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Before the Congressional Oversight Panel

HAMP, Servicer Abuses, and Foreclosure Prevention Strategies

October 27, 2010

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

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

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

I. Introduction and Summary

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

The foreclosure crisis has had catastrophic consequences for families and communities, especially communities of color. Millions of homeowners are in dire straits due to abusive mortgage originations, incompetent and predatory mortgage practices, ineffective government oversight, and a complex securitization system that lacks accountability all the way up and down the chain. Ultimately, the fate of these homeowners impacts all of us. Foreclosures bring down home values across the board, and devastate communities and municipal budgets. Even worse, since historically the housing sector has led the way out of economic downturns, weakness in the housing sector will likely slow or derail economic recovery and hamper efforts to create jobs and reduce unemployment.

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

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

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

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

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

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

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

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

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

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

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

Recommendations for Congress

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

Recommendations for Federal Agencies

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

Recommendations for States

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

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

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

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

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

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

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

Beyond the impact of the foreclosures on the families losing their homes, foreclosure "spillover" costs to neighbors and communities are massive. Tens of millions of households where the owners have paid their mortgages on time every month are suffering a decrease in their property values that amounts to hundreds of billions of dollars in lost wealth just because they are located near a property in foreclosure. Depending upon the geography and time period, the estimated impact of each foreclosure ranges from 0.6 percent to 1.6 percent in lost value to nearby homes. CRL estimates that the foreclosures projected to occur between 2009 and 2012 will result in $1.86 trillion in lost wealth, which represents an average loss of over $20,000 for each of the 91.5 million houses affected.[11] These losses are on top of the overall loss in property value due to overall housing price declines.[12]

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

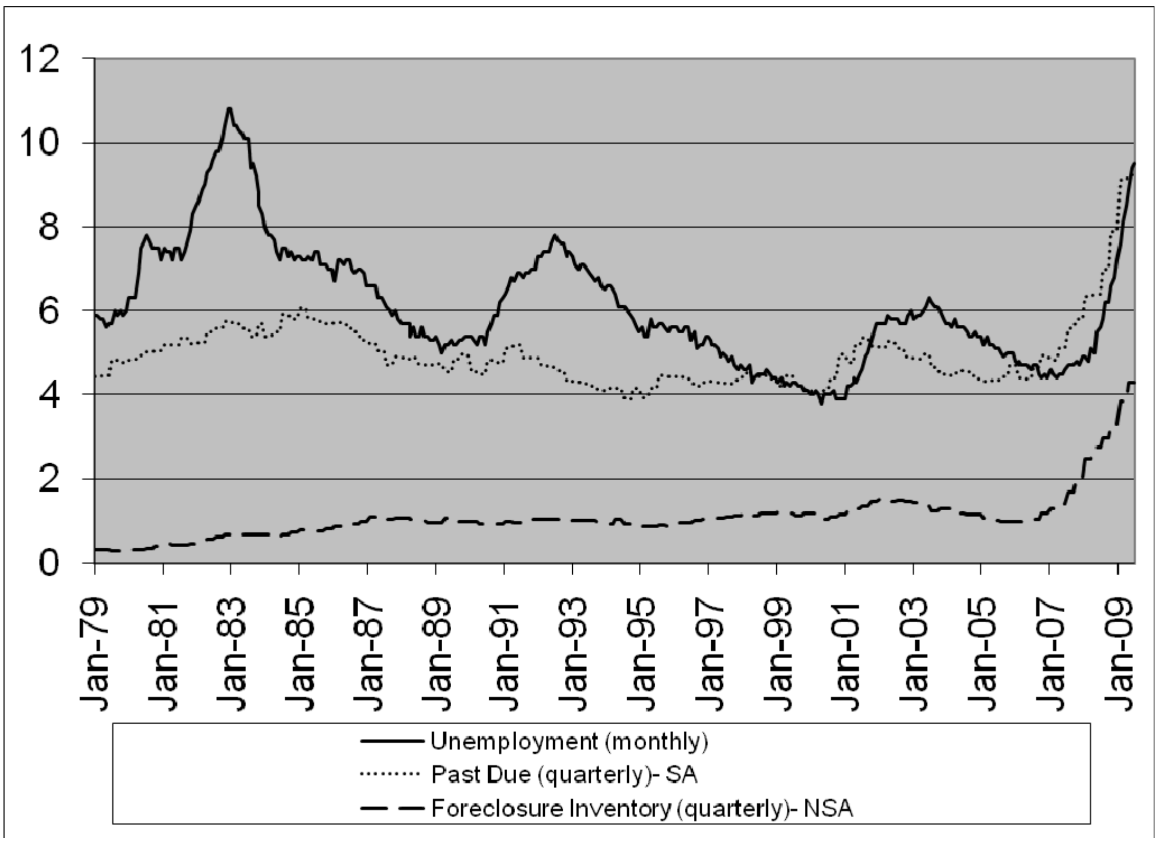
D. Unemployment is exacerbating the crisis but didn't cause it.

