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Before the U.S. House of Representatives
Committee on Financial Services
Subcommittee on Insurance, Housing and Community Opportunity

"Are There Government Barriers to the Housing Market Recovery?"

February 16, 2011

Good afternoon Chairman Biggert, Ranking Member Gutierrez, and members of the subcommittee. Thank you for the invitation to discuss the very important issue of the continued weak performance of the country's housing market, which has been devastated by a foreclosure crisis that has impoverished 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. 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 that have enabled thousands of families to build assets for the first time. 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.

You have asked us today to consider government barriers to the housing market recovery. In our view, the biggest barrier to recovery right now is the continued rapid pace of unnecessary foreclosures. The failure to prevent these foreclosures is largely due to the poor performance of the mortgage servicing industry. However, the government also bears some responsibility for the continuation of the crisis, particularly those government agencies that oversee the mortgage servicers. Government has not yet used all the tools at its disposal to ensure that mortgage servicers perform their core functions efficiently and effectively, thereby preventing unnecessary financial losses to investors and other financial institutions holding mortgages and saving crucial tax dollars for strapped municipalities. At the same time as the supply of foreclosed homes is increasing more than it should, demand is lower than it should be due to a dramatic tightening of credit has prevented many potential first time homebuyers from entering the market.

It is CRL's view that until we get far more serious about addressing the foreclosure crisis, we will not see the housing market recovery in a meaningful way. What's more, the fate of foreclosed homeowners impacts far more than the housing market. Foreclosures bring down home values across the board and devastate communities and municipal budgets. Even worse, since housing historically has led the way out of economic downturns, weakness in the housing sector is slowing economic recovery and hampering efforts to create jobs and reduce unemployment.

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 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 that 2006 report, there have already been as many as 3 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. The first wave of homeowners ended up 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. Now, millions more are in danger due to the toxic combination of underwater loans and unemployment that festers in so many areas.

In this dire situation, the private system of mortgage servicing is should be serving as the key resource for both homeowners and investors. Instead, the servicing system is compounding the problem. It has become crystal clear to even the casual observer that the servicing system cannot or will not serve either the best interests of homeowners or investors for a variety of reasons, including that the system's capacity is too strained to function correctly and that crosscutting financial incentives create conflicts between the best interest of the servicers and the best interest of investors and homeowners.

In analyzing what has gone wrong, consider whether the servicing system is properly distinguishing between those instances where foreclosure is unavoidable and those where another option would produce a more favorable financial result. Every available piece of evidence suggests the system cannot yet reliably make this distinction. Part of the problem is the practice of continuing with foreclosure proceedings even while evaluating a homeowner for loss mitigation, a practice now termed “dual track.” The failure to prevent foreclosures that would save money for both investors and homeowners is both perverse and bad for economic recovery.

Beyond loss mitigation failures, mortgage servicers also are engaging in other shoddy, abusive, and even illegal practices that are clogging up the foreclosure system and exacerbating the servicers' reputational problems. The so-called "robosigning" scandal, in which employees have lied about having personally reviewed the information alleged in their summary judgment affidavits, was not just a cosmetic corner-cutting exercise, but was a symptom of the servicer's underlying systems failures. To get the housing market back on track, buyers need assurances that foreclosures are legal and not vulnerable to challenge. Having banks claim to "fix" thousands of mortgages within a couple of weeks without more information has so far failed to restore public confidence in the system.

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. For too long, we have listened to the insistence of the servicers that they can solve this problem on their own. While it always seemed improbable that would be the case, after almost four years, we now know that is impossible.

At the same time, as we retool the entire system of mortgage finance, it is important to consider that a healthy market needs a continuous influx of new customers. The failure to consider the needs of first-time homebuyers and customers from low-wealth backgrounds when we create any new system could be catastrophic for future growth.

