Analysis of Recent Reports from the Monitor of the National Mortgage Settlement

August 22, 2013

On June 19, 2013, Joseph A. Smith, Jr., Monitor of the National Mortgage Settlement, issued *Summary of Compliance: A Report from the Monitor of the National Mortgage Settlement*.[1] This was the Monitor's first report on the settling banks' compliance with the servicing standards set forth in the Settlement. The report shows that the servicers have made progress in improving their servicing standards. At the same time, the report shows that four of the five banks have failed at least one metric (but no more than three metrics) testing their compliance with the standards out of a total 29 evaluated at that point. Pursuant to the provisions of the settlement, the Monitor reports working with the banks on corrective action plans (CAPs), and we will have to wait until the next report to see whether the banks' CAPs and remediation measures (where required) are effective, and how the banks have performed since the last reporting period.

As a whole, however, the report shows that in many ways borrowers are receiving improved servicing from these banks, and it illustrates that borrowers now have the benefit of more in-depth and transparent oversight of the servicing practices of these banks. It is also important to remember that the servicing standards in the Settlement formed the basis for the CFPB's servicing rules, which will go into effect on January 1, 2014, and will apply to all servicers.[2]

On August 22, 2013, the Monitor released his final consumer relief report, *Final Progress Report*, detailing the progress the five largest mortgage servicers have reported in meeting their borrower relief obligations under the settlement.[3] The report shows that over $51 billion in gross benefits have been provided to more than 643,000 borrowers. Of this amount, Bank of America has provided $27.9 billion in relief to 326,000 customers; Citi has provided $3.5 billion in relief to 58,000 customers; Chase has provided $11.2 billion in relief to 126,000 customers; Wells has provided $8 billion in relief to 122,000 customers; and the ResCap Parties have provided $659 million in relief to 8,900 customers. Just under half of all assisted borrowers received a loan modification or extinguishment with a significant amount of principal forgiveness through the first sixteen months of the settlement. Indeed, based upon the raw numbers (that have not yet

[1] *Summary of Compliance: A Report from the Monitor of the National Mortgage Settlement* (Office of Mortgage Settlement Oversight June 19, 2013), ***available at*** https://www.mortgageoversight.com/wp-content/uploads/2013/06/printablesummary.pdf.

[2] The CFPB rules include a partial exemption for small servicers, defined as one which, together with its affiliates, services (either as the originator or as an assignee) 5,000 or fewer single family residential mortgage loans, as of January 1st of any given year, and housing finance agencies regardless of size. Mortgage Servicing Rules under the Real Estate Settlement Procedures Act (Regulation X), 78 Fed. Reg. 10695, 10876 (Feb.14, 2013) (to be codified at 12 C.F.R § 1024.30(b)).

[3] *See Fact Sheet: Updated National Consumer Relief* (Office of Mortgage Settlement Oversight May 21, 2013), ***available at*** https://www.mortgageoversight.com/wp-content/uploads/2013/05/Fact-Sheet_May-progress-reportFINAL.pdf, and additional information ***available at*** https://www.mortgageoversight.com/reports/monitors-updated-national-consumer-relief/.

been certified by the Monitor), it appears that the settling banks are very close to satisfying their obligations under the Settlement. Bank of America, Chase and the ResCap Parties have each asserted that they have fulfilled their consumer relief obligations under the Settlement (and the Monitor has confirmed that the ResCap Parties have indeed fulfilled their obligations, while the others remain under review).

In this paper we review the reported results, offer analysis and then pose questions that remain outstanding.

The settling banks have reported engaging in the following home retention and other activities under the settlement between March 1, 2012 and June 30, 2013:

TOTAL: $51.33 billion to more than 643,726 borrowers, averaging nearly $80,000 per borrower (including active first lien trial modifications).

- Home retention activities: $28.8 billion in principal forgiven or interest payments saved for 393,742 borrowers, averaging more than $73,000 per borrower:

  --Completed and active trial first-lien modification forgiveness and second lien modifications and extinguishments: $25.9 billion in principal forgiveness for 320,345 borrowers, averaging $80,850 in principal reduction per borrower.

    --Completed first-lien modification forgiveness: $10.4 billion in principal forgiven for 95,582 borrowers ($8.9 billion of new modifications and $1.5 billion of forgiveness of existing modification forbearance amounts), averaging nearly $110,000 per borrower

    --Active first-lien trial modifications in progress: $151.7 million in forgiveness for 1,595 borrowers, averaging nearly $95,104 per borrower if the trials are completed.