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

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

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

Figure 1: Historical relationship of unemployment and foreclosure rate

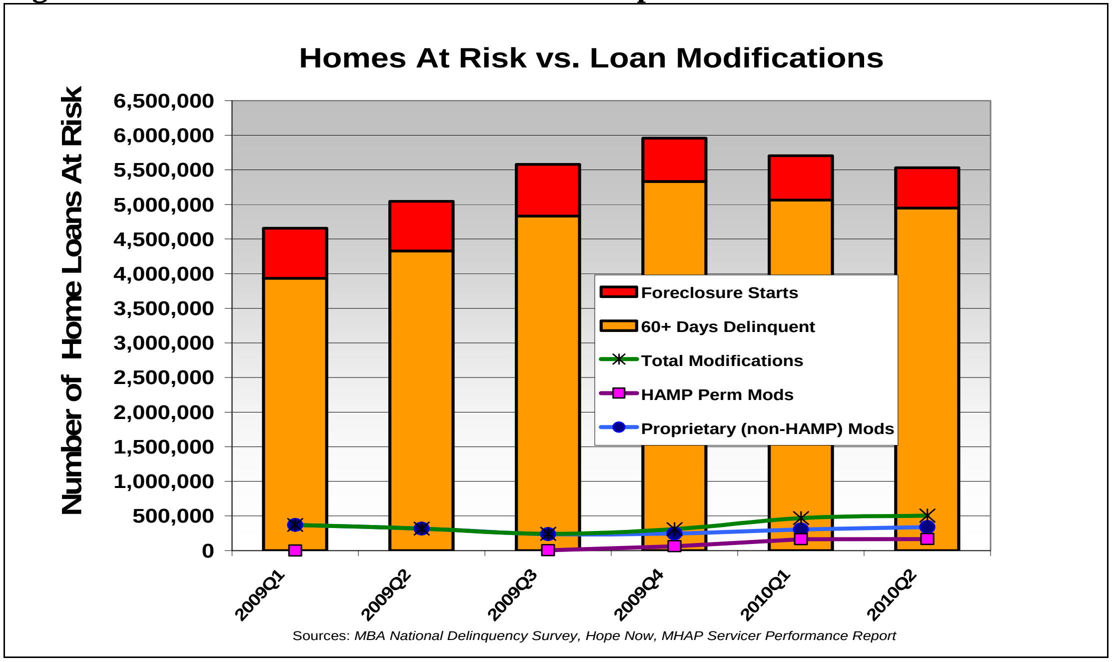


Sources: MBA National Delinquency Survey, Bureau of Labor Statistics.

E. Foreclosures continue to outstrip loan modifications.

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

Figure 2. Demand for Relief Continues to Outpace Loan Modifications



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

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

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

The most egregious of these abuses include:

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

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

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

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

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

The illegal practices of servicers during the foreclosure process are not simply a technical problem. Due process when taking private property is a cornerstone of our legal system, and case after case reveals that this is not just a question of dotting the I's and crossing the T's, but of unnecessary and even wrongful foreclosures. The rules that the banks have broken in their rush to foreclose are designed to give people a fair chance to save their homes.

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

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

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

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

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

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

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

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

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

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

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

2. Mandate loss mitigation prior to foreclosure.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

As of July 2011, the CFPB will acquire rule-making authority to prevent abusive, unfair, deceptive and harmful acts and practices and to ensure fair and equal access to products and services that promote financial stability and asset-building on a market-wide basis. It will also have strong enforcement tools, and the States will have concurrent authority to enforce the rules against violators in their jurisdictions. The CFPB should quickly move to regulate the servicing industry to prevent the abuses of the past.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

- public enforcement mechanisms to safeguard against systemic abuses.

- states with a mediation program or considering creating one could use the program as an appeal process when an adverse loss mitigation determination is made.[51]

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

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

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

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

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

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

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

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

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

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

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

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

However, given the way HAMP was created and implemented, many of these problems are no surprise. First, the program repeatedly raised public expectations that were then dashed when programs were not already operational. This pattern began at the inception of the program, when HAMP was announced to the public well before its infrastructure was in place. Servicers were quickly overwhelmed by requests when they were not yet prepared to qualify people for the program, thereby causing many homeowners to be very disappointed early on. Despite this initial bad experience with a lag between public announcement and rollout, Treasury continued to make every subsequent program change the same way. Rather than inform the servicers and wait for them to be ready before informing the public, Treasury's routine was to release the broad outline of a new initiative or guideline change and then have an implementation date months away.

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

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

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

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

B. Recommendations to make HAMP fairer and more effective.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Servicers are required to provide a HAMP modification whenever the NPV is positive, unless the Pooling and Servicing Agreement with the investor prohibits such a modification and the servicer has sought a change in policy from the investor and the investor has not agreed. Yet servicers are not required to document the contract language or the efforts made to otherwise obtain authority for the modification. It appears that many servicers are using "investor turndowns" as a reason not to do a modification in violation of HAMP rules, in most cases because the contract does not actually prohibit the modification and in some instances because the servicer has not requested a change in policy from the investor.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

- **Servicers should not be able to rescind permanent HAMP modifications.** Although HAMP trial modification contracts indicate that a homeowner can obtain a permanent modification by making three trial modification payments, servicers have been withdrawing trial modification offers, and, worse, cancelling existing permanent modifications, citing investor restrictions and other issues that should have been identified prior to these agreements. While servicers and others have sought to describe these cancellations as clerical errors, they are breaches of contract that epitomize the one-sided dynamic of HAMP modifications. For example, Ms. S. in Brooklyn, NY, an elderly homeowner, made five payments under a HAMP Trial Period Plan before obtaining a permanent modification in February 2010. After discussing the terms of the permanent modification in detail in a Settlement Conference in the New York State Court, she accepted the modification agreement and the foreclosure action was then discontinued. Inexplicably, although she was making payments under the modification agreement, Ms. S. then received a second permanent HAMP offer that lowered her payment slightly but did not extend the term of her loan and therefore had a balloon payment of $280,000. After almost a year of negotiations and multiple court appearances, the servicer is claiming that an investor restriction prohibits a term extension and thus refuses to honor the first modification.

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

Conclusion

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

[18] *Id.*

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

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

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

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

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

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

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

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

[27] *Id.*

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

[47] *Supra* Note 44 at 394.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

[67] SIGTARP, *supra* note 3.

[68] http://www.businessinsider.com/average-duration-of-unemployment-in-july-2010-8.

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

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

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