortunately Treasury does not intend on holding the servicing industry to the terms of their obligation under "Servicer Participation Agreement". In order to assure due process the Court may be the last resort to stopping preventable foreclosures.

The program outline has been available for two years and offered to Treasury, Fannie Mae, Freddie Mac, OCC, FDIC and all major servicers.

Attachments; Mediation Conference – Example Recommendation or Disposition Package

Respectfully submitted,



Steven Gillan
Executive Director
American Alliance of Home Modification Professionals
AAHMP, Inc.
www.aahmp.org

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American Alliance of Home Modification Professionals

Written Statement

American Alliance of Home Modification Professionals (AAHMP)
For
SENATE COMMITTEE ON THE JUDICIARY
FORECLOSURE MEDIATION PROGRAMS: CAN BANKRUPTCY COURTS LIMIT HOMEOWNER AND INVESTOR LOSSES?
FEBRUARY 2011

To; Chairman Leahy, Ranking Member Grassley, Senator Whitehouse, and members of the Committee, thank you for permitting the American Alliance of Home Modification Professionals (AAHMP) to submit the following written statement for the committee hearing record.

We appreciate the opportunity for our group to make our position known and to offer our support for Bankruptcy Court Foreclosure Mediation Programs in general and specifically S.222. Due to the lack of successful execution of all other Foreclosure Prevention Programs offered by the US Treasury Department, it is our position that there must be an outlet to address the Foreclosure Crisis facing this Country. Mediation between two parties, meeting face to face have shown to achieve greater success in a resolution of the situation in a timeframe beneficial to all parties.

Although we support the concept in general we see the challenges that the Home Affordable Modification Program (HAMP) has faced, specifically proper processing and underwriting according to guidelines, would also be present in a Bankruptcy Mediation Program. To that end we offer the following proposed addition to the language of S.222.

Propose addition to Senate bill S.222

We propose the following addition to Senate Bill S.222 which would help in its process, implementation, monitoring and transparency of the Mediation effort;

- That a Neutral Third Party be used to deliver to the Court a "Recommendation of Eligibility" of the application for loss mitigation efforts. The Neutral Third Party

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must provide trained processors, no less than the level of HUD Direct Endorsed Underwriters and full monitoring and transparency of the process to the Court. This information is to be provided in "Real Time" to any controlling authority designated.

Reasons for proposed addition;

Ample evidence over the past two years has demonstrated short fall in the national modification efforts. We know that the servicer does not always act in good faith in regard to process. These problems may not be in all cases from purposeful intent but rather from the lack of trained personnel doing the underwriting. We also know from anecdotal evidence and testimony from the experts at many hearings, including Chairwomen of the FDIC that the servicers' financial interest is not always in line with the Homeowner and Investor. We hear this from SIGTARP, COP, GAO, Housing Counselors and Attorneys' representing Homeowners. The same problems that exist in HAMP in general also impact the mediation conference.

A neutral third party will provide the Court with an accurate analysis of eligibility under HAMP guidelines. It will give the Homeowner the confidence that their file has been underwritten properly regardless of outcome. This work can all be completed with in the 30 days for completion set forth in HAMP reducing backlog in the courts.

Attached please find a Mediation/Settlement Conference program we where asked to develop by Fannie Mae for Florida using our general program. We where confident Fannie was going to move in that direction but after nine months we where informed they decided to stay with their current structure of working with the servicers, now Florida has over 500k mediation cases pending.

With the cooperation and assistants of the Court in the Mediation Conference program the Neutral Third Party can help reduce the time required to complete the process by supplying a fully underwritten "Recommendation or Disposition Package" based on HAMP guidelines. Attached please see "Disposition Package" which would be the document delivered at the conference. As you will see a determination of eligibility will be handed to the Court and servicer representative. This program will accomplish the following;

- Only one, possible two conferences will be needed.
- Court will know that the servicer did in fact underwrite the file correctly according to HAMP guidelines. This will give the Court the Neutral Third Party information to make a final determination moving forward.
- All documentation will be digitally attached to the file and delivered electronically to the servicer (no lost docs)
- The Homeowner or their representative is prepared to act.
- If the Homeowner does not qualified they will understand the reasons why knowing that a neutral third party has completed the work.

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Reporting;

Technology must provide monitoring, control and transparency in Real Time which is vital to any successful loss mitigation effort. These abilities perform many different functions to the Controlling Authorities';

- Provides the ability to determine success/failure of the effort immediately and to implement changes requires for success
- Provides status of every file in Real Time
- Track servicer and homeowner performance
- Track cost to HAMP/taxpayer

Unfortunately Treasury does not intend on holding the servicing industry to the terms of their obligation under "Servicer Participation Agreement". In order to assure due process the Court may be the last resort to stopping preventable foreclosures.

The program outline has been available for two years and offered to Treasury, Fannie Mae, Freddie Mac, OCC, FDIC and all major servicers.

Thank you for giving AAHMP the opportunity to submit our recommendation for addition to S.222. We are available to discuss further with the Committee this and other solutions available to implement a successful National Loss Mitigation effort.

Attachments; Mediation Conference – Example Recommendation or Disposition Package

Respectfully submitted,

Steven Gillan
Executive Director
American Alliance of Home Modification Professionals
AAHMP, Inc.
www.aahmp.org

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Statement for the Record

On Behalf of

AMERICAN BANKERS ASSOCIATION
CONSUMER BANKERS ASSOCIATION
THE FINANCIAL SERVICES ROUNDTABLE
HOUSING POLICY COUNCIL
INDEPENDENT COMMUNITY BANKERS OF AMERICA
MORTGAGE BANKERS ASSOCIATION

Before the

Committee on the Judiciary

United States Senate

For the Hearing

"Foreclosure Mediation Programs: Can Bankruptcy Courts Limit Homeowner and Investor Losses?"

February 1, 2011

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The above noted organizations respectfully submit this statement for the record for the Senate Judiciary Committee's hearing on February 1, 2011, entitled "Foreclosure Mediation Programs: Can Bankruptcy Courts Limit Homeowner and Investor Losses?"

As set forth below, we have serious concerns about compulsory mediation in the context of bankruptcy cases and urge caution when policy makers consider any effort, by legislation or otherwise, to encourage or create an across-the-board, mandatory "Loss Mitigation Program" (LMP) in bankruptcy courts across the country.

Our members are highly sensitive to the consequences of foreclosure for our customers and have supported efforts to foster voluntary work outs and loan modifications between home owners and lenders. For instance, we support the Home Affordable Modification Program (HAMP). This government program makes available $75 billion in funding to help homeowners at risk for foreclosure stay in their homes. HAMP allows eligible mortgagees to lower their monthly payments to 31 percent of their pre-tax income, or lower, through a loan modification. The adjustments are introduced on a temporary basis but are made permanent after the homeowner makes three on-time payments.

While HAMP was slow to start and could be improved by reducing the complexity of the program, we believe that the HAMP program nonetheless has been valuable, both in providing modifications to a significant number of homeowners and in helping to create standards that have been followed by industry in providing additional modifications to homeowners. According to Treasury Department statistics, at least 4.1 million borrowers have received restructured mortgages under HAMP, HOPE NOW and FHA loss mitigation and early delinquency interventions. Nearly 490,000 borrowers have received permanent modifications of their mortgages, which reduce monthly payments for a five-year period, as result of HAMP. In addition, through November 2010 the industry provided more than 1.67 million permanent loan modifications to homeowners outside of HAMP. (Data reported by servicers to the HOPE NOW Alliance.)

For borrowers who have had their mortgages modified under HAMP, the percentage unable to make their payments is extraordinarily low. According to a UPI press report, for permanent HAMP loan modifications the re-default rate for loans 90 or more days delinquent is less than 2 percent.[1]

Our members are very concerned that a mandatory LMP would undermine the HAMP program and other voluntary loan modification efforts. We are particularly concerned, as evidenced in testimony during an October 21, 2010, field hearing held by the Senate Judiciary Committee in Providence, Rhode Island, that LMPs in bankruptcy court could require home mortgage loan modifications (including reduction of principal balance, known as "cramdown"), even when the borrower/debtor would be ineligible for a modification under the Obama Administration's own criteria. Moreover, witnesses at the Senate hearing who supported LMPs conceded that they could provide no conclusive statistical evidence regarding the success of such programs, and also noted that many LMPs did not result in loan modifications but were resolved in other ways such

[1] [See "Success of HAMP Loan Modifications Stuns Experts," July 21, 2010, Steve Cook for Real Estate Economy Watch.

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as through short sales or by surrender in satisfaction of the loan. At this time, there is no comprehensive data or studies on the effectiveness of mandatory mediation programs.

In addition, we believe that LMPs are not true mediation as that term is generally understood. Under the LMP programs in existence now in New York and Rhode Island, judges may impose sanctions if servicers do not agree to loan modifications if the borrower and the judge subjectively believe that the servicer has not acted in "good faith." This subjective standard imposes a de facto punishment for declining to modify a delinquent loan, even if the modification would be expressly prohibited by Fannie Mae and Freddie Mac guidelines. This is not an equitable process. It also raises the problem of inequitable treatment of homeowners in similar circumstances if these programs allow subjective standards and individual modifications directed by the mediator or judge.

Bankruptcy courts should not become a venue in which such borrowers "shop around" for a forced loan modification or a mortgage cramdown. This would undermine HAMP and similar private programs as borrowers skip the HAMP process, or just go through the motions, because they plan to seek a more generous modification in an LMP, thereby creating a powerful new incentive to file for bankruptcy. Incenting new categories of bankruptcy filing, and placing additional obstacles and delays in the path of the foreclosure process – just as the economy is emerging from a deep and severe recession – will impose additional economic costs that will slow recovery. Without adequate controls, mandatory LMP programs may also be subject to substantial abuse. For example, a claim holder could be ordered to participate in a LMP involuntarily in cases where the debtor has occupied or even rented out the property for months or years without making payment, where all delaying tactics under state and local law have been exhausted, and where the claim holder has knowledge and belief that the debtor is unable or unwilling to make reasonable future payments, much less cure past arrearages. Also, while the claim holder would be unable to lift the automatic stay or rely on other protections in the Code during the pendency of the LMP, the debtor would remain free to bring or continue litigation against it in other judicial forums.

Congress should also consider the additional burden on the bankruptcy court system if hundreds of thousands of additional cases are filed annually by borrowers who are ineligible for a HAMP modification or otherwise unable to maintain acceptable payments on their mortgages. There would be a tremendous incentive for debtors to file in bankruptcy, as for legal fees totaling less than the cost of a single mortgage payment the foreclosure process could be halted by the automatic stay and the claim holder could be subjected to judicial pressure to agree to a loan modification. This will place a major new burden on bankruptcy courts that are already struggling to keep up with very high caseloads, particularly because each LMP negotiation will require a considerable expenditure of judicial oversight.

Although mandatory mediation programs do not legally require creditors to surrender bargained for contractual rights, the reality in bankruptcy court proceedings can be quite different. Creditors may well be pressured to agree to concessions to satisfy local bankruptcy courts if a borrower/debtor subjectively believes a creditor has not negotiated in "good faith" even when such concessions are not in the best interests of creditors and could not be obtained in a neutral legal proceeding. In fact, in its written statement in support of LMPs at the prior Senate hearing

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referenced earlier, the National Consumer Law Center (NCLC) specifically lauded this informal pressure as a reason for putting LMPs in place. In other legal filings, NCLC has indicated its belief that court-ordered LMPs override the Chapter 13 prohibition against cramdown of loans secured solely by a principal residence, and we would expect many bankruptcy judges to adopt that position if legislation authorizing LMPs is enacted. In short, the legislation would amount to back door repeal of that prohibition – even though, in the 111th Congress, a majority of the Senate voted against a floor amendment that would have directly eliminated that Code provision.

While LMP authority is presented as a simple way to "save homes," legislation of this type raises a broad range of issues of great concern to lenders and servicers. These include reasonable time limits for the LMP, termination for cause, holding of status conferences, ability of the debtor to continue with legal actions against the claim holder outside of bankruptcy, and a uniform standard for "good faith" negotiations. While we do not support enactment of LMP legislation, failure to address these and other issues will leave them to the varying discretion of local rules and individual judges and force national and regional lenders and servicers to deal with a patchwork quilt of LMP rules and standards.

The LMP concept could potentially create a one-sided program for forcing creditors to surrender their contractual and statutory rights. However, a bankruptcy court is a court of equity in which a debtor is seeking extraordinary, equitable relief. It is therefore highly inappropriate and inconsistent with time-honored principles of equity for the federal judiciary or Congress to approve a dispute resolution process that allows debtors to unfairly pressure creditors. A court of equity should not condone the use of inequitable methods by a party seeking equitable relief. Aside from the legal deficiencies associated with LMPs, we believe that a general bankruptcy requirement that lenders be required to "meet and confer" with borrowers who have defaulted on any loan, including a home mortgage loan subject to foreclosure proceedings in state court, will only add cost and delay to a legal process that is already too expensive and inefficient. This extra layer level of cost could easily harm the fragile American economy. Such delay would be tantamount to a judicially enforced foreclosure moratorium of unspecified duration.

An important component to a sustained economic recovery rests on a rebound in the housing market. Many thoughtful commentators contend that delaying foreclosures could exacerbate weakness in the housing market and therefore delay a more general economic recovery. For instance, Third Way, a centrist Democratic think tank, recently issued a report opposing efforts to create a foreclosure moratorium on the grounds that delaying foreclosures will push housing prices lower and slow an economic recovery. Third Way argues persuasively that a general policy slowing all foreclosures would "only prolong" our economic crisis.[2] The LMPs adopted by various bankruptcy courts are in reality a thinly disguised foreclosure moratorium and as such suffer from the defects identified by Third Way.

LMPs adopted by local court rules, or even on the whim of individual judges, could also impose a maze of conflicting procedures and varying standards on a national housing finance market. Congress and the federal judiciary should be wary of enacting new regulatory hurdles that

[2] See "The Case Against a Foreclosure Moratorium," http://thirdway.org/publications/342.

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merely delay a much-needed correction in the economy while introducing further turmoil and uncertainty into the housing marketplace.

We believe that a truly voluntary mediation program could have a productive role in loss mitigation efforts. Rather than imposing a mandatory LMP, efforts should be made to study, identify, and then put in place mediation procedures that are effective, consistent, and fair for all parties involved.

In conclusion, mandatory LMPs could threaten the economic recovery, force mortgage cramdowns, constitute an open-ended judicial foreclosure moratorium, appear to be inconsistent with multiple Code provisions, and fly in the face of time honored principles of equity in proceedings before the bankruptcy courts. It would be unwise to create an alternative process to HAMP that undermines the Obama Administration's effort to promote loan modifications for at-risk homeowners, many of whom have no wish to file in bankruptcy. We therefore urge the Committee not to move forward on legislation requiring mandatory LMPs in the bankruptcy courts.

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WRITTEN STATEMENT

ON BEHALF OF

THE ASSOCIATION OF MORTGAGE INVESTORS (AMI)

BEFORE THE

SENATE COMMITTEE ON THE JUDICIARY

FORECLOSURE MEDIATION PROGRAMS: CAN BANKRUPTCY COURTS LIMIT HOMEOWNER AND INVESTOR LOSSES?

FEBRUARY 2011

Introduction

Chairman Leahy, Ranking Member Grassley, Senator Whitehouse, and members of the Committee, thank you for permitting the Association of Mortgage Investors (AMI) to submit the following written statement for the committee hearing record.

AMI – Who We Are, Whom We Represent

The Association of Mortgage Investors (AMI) commends you and the other Committee members for your leadership in pursuing responsible and effective oversight, your vigilance in helping to keep Americans in their homes, and your tenacity in the development of effective tools against the foreclosure crisis. AMI is the primary trade association representing investors in mortgage-backed securities, including university endowments and pension funds. It has been developing a set of policy priorities that we believe can contribute to achieving this goal. We play a primary role in the analysis, development, and implementation of mortgage and housing policy to help keep homeowners in their homes and provide a sound framework that promotes continued home purchasing.

The Association of Mortgage Investors (AMI) is a public policy association that seeks long term, effective, and sustainable solutions to the Nation's mortgage and housing foreclosure crisis. It represents private investors, public and private pension funds, universities, and endowments, all of whom support the efforts of Congress, the Administration, and the state regulators to help responsible homeowners avoid foreclosure. A substantial majority of the funds invested into residential mortgage-backed securities ("RMBS") by AMI members comprise tax-payer dollars invested on behalf of state pension funds and retirement systems throughout the country.

Today's mortgage market consists of approximately $11 trillion in outstanding mortgages. Of that $11 trillion, $5.4 trillion are held on the books of the GSEs as agency mortgage-backed securities (issued by one of the agencies) or in whole loan form. Another $3.6 trillion are on the bank balance sheets as whole loans or securities in their portfolios, of which $1.1 trillion are second liens (home equity loans/lines of credit or closed end second mortgages). The remaining $1.5 trillion in first lien mortgages reside in private label mortgage-backed securities. AMI's members have an estimated $300 billion of these RMBS assets under management. Loss mitigation is a shared goal of AMI's members and our investor public and state institutions.

I. The Business Case for Enhanced Loss Mitigation

The AMI supports the underlying goals of the "Limiting Investor and Homeowner Loss in Foreclosure Act of 2011,"S. 222, and seeks to work with the committee to refine this proposal. Procedures for loss mitigation are vital for the health and soundness of the mortgage investors, and the state pension funds, retirement systems, and endowments whose funds we invest. We believe that a carefully, narrowly-tailored clarification of current federal bankruptcy law can be an important element for both investors seeking loss mitigation and responsible, distressed, borrowers trying to stay in their homes. Recently the AMI has supported tools such as arbitration in bankruptcy-related Alternative Dispute Resolution (ADR). *(See the attached, AMI White Paper: the Future of the Housing Market for Consumers after the Crisis: Remedies to Restore and Stabilize America's Mortgage and Housing Markets.)* We explain the reasons supporting bankruptcy-related ADR as a loss mitigation tool in more detail below.

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AMI shares your frustration with the slow pace of efforts to provide homeowners and the entire housing market with meaningful and permanent relief. We are hopeful that substantial solutions can be implemented more quickly. We believe that our interests are aligned with homeowners. The AMI supports initiatives designed to assist responsible homeowners avoid foreclosure and stay in their homes. AMI strongly believes that a mortgage modification can often be a preferable loss mitigation tool. Hence, this modification can keep families in their homes, preserve communities, avoid the blight of vacant homes, and sustain the region's tax base. The goal should be helping homeowners get out of bad mortgages and into sound mortgages; this will allow them to stay in their homes and build equity at the same time.

We respect the concerns voiced by some about the unintended consequences of bankruptcy mediation programs. The bankruptcy system has two purposes. The first purpose appears controversial; some critics describe it as "charity" toward debtors. This is the perception despite the cold, hard reality of a consumer standing in federal courtroom and resulting in a proverbial "scarlet letter." One of the best ways to deal with moral hazard is to ensure that the homeowner qualifies for the new mortgage and has an opportunity to stay current on the new mortgage. If policy-makers believe that "moral hazard" is still an issue, mortgage investors would be happy to represent the business community as a part of any such dialogue. The bankruptcy system's second purpose has a sound business rationale, namely it allows for a rational, comprehensive, and orderly reorganization of one's assets, liabilities, and cash flow, while respecting the legal priorities of liens. This process is advantageous for consumers, the business community, and investors, ultimately taxpayers alike. We are unaware of any other such beneficial process. Hence it permits homeowners to work out their debts, lower their debt burden, and most importantly – *it frees up cash flow to pay servicing the mortgage.* Because the solid business case outweighs the charitable rational so soundly, we should all welcome the bankruptcy process to permit freeing cash flows to pay mortgage servicing.

By engaging in any refinancing, the homeowner should be required to qualify for the new mortgage. This must include income verification and dealing with excessive debt issues. AMI believes that the balance of interests represented by bankruptcy-related mediation can favor all stake-holders such as homeowners, the tax-payer, mortgage investors, and the banking industry when certain safeguards are respected. Another suggested refinement is that in exchange for debt relief via a modified mortgage payment, the borrower must agree to sign the applicable legal documentation in each state that would allow the servicer to take title to the property (deed-in-lieu or quiet title) without a multi-year foreclosure process. If the borrower fails to make payments under the bankruptcy plan for the 1st mortgage for 90 days, the lender/servicer could ask the court to execute these documents and evict the borrower.

II. The Role of Mortgage Investors in the Marketplace

It is important to note that mortgage finance has been instrumental in reducing housing costs and helping citizens achieve the American dream of homeownership. In the 1970s, the mortgage finance industry was in its infancy. Mortgage investors are aligned with both homeowners and the government in our shared goals of keeping Americans in their homes and rebuilding and maintaining a vibrant real estate market. In fact, the maintenance of a healthy securitization market is a vital source of access to private capital for mortgages as well industries such as autos and credit cards. Moreover, an efficient securitization market provides increased and cheaper capital to originators, which allows them to issue more loans. The use of mortgage-backed securities equitably distributes risk in the mortgage finance industry, and prevents a build-up in a specific geographic region or a specific type of underlying asset. These features, and many others, are those of a market which makes access to capital cheaper and thus spurs additional mortgage lending.

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Those "private label" (non-Federal agency) securities are put together by investment banks that pool the mortgages into a trust. That trust is built around a document called a Pooling and Servicing Agreement (PSA). The PSA provides investors the rights and protections relating to the mortgages that make up the securitization and the terms and duties that are owed to the investors by the trustee of the security and the servicer of the individual mortgages. Within this Agreement, there are numerous representations and warranties regarding the quality of the mortgages that are included in the trust and the lending practices that were followed in the mortgage origination process. It is important to note that, historically, investment in these mortgage products has been attractive, in part, because they are governed by binding contracts that lend to the stability and predictability that investors desire. Like any purchaser, investors expected the sellers of mortgage securities (which were often large banks) to stand behind their promises. Unfortunately, this critical component of the mortgage securities market has broken down.

With a restored, vital and healthy securities market, we will be able to attract more private capital into mortgage investments and, in turn, provide more affordable mortgages for potential home buyers.

III. Investors' Solutions to Foreclosure Crisis

The AMI believes that any successful solution to the housing crisis must address two key components: affordability and negative equity. Negative equity, and near negative equity, mortgages account for nearly 28 percent of all residential properties nationwide. There are approximately 15 million borrowers who owe more than their homes are worth. About a third of those mortgages are already in default and potentially in need of assistance. The highest concentrations of these negative equity mortgages are in Nevada, Arizona, Florida, and Michigan. Negative equity is not going away soon; the numbers suggest the contrary. Last year alone, the percentage of "underwater" loans was approximately 24% (11.2 million).