    --Completed second lien modifications and extinguishments: $15.3 billion forgiven for 223,168 borrowers ($14.9 billion extinguished and $396.5 million forgiven by modification), averaging $68,611 per borrower

  --Savings from refinances completed: $2.9 billion in borrower interest savings for 73,397 loans, saving the average borrower an estimated $40,000 over the life of the loan.

- Short sales & Deeds in Lieu: $20.9 billion in principal balance deficiencies forgiven for 184,397 borrowers, averaging about $113,000 of forgiveness per borrower

- Other programs: $1.6 billion for 65,587 borrowers, averaging $24, 828 per borrower

Analysis and Outstanding Questions

Gross amounts of relief versus servicer credits toward $20 billion obligation

The above figures represent the gross dollar amounts that borrowers have received. The settlement has a schedule that translates each type of activity into a range of credits towards the nearly $20 billion that the mortgage servicers are required to provide under the settlement. For example, principal forgiveness on first liens for portfolio loans of 175% LTV or less is credited at $1 for each dollar of write-down, but a modification of a second lien that is more than 180 days delinquent is credited at only 10 cents for each dollar of write-down. Forgiveness of deficiencies on short sales is credited at 45 cents per dollar for portfolio loans and 20 cents for investor loans.

In addition, at least 60% of the total credits must be used for principal reductions for first and second liens combined,[4] at least half of which (a total of 30%) must be used for principal reduction on first liens alone. By contrast, no more than 10% can be used for deficiency waivers, no more than 12% on anti-blight activities, and no more than 5% on transitional funds.

> *The report does not provide information about how the gross settlement amounts translate to the specific crediting formulas under the settlement because the Monitor's work with individual servicers to verify their results follows the reporting of the gross amounts. Accordingly, we are not yet able to determine the extent to which the servicers are meeting their credit requirements under the settlement. However, it appears based upon the gross numbers reported and credit formulas that the servicers have either met or are very close to meeting their credit requirements.*

First Lien Modifications

The settlement requires the banks to aggressively provide affordable modifications through principal reduction to get credit for first-lien modifications. Servicers only get credit for them if the borrower pays on a modification for three months.

The settlement requires that principal reduction through first-lien modifications total at least 30% (or $5.1 billion) of the $17 billion of consumer credits required that are separate from the $3 billion in required refinance savings; to date, servicers have completed $10.4 billion in first-lien principal forgiven in gross dollars for 95,582 families (not including trial modifications). Of these totals, $1.5 billion in reductions applied to 26,459 families who had previously received a loan modification which included principal forbearance, and could be given credit under the settlement if these amounts were subsequently forgiven.

[4] The amount can be reduced by 10 percentage points if refinances exceed certain benchmarks, but that does not appear to be contemplated based upon the principal reduction data received thus far.

Even assuming the lowest crediting amounts across the board for first lien modification forgiveness and without including any credit for trial modifications,[5] the total first-lien forgiveness reported already totals $5.2 billion of the goal of $5.1 billion. Given the very conservative nature of these assumptions, it is likely that in the aggregate at least, the required amount of first-lien principal forgiveness has already been met.

Second Liens

Second liens have been a major obstacle to loan modifications that keep families in their homes, and therefore have been a major cause of foreclosures. Modifying first mortgages cannot keep borrowers in their homes if they still cannot afford a second mortgage. Similarly, seconds often prevent the sale of a house that would have equity but for the second lien or prevent short sales when the holder of the second lien does not grant timely permission to modify or extinguish it. Often, the only way to get rid of a second lien is through foreclosure. In addition, debt collectors attempting to collect on delinquent seconds or deficiencies associated with foreclosed second liens, as well as credit scores damaged by foreclosure or delinquency can prevent a family from getting back on its feet.

Thus, extinguishing, or to a lesser degree, modifying second liens can be very beneficial to borrowers. Under the agreement, if a mortgage servicer modifies a first lien and another participating bank services a second lien on the same property, that bank must modify or extinguish the second to help make the combined mortgages affordable. To date, second lien restructurings have heavily favored extinguishment: the servicers have extinguished $14.9 billion in second liens versus only $396.5 million in modifications.