It is high time for Congress, the Administration, banking regulators, federal and state law enforcement officials, and state legislatures to employ *every tool at their disposal* to end a crisis that has spiraled out of control for years now, unnecessarily, wasting billions (maybe even trillions) of dollars and standing in the way of broad economic recovery . In these recommendations, we describe many ways in which these various actors can help produce the results that will best serve investors, homeowners, and the market as a whole.

Recommendations for Congress

- Mandate loss mitigation prior to foreclosure.
- In making changes that impact housing finance and mortgage origination going forward, consider the needs of first-time homebuyers and customers from low wealth backgrounds who have the ability to repay safe and sustainable loans.
- 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.
- Change the bankruptcy code to permit modifications of mortgages on principal residences.

Recommendations for Federal Agencies

- The federal prudential banking regulators should immediately focus on the servicing operations of their supervisees and insist that servicers adhere to the loss mitigation requirements of their contracts.
- HUD, VA, and other government housing programs should aggressively enforce their servicing rules, especially those related to mandatory loss mitigation.

- The Consumer Financial Protection Bureau should make servicer oversight and enforcement a top priority.
- Fannie Mae and Freddie Mac should serve as models to the industry, participating in all HAMP and other loss mitigation programs.
- Treasury should take steps to improve HAMP so that it can help as many people as possible before its expiration next year.
- The regulators involved in creating the qualified residential mortgage exception to new “skin in the game” rules should not impose a hard down payment requirement on all borrowers.

Recommendations for Improving HAMP

- 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 twelve 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.
- Require servicers to provide the homeowner with the relevant written documentation any time a modification is denied due to investor restrictions.
- 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.

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.

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[2] and more than one in four mortgages underwater,[3] 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.[4] A recent study by CRL estimated that 2.5 million foreclosure sales were completed between 2007 and 2009 alone, while another 5.7 million borrowers are at imminent risk of foreclosure[5]

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.[6] These losses are on top of the overall loss in property value due to overall housing price declines.[7]

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.[8]

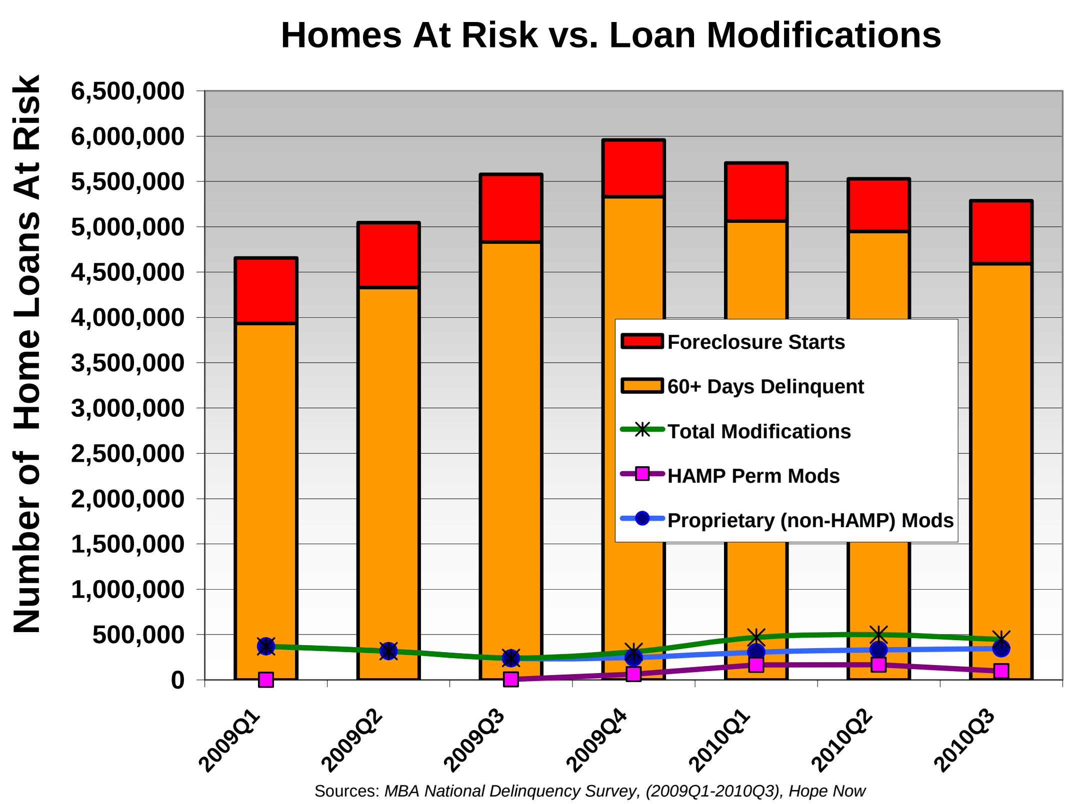
The crisis also severely impacts tenants in rental housing. According to the National Low-Income Housing Coalition, a fifth of single-family (1-4 unit) properties in foreclosure were rental properties and as many as 40 percent of families affected by foreclosure are tenants.[9] While tenants now have some legal protection against immediate eviction,[10] most of them will ultimately be forced to leave their homes.[11] 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.[12] 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.[13]