The nation's foreclosure crisis must be solved by addressing both the problems of *"ability to pay"* and *"willingness to pay"*. The interests of homeowners and mortgage investors are completely aligned. Homeowners who cannot afford their mortgage and who owe more than the home is worth run a serious risk of losing the home through foreclosure. In order to provide relief to both homeowners facing possible foreclosure and the entire housing market, a program must be introduced that reduces principal to provide affordability and equity to homeowners that are underwater and in financial distress. *The advantage of the bankruptcy process is that it increases the borrower's ability to pay and maintain cash flows to the bank servicer.* Hence, it permits responsible homeowners to stay in the homes, pay taxes to communities, and avoid the blight of empty homes in communities.

To be successful, a loan modification or principal reduction program must be designed to ensure that the risk of default is minimized. The only way to effectively accomplish this is to reduce the homeowner's overall debt to ensure that their "debt-to-income" ratio is sustainable. This involves reducing mortgage balances on all liens on the property, first mortgage, and other subordinate liens.

A. Narrowly-Tailored, Voluntary Bankruptcy Procedures as a Loss Mitigation Tool

The role of federal bankruptcy is to assist distressed responsible homeowners, families, and farmers re-organize their debts in an orderly fashion in accordance with rule of law and rooted in the U.S Constitution (Art. I, sec. 8, cl. 4). In the current housing and foreclosure crisis, a strong business case exists to utilize voluntary, bankruptcy mediation as an investor loss mitigation tool. This flows from the fact that the mortgage crisis reflects a wide-spread consumer debt crisis. This burden of overwhelming total debt mean that any mortgage modification alone may result in the consumer re-defaulting after a brief period of years, unless their entire consumer debt profile is properly addressed at the time of modification.

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The fundamental challenge before the Home Affordable Modification Program (HAMP) and other federal foreclosure mitigation programs is contending with the current consumer debt crisis. We wish to highlight the concerns expressed by many that the current foreclosure environment is amplified by underlying consumer debt problems experienced by many distressed homeowners across the country. This suggests that the proposed default model is deficient as it fails to reexamine the appropriate weight of factors directly linked to consumer debt (*i.e.*, back-end DTI, FICO, etc). Furthermore, the use of the front-end Debt-to-Income ratio ("DTI") can be useless outside of the given context. For example, consider the case of two families, with the identical mortgage and debt, but who each have different household sizes (*e.g.*, a varying number of children or elderly dependents). In this context, the households have the identical DTIs, however the respective whole family budgets will have a significant impact on the probability of default.[1]

AMI believes that permitting distressed homeowners a prompt resolution of their claims is in their own best interest, as well as all stake-holders and taxpayers. A key issue is the prompt resolution of a distressed borrower's status. He or she may discover their financial situation will rapidly deteriorate without a loan modification. Servicers often assess fines and late fees on delinquent borrowers. It has been noted that the longer the borrower's delinquency goes uncured, the farther behind he or she gets, and the harder it becomes to bring the loan current, in part, because of those fees. Some estimate that a foreclosure can cost $30 - $40 a day, or as much as $15,000 a year. Today the average foreclosure takes in excess of 450 days. Experts realize that this provides sufficient time to explore alternatives to foreclosure. Accordingly the bank servicers suspend foreclosures when a loan workout, short sale, or other option becomes viable. Hence any investor loss mitigation tool can only be effective if it considers key factors bearing on the default scenario, namely, back-end DTI, total consumer debt, and factors such as a family's whole budget.

The ability of a responsible borrower to pay a subsequently modified mortgage is critical for the success of any relief program. AMI is concerned with the Administration's current relief efforts around using reliable criteria for applicants who are likely to succeed in the program. One key criterion is the DTI calculations used in assessing a borrower's modification program application. Several critics contend that the DTI calculations do not adequately factor in the borrower's non-mortgage debts to the payment calculation (*e.g.*, auto loans, credit cards, etc.). This approach lacks the view needed to ensure that a borrower has an actual *ability to pay* a modified mortgage, and again is likely to lead to a re-default in the near future.

B. Bank Servicers and the Second Liens Issue

Another major impediment to the viability of any remedial foreclosure prevention program is the volume of second mortgages or other outstanding liens, and the uncertainty as to how those subordinate liens will be handled under the program. Traditionally, there is no such uncertainty because first lien mortgage holders had a clear understanding of the priority of second liens. The second lien problem exists because many banks, and their affiliated servicers, offered additional forms of financing to consumers, such as

[1] AMI has explained this in more detail in comments to the U.S. Department of Treasury: "The [default] model as we understand it utilizes 31% front-end DTI as a factor in determining the re-default rate. This ignores a significant risk factor that leads to a high rate of default for borrowers, which is the overwhelming burden of consumer debt. Ignoring the back-end DTI ratio will artificially lower the re-default rate produced by the model." *See* http://www.the-ami.org.

home equity loans and other second mortgages. As indicated earlier, the vast majority remain on the balance sheets of our nation's largest financial institutions and these second mortgages are a major financial burden for homeowners.

In fact, the largest four U.S. banks that service approximately 40 percent of mortgages held roughly $419 billion of second liens on their balance sheets as of December 31, 2009. Under temporary loan modification programs such as Making Home Affordable, banks are able to defer the recognition of losses on the second lien portfolios. In fact, the current HAMP program actually improves the cash flow available to the second mortgage at the expense of the first mortgage and defers the immediate loss that would be recognized in a foreclosure, short sale, or short refinance. Although the largest institutions have now signed up for the 2MP second lien modification program under HAMP, that program has yet to be implemented.

In these negative equity scenarios, the second lien would receive no proceeds in a foreclosure action. On the other hand, the modification program allows this uncollateralized obligation to remain outstanding and on the books of the financial institution as a performing asset, even though the homeowner has no equity in their home. Our analysis of 44.1 million first lien loans from a primary credit bureau database indicated that, of all second lien mortgages, only 3 percent are current with a corresponding first lien mortgage that is delinquent.

IV. Conclusion

The hallmark of any successful federal foreclosure mitigation program will be the number of Americans who ultimately stay in their homes. Many critics have expressed their disappointment that many of the current federal remedial programs have not proven as useful of a tool as intended. The ongoing foreclosure crisis reflects many factors, including an underlying consumer credit crisis. This is exemplified by the all-too high DTI ratios and the high re-default rates by homeowners who have undergone a trial modification. The underlying goals of a narrowly-tailored bankruptcy ADR program will address the fundamental aspects of the crisis in a voluntary, rational, pro-business, non-coercive, and Constitutional manner. We look forward to working with the Committee, other Administration agencies, the Judiciary, and all stakeholders on supporting and further refining legislation such as S. 222. Accordingly, we may finally have the effective, long-term, sustainable loss mitigation programs that mortgage investors and we all seek.

Thank you for the opportunity to share the views of the Association of Mortgage Investors (AMI) with the Committee. Please do not hesitate to use the AMI as a resource in your continued oversight concerning the many issues under review. Our main point of contact is Chris J. Katopis, Executive Director, at 202-327-8100 or by email at katopis@the-ami.org. We welcome any questions that you might have.

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Appendix

White Paper

The Future of the Housing Market for Consumers after the Crisis:
Remedies to Restore and Stabilize America's Mortgage and Housing Markets
January 2011

Summary: Investors in non-agency mortgage-backed securities are important stakeholders in the negotiations between mortgage servicers and the multi-state attorney general task force. Mortgage investors typically invest on behalf of state pension funds, retirement systems, university and charitable endowments. Overall, more than 90 percent of the money invested in mortgage-backed securities represents public money. These investors have suffered material losses as a result of faulty and inefficient and at times improper servicing of the mortgage loans, for example, the improper analysis of a borrower's finances and holistic debt. Instead of helping homeowners, servicers' interactions with borrowers often make the process more confusing. This delays resolutions and can worsen the homeowners' position. The current servicing model further harms borrowers by dumping excessive fees (ultimately recouped by servicers) on them during the modification process. More broadly, the abuses and conflicts within today's broken servicing model are creating longer term housing and mortgage problems that impact large parts of the U.S. population. Mortgage investors, who have long advocated improvements in the servicing business model, welcome and look forward to the review and the involvement of the Attorneys General. The Attorneys General have a unique opportunity to set market standards that benefit distressed homeowners and consumers without damaging investors or imperiling the future of housing and mortgage finance.

Investors have historically testified that the issues underlying the current housing and foreclosure problem result from a combination of bank-servicer abuses and a national consumer debt crisis. The Attorneys General are poised to develop a national solution that helps distressed consumers and prevents a repeated wave of foreclosures over the next two years.

Investors support effective, long-term, and sustainable solutions to the foreclosure crisis. We break the solution down into two components: *"Better Execution"* and *"Sustainable Solutions."*

1.) ***Better Execution***: Resolving this crisis requires intermediaries to interact with consumers and distressed borrowers in a fair and productive manner. This will require a paradigm shift within the current mortgage servicing industry.

- *Improve Servicing.* Collections operations should be staffed at consistent levels across the industry in the 120+ day delinquency bucket at not more than 100-150 accounts per employee. These accounts should be assigned to a single point of contact until they become current or need to move to a more aggressive loan resolution. We also recommend the use of special servicers which offer the enhanced counseling and operational capacity to help consumers find a "right-sized" modification. This also gets around the numerous existing servicer conflicts of interest, including second lien and

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other consumer debt ownership, fees and representation and warranty issues. The unwillingness of the owners of these other consumer debts to participate in the modification/restructuring process is still a central issue.

An independent party needs to resolve all of the consumer debt issues. Mortgage investors are willing to participate, but the other debt holders (*e.g.*, credit card and auto loans) have not been. This is discussed further in the Sustainable Solutions section below.

- *Transparency.* Loss mitigation and the process of foreclosure should be transparent and open to the homeowner. This process will require an increased effort on the part of the mortgage servicing staff to educate the homeowner. The servicers' first duty should be explaining the legal process of foreclosure and the alternatives available for homeowners. Improved and effective consumer debt strategies must continue to be refined. The current practices of face-to-face interviews and field collection calls may be appropriate options and should be increased and enhanced, as well as, developing improved web-based video materials explaining the process.

  The underlying mortgage and foreclosure data must be disclosed in a public and transparent manner, including servicing fees, foreclosure expenses, and the actual asset loss breakdown. The borrower and investor need to understand the full menu of additional costs that might be incurred due to a foreclosure. The costs due to servicer error are not to be reimbursed from the RMBS trust; such costs should be borne by the servicer, not the trust. Finally, vulnerable borrowers must be protected from paying egregious fees after falling behind on their mortgage payments.

- Investors do not have access (or servicers are blocking access) to the most basic information about the mortgages, such as the loan files. To ensure that the housing and mortgage system works for the years to come, transparency in the process is critical. The Task Force should look to provide reasonable access to these loan files, which are held for the benefit of investors as beneficiaries of the underlying trusts.

2.) ***Sustainable Solutions:*** Homeowners need lasting solutions that put them on a clear path to affording their debts. Anything less than this just prolongs their distress and the ultimate recovery of the U.S. housing market. In most situations, this requires a thorough review of all of the consumer's debts.

- *Investors Support Sustainable Modifications.* Modified consumer mortgage solutions should include:

  - (1) an option for the homeowner to re-establish a payment under a 31% front-end debt-to-income ratio (DTI) (as determined by full documentation of current income, assets, and/or verification of hardship);
  - (2) a refinance at 97.75% LTV into the FHA Short Refinance program;
  - (3) reduction of all junior liens at a minimum of a proportional write-down; and,

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- ***Most importantly***, all consumer debt should be restructured as part of the modification. This includes second liens, home equity loans, and credit card and auto debt. A sustainable mortgage will have combined loan-to-value (CLTV) no greater than 115% and a back-end DTI of no greater than 50%. Without a proper solution for high back-end DTI (consumer debt), it is inevitable that borrowers will re-default even after a modification and the housing crisis will continue.

- ***Bankruptcy/Binding Arbitration.*** Although mortgage investors are willing to participate in the restructuring, the other debt holders, including subordinate and unsecured debts, need to participate as well. This is a basic element of fixing a credit problem, whereby all debts are taken into account, not just the most senior secured debt. To date, the other debt holders have not participated. This is evident in the high modification re-default rates and continued broader consumer distress in the economy and housing sector.

- A mechanism to ensure the other debt holders participate in the solution is critical to a successful outcome. Some potential mechanisms include bankruptcy (whereby mortgage investors agree to a "voluntary cramdown" – which will not require any congressional legislation) or binding arbitration (whereby banks and servicers agree to participate as part of settlement of past bad acts).

- Where a sustainable modification does not work, the servicer and/or counselor should work with the borrower to efficiently avoid foreclosure, including completing a short sale or deed in lieu. If the second lien is underwater, there needs to be a mechanism to bypass their approval for these foreclosure avoidance measures.

Thank you for your consideration of these recommendations, for additional information about these and other remedies, please contact the Association of Mortgage Investors at 202-327-8100 or info@the-ami.org.

The Association of Mortgage Investors represents private investors, public and private pension funds, and endowments, all of whom support the efforts of Congress, the Administration, and state officials to help responsible, though distressed homeowners, avoid foreclosure. For more information, please visit www.the-ami.org.

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Testimony of Larry Britt
Hearing before the Senate Judiciary Committee
February 1, 2011

Thank you Senator Whitehouse and committee members for taking part in this important hearing.

My name is Larry Britt and I have owned my home in Riverside, Rhode Island since 2003. I bought the home as a permanent residence in which to spend my final working and future retirement years. My home purchase wasn't an attempt to get in on the crazy real estate boom of the times. I work in metro Providence as an adult educator teaching workplace readiness, English proficiency, and US Citizenship Preparation skills.

One month from now, I'll be entering my third year of the mortgage modification process.

When I started the process in March of 2009, I had never been late paying any bills to any creditors and my credit score was near perfect. Since entering into a modification process with BofA, the bank has ruined my credit rating and has been the major contributor of uncertainty about my future. As of November 2010, my credit score had dropped 160 points as a consequence of improper credit payment reporting by BofA. During the process I subscribed to a credit score monitoring service and I received weekly e-mail notifications of continuing negative impacts to my credit score. Also during that time, two creditors closed my accounts and three radically lowered my available credit limits. Equally, I'm concerned about rescinded and denied credit that my elderly mother and other family members have suffered as a consequence of their financial relationships with me.

BofA told me that I was told my credit score would be adversely impacted but could not provide documentation that proves I was told of this consequence when I started the modification process. I received documentation from the bank that contradicts my assertion *after* I contacted Senator Whitehouse as well as the Office of the Comptroller of Currency.

Because of legitimate financial hardships that I have documented, I entered into BofA's Mortgage Modification program hoping I could avoid prospective financial problems. In the past 24 months I have immediately replied to all BofA inquires and requests for documentation. If we have the time, I could read through a chronology of my interactions with Bank of America from March 2009 to May 2010. In short, the chronology lays out a repeated cycle of applications, providing documentation, approvals, denials, mixed messages, and multiple departments and customer service representatives that left me unsure about my modification status.

- In March 2009 – As advised by news reports, I went to Rhode Island Housing and submitted an application for mortgage modification. This allowed RI Housing to act as my agent for mortgage modification with BofA. At this time I was not behind on my mortgage or other debt obligations. I entered the program knowing that it would be difficult for me to continue making payments at this level. I thought I was doing the responsible thing to avoid problems down the road.

- Next in March 2009 – As required, I met with Money Management International, an approved credit-counseling agency. This organization determined that I was managing all of my finances correctly and that my only issue was my large monthly mortgage payment and under water mortgage.

- In late March 2009 – I provided copies of all required documents to RI Housing for forwarding to BofA.

- From March 2009 to October 2009 - I called RI Housing biweekly to check the status of my modification. Each time I called, I was told that there was a backlog and I should wait to hear something.

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- On October 5, 2009 – I was informed by RI Housing that BofA did not accept me into the loan modification program because I was not late or behind on my mortgage payments. RI Housing informed me to visit a BofA branch so that I could apply for a refinance of my mortgage.

- On October 8, 2009 – I went to a BofA branch and as advised, formally applied to refinance my loan. The refinance was denied that day. As I found out, the refinance step was a formality I needed to go through before I could apply for a mortgage modification with BofA a second time.

- On October 20, 2009 – I received notice that I had been accepted into BofA's Trial Modification program and I was a given a new monthly payment amount for a 3 month trial period.

- On October 24, 2009 – I mailed all requested documentation to BofA.

- From November 2009 to May 2010 – I paid BofA my new monthly payment on or before the due date.

- From October 24, 2009 to February 22, 2010 – I checked the status of my modification on a weekly basis to be sure the company had received my documentation. I was repeatedly assured that BofA had received all information that had been requested of me.

- February 23, 2010 – I received a letter from BofA requesting that I mail them all of the same documentation that I had already provided twice before.

- February 23, 2010 – I sent via FedEx and FAXED every requested piece of documentation that BofA wanted.

- From February 24, 2010 to May 7, 2010 – I called BofA weekly to check the status of my modification and to be sure that the bank had all of my required documentation. Each time I was assured that all requested documents had been received by BofA and that the modification was "being reviewed".

- On April 14, 2010 – I received a "Notification of Default and Mortgagees Right of Foreclosure" from BofA.

- On April 15, 2010 – I called BofA and the Customer Service Representative told me to ignore the letter, continue my modified payments and that I will continue to receive notices like this during the Modification Review process.

- On May 7, 2010 – I received a letter from BofA stating that I had been denied a mortgage modification because all requested documentation had not been received by the bank.

- On May 8, 2010 – I called BofA and was told to disregard the letter dated May 7. The Customer Service Representative stated that according to BofA records "all documentation was complete and received as of March 29, 2010".

At that time, I became truly frightened at the prospect of losing my home. I had mailings from BofA stating that I was about to go into foreclosure and that I was not eligible for mortgage modification. Two BofA Customer Service Representatives had told me to ignore the letters, yet I had nothing in writing from them that assured my case was still under review.

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That's when I contacted the Senator Whitehouse's office and gratefully got an immediate response from Karen Bradbury, a case worker in the Senator's Providence office.

Karen's efforts resulted in a connection for me with the Department of Treasury's HAMP Solution Center. At first, my HAMP case worker sounded like the answer to my ongoing problem. The HAMP representative told me that he would be an advocate for me with BofA. At that time, the HAMP representative told me that he had learned from BofA that I was "under review for the Making Home Affordable Second Look" program. Throughout July and August 2010, I contacted the HAMP Solution Center 7 times. Each time, the HAMP Solutions representative told me that his updates directly from BofA said that my modification was still under review and that I had complied with all requests for documentation as well as honored my agreement to make on-time modified monthly payments.

Honestly, after a few months with HAMP, I felt like they were reading from the same script as the banks. When I checked in with them, there was never any update and there were never any outstanding bank requests for documentation from me. Yet, once a month or so over this same period, I received additional requests from the bank for repeat documentation.

I continued to make on-time mortgage modification payments, and the bank continued to report me as delinquent on payments. Consequently, my credit score and available credit continued to go down.

Last September, I started to work on filing forms with all 3 credit reporting agencies in an attempt to get my BofA modified payments re-classified as modified payments rather than delinquencies. The credit reporting forms strongly encouraged trying to get the creditor in question to correct the problem. So on 10/04/2010, I called BofA's Making Home Affordable Modification Program and the following occurred:

- I asked the BofA representative to review my account and confirm that I had made all of the modified payments that I agreed to.

- The customer service representative told me that my mortgage was in default as of May 7, 2010 and that I had been sent a letter saying I was not eligible for the Making Home Affordable Modification program because I did not provide BofA with requested documents. The representative also said that I had been sent a letter requesting the documentation. I never received this letter. I explained the following to the representative:

- When I received the notice announcing my ineligibility for the program on May 10, 2010, I called the customer service number on the denial letter immediately. The BofA representative, who would only give her first name, looked up my account and told me that I was still in "modification status" and that I "should disregard the letter of denial and continue making my previously agreed upon modified payments": This representative also told me that "all requested documents had been received by BofA as March 29, 2010".

- I recounted to the customer representative at BofA's Making Home Affordable Modification that indeed I had received the letter of ineligibility from BofA but was instructed by phone by another BofA customer representative on May, 10, 2010 to disregard the letter and continue with my modified payments.

- The Making Home Affordable representative told me he could be of no further help because I was in default.

- I asked to speak to the representative's supervisor. I was so upset, I didn't get her name, but I explained the entire situation again. She told me that she had my phone records and she saw no call from me on the day I was

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told to continue with my modified payments. My personal phone records would prove her wrong. Next, the supervisor told me that she didn't have time to waste on me and hung up on me.

- Again, panicked about the prospect of losing my home, I reconnected with Rhode Island Housing.

- On October 18, 2010, RI Housing determined from BofA that I was not eligible for any modifications. On the same day, I received mail notification from BofA stating, as I understood it, that late fees, penalties, and interest were accumulating on my mortgage balance and that regardless of my outcome with the modification program, I would be liable for these charges.
- On the following day, October 19, I received a Modification approval from BofA via FedEx.
- So, after working with BofA from March 2009 to October 2010 as well as the HAMP solutions center from June 2010 to October 2010, BofA told me within a 2-day period that I was both ineligible AND approved for a mortgage modification.

Since my first modification agreement with the bank in October 2009, I have been paying my modified monthly payment on time. However, since the bank considered my payments to be incomplete, this most recent modification agreement states that my modified principal balance has been increased by over $11,000. As the bank specified in a prior mailing, the modification agreement states this amount includes "unpaid and deferred interest, fees, escrow advances and other costs". The agreement also states that "interest will now accrue on the unpaid interest that is added to the outstanding principal balance, which would not happen without this agreement". Had the bank honored its terms of the October 2009 modification agreement with me and permanently modified my loan after I had made the agreed upon trial modification payments, my principal loan balance would include 3 months of deferred interest and fees rather than the 16 month total of $11,000.

As with past modification agreements, I've once again provided all of the same paperwork and once again made 3 on-time Trial Modification payments. Unlike past modifications agreements with BofA, I now have a Customer Advocate from the bank's Office of the CEO and President. She has a first and last name, and I can talk to her when needed. Sadly, I believe it took the advocacy of my Senator to receive the level of customer service that all consumers deserve.

I guess I should be happy and I am truly grateful to the Senator's office and RI housing for what I hope is a final resolution. However, given the past 24 months of misinformation, can I be sure that BofA's "approval" is for real? Does another BofA division have me slated for foreclosure? I just can't be sure and the 24 month process has forced me into deeper financial trouble and emotional distress.

I know this story may be hard to follow. It's taken me untold hours to keep track of and compile the scores of interactions I've had with the bank and HAMP Solutions Center.

If needed, I can document all of my activities, phone calls, documents sent, and the names of customer service representatives.

Thank you again for your time and consideration. I would be happy to answer any questions or elaborate on any points that I've made.