> *An issue about extinguishing second liens through the settlement has been raised, however: is it legitimate for a servicer to get credit for modifying or extinguishing a second lien if the servicer of the first mortgage forecloses simultaneously or shortly thereafter?*

On the one hand, there are several reasons why providing credit should still be considered legitimate. The settlement provides only limited credit for delinquent seconds—10 cents on the dollar if the second is more than 180 days delinquent, which may mean it would otherwise be unlikely for the borrower to become current again. Extinguishing a second lien may also be helpful even if the borrower cannot pay the first, as it may permit the borrower to sell the house rather than go through the foreclosure process, or it may prevent harassment by debt collectors.

The settlement clearly permits some proportion of the relief to be provided to families who are unable to stay in their homes, such as through short sales or deficiency waivers. In addition, the settlement provides incentives for first lien modifications over second lien modifications by

[5] The Settlement credits first lien principal forgiveness at $1.00 per $1.00 write-down where there is an LTV less than or equal to 175% and at $.50 per $1.00 write-down where there is an LTV greater than 175% (for the portion forgiven over 175%). Here we use $.50 crediting across the board, even though this very likely underestimates the actual crediting that will be applied. Forgiveness of forbearance amounts on existing modifications is credited at $.40 per $1.00 write-down.

providing more credits per dollar of forgiveness for first lien modifications than for seconds. In addition, the Monitor will evaluate compliance with the servicing metrics, which includes testing whether the servicer accurately determined whether borrowers are eligible for first-lien modifications. If a servicer is found to have wrongly rejected first-lien modifications, and fails to correct the problem, it could face potential fines up to $1 million and $5 million and restitution for impacted borrowers.[6]

> *The Monitor issued his first report on the servicers' performance under their servicing metrics in June. All of the settling banks passed the servicing metric testing for "incorrect modification denial" (within the 5% allowable error rate of the settlement), but the report did not shed light on potential interactions between modifications of first and second liens.*

Short Sales

Waiver of deficiencies for short sales are a significant portion of the total *gross* forgiveness and savings reported in the first 16 months of the settlement, though they do constitute a minority—42 percent—of the total. Home retention activities—modifications of first and second liens, including three month trial modifications for first liens, as well as refinance interest savings—total $28.8 billion, or more than 56% of the *gross* total, and more than twice as many borrowers have received home-retention relief (393,742) as short sales (184,397). Because servicers receive between 20 and 45 cents of credit for every dollar in short-sale deficiency waivers, the credits for short sales will be between $4.2 billion and $9.4 billion and thus likely fall within the cap of 40% of the $17 billion in forgiveness required under the settlement. Short sales, as a percentage of the total consumer forgiveness, have been dropping over time: from 63% in the first report to 42% in this final report. In any case, as Tom Miller, Attorney General of Iowa and one of the key negotiators of the current deal, stated in March, and as the numbers appear to support, "[i]t is likely that the servicers won't need credit from short sales to fulfill their $17 billion consumer relief requirements" because they will have met the entire $17 billion in credits through principal forgiveness modifications and other activities.[7]

A short sale is, nonetheless, preferable to foreclosure. Short sales permit families to move when they are under water—their mortgage balance is greater than the value of their house—because of changes in job or family circumstances. They spare borrowers from having to face debt collectors and spare neighborhoods from vacant houses and negative spillover effects during a long foreclosure process. It is worth noting that that the servicers get credit by forgiving a deficiency after a short sale only in states that permit deficiency judgments. However, short sales are not preferred over a modification that would keep a borrower in his or her home.

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[6] ***See*** Exhibit A.IV.A.1-2, available at https://www.mortgageoversight.com/wp-content/uploads/2012/03/Servicing-Standards.pdf; *see also* Exhibit E-1 (Enforcement Metrics), and specifically Metric 1.B ("Incorrect Mod denial") at p. 1-3 and Metric 6.B. ("Loss Mitigation") at p. 1-10, available at https://www.mortgageoversight.com/wp-content/uploads/2012/03/Consent_Judgment_WellsFargo_4.11.121.pdf.

[7] Tom Miller, "Mortgage Settlement Is Beating Goals, Proving Doubters Wrong," *American Banker* (Mar. 7, 2013).

The Monitor's first report on the servicers' performance under the servicing metrics has shown that servicers have passed the metric testing whether they have been incorrectly denying loan modifications under the settlement (within the allowable 5% error rate). Three of the five settling banks, however, failed the metric testing "loan modification document collection timeline compliance" while another failed the metric testing "loan modification decision/notification timeline compliance." The Monitor's next servicing report will have further information detailing the banks' corrective measures and continuing compliance. We hope the next report will show full compliance with the settlement, and appropriate remediation for any failures.