B. Foreclosures continue to outstrip loan modifications.

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

Figure 2. Demand for Relief Continues to Outpace Loan Modifications



About 4.3 million mortgages are in foreclosure or 90 days or more delinquent as of September 30, 2010.[14] The third quarter of 2010 saw more than 215,000 new foreclosure

starts per month; by comparison, in August, there were roughly 30,000 permanent HAMP modifications and 76,000 proprietary modifications.[15] 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.[16]

C. 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.[17] 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[18] 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.[19] 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."[20]

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.[21]

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*.[22] 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.[23] 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. [24] 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.[25] The data overwhelmingly supports that irresponsible lending and toxic loan products lie at the heart of the crisis.

D. 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.[26] 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.[27] 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.[28] 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.

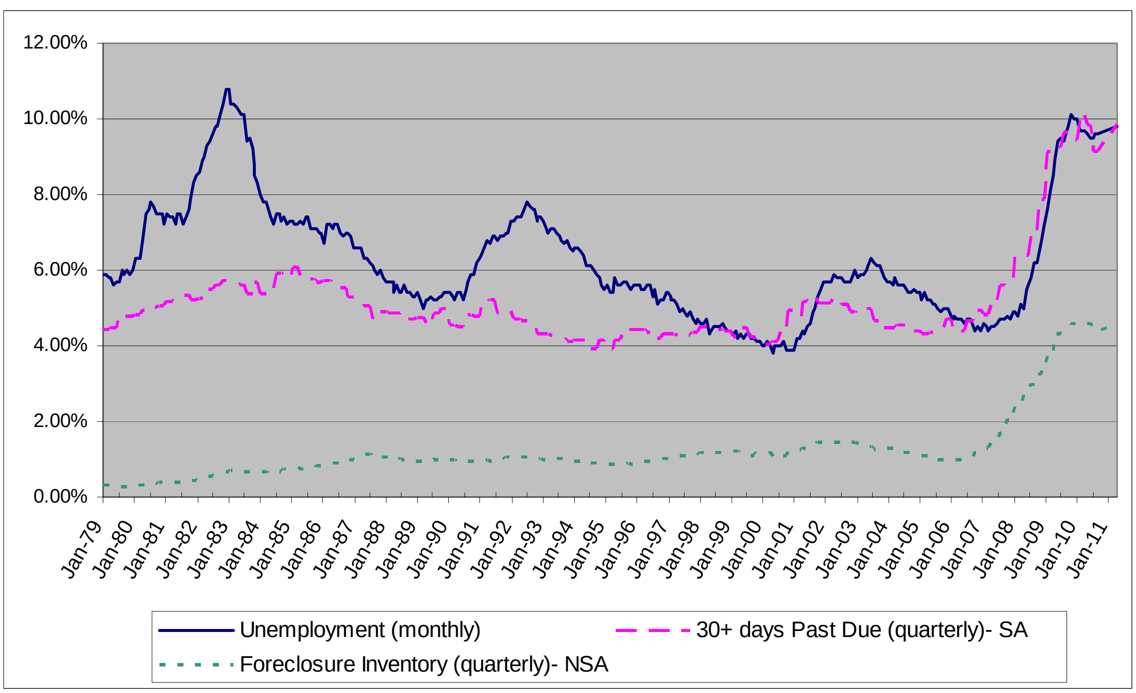
The impact of this crisis on families and communities of color is devastating. Homeownership is the primary source of family wealth in this country, and people often tap home equity to start a new business, pay for higher education and secure a comfortable retirement. In addition, home equity provides 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.[29]