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Foreclosure Prevention: Is The Home Affordable Modification Program Preserving Homeownership?

by Mark A. Calabria

House Committee on Oversight and Government Reform

House Committee on Oversight and Government Reform

Added to *cato.org* on March 25, 2010

This testimony was delivered on March 25, 2010.

Chairman Towns, Ranking Member Issa, and distinguished members of the Committee, I thank you for the invitation to appear at today's important hearing. I am Mark Calabria, Director of Financial Regulation Studies at the Cato Institute, a nonprofit, non-partisan public policy research institute located here in Washington. Before I begin my testimony, I would like to make clear that my comments are solely my own and do not represent any official policy positions of the Cato Institute. In addition, outside of my interest as a citizen and a taxpayer, I have no direct financial interest in the subject matter before the subcommittee today, nor do I represent any entities that do.

My testimony today will address two specific questions. The first is: why have the Obama and Bush Administration efforts, along with those of the mortgage industry, to reduce foreclosures had so little impact on the overall foreclosure numbers? This critique applies to the Home Affordable Modification Program as well as previous efforts, such as HOPE NOW.

The second question is: given what we know about why previous efforts have had such little impact, what are our policy options?

In answering both these questions, I rely on an extensive body of academic literature, the vast majority of which has been subjected to peer review, which has examined the determinates of mortgage delinquency and default. Foremost among this literature is a series of recent papers written by economists at the Federal Reserve Banks of Boston and Atlanta, in particular the work of Paul Willen, Christopher Foote and Kristopher Gerardi. My testimony owes a considerable intellectual debt to this research.

Why haven't previous efforts stemmed the foreclosure tide?

The short answer to why previous federal efforts to stem the current tide of foreclosures have largely failed is that such efforts have grossly misdiagnosed the causes of mortgage defaults. An implicit assumption behind former Treasury Secretary Paulson's HOPE NOW, FDIC Chair Sheila Bair's IndyMac model, and the Obama Administration's current foreclosure efforts is that the current wave of foreclosures is almost exclusively the result of predatory lending practices and "exploding" adjustable rate mortgages, where large payment shocks upon the rate re-set cause mortgage payment to become "unaffordable."

The simple truth is that the vast majority of mortgage defaults are being driven by the same factors that have always driven mortgage defaults: generally a negative equity position on the part of the homeowner coupled with a life event that results in a substantial shock to their income, most often a job loss or reduction in earnings. Until *both* of these components, negative equity and a negative income shock are addressed, foreclosures will remain at highly elevated levels.

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Given that I am challenging the dominant narrative of the mortgage crisis, it is reasonable to ask for more than mere assertions. First, if payment shock alone were the dominate driver of defaults then we would observe most defaults occurring around the time of reset, specifically just after the re-set. Yet this is not what has been observed. Analysis by several researchers has found that on loans with re-set features that have defaulted, the vast majority of defaults occurred long before the re-set. Of course some will argue that this is due to such loans being "unaffordable" from the time of origination. Yet according to statistical analysis done at the Boston Federal Reserve, the borrower's initial debt-to-income (DTI) had almost no predictive power in terms of forecasting subsequent default.

Additionally if payment shock was the driver of default, the fixed rate mortgages without any payment shocks would display default patterns significantly below that of adjustable rate mortgages. When one controls for owner equity and credit score, the differences in performance between these different mortgage products largely disappears. To further illustrate this point, consider that those mortgages generally considered among the "safest" - mortgages insured by the Federal Housing Administration (FHA), which are almost exclusively fixed rate with no-prepayment penalties and substantial borrower protections, perform, on an apples to apples basis, as badly as the subprime market in terms of delinquencies.

The important shared characteristic of FHA and most of the subprime market is the widespread presence of zero or very little equity in the mortgage at origination. The characteristics of zero or negative equity also explain the poor performance of most subprime adjustable rate mortgages. Many of these loans also had little or no equity upon origination, providing the borrower with little equity cushion when prices fell. Recognizing the critical role of negative equity of course raises the difficult question as to what exactly it is that homeowners are losing in the event of a foreclosure.

"Unnecessary" foreclosures

Central to the arguments calling for greater government invention in the mortgage market is that many, if not most, of the foreclosures being witnessed are "unnecessary" or avoidable. Generally it is argued that investors and loan servicers do not face the same incentives and that in many cases in would be better for the investor if the loan were modified, rather than taken to foreclosure, but still the servicer takes the loan to foreclosure.

The principal flaw in this argument is it ignores the costs to the lender of modifying loans that would have continued paying otherwise. Ex Ante, a lender has no way of separating the truly troubled borrowers, who would default, from those that would take advantage of the system, if they knew they could get a modification just by calling. As long as potentially defaulting borrowers remain a low percentage of all borrowers, as they are today, it is in the best interest of the investor to reject many modifications that might make sense ex post. In addition, lenders may institute various mechanisms to help distinguish troubled borrowers from those looking to game the system.

It is also claimed that the process of securization has driven a wedge between the interests of investors and servicers, with the implication that servicers would be happy to modify, and investors would prefer modifications, but that the pooling and servicing agreements preclude modifications or that servicers fear being sued by investors. The first fact that should question this assumption is the finding by Boston Fed researchers that there is little difference in modification rates between loans held in portfolio versus those held in securitized pools. There is also little evidence that pooling and servicing agreements preclude positive value modifications. According to recent Credit Suisse report, less than

10 percent of agreements disallowed any modifications. While the Congressional Oversight Panel for the TARP has been critical of industry efforts, even that Panel has found that among the sample of pools it examined with a 5-percent cap on the number of modifications, none of the pools examined had actually reached that cap. If few pools have reached the cap, it would seem obvious that the 5 percent cap is not a binding constraint on modifications. In many instances the pooling agreements also require the servicer to act as if the servicer held the whole loan in its portfolio, raising substantial doubts as the validity of the "tranche warfare" theory of modifications.

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A careful review of the evidence provides little support for the notion that high transaction costs or a misalignment of incentives is driving lenders to make foreclosures that are not in their economic interest. Since lenders have no way to separate troubled borrowers from those gaming the system, some positive level of negative value foreclosures will be profit-maximizing in the aggregate.

What could reduce the level of foreclosures?

The high level of foreclosures has left many policymakers and much of the public understandably frustrated and searching for answers. To be effective, those answers must be grounded in solid and unbiased analysis. In order to gauge the success of any federal efforts, we must also establish a reasonable baseline. I strongly encourage both Congress and the Administration to present detailed estimates of how many foreclosures are driven by which primary causes and how many of those foreclosures can be reasonably avoided.

Before discussing specific policy proposals, Congress should bear in mind that as approximately 50 percent of foreclosures are currently driven by job loss, the most significant way to reduce foreclosures is to foster an environment that is conducive to private sector job creation. Accordingly, the worst thing Congress can do is to insert uncertainty into the job market, pushing employers to the sides-lines.

In addition to focusing on owners currently in foreclosure, efforts can also be made to reach families before they fall behind on their obligation. For instance, approximately 4 million jobs have been lost in "mass lay-offs" since the beginning of the current recession. Mass lay-offs represent a double shock to households: the loss of a job along with a shock to the local housing market as the result of a major employer downsizing. As damaging as mass lay-offs can be, they do have one advantage - we know about them ahead of time, as the Department of Labor (DoL) collects data on mass lay-offs and workers must be given notice of such. Despite the strong connection between mass layoffs and foreclosures, there is almost no coordination between DoL and HUD (or the many non-profit organizations providing housing assistance). DoL and HUD should partner in an effort to provide currently appropriated housing counseling funds to workers when they receive a notice of mass lay-off.

Congress can also encourage bank regulators to give lenders more flexibility to lease out foreclosed homes to the current residents. Typically banks come under considerable pressure from their regulators not to engage in long term property leasing or management, as that activity is not considered a core function of banks. I believe we can avoid the larger debate of banks being property managers by giving banks greater flexibility in retaining properties with non-performing mortgages as rentals, preferably to current residents. In addition to many owners who may wish to stay in their homes as renters, approximately 20 percent of foreclosures occur on renter-occupied investment properties. If current renters can continue to make their rent, many banks may prefer to keep those renters rather than proceed to a foreclosure sale.

In order to separate out deserving borrowers, who are trying to get back on their feet, from those simply walking away from a bad investment, Federal lending entities, such as FHA and the GSEs, should engage in aggressive recourse against delinquent borrowers who have the ability to pay, but simply choose not too. All federal modification programs should also include strong recourse provisions. We should make every effort to turn away from becoming a society where legally incurred debts are no longer obligations to be honored but simply options to be exercised.

Lastly, Congress and the Administration should focus resources on those households most in need, who but for an intervention, would lose their home. Programs aimed at households who are not facing foreclosure, but simply cannot re-finance due to being "underwater" on their mortgage should be ended. These programs draw off limited lenders/servicer resources that should instead focus on at-need families.

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Conclusions

In concluding my testimony, I again wish to strongly state: the current foreclosure relief efforts have largely been unsuccessful because they have misidentified the underlying causes of mortgage default. It is not exploding ARMs or predatory lending that drives the current wave of foreclosures, but negative equity driven by house prices declines coupled with adverse income shocks that are the main driver of defaults on primary residences. Defaults on speculative properties continue to represent a large share of foreclosures. Accordingly, for any plan to be successful it must address both negative equity and reductions in earnings.

Given the relatively low number of actual permanent modifications under HAMP, it is likely that the program's overall impact has been negative. First, the program has delayed the needed adjustment in the housing market. HAMP also has likely provided an incentive for additional borrowers to withhold mortgage payments in order to receive modifications, pushing some of those borrowers into delinquency while also diverting limited resources to households not at risk of foreclosure.. I thank you for your attention and welcome your questions.

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WRITTEN TESTIMONY OF HON. ROBERT D. DRAIN
United States Bankruptcy Court for the Southern District of New York

"Foreclosure Mediation Programs: Can Bankruptcy Courts Limit Homeowner and Investor Losses?"

Hearing of the United States Senate Committee on the Judiciary
February 1, 2011

Senator Whitehouse, Senator Grassley, and other Members of the Committee, thank you for inviting me to testify on the Loss Mitigation Program implemented on January 1, 2009 by the United States Bankruptcy Court for the Southern District of New York.

I am one of 10 bankruptcy judges in our court and currently sit in White Plains, New York, just north of Manhattan. As my attached biography shows, I became a bankruptcy judge in 2002, having practiced bankruptcy law since 1984, including as a partner for over 10 years in a respected New York law firm. I dealt exclusively with large corporate bankruptcies and reorganizations, the types of cases for which the Bankruptcy Court for the Southern District of New York is well known: Johns-Manville, Maxwell/MacMillan, Enron, WorldCom, Adelphia Communications, Chrysler, GM, Lehman Brothers.

Like our colleagues around the country, we also preside, however, over thousands of consumer bankruptcy cases, where the fate of the home is of central importance, particularly in chapter 13 and individual chapter 11 cases, to which Congress in the 2005 amendments to the Bankruptcy Code rightly chose to steer individual debtors with regular income.

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When confronted in late 2008 with the mortgage foreclosure crisis (and, based not only on statistics but also my own experience presiding over individuals' bankruptcy cases, it was and remains a crisis) my colleagues and I saw a problem that cried out for a formal mediation structure. I believe that our experience in private practice representing large lenders and dealing with them in court led us to see the mortgage crisis and implement our approach to it as much from the lenders' perspective as from the homeowners'. In fact, it was creditors' lawyers -- representing mortgage lenders and servicers -- who first asked the court to consider a home mortgage mediation program.

The problem was, and is, basic. Increased defaults and the drop in home prices rendered the "autopilot" servicing model applied to the vast majority of home mortgage loans inadequate. In other words, a model premised on collecting payments in the ordinary course for all but a tiny percentage of mortgages, and foreclosing on the few defaulted ones in the context of a rising market, all too often simply did not work any more. In the present market, to maximize their recovery lenders actually would have to decide between adding to their stock of foreclosed homes or, alternatively, engaging in a workout with their borrower; either course could be preferable in the right circumstances.

And yet, this process simply was not happening with loan after loan after loan. Instead, loan servicers were leaving enormous amounts of money on the table -- you could see it; their lawyers could see it -- simply because they continued to press the foreclosure button rather than respond to their borrowers' calls to renegotiate defaulted loans. Moreover, whether because of fears about breaching the automatic stay, constraints in their governing documents or perceptions about the risk of liability to their beneficiaries if they negotiated with their borrowers, servicers wanted a court order

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setting a framework for such negotiations. Finally, the lenders wanted structure imposed on the negotiations to make sure that the homeowners would not simply waste the lenders' time.

Of course, these lender goals almost completely overlapped with the borrowers'. Nothing, I believe, not even the fact of being in default, has been more frustrating to homeowners than loan servicers' refusal or inability to address their defaulted loans directly, banker to borrower, on a businesslike basis. I believe people will testify to this at today's hearing. From my experience, such testimony does not describe merely isolated instances of lender deafness but a widespread and even, in our court at least until the Loss Mitigation Program became established, a pervasive problem.

To develop the mediation guidelines that eventually became the Loss Mitigation Program, we opened the discussion to consumer lawyers, eventually expanding the group of creditor and debtor lawyers with whom we consulted, and then put the proposal out for public comment. For any court considering such a program, I strongly recommend this approach, as it recognizes local concerns and context. We reached out to the creditor and consumer bar again after the program had been operating for about a year and a half, and, although we have modified it somewhat in the light of their comments, remarkable consensus continues in its support.

The Loss Mitigation Program, as embodied in two General Orders of the court, as well as model forms of commonly used documents, may be found on the court's public website at www.nysb.uscourts.gov under the "Forms" tab.

In summary, it applies in cases under chapters 7, 11, 12, and 13 of the Bankruptcy Code to loans secured by an individual debtor's primary residence. It may be invoked,

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on notice and with an opportunity to object, by either the homeowner or the lender. If there is no objection, the court enters an order establishing deadlines for the exchange of contact information for representatives with authority to negotiate; requests for and exchange of relevant information, such as the debtor's income and expenses, tax returns and appraisals of the house; the filing of affidavits listing the information that has been exchanged (this we found necessary to obviate disputes over whether information was provided, since a frequent homeowner complaint is that the lenders often ask for the same information after it has already been sent); a conference between the parties; a conference, if necessary, with the court; and an outside date to conclude the mediation. While the parties are negotiating, all litigation between them is put on hold, although either party can request that negotiations be terminated and litigation resume.

Lender objections to the invocation of Loss Mitigation (and requests to terminate negotiations) are granted if, taking into account the homeowner's financial circumstances and the value of the house, it is not reasonable to expect the parties, negotiating in their own self-interest, to reach an agreement. As best we can tell (we are trying to improve our statistics), there have been over 2,000 requests for Loss Mitigation, only 90 of which drew an objection. We have entered 75 orders granting such objections. As lenders became more familiar with the program and it became clear that we would not tolerate its invocation as a delaying tactic, objections to Loss Mitigation have almost ceased.

The program facilitates consideration of a homeowner's eligibility for the government-sponsored HAMP program, but it is not limited to HAMP modifications. Indeed, although the program most often results in some form of loan modification, it is expressly not limited to that outcome. The parties may consider, for example, negotiating

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a "graceful exit" in which the homeowner has a specified time to leave the house (perhaps coinciding with the end of the school year), parameters for a short sale, or a deed in lieu of foreclosure (which may benefit homeowners by cutting off their responsibility for taxes and upkeep while reducing the lender's wait to obtain the property, foreclosure in New York being a long process).

The Loss Mitigation Program has two primary benefits. It ensures, first, that there is a responsible lender representative with whom to discuss the loan. I cannot emphasize this enough: without the structure imposed by the program, most of the time this would not happen. Second, the program's structure, under the ultimate supervision of the court, ensures that the parties deal with each other in good faith.

Most of the program's corollary benefits relate to its bankruptcy context. In a bankruptcy case, the lender can see how the homeowner is resolving his or her entire financial predicament, often freeing up income to pay the mortgage; in addition, the Bankruptcy Code enables a debtor to resolve wholly underwater junior mortgages and judgment liens that have been placed on the home and otherwise clear title; and the bankruptcy case provides a forum for dealing with tax liens and claims. Moreover, lenders with document problems -- not a negligible concern today -- can settle those issues on notice to interested parties and with the approval of a bankruptcy court order, and an order approving even a simple loan modification provides comfort to a loan servicer or trustee about possible claims by trust beneficiaries that the loan was mismanaged.

The court's supervision is critical but limited. Our role is to ensure that the parties deal with each other in good faith. We may not impose an outcome on the parties,

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either directly or by, for example, refusing to relieve them of the Loss Mitigation procedures until they reach agreement. We are there to enforce the deadlines imposed by the Loss Mitigation order and to resolve complaints that a party is acting arbitrarily, capriciously or otherwise to the detriment of good faith negotiations. For example, the court might appropriately ask a lender representative if the lender has considered whether the debtor is offering to pay more, on a present value basis, than the value of the house in foreclosure, but it would not be appropriate for the court to insist that the lender reconsider a valuation that was not obviously in bad faith. At times we may make a suggestion about how to bridge an impasse, but only on a basis to which the parties are prepared to agree.

About one half of the Loss Mitigations that have concluded have resulted in some form of an agreement -- usually a loan modification reducing the interest rate and stretching out payments -- that has meant that the home remains occupied or that it is turned over in a way beneficial to both sides.

We often hear that the Loss Mitigation mediations that did not result in an agreement also had a good effect: the homeowners saw, after actually engaging with their lender, the dollars and cents reasons why they could not keep their house. At a time when many homeowners cannot even get their letters and phone calls returned (often by banks that homeowners are acutely aware have themselves been rescued by the federal government), this is no small achievement.

Obviously, before we implemented the Loss Mitigation Program, we assured ourselves of our legal authority to do so. The program is consistent with Congress and the federal courts' general encouragement of mediation, as well as with section 105(d) of

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the Bankruptcy Code, Bankruptcy Rules 7016 and 9014, and courts' inherent power to manage their own docket. The legal basis for our Loss Mitigation Program has never been challenged, although I am aware of such a challenge to a similar program in the Bankruptcy Court for the District of Rhode Island that has recently been denied by that court.

One reason for legislation in this area would be to make the courts' authority absolutely clear (although I trust that the Rhode Island challenge, if it is pursued on appeal, eventually will work its way through the system). There is another reason as well, however. By passing legislation expressly recognizing the benefits of home mortgage mediation programs, Congress would endorse a solution to one of the most vexing problems of the financial crisis by encouraging bankers to return to being bankers.

Since I am not testifying today on behalf of any group, I can tell you that my personal view of legislation is that less is best. Even if you share that view, however, and perhaps especially if you share it, enabling homeowners and lenders to negotiate the resolution of their loans is a good idea.

Thank you again for inviting me to testify on this important topic. I am happy to try to answer any questions that you have about it.

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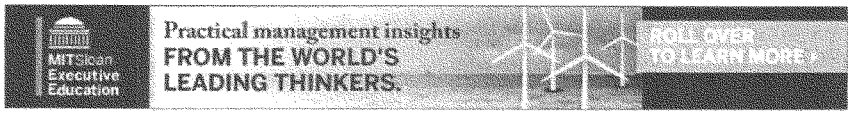

Forbes.com

Housing

Obama Mortgage Effort May Need Modification

Maurna Desmond, 08.26.09, 6:49 PM ET

In a sign that the Obama administration's plan to stem foreclosures needs retooling, one of the main reasons struggling mortgage borrowers are being turned away from the Home Affordable Modification Program is that their mortgages are, by its standards, too affordable.

In order to make the president's $75 billion loan modification initiative easy for servicers to implement and for borrowers to understand, eligibility is primarily based on the ratio of a borrower's mortgage payment to their income. If the mortgage requires more than 31% of their paycheck, the loan is considered "unaffordable" and the borrower is in, provided they meet other criteria. If it's less, which is the case for many, they are out of luck.

Loan servicers criticize the formula as too narrow, saying it doesn't take into account other debts that borrowers have racked up.

William Erbey, chief executive of Ocwen, the second-largest U.S. subprime mortgage servicer, says his borrowers are often saddled with credit card bills and auto loans and will pay those bills before their home loans. "It's not their mortgage that is out of whack. It's that their other consumption patterns are out of whack," Erbey says.

Low mortgage debt-to-income ratios is the No. 1 reason Ocwen is rejecting borrowers for the Obama program.

CitiMortgage, which services one in 10 mortgages in the U.S., says the formula is also the leading reason it has excluded borrowers from the program. Chief Executive Sanjiv Das chided policymakers for ignoring why many borrowers are falling behind. "This is people solving for a housing crisis not realizing we're in a credit crisis," he says.

Six months after HAMP was launched, the government reported earlier this month that only 235,000 borrowers had been enrolled. The Obama administration is pressuring servicers to ramp up modifications to meet its goal of 4 million taxpayer-sponsored workouts. (See "Weak Progress On Loan Modifications.") The slow pace of progress and obvious kinks in the program, like the rigid affordability formula, suggest the program itself is ready for a modification.

The financial incentives for servicers to participate are appealing: "Most servicers want to do the HAMP program because we get paid [to do it]," said Ocwen's Erbey. Nonetheless, mortgage companies are cooking up their own versions of mortgage relief. They churned out 1.5 million of their own in-house designed modifications during the first half of the year, according to HOPE NOW, an industry-led foreclosure mitigation group.

While the value and good faith of these industry efforts vary, some are trying interesting approaches to help borrowers (See "Mortgage Relief That's No Help To Homeowners").

Foreclosures were initially fueled by irresponsible lending to unqualified buyers, but rising unemployment, which was running at 9.4% in July, has begun to drive more borrowers under. During other downturns, many jobless homeowners were able to sell their homes at a profit, avoiding foreclosure. But since real estate values have plunged nationally by one-third from their 2006 peak, roughly one in three mortgages owe more on their homes than they are currently worth, according to First American CoreLogic, a real estate data firm.

Since taking over the Citigroup mortgage subsidiary a year ago, Das has pioneered one of the few programs aimed at helping borrowers who are unable to pay their mortgage due to unemployment. The program has helped only a handful of borrowers, about 600, but Das says he has been in discussions with Treasury to expand it to reach more people. "The subprime phenomena has been flushed out," Das says. "You've got to innovate around the problems of today."

In February, economists at the Boston Federal Reserve Bank proposed a plan under which unemployed mortgage borrowers

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would receive aid from taxpayers equal to half their former income for up to two years. "It would have definitely prevented foreclosures," says Paul Willen, one of the authors of the proposal, "and it's not that complicated to implement." (See "America's New Housing Problem: Unemployment.")

A Treasury Department spokesman says, "The administration is considering many ideas as part of our ongoing efforts to relieve struggling homeowners and stabilize the housing market. No decisions have been made on this matter."