E. 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.[30] Other research confirms that the risk of default due to unemployment rises when homeowners are underwater on their mortgage.[31]

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.

F. Although Fannie Mae and Freddie Mac should not have purchased subprime MBS, their purchases did not cause the crisis.

The roles of Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") have certainly had an impact on the shape of the housing market and the availability of certain products over the course of their existence. However, Fannie and Freddie did not cause the subprime crisis.

While Fannie Mae and Freddie Mac should not have purchased subprime mortgage-backed securities (and organizations such as ours urged them not to), their role in purchasing and securitizing problem loans was small in comparison with that of private industry. *All subprime mortgage backed securities were created by Wall Street.* Fannie Mae and Freddie Mac did not themselves securitize any of these loans because the loans did not meet their standards.[32] When they finally began to purchase the MBS, they were relative late-comers to a market that had been created by private sector firms, and they also purchased only the least risky tranches of these securities.[33]

Ironically, as subprime lending rose, the GSEs' role in the overall mortgage market diminished substantially. As of 2001, Fannie Mae and Freddie Mac funded almost two-thirds of home mortgage loans across the United States. These were loans that Fannie Mae and Freddie Mac purchased directly from originators who met the GSE guidelines and either held on their balance sheets or securitized and sold to investors. Subprime loans accounted for just 7 percent of the market. Around 2003, private issuers were beginning to introduce new, riskier loan products into the market, and began to displace the GSEs. In early 2004, private-issue MBS surpassed the GSE issuances of all loans, and by early 2006, Fannie and Freddie's market share of new issuances had dropped to one-third of the total. As the role of the GSEs was declining, the percentage of subprime loans in the mortgage market almost tripled.[34]

Eventually, Fannie and Freddie eventually guaranteed and securitized Alt-A loans—loans to relatively wealthier borrowers with higher credit scores and risky features such as limited documentation. These investments are the primary source of the GSEs' losses, and are the reason why the GSEs were placed into conservatorship.[35] But here too, the GSEs did not lead the market; rather, they followed the market into these loans. The market did not depend on the GSEs.

Finally, it is important to note that GSE loans—including loans to "riskier" borrowers—are performing better than the private market. As of June 2010, 13.35% of GSE loans to borrowers with credit scores under 660 were 90+ days delinquent or in foreclosure. By comparison, the Mortgage Bankers Association reports that the serious delinquency rate for subprime loans was *over 28%*.[36]

G. The Community Reinvestment Act did not lead to the foreclosure crisis

Critics of the Community Reinvestment Act ("CRA") claim it caused the crisis by "forcing" lenders to make risky loans to low- and moderate-income families and to communities of color. Yet – even apart from the fact that the CRA requires loans to qualified buyers, not risky ones – most subprime lending was done by financial institutions that are not even subject to CRA requirements. CRA covers banks and thrifts. These institutions did not make many subprime loans. In fact, fully 94% of subprime mortgage loans were made by institutions not covered by CRA, or outside the institutions' CRA assessment areas, including affiliates that were excluded from CRA compliance review.[37] Moreover, the CRA was passed in 1977, and was in effect for more than two decades before subprime lending appeared.[38]

Nor can CRA be blamed for the big banks' disastrous investment in mortgage-backed securities backed by subprime loans. These investments were not covered by CRA—they did not produce CRA credit and were not encouraged by CRA.[39] A 2008 study found that CRA-covered banks were less likely than other lenders to make risky, high-cost loans.[40]

Finally, a report issued by the Federal Reserve Board in 2000 concluded that mortgage loans satisfying the low- and moderate-income element of the CRA's lending test proved to be at least marginally profitable for most institutions, and that many institutions found that CRA lending performed no differently than other lending.[41] Similarly, the experience of community development financial institutions (CDFIs) serving low- and moderate-income communities, demonstrates that responsible loans in these communities can succeed. A recent report on the FY 2007 performance of community development financial institution ("CDFI") banks—over 71% of whose branches are operated in low- to moderate-income communities—found that the majority were profitable. Community development credit unions had a loan loss rate that was on a par with that of mainstream credit unions.[42]

Those who have studied the issue have concluded, as did, John Dugan, Comptroller of the Currency, that "CRA is not the culprit behind the subprime mortgage lending abuses, or the broader credit quality issues in the marketplace."[43]

H. Mortgage servicers engage in a range of predatory and illegal practices both in the foreclosure process and leading up to foreclosure.

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.[44]

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 refinancing 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.

Perverse financial incentives in pooling and servicing contracts explain 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.[45] The problem of misaligned incentives is compounded by a lack of adequate resources, management, and quality control.

What's more, recent legal proceedings have uncovered the servicing industry's stunning disregard of basic due process requirements.[46] Numerous servicers have engaged in widespread fraud in pursuing foreclosures through the courts and, in non-judicial foreclosure states, through power of sale clauses. 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.[47]

As noted above, 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 were put in place specifically to give people a fair chance to save their homes, and without them, homeowners are powerless 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. Mandate loss mitigation prior to foreclosure.

Congress has the power to require that all servicers, industry-wide, must engage in loss mitigation before foreclosing, 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.

Almost two years ago now, Rep. Maxine Waters introduced legislation that would require loss mitigation.[48] This legislation also would have addressed many of the other shoddy servicing practices that have resulted in the problems we see today. We strongly suggest that this legislation be updated to reflect current understandings of the issues and be reintroduced in the 112th Congress.

2. In making changes that impact housing finance and mortgage origination going forward, consider the needs of first-time homebuyers and customers from low wealth backgrounds who have the ability to repay safe and sustainable loans.

The mortgage foreclosure crisis and resulting dramatic scaling back of mortgage lending has had grave consequences for those lower-income and minority households desiring to become homeowners. The consequences of predatory lending have effectively set the clock back to the mid-1990s, when underserved borrowers with less than perfect credit struggled to access any mortgage credit.

From the subprime boom years of the early 2000s, where irresponsible and unsustainable mortgage credit was all too easily available, the pendulum has swung to the other extreme, leading to overly tight lending standards. Fannie Mae, Freddie Mac, mortgage insurers and most lenders today have credit score floors of 620 and in some instances substantially higher. Most lenders are requiring substantial down payments, and now there are suggestions that FHA will soon be raising down payments and other upfront closing costs and establishing new credit score minimums.

Further evidence of the consequences of the tightening of credit eligibility comes from 2009 HMDA data. These data show that that mortgage application denial rates for minorities exceeded those for whites and that minorities were increasingly reliant on FHA and VA for access to any mortgage credit.[49] More than 80 percent of home-purchase loans and more than 50 percent of refinance loans to black borrowers were nonconventional. For Hispanic white borrowers in 2009, nearly three-fourths of their home-purchase loans and 30 percent of their refinance loans were nonconventional."[50] Moreover, many borrowers have suffered damage to their credit scores due to no wrongdoing of their own, which might nevertheless hinder their ability to qualify for mortgages or other forms of credit going forward. There are many examples: borrowers who experienced foreclosures from irresponsible loans with no meaningful underwriting, verification of income or other evaluation of the borrower's ability to repay. Similarly, the New York Times has reported that borrowers who have received loan modification programs but without ever missing or being late on mortgage payments can suffer credit score impairments, based only on the servicers use of outdated credit scoring designations.[51] In addition, many credit card companies have executed across the board reductions in credit balances without regard to the cardholder payment history, resulting in negative credit scoring consequences tens of thousands of cardholders.