As the administration continues to pressure servicers to increase their government workouts, some analysts worry that there's nothing in the way the HAMP program is designed, other than intensive oversight, to prevent servicers who modify lots of borrowers who don't really need it.

"Measuring the success of the modification program based on re-default is risky because it encourages servicers to find the loans that are most likely to remain current," says the Boston Fed's Willen. "They will end up modifying 4 million loans to look like they're doing something, and it will not make a big dent in the number of foreclosures."

Senate Judiciary Committee
Hearing on "Foreclosure Mediation Programs:
Can Bankruptcy Courts Limit Homeowner and Investor Losses?"
February 1, 2011

Statement of U.S. Senator Al Franken

Mr. Chairman, thank you for holding this important hearing on how foreclosure mediation programs in bankruptcy courts can better protect consumers. You have been a real leader on bankruptcy issues, and you should be applauded for your work in this important area.

Many problems have come to light since the beginning of the foreclosure crisis. Most recently, we have seen mortgage servicers fraudulently signing affidavits to execute foreclosures, when they have zero personal knowledge of the individual borrower's situation. This problem, known as "robo-signing," is particularly troubling to me.

Last year, I wrote letters to Ally Financial and JP Morgan Chase calling for a suspension of all foreclosure proceedings until this issue had been resolved. I also joined with Senator Menendez in asking GAO to investigate the role of federal regulators in overseeing foreclosure proceedings. While some mortgage servicers have taken action on this issue, I worry that it is a day late and a dollar short.

Borrowers are at such an extreme disadvantage in these foreclosure proceedings that I fear robo-signing is only one of many ways that servicers have been able to take advantage of vulnerable families and homeowners. And because most homeowners don't have access to legal advice or even basic counseling, most of these abuses never come to light.

Many of you have heard me tell the story of Tecora, a Minneapolis homeowner who fell behind on her mortgage when her payments went up. She entered the Home Affordable Modification Program, or for short, HAMP, but was told by her mortgage servicer that her file was closed because she had "declined a final modification of her mortgage." The problem was that she actually hadn't done that. Tecora is working with the Twin Cities' Habitat for Humanity, a wonderful nonprofit that is helping her fight this mistake and stay in her home. Every homeowner deserves this type of assistance. Unfortunately, not everybody gets it.

Minnesota has taken important first steps to address this matter by requiring mortgage service providers to provide homeowners with pre-foreclosure notices that include foreclosure prevention counseling resources. Every state needs to adopt this and other services to help give homeowners a fighting chance.

I'm pleased that Judge Drain could join us today to tell us about the innovative foreclosure mediation program that was developed in the Southern District of New York. In Minnesota, more than 22,000 people filed for bankruptcy this year. This is more than 87 percent higher than the bankruptcy rate in 2007, before the recession occurred. Although I realize bankruptcy reforms won't help all families going through devastating foreclosures, these types of mediation programs are one important way we can help families in Minnesota and elsewhere to stay in their homes.

Thank you, Mr. Chairman.

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Statement of

The Honorable Chuck Grassley

United States Senator
Iowa
February 1, 2011

Prepared Statement of Senator Chuck Grassley
Senate Committee on the Judiciary
"Foreclosure Mediation Programs: Can Bankruptcy
Courts Limit Homeowner and Investor Losses?"

Tuesday, February 1, 2011

Mr. Chairman, thank you for holding this hearing today. It's important to study the relationship between bankruptcies and foreclosures and whether there is a need for a change in the Bankruptcy Code.

The Committee also needs to study how the Obama Administration is responding to foreclosures, whether that response is working and whether the 75 billion dollars that the administration is spending is a proper use of taxpayers' hard earned money ---- and if so, whether that money is being used in the best and most effective manner.

This hearing is a chance to have some of the facts come out and as a chance to have the issue fully and fairly examined. I'm open to listening to proposals that can make a difference.

The nation is experiencing some difficult times. Our fellow citizens are hurting and we must get the economy moving in the right direction. That means helping spur job creation and wisely and properly spending taxpayers' money.

But our efforts must be fully thought out. As part of our responsibilities to our fellow citizens, we must carefully examine how relief proposals will impact the whole economy and how the money spent on them will impact future generations of Americans.

The issue of mortgage modifications is not a simple one. There are significant and real concerns about the mortgage or loan modification programs being run by bankruptcy courts. There are questions about how those programs are being administered and how they might impact the economy.

For example, concerns also include questions about whether judges will use these programs to mandate "cram-downs" --- that is a reduction on the principal amount of the loan --- something that even the Obama Administration's program doesn't condone.

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I also know that there are questions about whether the discussion on loan modification programs being run by bankruptcy courts is just ignoring the real problem.

If you review the written materials and procedures for the program run by the bankruptcy court in Rhode Island, you see multiple references to the Home Affordable Modification Program --- commonly referred to as "HAMP."

As you know the Treasury Department currently operates a number of foreclosure mitigation programs. One of those programs is the Home Affordable Modification Program, a $75 billion program, which began two years ago.

However, the Home Affordable Modification Program has come under severe criticism, even from Obama Administration officials.

Although homeowners have applied to the program and received trial modifications, the number of these modifications that are converted to permanent agreements that enable homeowners to permanently avoid foreclosures is low.

Particularly disturbing is the fact that the Treasury Department still hasn't established performance goals or benchmarks for the Home Affordable Modification Program, meaning that there's no effective way for us to know whether this $75 billion program is accomplishing its intended purpose. That's not accountability. That's not transparency. That's just more taxpayer money flying out the window.

In July of last year, as the Ranking Member of the Finance Committee, I participated in a hearing examining the failures of the Home Affordable Modification Program. A few days after the hearing, I sent a letter to Treasury Secretary Geithner urging him and his department to establish specific goals and benchmarks for the program.

Remarkably, the letter I received back from the Treasury Department defended the program as a success and confirmed that the department does not -- and apparently refuses to -- set performance goals for the program.

My concerns are shared by the Special Inspector General – SIGTARP. Just six days ago, on January 26, the Special Inspector General issued a report that continues to confirm the failures of the Home Affordable Modification Program. That report also continues to call for the Treasury Department to establish specific goals and benchmarks for the program.

As the Special Inspector General's report reveals, the numbers for the program are "remarkably discouraging."

The number of permanent mortgage modifications under the Home Affordable Modification Program remains anemic — there were just under 522,000 ongoing permanent modifications as of December 31, 2010. A combined total of more than 792,000 trial and permanent modifications have been cancelled, with more than 152,000 trial modifications still in limbo.

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These permanent modification numbers pale in comparison not only to foreclosure filings, but also to the Treasury Department's initial prediction that the Home Affordable Modification Program would "help up to 3 to 4 million at-risk homeowners avoid foreclosure" "by reducing monthly payments to sustainable levels."

In particular, the Special Inspector General's report confirms my concerns by describing the Treasury Department's steadfast refusal to adopt meaningful goals and benchmarks --- as perhaps the most fundamental of the causes of the program's failure to have a material impact on preventing foreclosures.

The report also outlines some disturbing conduct by the Treasury Department. The report explains:

"Rather than develop meaningful goals and metrics for the program, which would allow meaningful oversight, promote accountability, and provide guidance for useful change, Treasury instead has regularly changed its criteria for success, citing at different times the total number of trial modification offers extended to borrowers, regardless of whether they were accepted, and then the total number of trial modifications, regardless of whether they became permanent, which far fewer than half have actually done."

I agree with the Special Inspector General's conclusion that "given the current pace of foreclosures, achievements of the program look remarkably modest, and hope that this program can ever meet its original expectations is slipping away."

In light of the documented problems with the program and its continued failure to provide real relief, the question becomes why are taxpayers paying for a $75 billion program that doesn't work?

The next question is --- will another government program, -- this time in the bankruptcy courts and this time without any Congressional oversight, -- really work or could it actually damage our suffering economy?

We must be mindful that there will be limited Congressional or other oversight of the substantial authority and power wielded by the judges within this bankruptcy court program. Accordingly, we must always be very careful before we grant judges -- who are not elected and, in the case of bankruptcy judges, not subject to Senate review through the confirmation process -- new and unchecked powers.

I look forward to hearing the witness testimony and working with members of the Judiciary Committee on finding the right approach to this issue.

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ADDITIONAL DOCUMENTS FOR THE RECORD

FROM SENATOR CHARLES GRASSLEY

FOLLOWING THE SENATE JUDICIARY COMMITTEE HEARING:

"FORECLOSURE MEDIATION PROGRAMS: CAN BANKRUPTCY COURTS LIMIT HOMEOWNER AND INVESTOR LOSSES?"

HELD ON FEBRUARY 1, 2011

In the interest of efficiency, in addition to the actual hard copies of documents submitted for the record, the following documents, which are lengthy, are incorporated by reference into the record:

1. OFFICE OF THE SPECIAL INSPECTOR GENERAL FOR THE TROUBLED ASSET RELIEF PROGRAM, FACTORS AFFECTING IMPLEMENTATION OF THE HOME AFFORDABLE MODIFICATION PROGRAM (Mar. 25, 2010), which is available through the SIGTARP webpage, http://www.sigtarp.gov/reports, (http://www.sigtarp.gov/reports/audit/2010/Factors_Affecting_Implementation_of_the_Home_Affordable_Modification_Program.pdf);

2. OFFICE OF THE SPECIAL INSPECTOR GENERAL FOR THE TROUBLED ASSET RELIEF PROGRAM, QUARTERLY REPORT TO CONGRESS (Oct. 26, 2010) which is available through the SIGTARP webpage, http://www.sigtarp.gov/reports, (http://www.sigtarp.gov/reports/congress/2010/October2010_Quarterly_Report_to_Congress.pdf);

3. OFFICE OF THE SPECIAL INSPECTOR GENERAL FOR THE TROUBLED ASSET RELIEF PROGRAM, QUARTERLY REPORT TO CONGRESS (Jan. 26, 2011), which is available through the SIGTARP webpage, http://www.sigtarp.gov/reports, (http://www.sigtarp.gov/reports/congress/2011/January2011_Quarterly_Report_to_Congress.pdf)

4. Karen M. Pence, *Foreclosing on Opportunity: State Laws and Mortgage Credit*, May 13, 2003, *available at* http://www.federalreserve.gov/pubs/feds/2003/200316/200316pap.pdf.;

5. U.S. Department of the Treasury and U.S. Department of Housing and Urban Development, Making Home Affordable: Overview of Programs, http://www.makinghomeaffordable.gov/docs/MHA-Borrower_EN_09-23-10FINAL.pdf (last visited Feb. 8, 2011); and

6. U.S. DEPARTMENT OF THE TREASURY AND U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, MAKING HOME AFFORDABLE PROGRAM HANDBOOK FOR SERVICERS OF NON-GSE MORTGAGES (2010), *available at* https://www.hmpadmin.com/portal/programs/docs/hamp_servicer/mhahandbook_20.pdf.

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Congressional Testimony

Coercing Mortgage Modifications in Bankruptcy Courts: Unlikely Benefits, Certain Risks

Testimony before the Committee on the Judiciary, United States Senate

February 1, 2011

Andrew M. Grossman
Visiting Legal Fellow
The Heritage Foundation

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My name is Andrew Grossman. I am a Visiting Legal Fellow in the Center for Legal and Judicial Studies at The Heritage Foundation. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

The Committee is to be commended for holding this hearing today to consider the promises and pitfalls of approving bankruptcy courts' loss mitigation programs. These programs are a recent innovation, and while there is some anecdotal evidence on their operations, there has yet to be the kind of formal study or statistical evidence that could drive sound policymaking with respect to them. This hearing, then, is a step in the direction of marshaling evidence, raising awareness, and gaining a better understanding of what these programs are, how they work in practice, and whether they achieve their goals in a way that furthers the greater common good.

As to that question, whether loss mitigation programs are, in the broadest possible sense, successful, I offer no firm opinion today because I do not believe that anyone, at this time, could say with any degree of certainty that these programs are or are not having a positive impact on our housing market, on homeowners in distress, or on the bankruptcy process in those districts that have such programs in place.

There are, however, good reasons to doubt that loss mitigation programs are making a positive contribution. First, it is difficult to pinpoint what additional benefit these programs provide over the myriad of programs that already exist to aid responsible homeowners who find themselves in financial distress. Second, it seems unlikely that these programs, which offer no additional financial incentives to mortgage lenders or servicers, would succeed where programs that offer generous incentives to make reasonable modifications, as well as subsidies to compensate lenders for reducing monthly mortgage payments, have failed. Third, there is a real cost to any interventions that delay ultimate resolution of a mortgage claim or increase legal uncertainty, as an open-ended mandate to negotiate in "good faith" necessarily does. Fourth, there is a question of rights and fundamental fairness when a creditor is forced to "show cause" as to why it has been unable to reach an agreement to reduce the value of its claim or otherwise cede its legal rights. Fifth, there is the question of harm to the debtor, whose "fresh start" coming out of bankruptcy may be delayed or compromised. Indeed, some individuals may even file for bankruptcy, with all of the attendant injury to an individual's creditworthiness and reputation, in the false hope of getting a better deal than may realistically be possible. Sixth is the real risk that further hurdles to resolving defaulted mortgages will delay the bottoming out of the housing market, at great cost to the economy. Seventh and finally, like all policies that create hurdles to enforcing creditors' rights, loss mitigation programs may cause lenders to demand larger risk premiums, in the form of higher interest rates, or to undertake other risk minimization strategies, such as still-greater down payments, that will have the effect of restricting access to credit—an especially damaging result at a time when the market continues to flounder.

It is for very similar reasons that Congress rejected attempts to allow bankruptcy courts to "cramdown" mortgage holders' secured claims on debtors' principal residences. Loss mitigation programs, as they have been structured by several bankruptcy courts,

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resemble nothing so much as "cramdown lite," in that the bankruptcy court may effectively coerce the mortgage holder to abandon a portion of its secured claim. This process is, without question, more gentle than the "cramdown" proposals that Congress considered and rejected, but the two policies, "cramdown" and "loss mitigation," are close cousins.

Accordingly, Congress should be wary of giving its blessing to a policy that bears so many risks and offers only ill-defined rewards, and it certainly should not do so at a time when there is no reliable evidence to guide its decision. Instead, Congress should focus on targeted policy interventions that address tangible problems and help to speed the recovery of the housing market, to the benefit of all Americans.

BACKGROUND

Four years after home prices first began to tumble, they have yet to recover, and the housing market remains weak. According to many experts, the primary cause of this persistent weakness is the inability of the market to reach equilibrium—that is, for home prices to bottom out. This problem is both economic and legal in its origins. The economic aspect is price stickiness, or the unwillingness of homeowners, mortgage lenders, and sellers to mark down properties to prevailing market values. Legal uncertainty also plays a large role. Delays in the foreclosure process, due to a variety of causes, have left many properties trapped in a legal limbo, in which their owners, who may be unable to afford mortgage payments, remain in their homes for months or years while mortgage-holders attempt to take possession of the homes and put them on the market. The result is a pent-up supply of temporarily unmarketable homes that depresses prices across the market, prolonging the housing crisis.

Before the market can recover, this backlog of homes in limbo will have to be addressed. Many are proceeding, albeit very slowly, through the foreclosure process, which in many jurisdictions now takes a year or more and imposes great transaction costs on all participants. Others are resolved through alternative legal arrangements, such as short sales and deed-in-lieu-of-foreclosure arrangements, which promise greater speed at far lesser expense.

Still others leave limbo by means of mortgage modifications, which often involve a reduction in mortgage principle, reduction in interest rate, and extension of the term of the mortgage. Taken together, these modifications can, in some instances, reduce monthly payments to a level that is affordable to the borrower, while reducing the mortgage lender's expected loss. In general, modification benefits both the lender and the borrower if it results in a payment stream with a risk-adjusted net present value that is greater than the proceeds the lender could expect were it to foreclose, net of the expenses of doing so and then marketing the home. Of course, modification is a possibility only where the borrower can afford to make those modified payments. In many cases, modification would be pointless, because the payments would still be unaffordable, and indeed, many modifications fail for that precise reason. But where the payments can be made, successful modifications are win-win: both the borrower and the lender achieve

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benefits above and beyond those possible under the old, unaffordable mortgage. It is for this reason that, in the absence of significant transaction costs, modifications need not be coerced—since both stand to benefit, both should, theoretically, be willing to negotiate a deal.

Unfortunately, all of life is marked by transaction costs, and they have proven to be especially great and stubborn in the relationships between mortgage lenders, servicers, and borrowers, stymieing the possibility of achieving win-win modifications. The result is, in some instances, an impasse: though, based on the numbers, a modification is possible, the parties are unable to reach any agreement. Both sides lose out.

Fortunately, such impasses have become far rarer due to initiatives by mortgage lenders and servicers, as well as, to a much lesser extent, those by the federal government. These come in two varieties. The first are those that function by simply streamlining the negotiation and modification process. The second take an additional step of subsidizing beneficial modifications to overcome even significant transaction costs and to achieve modifications that, absent subsidies, would be one-sided in favor of the borrower.

The most prominent of the first type of program is HOPE NOW, a coalition effort by the nation's largest mortgage lenders and servicers and a variety of community organizations that provide counseling to distressed homeowners. HOPE NOW, which is in its fifth year of operation, provides a point of initial contact for borrowers facing the risk of default and foreclosure to participate in proprietary modification programs offered by their lender or servicer. From January through November 2010, HOPE NOW participants completed approximately 1.65 million permanent mortgage modifications, against about one million foreclosures over the same period. On both a numerical and proportional basis, this represents an enormous increase in modification activity over even 2009, which also saw substantial growth in modifications. The vast majority of these modifications occur outside of the federal government's Home Affordable Modification Program (HAMP), which is described further below. An additional 1.5 million or more borrowers in 2010 received other relief through HOPE NOW to avoid foreclosure, such as temporary forbearance and negotiated short sales.

Given the subject of today's hearing, it is worth describing HOPE NOW's outreach efforts. The coalition holds dozen of outreach events in distressed housing markets each year, at which counselors, servicer representatives, and information are available. Each month, its members send a quarter-million notices describing the program to delinquent borrowers. It operates a free hotline which borrowers can use to reach counselors 24 hours a day, seven days a week. That hotline receives, on average, more than 5,500 calls per day. It also operates a website that documents its various activities, provides tools for homeowners to evaluate different modification and other options, and provides contact information for all of its participants. A separate website allows borrowers to compile a modification application online, with assistance from counselors, and then submit the completed application directly to the mortgage servicer for expedited consideration.

The most prominent of the subsidy-providing programs is HAMP, which was launched in early 2009. HAMP provides "incentive payments" to mortgage servicers and

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lenders to reduce monthly payments of borrowers who are in default or at risk of default. HAMP operates with respect to mortgage payments as a proportion of the borrower's monthly gross income. The lender is responsible for reducing payments to 38 percent of monthly income, as necessary, and then the lender and government split the expense of reducing payments to the program's target of 31 percent of monthly income. To achieve these reductions, the interest rate is reduced to as low as 2 percent; the term is extended up to 40 years from the modification date; and the lender may forbear some amount of principle until the property is sold or the payoff date of the loan. Lenders are not required to forgive principle to achieve the 31-percent target, though they may do so. The modified terms, with reduced payments, are imposed on a trial basis, during which the borrower must make at least three payments. After three payments, the modification may be made permanent. Failure to complete the trial payments, however, leaves the borrower liable for all payments due under the original mortgage.

HAMP offers a variety of subsidies to servicers and lenders to undertake the modification process and reduce monthly payments. As described above, the government will cover, in part, the cost of reducing payments, effectively increasing the borrower's ability to pay under the modified terms. In this way, HAMP facilitates modifications that would otherwise be impossible because they would require the lender to take a loss, relative to the foreclosure value of the property. The HAMP process is also replete with "incentives" for servicers and lenders: $1,000 for each permanent modification; an additional $500 where the borrower was current but at risk of defaulting at the time of the modification; an additional $1,500 where the borrower was current but at risk of defaulting at the time of the modification and the monthly payment was reduced by at least 6 percent; and "home price decline protection" payments for declines in the value of the home that secures the mortgage. Borrowers are also eligible for "pay for performance" subsidies of up to $5,000 total to reduce the principal balance. All of these payments are made out of a $23 billion allocation of TARP funds.

HAMP participation is mandatory for servicers of loans owned or guaranteed by Fannie Mae or Freddie Mac. Borrowers who submit complete applications for HAMP modifications must be evaluated for eligibility, and their servicers are obliged, in certain instances, to complete modifications pursuant to the program's terms.

Since its inception, HAMP has facilitated about 1.5 million trial modifications, about half of which have been canceled due to the inability of borrowers to make modified payments or for other reasons. Over 575,000 trial modifications have been converted into permanent modifications, and about one-tenth of those subsequently failed.

HAMP has failed to live up to expectations, particularly the Obama Administration's stated goal of achieving three to four million mortgage modifications under the program. Far fewer homeowners than forecast have proven eligible for the program; in many cases, even with hefty reductions in monthly payments, the home remains fundamentally unaffordable. Worse, many homeowners lured into the program have been thrown into foreclosure after they failed to make trial payments and then became liable for the total delinquency on their mortgage during the trial period. HAMP has shown that, even with major subsidies, there may not be a large pool of mortgages that can be reasonably modified so as to keep at-risk homeowners in their homes. It has

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also demonstrated the sometimes severe consequences of holding out false hope to homeowners burdened by excessive mortgage debt.

HOPE NOW and HAMP are just two of the myriad programs that facilitate foreclosure alternatives. Other programs target second liens, mortgages insured or guaranteed by the Federal Housing Administration or other federal agencies, borrowers who are temporarily unemployed, and homeowners in the regions hardest hit by the housing crisis.

Nearly all of these efforts are of recent origin, and they represent a fundamental reworking of the mortgage modification landscape. Whereas previously, modification was a process that involved only two parties directly—the servicer and the borrower—and was often ad-hoc, arbitrarily offered, or even unavailable, now it is a permanent feature of the housing market, with regularized procedures.

It is in this context that several bankruptcy courts have created an additional avenue for mortgage modification that they call "loss mitigation." Under these programs, which are implemented through standing orders of the court, a mortgage lender must participate in a negotiation process with the debtor to settle the mortgage claim by means other than foreclosure. During this process, the automatic stay is extended (the creditor is also barred from seeking a lift of the stay), the debtor retains possession of the home, and the parties provide periodic updates to the court on the status of the settlement negotiations.

Though these programs differ in their terms, they share several features intended to push the parties toward settlement. First, a party objecting to the loss mitigation process, or seeking to terminate it, must provide the court with "specific reasons why loss mitigation would not be successful." *In re Sosa*, No. 10-11702 (Br. R.I. Jan. 28, 2011). Second, the creditor must be represented by an individual with full decision-making authority to enter into a loan modification or take other settlement action. Third, the parties must negotiate in "good faith" and are subject to sanction for failure to do so. Fourth, when the period allotted for loss mitigation negotiation has run its course without agreement, any party (though probably the debtor) may seek an extension to continue negotiations, and a party (probably the creditor) opposing the extension must, again, show cause as to why an extension would be inappropriate.

Taken together, these features effectively place the burden on the lender to demonstrate why the debtor is not eligible for relief from foreclosure in order to proceed with a properly proven secured claim. This represents a reversal of normal bankruptcy practices regarding secured debt, in which proof of claim alone suffices.

ANALYSIS: FAULTY PREMISES

As should be apparent, bankruptcy courts' loss mitigation programs do not exist in a vacuum, but enter a field crowded with modification programs. How loss mitigation interacts with those other programs, as well as the complicated features of the housing market, is unclear from the limited amount of experience with loss mitigation in the

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bankruptcy courts. But there is good reason to believe that these programs are duplicative of preexisting alternatives, are unlikely to provide much or any relief to most debtors unless operated in a coercive manner, may injure some debtors, and may prolong the housing crisis.

As an initial matter, it is useful to identify the premise on which support of these programs rests: that, in a large number of cases, it is possible to reach a mutually beneficial negotiated settlement—especially a mortgage modification—if the debtor and lender are merely made to confer.

This is, however, a questionable premise. As experience with HAMP has shown, the low-hanging fruit is gone. Modifications that are obviously win-win have been done, through programs such as HOPE NOW, often well prior to any bankruptcy filing. They are off the table. Modifications that fall slightly outside the band of mutual benefit, due to the borrower's inability to make payments that would provide the lender a reasonable stream of payments, either have been evaluated for HAMP eligibility, or could be at any time, without any action by the bankruptcy court. And modifications that fall outside of that band—that is, where even HAMP subsidies are insufficient to enable the parties to make a deal—are likely to be unworkable; a fair payment to the lender is likely to be more than the borrower can afford to pay. So there is no good reason to believe that, absent coercion, loss mitigation during the bankruptcy process will cause deals to emerge that were previously unavailable. To believe otherwise would be to expect a free lunch: without putting any additional money on the table, bankruptcy courts can somehow bridge the gap between a borrower's ability to pay and what the lender is willing to accept.

There is also little reason to believe that loss mitigation is necessary to overcome informational barriers between borrowers and servicers. Through HOPE NOW and other efforts, at-risk homeowners have access to credible, useful information on seeking modifications, as well as tools that allow them to evaluate their eligibility for different modification programs and approaches. Mortgage servicers have ramped up their modification capabilities significantly over the past two years, as demonstrated by the unprecedented number of modifications being completed through proprietary programs. Most servicers have established modification hotlines for their existing mortgage customers, and some even allow borrowers to apply for modifications online. Not all homeowners may take advantage of these resources, but they do indicate that the time when information on modification was hard to come by, and modification decisions were made slowly through opaque processes, is long gone.

There is a real risk that loss mitigation programs, as they have been structured by the bankruptcy courts, will undercut these more comprehensive and efficient solutions. Both the mortgage industry and the political branches of the federal government have recognized the benefits of channeling at-risk homeowners into comprehensive evaluation and modification programs. Channeling modification requests into existing programs facilitates consistent procedure, expedient review, and consistent application of modification standards. It also serves to connect borrowers with other resources and programs that may prove useful in addressing their indebtedness. Loss mitigation, however, proceeds outside of these programs and does not enjoy these advantages. To

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the contrary, it requires servicers and lenders to engage in an ad hoc, semi-adversarial negotiation process. This is expensive in terms of resources and fails to ensure consistent results. To the extent that some homeowners see court-supervised modification as a superior option to simply applying for relief from their servicers and forgo participation in programs such as HOPE NOW, this will prove expensive and broadly counterproductive to avoiding foreclosure for the greatest number of mortgages in the most successful manner possible. Other homeowners may use loss mitigation as an opportunity to "forum shop" for the best possible modification, with the same results.

Loss mitigation also threatens to delay resolution of at-risk mortgages, while imposing significant burdens on both the servicer or lender and borrower. Specifically, all of the loss mitigation programs created to date extend the automatic stay, allowing the homeowner to retain possession of the mortgage-encumbered home while the parties negotiate. It should be no surprise that evaluating ad hoc loan modifications can be a resource-intensive and time-consuming process, and, indeed, Bankruptcy Judge Cecelia Morris of the Southern District of New York has noted that "slowdown" is a common feature of loss mitigation. This delay, while obviously detrimental to lenders, also injures debtors by putting off the date of their "fresh start" following plan confirmation.

The burden on the lender or servicer in terms of personnel can also be considerable because these programs require the direct participation of an individual with full decision-making authority. This prevents the use of local counsel or clerical workers who, in other modification scenarios, would compile the application and perform many initial evaluative steps. On the one hand, this feature of the programs demands an unreasonable misallocation of resources; on the other, it is central to a negotiation process that depends for its success on exerting pressure on mortgage servicers and lenders.

That pressure—and many features of these programs, from the decision-maker requirement to the "good faith" requirement, do act to exert significant pressure on servicers and lenders—suggests that loss mitigation programs may threaten the rights of mortgage holders. This analysis assumes, in the main, that bankruptcy courts' loss mitigation programs will not be successful because they will be unable to achieve results any different from those possible in their absence. If that assumption is relaxed, however, there is the possibility that courts could use loss mitigation procedures to coerce lenders into accepting quite prejudicial modifications. Although bankruptcy judges are without power to "cramdown" a mortgage securing a debtor's principle residence, they may, through requiring the direct participation of high-ranking officials, heavy-handedly enforcing the "good faith" requirement, and placing the burden on servicers and lenders to show cause why a modification was not reached, achieve effectively the same result. In these ways, loss mitigation programs can coerce creditors—repeat players who recognize the necessity of remaining on good terms with bankruptcy courts—to make concessions that compromise their rights.

This would allow some debtors to retain their homes, but it should not be counted as a success. In effect, it would be no different from the "cramdown" proposals for debtors' principal residences that Congress has repeatedly rejected due to the likelihood that they would exacerbate tensions in the housing market.

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There is also a real risk that modifications achieved through loss mitigation will ultimately harm the very homeowners they were intended to aid. As with HAMP, homeowners may enter into modifications that ultimately prove unworkable and result in additional financial distress without preserving their home. This is, if anything, a greater risk under loss mitigation programs because of their ad hoc approach to making modifications without any of the safeguards and strict eligibility criteria that are embedded into HAMP or the generous subsidies that serve to reduce payments. Unfortunately, the bankruptcy courts lack the facilities to undertake the kind of data collection that would be necessary to chart the subsequent performance of mortgages modified in loss mitigation proceedings. Not only do we not know whether these modifications are injuring a substantial proportion of those whom they are intended to benefit—which has been the case under HAMP—but we will have no way of knowing that even in the future.

The fact that loss mitigation may drive some homeowners to file for bankruptcy who would otherwise have not done so is also harmful. Bankruptcy is an expensive, disruptive, and potentially damaging process. Most would probably file under Chapter 13. While the total fees for filing are only about $300, guideline attorney's fees range from about $2,500 to $5,000 in simple cases, depending on the district; in complex cases, the fee can be much higher. In addition, filings are included on credit reports immediately upon filing and remain there for seven years. Thus, bankruptcy damages credit scores and impairs access to credit for a significant period of time.

Many Chapter 13 bankruptcies fail; that is, the filer never obtains a discharge of his debts. Nearly 20 percent of Chapter 13 cases fail before the court has confirmed the filer's plan. Another 55 percent fail between confirmation and discharge because the filer has been unable to carry out his plan. This means that only one-third of all Chapter 13 filers complete the process successfully and get the fresh start that bankruptcy promises. The rest—two-thirds of all filers—pay court fees, pay attorney's fees, pay fees to the bankruptcy trustee, invest time and money to restructure their financial affairs, and then wind up with nothing more than temporary relief. It is therefore not surprising that a substantial number of Chapter 13 filers—nearly one-third—go on to file for bankruptcy again.

These statistics suggest that holding out the promise of significant relief from mortgage debt to encourage more individuals to file for bankruptcy is bad policy. At best, bankruptcy would serve only to delay foreclosures in most cases, while imposing enormous costs on those who are already financially vulnerable and limiting their access to credit.

Loss mitigation programs may also further slow recovery of the housing market by delaying resolution of the statuses of the millions of homes that are presently "underwater" or, for a variety of other reasons, unmarketable. If there is a flood of bankruptcy filings to take advantage of loss mitigation programs, the homes involved will be trapped in legal limbo for months as the bankruptcy cases and negotiations play out in slow motion. Where modifications do occur, they may ultimately fail over a period of months, effectively resetting the clock on foreclosure. In this way, loss mitigation would serve as yet another hurdle to completion of the foreclosure process. Depending on how

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many borrowers attempt to take advantage of this alternative, the result could be to slow the inevitable bottoming out of housing prices and delay the market's recovery.

Finally, loss mitigation programs may have an ex ante effect on lending practices, especially within bankruptcy districts where they are employed in a coercive manner. It is unreasonable to expect that lenders would not adjust their up-front terms in response to changes in the law that weaken loan enforcement. Experience and research show that any proposal that has the effect of undermining the certainty of mortgage agreements or imposing losses on mortgage lenders will serve to reduce the availability and increase the cost of mortgage loans. Two responses could be expected. First, lenders would demand higher interest rates and fees as compensation for taking on the added risk of losing money due to the inability to foreclose on a secured interest, as well as the risk of hefty legal and administrative expenses. Second, to guard against coerced modifications that amount, in whole or in part, to "cramdowns," lenders would demand increased down payments from mortgage borrowers. Requiring that borrowers put down enough money to cover potential declines in the value of their homes is the only way to avoid this risk. The result would be to reduce the availability, and increase the cost, of mortgage borrowing.

Recent research confirms this effect. In one study, Karen Pence, a senior economist at the Federal Reserve Board who studies household and real estate finance, determined that state laws that impose costs on lenders (as much as 10 percent of the value of the loan balance) prior to foreclosure reduce the availability of credit for residents of those states. As a result of these laws, families "may pay more for their mortgages, purchase smaller houses, or have difficulty becoming homeowners."[1]

Similarly, economists Emily Lin and Michelle White found that unlimited homestead exemptions, which allow individuals to shelter home equity from creditors in bankruptcy, significantly reduce the availability of mortgages and home-improvement loans.[2]

The result, then, of coerced modifications to mortgages—which would be the only thing that bankruptcy courts could offer that is unavailable outside of bankruptcy—would be to put home lending out of reach of many Americans and to raise the cost of borrowing for those who are able to secure mortgages, further weakening the housing market. This is a perverse result, considering that the long-standing aim of U.S. housing policy has been to encourage homeownership by promoting affordability in the mortgage market.

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[1] Karen Pence, "Foreclosing on Opportunity: State Laws and Mortgage Credit," *Review of Economics and Statistics*, Vol. 88, No. 1 (February 2006), pp. 177–182, at *http://works.bepress.com/cgi/viewcontent.cgi?article=1001&context=karen_pence.*

[2] Emily Y. Lin and Michelle J. White, "Bankruptcy and the Market for Mortgage and Home Improvement Loans," *Journal of Urban Economics*, Vol. 50, No. 1 (2001), pp. 138–162, at *http://econ.ucsd.edu/~miwhite/lw-jue-reprint.pdf.*

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CONCLUSION

When an individual is living in a home that he fundamentally cannot afford, there are only bad options, and filing bankruptcy in a last-ditch attempt to keep the home or to stay in it a while longer is among the worst. Encouraging at-risk homeowners to do so would be irresponsible. For that reason, Congress should be very wary of bankruptcy court-based loss mitigation programs that offer few or no options unavailable outside of bankruptcy, while holding out hope for homeowners facing foreclosure. Unless and until there is evidence that these programs can be operated in a manner that (1) does not injure at-risk homeowners, (2) does not compromise creditors' lawful rights, and (3) does not cause undue delay in the foreclosure process, encouraging their proliferation would be unwise.

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The Honorable Sheldon Whitehouse
United States Senate
Washington, D.C. 20510

February 4, 2011

Dear Senator Whitehouse:

The Homeownership Preservation Foundation ("HPF") is writing this letter in order to correct certain inaccurate information that we believe was unintentionally presented by one of the witnesses at the hearing you chaired last Tuesday, February 1st 2011, in the Senate Judiciary Committee entitled "Foreclosure Mediation Programs: Can Bankruptcy Courts Limit Homeowner and Investor Losses?"

One of the witnesses at the hearing, Andrew M. Grossman (Visiting Legal Fellow at The Heritage Foundation), in describing the HOPE NOW Alliance stated:

> ... It operates a free hotline which borrowers can use to reach counselors 24 hours a day, seven days a week. That hotline receives, on average, more than 5,500 calls per day. It also operates a website that documents its various activities, provides tools for homeowners to evaluate different modification and other options, and provides contact information for all of its participants. A separate website allows borrowers to compile a modification application online, with assistance from counselors, and then submit the completed application directly to the mortgage servicer for expedited consideration.

In fact, HOPE NOW neither owns nor operates the **Homeowner's HOPE™ Hotline, 888-995-HOPE™**; rather, HOPE NOW has partnered with the **Homeownership Preservation Foundation**, an independent national nonprofit organization which owns and operates the **Homeowner's HOPE™ Hotline, 888-995-HOPE™.**

The Homeownership Preservation Foundation is dedicated to helping distressed homeowners navigate financial challenges and avoid mortgage foreclosure. HPF guides consumers onto the path of sustainable homeownership and develops innovative solutions to preserve and expand homeownership. Through its Homeowner's HOPE™ Hotline, 888-995-HOPE™, HPF provides comprehensive financial education and confidential foreclosure prevention counseling for FREE, 24 hours a day, 7 days a week, 365 days a year, in over 170 languages. Since 2007, HPF has served more than four million distressed homeowners, an average of 5,500 persons each business day, who depend upon HPF as a trusted, neutral source of information and assistance.

As I noted at the outset, I have no reason to believe that the information contained in Mr. Grossman's testimony was intended to be inaccurate. However, I respectfully request that this letter correcting the inaccurate information contained in Mr. Grossman's written testimony be included in the permanent hearing record.

If you have any questions please do not hesitate to contact me.

Sincerely,

Colleen Hernandez
President & CEO

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Michigan Family Says Obama Foreclosure-Prevention Program Cost Them Their Home

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The following story is produced in partnership with The Dylan Ratigan Show's week long "No Way To Live" series on the financial crisis and its impact on ordinary Americans, and in collaboration with Meetup.com, which is hosting HuffPost Mortgage Modification Madness Meetups across the country, where homeowners can meet others who've had similar difficulties with lenders.

After nine months of dutifully making lowered mortgage payments under the Obama administration's foreclosure-prevention program, Bea and Terry Garwood of Pinckney, Mich., are all set to move out. Despite the promise of relief, they are losing to foreclosure the two-story house that has been their family home since 1994. They say the administration's initiative has effectively pushed them out the door.

The Garwoods are among nearly 800,000 American households that have managed to enroll in the program before failing to secure permanently lowered monthly payments. Their experience underscores why many housing experts and lawmakers have proclaimed the effort a failure. Though President Barack Obama promised it would help three to four million homeowners avoid foreclosure, only 522,000 had successfully secured so-called permanent loan modifications by the end of last year, according to the Treasury Department.

More homeowners have actually been bounced from the program than have been helped, the data show. Despite widespread anticipation that foreclosures will only accelerate in 2011, breaking a record set last year, the number of new borrowers entering the program has been slowing to a trickle: Most of the potential new applicants lack sufficient income to qualify for lowered payments. The program was designed to help people confronting mortgages whose low promotional interest rates give way to much more expensive terms, and not for the circumstances at hand, with holders of traditional loans losing jobs and income.

A Treasury spokeswoman said the HAMP program was never intended as a cure-all for the foreclosure crisis. "It wasn't designed to prevent every foreclosure," said the spokeswoman, Andrea Risotto.

The Garwoods--who live with their two children, a 13-year-old daughter and an 11-year-old son--complain that they wasted their money making payments on a trial basis, hoping this would deliver permanent relief, only to find themselves on the verge of losing their home of more than 16 years.

"I feel like I am in hell," said Bea Garwood, 41, who works as an accountant at the University of Michigan in nearby Ann Arbor. "The last thing we ever, ever wanted was this to happen. We don't even want to be there no more. We don't feel comfortable no more. We don't feel like it's our place."

> The Garwoords' experience with their bank - the unexplained delays; the conflicting advice; the lost documents; the difficulty in finding a human being to talk to, let alone one familiar with their case; the inexplicable fees and letters of rejection - is familiar to millions of homeowners who have sought mortgage modifications either through HAMP or a bank's own program. Based on hundreds of hours of interviews with homeowners over the past two years, a strikingly clear picture emerges of the similarities between the many experiences of homeowners that are unique only in their details. A homeowner lost in the maze of a bank's phone system may feel alone but, in reality, is lost with millions of others. To connect homeowners who've had similar trouble with their banks, HuffPost is teaming with Meetup.com and MSNBC's Dylan Ratigan to launch Mortgage Madness Meetups across the country. Get a Meetup in your neighborhood going here.

Last week, Republicans in the House introduced a bill that would end the program, known as the Home Affordable Modification Program, or HAMP. Though few observers anticipate the measure has any real chance of becoming law, Democrats are hardly eager to defend it. In a written statement, the administration said homeowners would suffer if Congress repealed the program, but the President made no mention of it in his recent State of the Union address.

Obama's initiative enables homeowners to lower their monthly payment by decreasing the interest rate on their mortgage, extending the life of the loan, and, in some cases, deferring large amounts of principal to the end of the loan. But the program depends upon the cooperation of mortgage companies, whose participation is voluntary. The institutions that collect monthly mortgage payments--servicers, in industry parlance--control the process through which homeowners receive assistance, under contracts with the Treasury. In return for incentive payments, banks administer the program and try to place homeowners in new mortgages to avoid foreclosure.

Many homeowners who have tried to avail themselves of the relief program complain that they have fallen prey to a never-ending run-around in which they are frequently told they qualify for debt relief, then make on-time payments and submit the necessary paperwork, only to eventually be informed that their payments have been lost or their documents never received. Finally, they are kicked out of the program, with their houses placed in foreclosure.

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A federal auditor noted in October that the program's drawn-out trial modifications waste the resources of homeowners who have no shot at securing permanent relief, leaving them with "more principal outstanding on their loans, less home equity (or a position further 'underwater'), and worse credit scores."

"Even in circumstances where they never missed a payment," the report added, "they may face back payments, penalties, and even late fees that suddenly become due on their 'modified' mortgages and that they are unable to pay, thus resulting in the very loss of their homes that HAMP is meant to prevent."

That is precisely what the Garwoods say happened to them.

The Garwoods say they never even asked for a loan modification, but applied only after their bank, JPMorgan Chase, contacted them in early 2009 and identified them as ideal candidates. According to the Garwoods, the bank noticed that they were one month behind on their mortgage, owing to the seasonal nature of Terry Garwood's roofing business.

Chase, through a spokesman, declined to comment on the family's history, but noted that it has willingly postponed planned sheriff's sales of their home pending resolution.

"We try to help homeowners stay in their homes whenever possible through programs like HAMP and our own modification programs," said the Chase spokesman, Tom Kelly. "We have helped nearly 500,000 families avoid foreclosure."

Under the program rules, homeowners who are delinquent or at risk of falling behind on their mortgages are eligible for lowered payments if their current monthly payments amount to more than 31 percent of their existing income. Chase put the Garwoods in a trial plan that saved them about $500 per month.

Homeowners that succeed in making three timely trial payments and are then able to document their continued eligibility are supposed to be approved for permanent modifications. But last March, after making trial payments for nine months, the Garwoods say they received a letter from the bank informing them that they had been rejected for a permanent modification. Worse, the bank said they now owed an additional $12,000--the difference between their reduced payments under HAMP and what they would have been paying without it, plus fees. If they failed to pay, the result would be foreclosure, Chase said.

Since then, the fees and arrears have only multiplied. According to the Garwoods, Chase now demands $26,000 to catch up--a number far from the realm of possibility. They say they have enough to move into a rented apartment, but nowhere near enough to settle the account.

The Garwoods owe roughly $140,000 on their mortgage, and similar homes in their neighborhood are going for about $100,000. That places them among the one-fourth of all American mortgage-holders who are underwater, meaning they owe the bank more than their home is worth. Researchers say homeowners who fall underwater are significantly more likely to default on their mortgage.

The administration's program, though, was not designed to address this. Experts say the only way to give underwater borrowers an incentive to keep making payments is to cut the size of their loan principal to restore their ownership stake. The average homeowner with a permanent HAMP modification owes $1.18 on their mortgage for every $1 their home is worth, according to the Treasury Department. Most HAMP modifications push borrowers even deeper under water by tacking on late fees and delinquent payments to their overall mortgage, raising the total amount due.

Meanwhile, home prices are falling, adding momentum for more defaults, more foreclosures and--completing a feedback loop--further drops in home values. Fitch Ratings, one of the three major credit rating agencies, forecasts a 10 percent decline in home values this year.

Experts criticize the Obama administration for declining to pressure mortgage companies to write down the value of outstanding home mortgages, which has left homeowners in untenable positions while shielding lenders from losses they would otherwise have to absorb.

"HAMP is a failure," said Joshua Rosner, managing director at independent research consultancy Graham Fisher & Co., adding that the only way to transform it into a meaningful support for homeowners is to shrink principal balances.

The Garwoods say their experience has been bewildering. Every week, says Terry Garwood, 39, a different Chase representative calls him with a different account on the status of his application.

"They call and leave numbers to extensions that don't exist," he said. "You can't talk to anybody. You can't get anywhere with these people."

Even as he has made payments on time on a trial basis, he complains, Chase has reported him to credit agencies as delinquent.

"I didn't know I was getting a black spot on my credit," he said. "It completely destroyed my credit and the chances of owning a home or buying a car."

The Garwoods have not made a mortgage payment since last spring, when they were confronted with the ultimatum--hand over money they do not have or submit to foreclosure. Now, they are preparing to pack up and move into a nearby apartment. But when they will have to leave remains as uncertain as every aspect of their frustrating experience with their bank.

"It's got to be borderline criminal," said Terry Garwood. "Basically it allowed them to steal my house from me."

Shahien Nasiripour is a business reporter for The Huffington Post. You can send him an e-mail; bookmark his page; subscribe to his RSS feed; follow him on Twitter; friend him on Facebook; become a fan; and/or get e-mail alerts when he reports the latest news. He can be reached at 646-274-2455.