For these reasons, we believe it would be a mistake to build barriers to first-time homeownership into the fundamental structure of the nation's housing finance system, either through the process of GSE reform, through the qualified residential mortgage definition, or in any other way.

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 was never 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 dramatically 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.[52]

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.

One additional note: Congress also should clarify that foreclosure prevention funds allocated under TARP and being used in the HAMP and Hardest Hit Programs can be used for legal assistance when appropriate.[53] We know now that there are many types of servicing abuses that cannot be handled by a housing counselor alone. This change would not require any new allocations of funding, and Treasury Secretary Geithner supports it.

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.[54]

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.[55] 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. [56]The National Taxpayer Advocate reports that in 2007, less than one percent of electronic filers eligible for the exclusion claimed it.[57] 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.

5. 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 <u>not</u> 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.[58]

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.[59] As foreclosures continue to worsen, more and more analysts and interested parties are realizing the many benefits this legislation could have.[60] 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.[61]

B. Federal agencies have significant authority that should be employed to help fight foreclosures.

There are a number of federal regulatory 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 focus on the servicing operations of their supervisees.

Federal supervisory banking regulators are currently conducting a review of 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. The methodology and results of these investigations should be made available to the public as soon and as extensively as possible.

To the extent that problems are found, the regulators should move to correct them quickly and thoroughly through an open and transparent process, and when necessary, referrals should be made to the appropriate enforcement authorities.

At the same time, the regulators should create national servicing standards that would govern mortgage servicers, including standards that require loss mitigation prior to foreclosure. One quick and effective place for those standards would be as part of the risk retention scheme created by Title IX of the Dodd-Frank Act. Because securitized loans have posed the most challenging set of obstacles to servicers, it makes sense to introduce strong standards that would apply to securitized loans related to loss mitigation, conflicts of interest, and servicer compensation.

2. 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.

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

The Consumer Financial Protection Bureau (CFPB) is ideally positioned to provide consumers with a strong voice in the foreclosure fight -- a voice that has largely been absent in the regulatory structure and executive branch. The 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.[62] Right now, the nation's three largest banks (Bank of America, Wells Fargo, and JP Morgan Chase) account for approximately 50% of all mortgage servicing, so exercising this supervisory function with respect to the operations of these banks can begin immediately. Banks should be examined 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.

Moreover, 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. The CFPB can use this authority to create national servicing standards and to help address the foreclosure crisis. For an example of useful rules, the CFPB can look to what some states have already done.[63] 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 begin now to prepare to use its authority and tools to prevent predatory servicing practices.

Finally, apart from specific regulatory authority, as the voice of consumers in the regulatory structure, the CFPB can help to educate both policymakers and the public about this issue and thereby to help ensure that proposed solutions are as responsive to consumer interests as they are to bank interests.

4. 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.

We call upon the FHFA to end the "dual track" practice of proceeding with foreclosures even when engaged in loss mitigation, to make its loan modification decisions more transparent, and to revisit its decision not to reduce principal on mortgage loans. Permitting modifications that produce both a positive net present value and a more sustainable loan modification will have a long-term, beneficial impact that needs to be weighed fairly against short-term profitability concerns.

5. The regulators involved in creating the Qualified Residential Mortgage safe harbor to "skin in the game" rules should not impose a hard down payment requirement on all borrowers.