Arthur Delaney is a reporter for The Huffington Post. You can reach him at arthur@huffingtonpost.com or find him on Twitter at ArthurDelaneyHP.

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January 31, 2011

The Honorable Patrick Leahy
Chairman, Committee on the Judiciary
United States Senate
224 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Charles E. Grassley
Ranking Member, Committee on the Judiciary
United States Senate
135 Hart Senate Office Building
Washington, D.C. 20510

Dear Chairman Leahy and Senator Grassley:

Chairman Leahy and Ranking Member Grassley, the Iowa Bankers Association submits this statement for the record for the Senate Judiciary Committee's February 1, 2011 hearing entitled "Foreclosure Mediation Programs: Can Bankruptcy Courts Limit Homeowner and Investor Losses?" The Association currently serves more than 95 percent of banks and savings institutions in the state. The IBA serves it members by providing legislative advocacy, training, regulatory compliance, and services designed to enhance the ability of banks to serve their communities.

We understand that the Committee may consider legislation to require mediation-like procedures in bankruptcy court based on programs in Rhode Island and New York, and we would like to offer our comments on the utility of such programs.

Our member banks have in place numerous programs to identify and work with customers who default on their mortgages, and they strongly believe that a foreclosure is a poor outcome for borrowers and lenders alike. In fact, we have a voluntary mediation program in place currently in cooperation with the Iowa Attorney General's office and the Iowa Mediation Service that is fair to all parties and is working well.

We believe the appropriate task for lenders and policy makers is to identify those borrowers who could repay their loans with the assistance of modifications. However, an overly broad program – one that permits the participation of borrowers who have no reasonable likelihood of affording their mortgages – will only prolong the housing crisis by preventing a much needed correction.

Any bankruptcy mediation program should be targeted and focused. As we understand the Rhode Island and New York programs, any debtor/borrower can effectively compel mediation even if the debtor/borrower has been in default for many months and has not attempted to use other programs such as HAMP or proprietary loan modifications. In addition, we understand that there are significant notice problems with the Rhode Island and New York programs.

We believe that any mediation program adopted nationally should be truly voluntary, and that the programs in existence currently could permit a judge to issue sanctions when a servicer declines to make concessions. The Iowa Bankers Association therefore suggests that if Congress decides that existing loan modifications and state-law mediation programs are not sufficient and that bankruptcy mediation should be adopted, the program should be voluntary and lenders and servicers should not face the possibility of sanctions if they do not agree to modify a loan and proceed with foreclosure. Otherwise, the program is not truly a mediation program – it is merely tool that could be used to force lenders to make concessions that would be unavailable under HAMP, state law or proprietary loan programs.

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In short, there is much concern among lenders that a national bankruptcy mediation program is a disguised way to impose a foreclosure moratorium or to force lenders to cram down mortgages. The negative effect of a mandatory program that includes the possibility of sanctions is especially troubling for smaller community banks who are portfolio lenders because they will directly suffer the worst consequences of cram down or a foreclosure moratorium. Larger institutions typically sell mortgages and have no substantial continuing interest in the loan; losses will be suffered by investors (typically the US government, through its ownership of Fannie Mae and Freddie Mac) and loan servicers. Community bank portfolio lenders, by contrast, will directly face losses from either a moratorium or a cram down. We ask that Congress not implement a program that will disproportionately penalize smaller banks that are portfolio lenders.

The Iowa Bankers Association appreciates this opportunity to submit this statement for the record, and we look forward to working with you.

Sincerely,

Iowa Bankers Association
John K. Sorensen
President & CEO
(515) 286-4313
jsorensen@iowabankers.com

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Statement of

The Honorable Patrick Leahy

United States Senator
Vermont
February 1, 2011

Statement Of Senator Patrick Leahy (D-Vt.),
Chairman, Senate Judiciary Committee,
"Foreclosure Mediation Programs: Can Bankruptcy Courts Limit Homeowner And Investor Losses?"
Senate Judiciary Committee
February 1, 2011

I thank Senator Whitehouse for chairing today's hearing. Our Nation's foreclosure crisis is severe and continuing. Millions of Americans have lost their homes or are in the foreclosure process. This crisis has devastated individual families, entire communities, and our economy. Today's hearing will examine the way in which some bankruptcy judges are trying to ensure fairness in their courts by demanding accuracy in the documentation used in foreclosures. Last Congress, Senator Whitehouse took one of our subcommittees to Rhode Island to discuss innovations in the bankruptcy courts there related to the foreclosure crisis. I am glad he has continued to focus on this important issue with today's hearing.

Several bankruptcy courts have implemented loss mitigation programs that are intended to alleviate the losses to both homeowners and lenders as the result of foreclosure. These programs facilitate mediation and communication between the parties. Bankruptcy judges in Rhode Island and New York have developed mediation programs to encourage a voluntary resolution between a lender and homeowner, and in lieu of foreclosure. These programs are within the bankruptcy court's statutory and inherent authority. The Rhode Island bankruptcy court just recently upheld that authority in rejecting a litigation challenge to the court's loss mitigation program. Nonetheless, Senator Whitehouse has introduced legislation to clarify and reinforce this authority for the bankruptcy courts.

From what I understand, these programs require the good faith participation of the homeowner and creditor in a meeting to discuss whether a mutually beneficial agreement can be reached in lieu of foreclosure. The programs do not compel any preordained result. And though results so far are relatively modest, I understand that these programs are working to the benefit of homeowners and lenders.

These loss mitigation programs also serve to ensure that the documentation underlying a foreclosure is accurate and truthful. Proponents of these programs note that they promote transparency and accountability between homeowner and creditor in the foreclosure process.

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This is a good thing in light of the many judicial opinions from both state and bankruptcy courts that have highlighted in great detail severe evidentiary problems related to foreclosures.

The courts are not alone in their concerns about faulty foreclosure documentation. Former Senator Ted Kaufman, now Chairman of the Congressional Oversight Panel, discussed in his November 2010 Oversight Report the very serious implications that widespread documentation problems hold for homeowners in foreclosure, the broader housing market, and our economic recovery. And many attorneys and scholars have cautioned that pervasive foreclosure documentation problems pose the threat of significant injustice for homeowners and potential widespread fraud on the bankruptcy and state courts.

I share the concerns Senator Kaufman and others have expressed. Where an unprecedented number of individuals and families are experiencing such profound upheaval, at the very least they deserve a fair and lawful foreclosure process. And where the bankruptcy courts can help alleviate these problems and promote fairness and the chance at a mutually beneficial resolution between a homeowner and a lender, we should be encouraging and supporting them.

In addition to the bankruptcy courts in New York and Rhode Island that are taking these positive steps, I want to commend the Vermont legislature, Vermont's Attorney General, and Vermont Legal Aid for their work in drafting and enacting state legislation to implement a foreclosure mediation program. The Vermont legislature acted quickly on behalf of Vermonters, and I am proud of what they accomplished.

I also want to recognize Chief Judge Colleen Brown of the Vermont Bankruptcy Court for the way in which she has adapted her court's procedures for those who enter bankruptcy while involved in Vermont's foreclosure mediation program. In addition to supporting Vermont's foreclosure mediation process, she has been responsive to foreclosure documentation problems and has worked to ensure that Vermonters are treated fairly and honestly, and that all parties are accountable for the representations they make in court.

I am encouraged to see the Federal Bankruptcy Courts working to ensure that there is not a fraud on the courts. These "best practices" deserve the praise of Senators on both sides of the aisle. I also hope that, where appropriate, the United States Bankruptcy Trustee encourages and promotes this sensible approach, along with others to ensure that fraud is not committee in our bankruptcy courts. I look forward to receiving the testimony of the witnesses before the Committee today and I thank Senator Whitehouse for his commitment to this issue.

# # # # #

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Testimony of John Rao

Attorney,
National Consumer Law Center

Vice President,
National Association of Consumer
Bankruptcy Attorneys

**Before the United States Senate
Committee on the Judiciary**

"Foreclosure Mediation Programs: Can Bankruptcy Courts

Limit Homeowner and Investor Losses?"

February 1, 2011

Senator Whitehouse, Senator Grassley, and members of the Committee, thank you for holding this hearing and for inviting me to testify today concerning the potential role of bankruptcy court loss mitigation programs as an effective tool in addressing our foreclosure crisis and limiting losses to homeowners and investors. I testify here today on behalf of the low income clients of the National Consumer Law Center (NCLC),[1] as well as on behalf of the National Association of Consumer Bankruptcy Attorneys.[2] The clients and constituencies of NCLC and NACBA collectively encompass a broad range of families and households who have been affected by the current foreclosure crisis.

The Treasury Department's Home Affordable Modification Program (HAMP) has failed to reach its goals because it has relied upon the voluntary efforts of servicers, and

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[1] The National Consumer Law Center, Inc. (NCLC) is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of eighteen practice treatises and annual supplements on consumer credit laws, including *Consumer Bankruptcy Law and Practice* (9th ed. 2009); *Foreclosures* (3d ed. 2010); *Truth In Lending* (6th ed. 2007) and *Cost of Credit: Regulation, Preemption, and Industry Abuses* (4th ed. 2009), as well as bimonthly newsletters on a range of topics related to consumer credit and bankruptcy issues. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low income people, conducted training for thousands of legal services and private attorneys on the law and litigation strategies to deal predatory lending and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. NCLC's attorneys have been closely involved with the enactment of all federal laws affecting consumer credit since the 1970s, and regularly provide extensive comments to the federal agencies on the regulations under these laws. This testimony was written with the assistance of Geoff Walsh, NCLC Staff Attorney.

[2] The National Association of Consumer Bankruptcy Attorneys (NACBA) is the only national organization dedicated to serving the needs of consumer bankruptcy attorneys and protecting the rights of consumer debtors in bankruptcy. NACBA has more than 5,000 members located in all 50 states and Puerto Rico. NACBA has been actively involved in promoting reasonable and fair bankruptcy legislation since it was founded in 1992.

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no effective method of enforcement was incorporated into the program's design. I believe that legislation amending the Bankruptcy Code to give bankruptcy courts authority to modify home mortgages in Chapter 13 cases would have been the most effective way to encourage servicers to voluntarily modify home mortgages. Even without that amendment, however, bankruptcy courts can play an important role in assisting voluntary loan modifications through the adoption of loss mitigation programs. Legislation introduced by Senator Whitehouse (S. 222) would avoid unnecessary litigation by clarifying that bankruptcy courts have authority to set up such programs.

In my work as an attorney at NCLC, I provide training and technical assistance to attorneys and housing counselors across the country representing homeowners who are facing foreclosure. Because of my extensive experience in bankruptcy matters, I often speak at educational programs for bankruptcy attorneys, trustees and judges, and I serve as a member of the federal Judicial Conference Advisory Committee on Bankruptcy Rules. I was also appointed as Amicus Counsel to defend the Rhode Island Bankruptcy Court's Loss Mitigation Program from a legal challenge brought by two mortgage servicers. My testimony is based on this work and my many years of experience representing consumers in debt collection, bankruptcy and foreclosure defense matters, initially as an attorney with Rhode Island Legal Services and head of its Consumer Unit.

HAMP Has Failed to Curb the Foreclosure Crisis

The nation continues to endure the worst foreclosure crisis since the Great Depression. According to the Mortgage Bankers Association National Delinquency Survey for the fourth quarter of 2009, the combined percentage of loans in foreclosure or seriously delinquent was 15.02 percent, the highest ever recorded in the MBA

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delinquency survey.[3] Mortgage industry analysts estimate that, from the last quarter of 2008 through 2014, as many as 13 million foreclosures will be started.[4]

The primary government response to the foreclosure crisis has been HAMP, which was initiated by Treasury in 2009. However, HAMP is not providing a sufficient number of permanent loan modifications to homeowners.

Implementation of HAMP by servicers continues to be slow and hampered by administrative problems. While Treasury has made improvements to the program's design in the past year, the lack of compliance by servicers with program guidelines, and the inability of Treasury to enforce program requirements, continues to prevent HAMP from reaching its stated goals. The Administration's most recent report on HAMP progress shows that 549,620 permanent loan modifications have been made.[5] Treasury had initially projected that HAMP would modify 3 to 4 million mortgages over a three year period. Assistant Treasury Secretary Herbert Allison, in responding to questioning in 2009 from the Senate Banking Committee, stated that the program would need to do 1 million modifications per year in order to meet Treasury's goals.[6] With slightly more

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[3] Mortgage Bankers Association, *National Delinquency Survey Quarter 4 2009* (Feb. 19, 2010).

[4] Goldman Sachs Global ECS Research, *Home Prices and Credit Losses: Projections and Policy Options* (Jan. 13, 2009), at 16; *see also* Rod Dubitsky, Larry Yang, Stevan Stevanovic & Thomas Suehr, Credit Suisse Fixed Income Research, *Foreclosure Update: Over 8 Million Foreclosures Expected* (Dec. 4, 2008) (predicting 9 million foreclosures for the period 2009-2012).

[5] United States Department of the Treasury, *Making Home Affordable Program Servicer Performance Report Through November 2010, available at*: www.treasury.gov/initiatives/financial-stability/results/MHA-Reports/Documents/Nov%.

[6] *Preserving Homeownership: Progress Needed to Prevent Foreclosures*: *Hearing Before the Senate Commi. on Banking, Housing & Urban Affairs*, 111th Cong. (July 16, 2009) (Senator Schumer's question of Assistant Treasury Secretary Herbert Allison).

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than 500,000 permanent modifications made as we approach the program's two-year anniversary, HAMP is significantly lagging behind these early projections.

The recent Treasury report also suggests that the number of modifications being made is actually declining, with only 31,290 trial modifications and 29,972 permanent modifications made in November 2010. Moreover, even if HAMP reached its stated goals, the majority of all foreclosures would still be unaddressed.

Another huge problem that developed in the first year of HAMP is that a large number of homeowners were put on temporary loan modifications and then denied permanent modifications. Treasury's November, 2010 report shows that 729,109 homeowners have had their trial modifications canceled since the start of the program. Although trial modifications are intended to last only for three months, many homeowners have been making payments on trial plans for a year or more before even receiving a decision that their permanent modification has been denied based purportedly on some program eligibility requirement. These homeowners are often worse off at this point because they now face renewed foreclosure proceedings and a large arrearage resulting from the difference between their trial plan payment and their regular unmodified mortgage payment. For homeowners who were not in default when they went on the trial modification, they now have negative credit reports that will hurt any chance they may have had to obtain a loan refinancing.

Perhaps the biggest problem with HAMP is that it is effectively the "only game in town." No other national program has been put in place to assist homeowners in foreclosure. To make matters worse, HAMP has relied solely on the voluntary efforts of mortgage servicers to implement the program, and these efforts have been woefully

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inadequate. Neither Congress nor Treasury has developed an enforcement mechanism to combat servicer noncompliance with HAMP. Treasury has used various incentives to encourage servicer participation, but these carrots have not resulted in servicer compliance with HAMP guidelines. Moreover, Congress' failure to amend the Bankruptcy Code to permit mortgage modifications in bankruptcy court has meant that homeowners have not had an effective stick to leverage modifications both in and outside bankruptcy.

Bankruptcy Court Mediation and Loss Mitigation Programs.

The bankruptcy court for the Southern District of New York established the first formal Loss Mitigation Program (LMP) in 2009,[7] followed soon after by a similar program implemented by the bankruptcy court in Rhode Island.[8] A more limited program designed in coordination with the state court foreclosure mediation program has been adopted by the bankruptcy court in Vermont.[9] The stated purpose of the LMPs is to "bring debtors and secured lenders together, to encourage them to discuss mutually beneficial financial resolution of their home mortgage difficulties..."[10] and "to facilitate resolution by opening the lines of communication between the debtors' and lenders' decision-makers."[11] Consistent with the goal of court-annexed mediation and alternative

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[7] *See In re* Adoption of Loss Mitigation Program Procedures, General Order M-364 (Dec. 18, 2008), amended by General Order M - 413 (Dec. 30, 2010), *available at*: www.nysb.uscourts.gov/orders/m364.pdf. Several of the judges in the E.D. of New York have also adopted the program.

[8] *See* General Order Adopting Second Amended Loss Mitigation Program and Procedures 10-002 (Aug. 23, 2010), amending General Orders 09-003 and 10-001; available at http://www.rib.uscourts.gov/newhome/RulesInfo/generalorders.asp.

[9] Vermont Standing Order 10-01, July 1, 2010, available at: http://www.vtb.uscourts.gov/orders/ord10-01.pdf.

[10] *In re* Simarra, 2010 WL 2144150, * 1 (Bankr. D.R.I. April 14, 2010).

[11] New York General Order M-413, p. 1.

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dispute resolution programs, LMPs are intended to "avoid or reduce unnecessary bankruptcy litigation and cost to debtors and secured creditors."[12] In this respect these programs fall squarely within authority granted to bankruptcy courts under Bankruptcy Code section 105(d) and Bankruptcy Rule 7016.

The bankruptcy court programs are similar to the numerous programs adopted nationwide by state and local courts in response to the foreclosure crisis. These courts have recognized the need for a degree of heightened judicial supervision over foreclosures to help avoid hundreds of thousands of families from losing their homes unnecessarily. County courts serving such large cities as Chicago, Philadelphia, Cleveland, and Pittsburgh have implemented foreclosure conference and mediation programs similar to the Rhode Island and New York Loss Mitigation Programs.[13] Courts in smaller cities, as diverse as Santa Fe, New Mexico and Louisville, Kentucky, have followed suit.[14]

In addition to these initiatives from local courts, state supreme courts have implemented similar programs. The New Jersey Supreme Court promulgated rules for a

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[12] Rhode Island General Order 09-003.

[13] Chicago, Philadelphia, Cleveland, Pittsburgh Cook County Chicago Court Program: http://cookcountyforeclosurehelp.org/about/; Philadelphia County: http://s98001.gridserver.com/images/pdf/foreclosure_mortgage/foreclosure_med_prog_by_state/pa_philly_pilot_program.pdf; Cuyahoga County (Cleveland): http://s98001.gridserver.com/images/pdf/foreclosure_mortgage/foreclosure_med_prog_by_state/ohio_prgm_summary.pdf; Allegheny County (Pittsburgh): http://s98001.gridserver.com/images/pdf/foreclosure_mortgage/foreclosure_med_prog_by_state/pa_pitts_admin_order.pdf

[14] Santa Fe First Judicial District Admin Order: http://s98001.gridserver.com/images/pdf/foreclosure_mortgage/foreclosure_med_prog_by_state/nm_admin_order.pdf Jefferson County Kentucky Admin Order: http://s98001.gridserver.com/images/pdf/foreclosure_mortgage/foreclosure_med_prog_by_state/kentucky_admin_order.pdf.

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uniform statewide foreclosure mediation program.[15] In Delaware, the president judge of the state's superior courts issued a mediation rule applicable to all the state's superior courts.[16] The Ohio Supreme Court has established a model program which common pleas courts in many of the state's most populous counties have implemented.[17] Florida's Supreme Court has implemented a statewide initiative that requires mediation automatically in all foreclosure cases filed in that state.[18]

In addition to these court-initiated programs, the legislatures in several states have recently enacted statutes which direct state courts to implement various forms of conference and mediation programs for foreclosure cases. These include programs now in effect in Connecticut, Indiana, Maine, New York, and Vermont.[19] In the non-judicial foreclosure states of California, Oregon, Maryland, Michigan, and Nevada the

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[15] http://www.nj.gov/foreclosuremediation/resources.html.
[16] http://www.deforeclosurehelp.org/mediation.html.
[17] *See:* http://s98001.gridserver.com/images/pdf/foreclosure_mortgage/foreclosure_med_prog_by_state/ohio_prgm_model.pdf . Cities with programs in effect include Cleveland, Cincinnati, Columbus, Toledo, and Akron.
[18] Florida Supreme Court: No. AOSC09-54 *Re: Final Report and recommendations on residential Mortgage Foreclosure Cases* (December 28, 2009) http://www.floridasupremecourt.org/pub_info/documents/AOSC09-54_Foreclosures.pdf.
[19] Connecticut (Conn. Gen. Stat. Ann. § 8-265ee); Indiana (2009 Senate Enrolled Act No. 492); Maine (14 Maine Rev. Stat. Ann. § 6321-A); New York (New York Civil Practice Laws Rule § 3408); Vermont (2010 House Bill 590). The Supreme Court of South Carolina has issued an administrative order that, while not requiring a specific form of conference, requires servicers to certify completion of HAMP-related loss mitigation reviews as a condition to proceeding with a foreclosure in the state. S.C. Administrative Order No. 2009--05-22-01 *Re: Mortgage Foreclosures and the Home Affordable Modification Program (HMP).* *http://www.floridasupremecourt.org/pub_info/documents/AOSC09-54_Foreclosures.pdf.*

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legislatures have enacted forms of conference and mediation requirements for foreclosure cases, with varying degrees of court involvement.[20]

All of these programs, including the Rhode Island and New York Bankruptcy Courts' Loss Mitigation Programs, have several features in common. They are designed to bridge the communication gap between loan servicers and homeowners, a gap that has often been cited as the major obstacle to effective loss mitigation. The programs require active participation by a representative of the servicer with full authority to consider all loss mitigation options. They regulate production of documents and facilitate some form of meeting between the homeowner and servicer, either in person or by phone. The courts play a role in supervising and, when necessary, intervening to move the process along. The programs do not require servicers or lenders to implement a particular loss mitigation option. In the bankruptcy context, these programs importantly do not compel a modification of the mortgage creditor's claim and therefore are not in violation of section 1322(b)(2) of the Bankruptcy Code.[21] Instead, they set a standard for transparency and accountability in the foreclosure process that is often lacking without this intervention. The Rhode Island and New York Bankruptcy Courts' Loss Mitigation Programs have all of these attributes and function with procedures modeled after many similar programs in effect in courts around the country.

Bankruptcy Court Mediation Programs Can Make a Difference

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[20] California (Cal. Civ. Code § 2923.5 and §§ 2923.52-53); Maryland (2010 House Bill 472 (Chapter 485); Michigan (2009 Enrolled Bills 4453, 4454, 4455); Nevada (2009 Enacted Assembly Bill 149); Oregon (Enrolled Senate Bill 628).
[21] *See In re* Simarra, 2010 WL 2144150 (Bankr. D.R.I. April 14, 2010).