We suggest that the Qualified Residential Mortgage safe harbor closely track the definition of the rebuttable presumption laid out in Sec. 1412 of Title XIV to the Dodd-Frank Act, which does not include a down payment requirement. This definition includes an extensive array of requirements that define responsible, well-underwritten loans. Keeping origination and securitization standards as identical as possible will simplify the securitization process, which will keep regulatory costs down and provide a more favorable environment for private investment.

In addition, we believe that requirements mandating specific loan-to-value ratios will unnecessarily disadvantage well-qualified borrowers who lack the wealth necessary for a large down payment, a particular concern for communities of color, low- and moderate-income families, and others traditionally underserved by mainstream lenders. Barring these families from access to responsible loans would reinforce an unfair, separate and unequal housing finance system that relegates underserved families to FHA or to higher cost, less desirable lending channels – or even excludes them entirely from homeownership they could otherwise sustain. Creditworthy borrowers should not be limited to FHA or to loans that do not meet QRM standards simply because they cannot make a large down payment. That is not good for homeowners or for the health of the overall market.

Moreover, disruptions in the housing market have stripped equity from homeowners everywhere, and home values have yet to stabilize. In this environment, mandating loan-to-value ratio requirements would impose unnecessary barriers to homeownership for all borrowers, including those traditionally well-served by the housing finance system.

C. The Treasury Department should continue to improve HAMP and its associated programs.

While HAMP's performance has been very disappointing, HAMP remains the principal federal response to the foreclosure problem and sets guidelines and standards that are very useful for any loan modification. If HAMP were to cease to exist, we would return to a time of no standards at all, when loan modifications were just as likely to raise a borrower's monthly payment as lower it.[64]

The vast majority of modifications continue to be made outside of HAMP. Servicers routinely ask borrowers to waive their right to a HAMP modification.[65] While we do not know all the reasons why this happens, some likely contributors are: (1) the design of the HAMP program does not fit the majority of borrowers; (2) servicers profit more from the proprietary modifications because the HAMP incentives are insufficient to overcome other financial incentives; (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. Servicers should be required to release public, loan-level data for all modifications, not just HAMP modifications.

Similarly, the fact that servicers have violated HAMP guidelines and have resisted any kind of independent appeals process has resulted in 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 when servicers ignore HAMP guidelines.

We make the following recommendations to refine HAMP's design and improve its performance.

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 reports to the contrary 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, Treasury 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 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. There is legislation currently pending that would establish such an office, although it is unlikely to pass during the 111th Congress (this idea did already succeed in a Senate floor vote with bipartisan support when it was offered as an amendment to another bill, the initial underlying legislation failed.[66] For states or localities that have foreclosure mediation programs, those programs could also be used to handle this type of appeal.

3. End the dual track of foreclosure and loss mitigation.

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.[67] 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. Furthermore, if an applicant was already in foreclosure, services were to stop additional steps toward a foreclosure once that borrower was in a verified trial modification.

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,[68] 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 more than one in four,[69] 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.[70] 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.[71] 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.[72]

Many stakeholders believe that principal reduction is ultimately the only way to help the housing market reach equilibrium and begin to recover.[73] 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.[74]

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, that program has modified only a few thousand second liens.[75] 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 twelve 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.[76] 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 Emergency Home 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 have received a stated income trial modification in good faith, have made all their trial payments in a timely way, but have been denied a permanent modification should not end up financially worse off than they were before the trial modification. Currently, however, they often 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 should 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. 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. When a servicer believes a PSA prevents an NPV-positive modification, the servicer is supposed to contact the trustee and any other parties authorized under the terms of the PSA to attempt to obtain a waiver. However, 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.

Recognizing this problem, the Treasury Department changed its policy last November to require servicers to provide basic information related to investor denials.[77] While this is a small step in the right direction, it is crucial that servicers provide the borrower with this information directly, in hard copy form, as he or she is in the best position to act quickly if there is a problem but may be unable to access online databases. To minimize paperwork burden on servicers, we suggest that the servicer provide the borrower or the borrower's representative a photocopy of the limiting language in the PSA along with information on how to electronic access to a complete and unaltered copy of the PSA, and a copy of all correspondence with the lender and investors attempting to obtain authority to perform a modification,

8. 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 re-default 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.