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Bankruptcy courts can play an important role in avoiding unnecessary foreclosures and facilitating mortgage modifications through implementation of LMPs. In many respects, bankruptcy courts are ideally suited to facilitate mortgage modifications through implementation of mediation programs such as those in Rhode Island and New York. These reasons include:

1. **Breaking Through Servicer Roadblocks.** Homeowners routinely encounter numerous bureaucratic barriers in attempting to obtain HAMP modifications. Homeowners are repeatedly asked to provide documents because they are lost by servicers.[22] The testimony given by a Rhode Island homeowner at a recent Senate subcommittee hearing conducted by Senator Whitehouse, about his quest to obtain a mortgage modification, is not uncommon.[23] After providing all required documentation to complete his application for a HAMP modification, he was repeatedly asked over a 19 month period to resubmit the same documentation to his mortgage servicer. Despite faxes, overnight deliveries, and almost weekly calls to verify that his application was complete, he received a barrage of conflicting notices from his servicer. Some stated that all documentation had been received, others noted that additional documents were needed, and several informed him that his modification request had been denied because of missing documentation. Often he was simply told to ignore the letters and foreclosure notices, and was assured that his application was being reviewed. When he finally turned

[22] Peter S. Goodman, *Paper Avalanche Buries Plan to Stem Foreclosures,* N.Y. Times, June 28, 2009.
[23] See Testimony of Larry Britt, Hearing before the Senate Judiciary Subcommittee on Administrative Oversight and the Courts, October 28, 2010, available at: www.judiciary.senate.gov/pdf/10-10-28BrittTestimony.pdf.

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to the HAMP Solutions Center, the organization charged by Treasury with handling disputes, he received no help, noting that "it felt like they were reading from the same script as the banks."

Many homeowners are not able to endure these burdensome requests and long delays, and simply give up in their pursuit of a loan modifications. A growing number of homeowners facing foreclosure who are frustrated by roadblocks set up by servicers have turned to bankruptcy as a last resort for saving their homes. This has led to procedural concerns by bankruptcy courts as they struggle with how to handle hearings on chapter 13 plan confirmation and stay relief motions while a HAMP application is pending. Many trustees and judges agree that it makes no sense to proceed with these hearings without first having a decision on the modification request, but they are nevertheless mindful of court docket concerns.

The New York and Rhode Island LMPs address this problem by requiring the debtor and servicer to designate contact persons for the exchange of information. Importantly, the LMPs provide for the entry of a Loss Mitigation Order which specifies time deadlines for requests of information by the servicer and responses by the debtor. If a servicer makes unjustified and duplicative requests for information, the debtor's attorney can seek compliance with the Loss Mitigation Order. Likewise, a servicer can seek to end the process if the debtor does not comply with valid document requests, or a servicer may object to the entry of the Order itself if, for example, the request has been made in bad faith.

2. **Getting a Timely Answer.** Too often homeowners wait for over a year to get a decision on a HAMP modification request. One survey found that the average

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length of time homeowners spend seeking a HAMP loan modification is 14 months.[24] Long delays exist with respect to both decisions on eligibility for trial modifications as well as for permanent modifications. These delays occur despite HAMP guidelines which require servicers to render a decision on a completed HAMP application within 30 calendar days.[25] More troubling than this paralysis in rendering a decision is that homeowners may simply never get a decision at all on a HAMP modification, and are instead offered a "proprietary" modification on less favorable terms than HAMP.

The advantage of mediation programs is that they require that each of the participating parties designate a person having authority to resolve the matter. For example, the New York and Rhode Island LMPs require that each party "must have a designated person with full settlement authority present during the loss mitigation session."[26] The participating parties are also required to negotiate in good faith.[27] The Loss Mitigation Order contains a set of time deadlines, including a designation of a loss mitigation period and the dates for the filing of status and final reports. While these programs do not compel a creditor to provide a loan modification, they ensure that debtors have a fair opportunity for consideration of their HAMP applications by a decision-maker for the creditor. Unlike applications that linger for months outside this process without judicial supervision, a debtor may seek court enforcement of the Loss Mitigation Order. This is critically important for homeowners in non-judicial foreclosure states such as Rhode Island where there is no judge overseeing the foreclosure process.

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[24] *See* www.propublica.org/article/homeowner-questionnaire-shows-banks-violating-govt-program-rules.
[25] U.S. Treasury Dept. HAMP Supplemental Directives, No. 09-07, p. 7; No. 10-01, p. 3.
[26] Rhode Island General Order 09-003, Appx. IX, Part VIII, subpart D.
[27] Rhode Island General Order 09-003, Appx. IX, Part VII, subpart A; New York General Order M-413, Part VII, subpart A.

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The LMPs also provide that at anytime in the process, the parties may request that the court appoint an independent mediator. The experience under the New York and Rhode Island LMPs is that there have been very few requests for mediation. It may be that simply providing a structured forum for the parties (who have settlement authority) to communicate is all that is needed to break the deadlock in getting a HAMP decision. Another factor may be that most debtors in bankruptcy are represented by counsel, who can assist in navigating through the HAMP program requirements. Homeowners in state foreclosure proceedings are not so fortunate. For example, 63% of the homeowners in the New York state court system attended foreclosure mediation conferences without an attorney.[28]

3. **Providing Basic Due Process.** A major failing of HAMP is that homeowners are often never told the reason their modification request has been denied. Participating mortgage servicers routinely fail to comply with Treasury Department guidelines that require notice to a borrower of the reason for rejecting a HAMP application. Servicers frequently do not offer homeowners the opportunity for a review of HAMP denial decisions. The Congressional Oversight Panel noted in its April 2010 Report that servicers were reporting reasons for only 31% of disqualified or cancelled HAMP modifications.[29] Much of the data the servicers did report was plainly erroneous.

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[28] State of New York Unified Court System, 2010 Report of the Chief Administrator of the Courts.

[29] Congressional Oversight Panel: *Evaluating Progress of TARP Foreclosure Mitigation Programs* (April 14, 2010); see also U.S. Government Accountability Office, *Troubled Asset Relief Program, Further Actions Needed to Fully and Equitably Implement Foreclosure Mitigation Programs* GAO 10-634 (June 2010); *Factors Affecting Implementation of the Home Affordable Modification Program* (March 25, 2010); and U.S. Government Accountability Office: *Troubled Asset Relief Program Home*

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For 71% of denials, servicers gave no valid reason. For modification cancelations servicers provided no reason in 72% of cases.[30]

Under the Rhode Island and New York loss mitigation programs, a servicer who wishes to terminate negotiations for cause must state the reasons for this request in filing with the court. In addition, the parties must file status and final reports indicating the progress and outcome of the negotiations. These procedures encourage transparency in the decision-making process and provide an opportunity for homeowners to obtain information that has thus far eluded homeowners and is required to be provided under HAMP.

4. Providing Protection from Foreclosure. HAMP participating servicers are under contractual obligations to consider homeowners for an affordable loan modification before they foreclose. They are required to consider a debtor in an active bankruptcy case for HAMP if a request is made by the debtor, debtor's counsel, or the case trustee.[31] If a homeowner is found eligible under the HAMP program guidelines and placed on a trial plan, servicers must stop the foreclosure and implement the loan modification.[32] However, the HAMP guidelines do not provide this same protection for homeowners while their application is under consideration. Because the foreclosure units

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Affordable Modification Program Continues to Face Implementation Challenges (March 2010).

[30] COP Report, p. 54. The COP Report goes on to state: "[T]he panel is deeply concerned about the unacceptable quality of the denial and cancelation reasons and strongly urges Treasury to take swift action to ensure that homeowners are not denied the opportunity for a modification and shuffled off to foreclosure without a servicer at least accounting for why the modification was denied or cancelled." Among the Panel's specific recommendations in April 2010 were that Treasury impose "meaningful monetary penalties for non-compliance" with the requirement to refrain from foreclosure until the required review is completed.

[31] U.S. Treasury Dept. HAMP Supplemental Directive. No. 10-02, p. 7.

[32] U.S. Treasury Dept. HAMP Supplemental Directive. No. 09-01, pp. 6, 2.

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within a servicer operation (and the law firms that handle the foreclosures) often do not communicate with the loss mitigation units handling modification requests, this "dual-track" system has resulted in a number of homeowners being foreclosed while their applications have been pending, only to be told after the sale that they were eligible for a modification.

Bankruptcy Courts' mediation programs can fulfill a much needed role in ensuring that foreclosures do not proceed without consideration of alternatives if requested by the parties. The automatic stay under section 362 of the Bankruptcy Code protects the homeowner at least until the settlement negotiations can be concluded. If a stay relief motion is filed by the creditor, the LMP provides that any continuances will be made in accordance with Bankruptcy Code section 362(e).[33]

5. Avoiding "Robo-Signer" Abuses by Servicers. There has been considerable press coverage in recent months concerning servicer abuses in the filing of false affidavits in foreclosure court proceedings. These affidavits are presented to verify the amounts owed on the mortgage debt and to confirm that the party filing the foreclosure action has standing and is the real party in interest as the holder and owner of the mortgage and note. Depositions in state foreclosure actions have revealed that these "robo-signers" often sign hundreds of affidavits per day attesting to facts not within their personal knowledge, and that the affidavits have not been properly notarized.

This problem is not new to bankruptcy courts. Long before the recent press coverage involving state court proceedings, bankruptcy courts have exposed false affidavit abuses in proceedings often brought by consumer bankruptcy attorneys and

[33] Rhode Island General Order 09-003, Appx. IX, Part VI, subpart B; New York General Order M-413, Part VI, subpart C.

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judges in these cases have taken appropriate action in response.[34] If there are concerns that a loan modification may be entered into by a servicer who does not have authority to

[34] *See, e.g.*, *In re* Lee, 408 B.R. 893 (Bankr. C.D. Cal. 2009) (Rule 9011 sanctions imposed on creditor's attorney for failure to disclose transfer of ownership of note, failure to join true owner in motion for relief from bankruptcy stay, and for submitting copy of note with motion that was not true and correct copy of the original note); *In re* Taylor, 407 B.R. 618 (Bankr.E.D.Pa. 2009)((local law firm violated Rule 9011 by allowing its attorneys to sign off on electronic filings for stay relief motions prepared by non-attorneys working with national computer data base; finding that proofs of claim filed by national firm were prepared by clerks who are not legally trained and are not paralegals, and that attorney for firm reviews only a random sample of 10 per cent of filed claims), *rev'd*, 2010 WL 624909 (E.D. Pa. Feb. 18, 2010) (setting aside bankruptcy court's findings of Rule 9011 violations by specific local counsel, but noting concerns about wider LPS practices that were the subject of lengthy critical analysis by bankruptcy court); *In re* Cabrera-Mejia, 402 B.R. 335 (Bankr. C.D. Cal. 2008) (sanctioning law firm under Rule 9011 and Bankr. Rule 105(a) after it filed twenty-one motions for relief from stay with the court without factual investigation and without properly authenticated documents to support claims). *In re* Haque, 395 B.R. 799 (Bankr. S.D. Fla. 2008)(law firm Florida Default Law Group and creditor Wells Fargo jointly and severally sanctioned $95,130.45 for filing 45 false affidavits related to stay relief motions in which a bogus "penalty interest" fee was charged to debtors); *In re* Prevo, 394 B.R. 847, 851 (Bankr. S.D. Tex. 2008) (reviewing servicers' practices of inflating proofs of claim with undocumented and excessive fees, court concludes, "[b]ased upon hearings in this and other cases, the Court believes that certain members of the mortgage industry are intentionally attempting to game the system by requesting undocumented and potentially excessive fees and then reducing those fees in amended proofs of claim only after being exposed by debtor's counsel."); *In re* Stewart, 391 B.R. 327, 346 (Bankr. E.D. La. 2008) (servicer falsely represented BPO as pass through of a charge of between $90 and $125, when it actually paid $50 for each inspection; servicer also improperly compounded late fees to charge $360.23 over thirteen months for one $554.11 missed payment); *In re* Parsley, 384 B.R. 138 (Bankr. S.D. Tex. 2008) (inaccuracies regarding account arrears alleged in motion not detected in part because national default service firm's engagement letter with local law firm specifically prohibited any communication between local firm and its client, the mortgage servicer); *In re* Osborne, 375 B.R. 216 (Bankr. M.D. La. 2007) (attorney sanctioned for filing affidavit alleging debtor defaulted on agreement despite attorney's lack of personal knowledge); *In re* Ulmer, 363 B.R. 777 (Bankr. D.S.C. 2007) (awarding $33,500 in sanctions and finding that affidavits of default related to motions for relief from stay prepared by out-of-state paralegals were not executed before a notary public and may not have been reviewed and signed by attorney whose signature appeared on the affidavits); *In re* Rivera, 342 B.R. 435 (Bankr. D.N.J. 2006) ($125,000 sanctions imposed on foreclosure law firm for filing default affidavits in 250 stay relief motions using "blanks" that were pre-signed by employee who no longer worked for servicer), *aff'd*, 2007 WL 1946656 (D.N.J. June 29, 2007); *In re* Porcheddu, 338 B.R.

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act on behalf of the true owner of the mortgage, or if the homeowner contends that the unpaid amount of the debt listed in the loan modification agreement includes fees and charges not permitted by the mortgage documents or state law, these matters can be resolved by the bankruptcy court as part of the claims allowance process under sections 501 and 502 of the Bankruptcy Code.

6. Ensuring Proper Review of Modification Agreement. More troubling than servicer paralysis in rendering decisions on HAMP applications is that homeowners may simply never get a decision at all, and are instead offered some "proprietary" workout on less favorable terms than HAMP. For the first three quarters of 2010, only 30 per cent of modifications by servicers were completed under HAMP.[35] It is not at all certain that the 70 per cent of homeowners receiving non-HAMP modifications were properly evaluated for HAMP before a proprietary modification was offered, as required by Treasury guidelines. What is clear, based on the analysis of the Congressional Oversight Panel, is that HAMP provides a "modification offering more relief to the borrower and having a lower likelihood of redefault" than a non-HAMP modification.[36]

In an LMP, any loan modification or other settlement reached by the parties will be submitted to the court for approval. The debtor's counsel, chapter 13 trustee, and the

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729 (Bankr. S.D. Tex. 2006) (foreclosure law firm sanctioned for filing false fee applications and misrepresenting that fee statements were based on contemporaneous time records); *In re* Brown, 319 B.R. 876 (Bankr. N.D. Ill. 2005) ($10,000 sanction imposed on national mortgage servicer for groundless stay relief motion based on false motion); *In re* Gorshtein, 285 B.R. 118 (Bankr. S.D.N.Y. 2002)(sanctions imposed on mortgage creditors and their attorneys for filing motions for stay relief based upon false certifications that debtors had failed to make postpetition payments).

[35] HOPE NOW Alliance, Industry Extrapolations and Metrics (November 2010), p. 4.

[36] Congressional Oversight Panel, December Oversight Report, A Review of Treasury's Foreclosure Prevention Programs, Dec. 14, 2010, p. 34.

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court thus have an opportunity to consider whether the debtor was properly evaluated for HAMP and other programs, and whether the agreement is in the debtor's best interest.

7. **Dealing with Second Mortgages.** A major impediment to loan modifications has been the existence of secondary mortgage loans. Treasury estimates that up to 50 percent of at-risk mortgages have second liens.[37] Many servicers are reluctant to modify a first mortgage if the second mortgage holder does not consent or agree to subordinate its mortgage, and second mortgage holders have not been willing to cooperate. HAMP has recently attempted to address this problem through its Second Lien Program, but it is unclear whether it will overcome barriers to participation by second lien holders and thus far there have been very few participants.

Loan modifications facilitated in a bankruptcy court LMP resolve this problem because all of the liens on the property can be provided for in the debtor's chapter 13 plan based on a uniform set of laws and valuation standards. If the amount of the senior mortgages on the property exceeds the value of the home, any "underwater" junior mortgages can be voided or "stripped off" and treated as an unsecured debt under the debtor's plan. More than 76 percent of first mortgages in permanent HAMP modifications have a negative loan-to-value ratio.[38] Thus, many homeowners seeking HAMP modifications would be able to provide for junior mortgages by making affordable payments on them in a chapter 13 plan, thereby permitting a modification of the first lien over the objection of junior mortgage holders.

8. **Dealing with the Homeowner's Entire Debt Load.** Finally, another problem not addressed by HAMP is that many homeowners are burdened with debt other

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[37] *See* Dept. of Treasury Making Home Affordable Program Update, April 29, 2009.
[38] COP December Oversight Report, *supra* note 36, p. 28.

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than their home mortgages. Unable to refinance their homes, many homeowners are struggling to pay off credit card, medical bills, and other non-mortgage debt. This problem is made more acute by the current unemployment situation, with many homeowners experiencing a loss or reduction in family income. A recent Treasury report shows that after receiving a HAMP loan modification, homeowners on average still have a back-end debt-to-income ratio of 62.4 per cent.[39] A Congressional Oversight Panel report states that one-third of HAMP permanent modifications have back-end DTI ratios of more than 80 per cent.[40] While HAMP requires borrowers whose back-end DTI is 55 percent or greater to obtain credit counseling, there is no plan to directly assist homeowners in dealing with unmanageable debt.

Loan modifications made during a bankruptcy proceeding address this problem because all of the family's financial problems are dealt with under the supervision of a court approved Chapter 13 plan or discharged in a Chapter 7 case. In this way homeowners are far more likely to avoid default on a mortgage modification.

Results So Far Are Promising

From November 1, 2009 through December 31, 2010, loss mitigation requests were filed in approximately 11.8 per cent of the cases filed in Rhode Island during that period (chapter 7 debtors are also permitted to request loss mitigation). Of those cases that have completed the loss mitigation mediation process, approximately 35 per cent

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[39] The back-end DTI is the ratio of total monthly debt payments (including mortgage principal and interest, taxes, insurance, homeowners association and/or condo fees, plus payments on installment debts, junior liens, alimony, car lease payments and investment property payments) to monthly gross income. *See* November 2010 HAMP Servicer Performance Report, www.treasury.gov/initiatives/financial-stability/results/MHA-Reports/Documents/Nov%.

[40] COP December Oversight Report, *supra* note 20, p. 102.

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have resulted in a successful approved loan modification.[41] Similar results have been obtained under the New York LMP. For many of these participating debtors, it is likely they would not have obtained modifications if the LMP had not been in place. Moreover, the number of modifications attained should not be the only goal of LMPs. Providing for a fair and transparent process, judicial efficiency, and speedy outcomes are other measures of success. Importantly, those that complete the LMP process now have a decision upon which they may move on with further proceedings in their cases, and ultimately their lives, even if that may involve a plan to sell or surrender the property.

Conclusion

To help facilitate the adoption of bankruptcy court mediation and loss mitigation programs, we would welcome the opportunity to discuss with the Committee the following recommendations:

1. **Clarifying Bankruptcy Code Amendment.** We firmly believe that bankruptcy courts currently possess authority to adopt mediation and loss mitigation programs under section 105(d) of the Bankruptcy Code, Bankruptcy Rule 7016, and the inherent authority of the courts themselves. The Bankruptcy Court for the District of Rhode Island just recently issued a decision rejecting a challenge to the Rhode Island LMP and finding that such authority does in fact exist.[42]

However, to avoid unnecessary litigation such as in Rhode Island and to address any uncertainty and hesitation on the part of local courts to adopt such programs, Congress should consider enacting a clarifying amendment to section 105(d) of the

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[41] This slightly undercounts the success rate as 7 cases had more than one approved modification agreement.
[42] *In re* Sosa, --- B.R. ----, 2011 WL 258673 (Bankr. D.R.I. Jan. 28, 2011).

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Bankruptcy Code making clear that the courts have authority to set up programs. This would be similar to what was done in 1994 when Congress added subsection (d) to section 105 in order to clarify that the full range of settlement and conference procedures authorized under F.R. Civ. P. 16 are available in bankruptcy cases.

We understand that Senator Whitehouse is planning to introduce a bill that would amend section 105 in this manner. We believe that this proposed legislation would provide a great benefit to consumer debtors and the bankruptcy system.

2. **Promotion by the Executive Office of the United States Trustees.** We believe that the Executive Office of the United States Trustees should take an active role in encouraging local bankruptcy courts to adopt mediation and loss mitigation programs. The EOUST should prepare and make available model local rules or standing orders to implement such programs that courts may use, perhaps based on those already issued by the New York and Rhode Island courts. The EOUST should also release a memorandum which sets forth the legal authority bankruptcy courts have for adopting such programs. Finally, the EOUST can enlist the cooperation of Chapter 7 and 13 trustees in setting up such programs and provide them with materials and training support for their participation in mediation programs. All of these actions are within the EOUST's stated mission of promoting the integrity and efficiency of the bankruptcy system.

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Testimony of Anthony B. Sanders
Judiciary Committee, U.S. Senate
Washington, D.C.
February 1, 2011

Mr. Chairman and Members of the Committee:

My name is Anthony B. Sanders. I am Professor of Finance, Distinguished Professor of Real Estate Finance and Senior Scholar at the Mercatus Center at George Mason University. My research focuses on real estate finance, securitization and housing economics.

Thank you for the invitation to testify before you today.

Declining House Prices, Unemployment Make Loan Modifications Very Difficult

When President Obama was elected in November 2008, the Case and Shiller Composite-10 index was 165.95, down from its peak in June 2006 of 226.29. The unemployment rate in November 2008 was 6.5%, up from 4.8% at the peak of the housing bubble in June 2006. According to the most recent releases, the Case Shiller index has declined further to 157.28 (November 2010) while unemployment has risen to 9.1% (December 2010). [See Figure 1]

While housing and unemployment numbers are disturbing at a national level, they are far worse in many states. House prices a haven fallen substantially in the "sand states" of Florida, Arizona, Nevada and California (each over 40% from peak to recent). Other states such as Rhode Island, Maryland and Michigan have experienced a decline of over 20% in house prices [See Figure 2]. In terms of unemployment, Nevada, California and Florida have unemployment rates far higher than the national average of 9.1%. [See Figure 3]

Thus, until unemployment starts to shrink dramatically and housing prices began a serious recovery, successful loan modifications will be very difficult to achieve.[1] The forecast for unemployment is not positive, so difficulties in loan modifications are likely to continue. [See Figure 4]

Government Intervention in Loan Modifications

The Obama Administration announced the Making Home Affordable ("MHA") program on February 18, 2009 shortly after President Obama was sworn into office. The goal to help as many as three to four million financially struggling homeowners avoid foreclosure by modifying loans to a level that is affordable for borrowers now and sustainable over the long term. $45.6 billion was allocated to support MHA.

[1] The private market is facing similar headwinds.

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Between the GSEs and the Non-GSEs, a total 1,466,488 of loan modifications were started.[2] As of December 31, 2010, a total of 734,509 trials were cancelled with 673,919 mortgages were still undergoing modification, either permanently or on a trial basis. Of those, 521,630 were active permanent modifications and 152,289 were active trial modifications in limbo. In other words, the active permanent modifications to trials started are only 35.6%. These numbers are far lower than the original goal of 3-4 million loan modifications. If we compare the number of successful permanent modifications as a percent of the funds that have been allocated, the cost of each loan permanently modified is $87,418.28 per loan.[3]

As I mentioned previously, the collapse of housing prices and high, sustained unemployment makes it very difficult for Home Affordable Modification program (HAMP) to be successful. When you add the investors and mortgage insurers to the mix, the servicer may be conflicted in terms of offering a loan modification or the terms of the modification that please everyone (or anyone).

Clearly, the HAMP program has been a very costly program that has achieved relatively few loan modifications resulting in permanent foreclosure avoidance. Since the goal of home preservation (where loan modifications are used to keep borrowers in their home) may be the inappropriate objective, perhaps it is time to consider other alternatives.

Alternatives to HAMP and HAMP-related Programs

A number of alternative proposals to HAMP and voluntary, privately initiated current servicer programs for loan modification have been proposed. They range from dramatic principal reductions (e.g, Hubbard and Mayer[4]) to loan modifications for the unemployed.

Whatever proposal Congress pursues, it will be a steep hill to climb. Lenders filed 3.8 million foreclosures in 2010 and even more are expected to be filed in 2011. It is projected that the foreclosure wave will subside in 2012, but not before several million foreclosure notices have been filed. And we can only hope that house prices have started rising again in 2012 and unemployment begins to decrease.

The Hubbard-Mayer proposal highlights the difficult of a government solution to the problem. Essentially, Hubbard and Mayer advocate having Fannie Mae and Freddie Mac reduce borrower loan principal through refinancing on mortgages they insure or hold. The borrower's principal would be reduced to local house price levels, thus negating the negative equity problem and partial income curtailment problems.

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[2] http://www.sigtarp.gov/reports/congress/2011/January2011_Quarterly_Report_to_Congress.pdf

[3] This is not the "true" cost per loan, simply a representation of the cost of HAMP given that permanent modifications have been extremely modest.

[4] http://www.nytimes.com/2010/09/19/opinion/19hubbard.html?_r=2&adxnnl=1&rref=opinion&pagewanted=1&adxnnlx=1284899990-ve6qTvd4bPS5vlT0vokRsQ

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"Would the refinancing program increase the federal budget deficit? No. In fact, the change will probably reduce the federal deficit in the long term. Taxpayers are already on the hook for hundreds of billions of dollars of likely losses from loan guarantees to Fannie Mae and the other agencies. If we can lower mortgage payments for struggling homeowners, it will reduce future foreclosures on federally backed loans, providing savings to taxpayers." Source: Hubbard and Mayer, New York Times, 09/19/2010.[5]

While it is true that their plan would lower mortgage payments and may reduce future foreclosures, the costs are staggering (not free). Someone has to bear the losses of the principal reductions and interest rate reductions. Fannie and Freddie bondholders would have to accept lower interest payments and suffer large declines in bond value (also known as a haircut). In addition, Fannie and Freddie cannot cast a magic spell and decree that borrowers have to refinance their mortgages; borrowers would have to go through the refinancing process. Finally, the bondholders purchased these bonds without any understanding that the government would step in and reduce their value.

Stepping into markets with "ex-post contracting" is dangerous because it sends a signal to the global community that the government cannot be trusted to deliver what was promised. The problem, of course, is that the best intended government attempt to fix the crisis may not work, leaving investors (such as China, pension funds, insurance companies, etc) with a jaundiced eye about U.S. debt, whether Fannie/Freddie debt or national debt. Of course, this eventually leads to higher interest rates and a lower demand for our debt securities, further destabilizing the American economy and preventing economic recovery.

As I have testified before, we need to restore confidence in the securities markets, not surprise and anger the markets.

Bankruptcy Court and Loan Modifications

One of the objectives of government loan modification programs is home preservation. Home preservation is achieved when loan modifications are used to keep borrowers in their home. The desire to keep borrowers in their home must make economic sense to both the investor and servicer.

There is a movement to provide homeowner relief by allowing bankruptcy courts to force the borrower and servicer to into attempting to mediate a solution. The servicer would be required to make a good faith effort at offering a loan modification; whether good faith requires the servicer to be willing to modify the loan may be an open question under this legislation.

We already have HAMP and individual lender/servicer programs in place; do we really want yet another variation of HAMP (through bankruptcy courts)? While legislation

[5] http://www.nytimes.com/2010/09/19/opinion/19hubbard.html?_r=2&adxnnl=1&ref=opinion&pagewanted=1&adxnnlx=1284899990-ve6qTvd4bPS5vlT0vokRsQ

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mandating mediation between the parties sounds benign, there are several serious problems with this approach to the loan modification problem.

First, having a mandatory mediation assumes that a borrower would be better-off in their home as an owner than as a renter. Given the prevalence of negative equity and the large supply of vacant and rentable property in the country, it is highly likely that many borrowers would be better off renting. Homeownership is expensive and not for everyone since it has always been a risky investment.[6] Just based on tax reasons, many households are in a very low marginal tax rate already; hence, the interest and property tax deduction is thrown away or valued at a low rate. Renting is more efficient in terms of taxation. When you combine the tax disincentives with the risk of homeownership, borrowers would often be better-off renting and getting a fresh start.

As Raphael Bostic, HUD's Assistant Secretary for Policy Development and Research, stated in a recent Washington Post interview,[7]

"In previous eras, we haven't seen people question whether homeownership was the right decision. It was just assumed that's where you want to go. You're not going to hear us say that."

Second, a mandatory mediation adds additional costs and delays to the process, a process that is already severely strained. The average time to liquidation of a house averages 17 months already (costing the investor/lender lost interest and asset value declines). If bankruptcy becomes more appealing to borrowers because of the mandatory mediation, we would expect rather onerous delays in moving borrowers to foreclosure. Furthermore, the mandatory modification may result in borrowers bypassing HAMP (or lender/servicer programs) and go directly into bankruptcy.

Third, Fannie Mae and Freddie Mac, the mortgage giants, have expansive data bases and models regarding the likelihood of a borrower surviving with a loan modification. If Fannie Mae and Freddie Mac are having trouble with serious delinquencies and foreclosures, what are the odds that a bankruptcy court can intervene with a sensible loan modification solution that Fannie/Freddie couldn't direct its servicers to accomplish?

Fourth, any requirement of mediation between a borrower and the servicer must be made explicit when the mortgage loan is originated and the securities are created. As of now, there is no understanding by borrowers or investors that mandatory mediation in bankruptcy is required, or that it is even possible. This represents another "surprise" to investors and other market participants which is almost always viewed negatively. Creating more surprises may further decrease interest in mortgage-market investment, resulting in less available mortgage credit and higher interest rates.

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[6] I was quoted in the New York Times in 1988 concerning Governor Dukakis' proposal concerning getting more lower income households into homeownership: "Ask investors in Houston how they would have liked it if they'd been stimulated to buy housing," Professor Sanders said, referring to the housing crash in Texas.
[7] http://www.washingtonpost.com/wp-dyn/content/article/2010/07/20/AR2010072005946.html

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Finally, while mediation may result in more loan modifications being made, we know that the failure rate on loan modifications is about 50%. And this could be higher if house prices continue to be soft and unemployment doesn't improve. Stated differently, if the standards for getting a loan modification are lowered, the more likely it is that the failure rate for loan modifications would increase.

In summary, the housing market needs to recover and persistent attempts at delaying foreclosure (whether through mediation or moratorium) only adds additional uncertainty to the housing market and slows any recovery.

I suggest that lenders/servicers continue their efforts to offer sensible loan modification programs. Mediation in Chapter 13 could cannibalize HAMP and private market attempts at loan modifications. And we need to reconsider that policy of keeping borrowers in their homes if it does not make economic sense to any of the parties involved.

Thank you for your willingness to let me share my thoughts with you.

Figure 1. S&P/Case-Shiller Home Price Indices as of November, 2010.

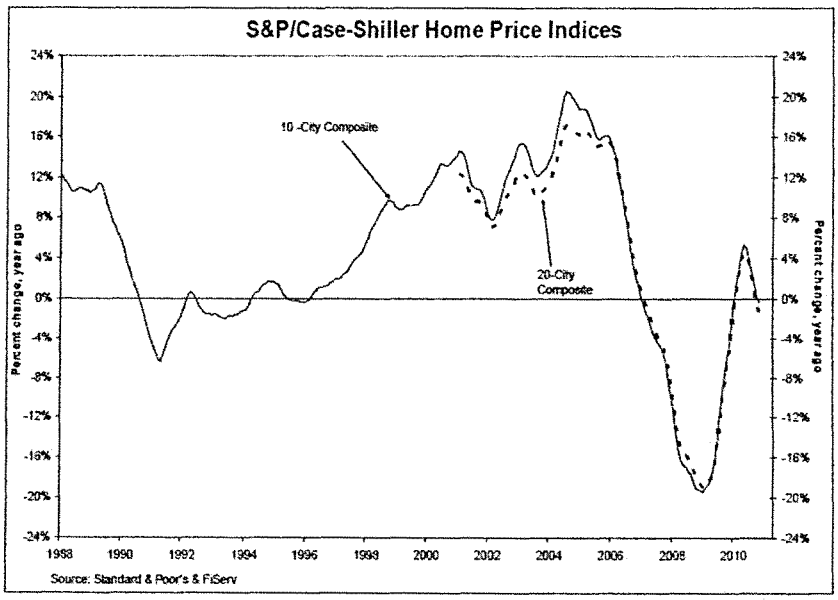


Figure 2. Peak-to-current house price declines illustrating the difficulty in performing loan modifications in states where house prices have declined more than 15% (red).

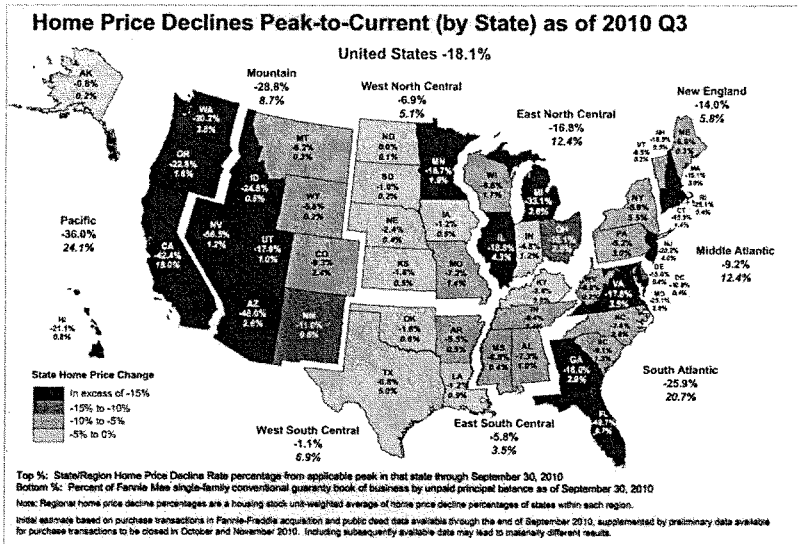


Figure 3. Unemployment rates in the U.S. and Nevada, California and Florida.

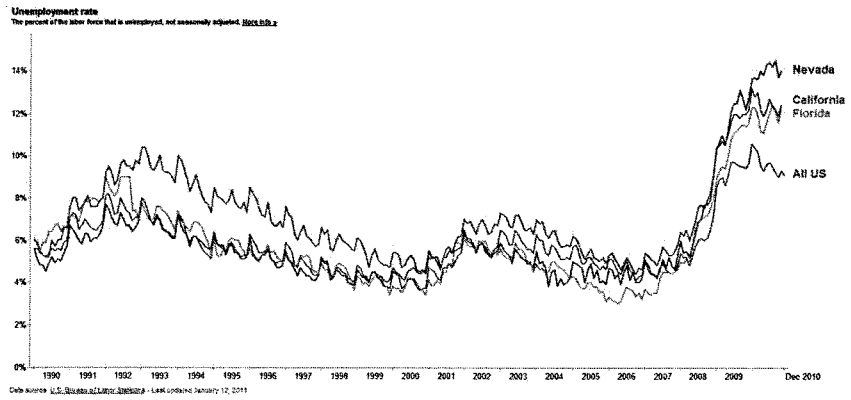
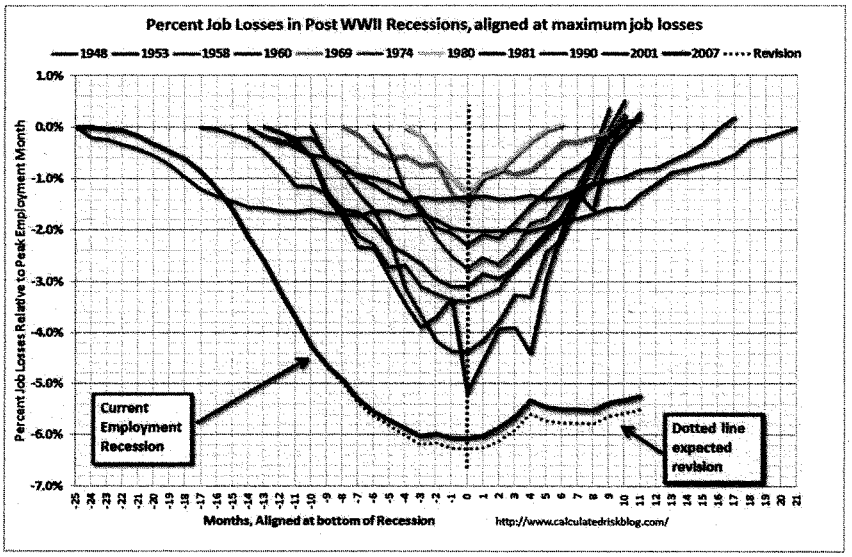


Figure 4. Unemployment is very slow to recover after the last recession making loan modifications very difficult to sensibly achieve.



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POLITICS | FEBRUARY 1, 2011

Banks Boost Home-Loan Relief

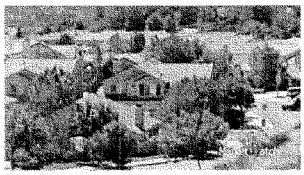
Direct Talks With Borrowers Get More Results Than Government's Mortgage-Modification Program

By ROBBIE WHELAN and ANTHONY KLAN

As the federal government's flagship mortgage-modification program comes under scrutiny for failing to meet its goal of helping three to four million troubled homeowners, state-level efforts to boost modifications appear to be picking up momentum.

The Treasury reported Monday that the government's Home Affordable Modification Program, or HAMP, had provided permanent help to 521,630 homeowners since the program began in spring 2009.

By comparison, over the same period, banks negotiating directly with borrowers have made about two million permanent loan modifications outside the government's program. These modifications continued to rise in recent months even as the number of HAMP modifications trailed off.



The U.S. housing market may take five or six more years to recover, TrimTabs Investment Research warned recently. Madeline Schnapp, director of macroeconomic research at TrimTabs, talks to MarketWatch's Alistair Barr about what that means for the world's largest economy.

Critics of HAMP say the program has made little impact on the housing market and should be ended. Last week, House Republicans introduced a bill to end the effort, calling it a "colossal failure." The administration defends the program.

"I think we've got to remember that HAMP has achieved over a half-million modifications. These are people that make $50,000 a year, so to sort of write it off and say, 'Well, it's a failure,' I think is not really appropriate," said Tim Massad, an acting assistant Treasury secretary, in a hearing on Capitol Hill last week.

Banks say they are doing more of their own modifications—and fewer HAMP mods—because eligibility requirements for HAMP are more stringent. Once a borrower is deemed ineligible for the government program, a modification worked out directly with the bank sometimes is the best option.

But also having a big impact are state mandates requiring banks and loan-servicing companies to hold mediation sessions with borrowers prior to foreclosing, said lawyers for delinquent borrowers and judges handling foreclosure cases.

About 20 states encourage some type of foreclosure mediation program to allow borrowers and lenders to hammer out a settlement, according to the Center for American Progress, a liberal Washington think tank. Three of those states—New York, Florida and Connecticut—and a handful of cities make mediation mandatory.

In Florida, Fannie Mae has begun testing a foreclosure-prevention program to get banks to meet with troubled

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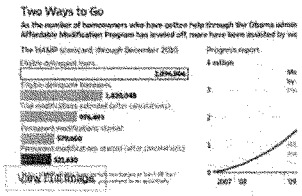

borrowers to negotiate mortgage modifications and other alternatives before filing foreclosure documents in court.

"If they're looking at mounting legal costs and risks to foreclose, then the workout process might seem like the best option," said Alan M. White, a professor of law at Valparaiso University in Indiana, who has written extensively on the mortgage crisis. "Banks have got states preventing you from foreclosing...dismissing cases and ordering mediation, those are just two tools that state judges have."

Others say banks are more willing to modify loan terms—which generally means reducing interest rates, forgoing late fees and extending the terms of loans—because it's starting to be cheaper than completing a foreclosure. In some cases, in some states, that process can take years and thousands of dollars in legal fees to complete.

Among the banks to ramp up modifications isWells Fargo & Co., which plans to hold 20 large-scale mediation sessions across the country this year. More than 150,000 borrowers who have missed payments, or have been in modification negotiations, have or will be invited to come to hotels and convention centers for rapid-fire meetings the bank hopes will result in loan modifications.

That's what happened to Patricia Yador, 53, of West Orange, N.J. at a "home preservation workshop" held at the Marriott hotel in downtown Brooklyn last Tuesday. Wells Fargo, her mortgage servicer, agreed after a mediation conference to knock more than 2 percentage points off the interest rate on her $300,000 mortgage.

That cut her monthly payments from $3,257 to $2,833.

"These are tears of joy because [before] they always turned me down," said Ms. Yador, who has owned her home for 17 years and lives on $2,100 in disability and pension payments since she stopped working as a hospital accounts manager about three years ago.

Ms. Yador was one of 30,000 borrowers that Wells Fargo invited to participate in the modification fair in the New York-New Jersey area. Borrowers like Ms. Yador, who end up in a non-HAMP modification, are far more common than those who go through the government program. Of the roughly 600,000 loan modifications made by Wells Fargo since January, 2009, 86% have been done outside of HAMP, and 14% through HAMP.

HAMP offers servicers financial incentives to reduce loans to 31% or less of a borrower's income, but it also has stringent requirements for eligibility. Borrowers who have lost their jobs or who have expensive medical conditions or other debts often are rejected by HAMP.

A Wells Fargo spokesman said the modification fairs are driven by the bank's desire to do right by its customers. But others say the stepped up efforts are in response to ratcheted-up pressure from the states.

For the last two years in Philadelphia, where foreclosures are handled by judge, courts have moved to a system where they automatically schedule a "conciliation conference" within 30 to 45 days of each foreclosure filing.

Servicers are required to send a representative in person or by telephone to these conferences. If they fail to do so, the case can be postponed. The courts also keep mediators and pro bono housing lawyers on hand to serve borrowers.

"Yes, we are asserting pressure, but it's almost as if they want the pressure," said Annette Rizzo, a judge with the Court of Common Pleas in Philadelphia. "The banks always say that reaching out to homeowners, it's a black hole. It's so hard to connect with them. That's what we offer, to connect with them."

About 75% of eligible, struggling homeowners show up for and participate in mediation sessions in Philadelphia court rooms, and they have produced about a 35% success rate for about 14,000 loans according to an evaluation of the program to be released next month. Programs in Staten Island, NY and Bloomington, Indiana, have produced similarly high participation rates.

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To be sure, not every mediation or modification results in significant savings for homeowners and it's not clear how these modification will perform over time.

In the third quarter, modifications done in the HAMP program reduced monthly payments by an average of $585, almost double the $332 reduction in payments for modifications done outside the HAMP program. Those loans with modifications that reduced payments by 10% or more were almost twice as likely to be current than those loans with modifications that reduced payments by less than 10%.

—Alan Zibel contributed to this article.

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Statement of

The Honorable Sheldon Whitehouse

United States Senator
Rhode Island
February 1, 2011

Last October, I convened a subcommittee hearing in Providence to examine a novel approach to reducing foreclosures that has been adopted by the Bankruptcy Court for the District of Rhode Island. Under the foreclosure loss mitigation program, the court, at the petition of the homeowner or loan servicer, will order the parties to see if settlement would be mutually beneficial. While the settlement must be consensual and none is required, the mere act of sitting the homeowner down with someone who has the authority to modify the mortgage or agree to another commonsense settlement often is enough to avoid a costly and painful foreclosure. It is often the first time the homeowner gets that chance. The Rhode Island program is modest, but I believe that it has the potential to help many thousands of homeowners, and help is definitely needed.

As the foreclosure crisis continues in Rhode Island and across the nation, the Administration's Home Affordable Modification Program, while well-intentioned, has not succeeded in producing anywhere near enough modifications to stem the tide of foreclosures. The Congressional Oversight Panel recently estimated that the HAMP is on pace to modify 700,000 to 800,000 mortgages – far short of the three to four million that was the original goal of the program and nowhere near the eight to thirteen million foreclosures expected through 2012. Even the relatively few homeowners that manage to get HAMP modifications must endure a disorganized and often harrowing process.

Members of Congress hear frequently from our constituents being ignored and abused throughout the modification process: documents repeatedly lost, inconsistent advice, hours trapped on the phone, common sense turned on its head to reject fair modifications or even short sale requests in favor of foreclosure. We have likely heard from our mayors about the terrible collateral cost to communities from foreclosure. We have seen the big loan servicers drag their feet in the HAMP. And, we have learned that these companies were playing fast and loose in the foreclosure process, carrying out foreclosures in the cheapest manner possible, often outsourcing the process to "foreclosure mill" document processing companies. Tragically, these foreclosures are often unnecessary, indeed often not even in the mortgage holder's best interests, but they are driven forward by conflict-ridden bureaucratic machinery that lacks the most basic American failsafe: the chance to talk to a responsible human being who can make an actual decision.

The bankruptcy court loss mitigation programs won't save every home, but they can help countless frustrated homeowners cut through the bureaucratic nightmare and get answers to their modification requests. Because foreclosures can trash the value of a house, loss mitigation

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programs can save investors money too. Servicers too often act in their own fee-driven interests and not in the interests of the investors who actually hold the mortgages. A court-supervised negotiation can ensure that servicers don't reject reasonable settlements that would benefit the investors.

Loss mitigation programs have important benefits even for servicers. Bankruptcy courts have the power to clear title questions with respect to mortgages. Court approved settlements can protect servicers against future investor litigation. Pooling and servicing agreements often leave servicers unsure if they should modify mortgages or foreclose. A court can help to alleviate this uncertainty by signing off on the reasonableness of a settlement.

Ultimately, giving bankruptcy court judges the power to reduce the principal on primary residence mortgages would be the most efficient and least costly way to keep families in their homes, but that is not the topic of today's hearing. This morning we will focus on far more modest loss mitigation programs, which, without conferring any new substantive powers on bankruptcy courts, have proven effective in avoiding unnecessary foreclosures.

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