9. 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.

10. 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.

- **Non-borrower surviving spouses and those awarded the home in a divorce decree should be 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.

- **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.

D. States also should act to prevent servicing abuses and save homes.

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

States are also in a strong position to prevent unnecessary 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.[78]

While states ideally 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 other stages of the foreclosure process. Currently, loss mitigation components exist in state foreclosure laws, either implicitly or explicitly, in the following four places: (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.

States can further 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.

- using existing or planned mediation programs as an appeal process when an adverse loss mitigation determination is made.[79]

Finally, state authority to regulate and license mortgage servicers provides yet another avenue through which States can promote servicer accountability and incorporate mandatory loss mitigation. For example, New York recently enacted a strong set of rules that will go a long way toward ending predatory servicing practices and ensuring that homeowners do not lose their homes due to servicer failures.[80] These rules are easily replicable and provide a very useful set of tools for enforcement authorities and advocates.

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 is one of the most promising developments to date in the fight against foreclosures. We recommend that in addition to any monetary damages, states seek injunctive relief to help promote sustainable loan modifications and eliminate shoddy and illegal business and legal practices.

Conclusion

Today's foreclosure crisis is arguably the most significant obstacle to national economic recovery, so the stakes are high. Even under a best-case scenario, the current crisis will continue and fester if interventions remain on the current narrow course. 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 aimed at reviving the ailing housing market, we hope they also will be mindful of the 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, to prevent another disaster in the future. Government can play a crucial role in supporting a healthy housing market by exercising its oversight function to guard against inappropriate risk-taking and abusive practices and to ensure a level playing field for market competition.

We appreciate the chance to testify today and look forward to continuing to work with Congress on these crucial issues.

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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] 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.

[3] This is for Q4 2010 and can be found at Zillow's Real Estate Market Reports at zillow.com. Another source is the First American Core Logic Negative Equity Report, which has reported similar statistics and whose Q4 2010 report should be out in a few weeks.

[4] 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.

[5] 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), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/foreclosures-by-race-and-ethnicity.pdf.

[6] 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.

[7] 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.

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

[9] 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.

[10] 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).

[11] 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.

[12] "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.

[13] *Id.*

[14] Based on MBA Delinquency Survey for 2010 Q3, adjusted to reflect MBA's estimated 88% market coverage.

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

[16] *Supra* note 3.

[17] 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.

[18] 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.

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

[20] 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).

[21] 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.

[22] *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).

[23] 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.

[24] 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.

[25] *Id.*

[26] 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

[27] *Supra* note 2, at 3.

[28] *Supra* note 5.

[29] 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.

[30] 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).

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

[32] See Freddie Mac Seller/Servicer Guide, available at http://www.freddiemac.com/sell/guide/#; Fannie Mae Single Family Selling Guide, *available at*

http://www.allregs.com/efnma/index.asp?dv=0&id=a&ii=0&im=0&io=fnma&ip=/&iq=0&iv=0&iw=0&iy=0&iz=0&fc=0&fk=_&fm=0&fs=0&fv=0&sd=/&sm=1&sp=fnma&sq=_&st=_&sv=0&sx=/&sy=0&sz=0&t=0&tc=fnma&tp=/&td=0&ti=0&tm=0&to=fnma&tw=0&tv=0&tq=0&tx=/.

[33] *Inside the GSEs*, January 3, 2007, p. 4. These securities are divided into tranches, with the AAA tranches being the least risky, and for this reason the easiest to sell to investors. Fannie Mae and Freddie Mac purchased only AAA tranches. The harder securities to sell are those from the subordinate tranches. These were made palatable to investors through the creation of collateralized debt obligations, which repackaged BBB tranches into, in part, a new set of AAA tranches, which help to further market the securities; to my knowledge the GSEs did not invest in CDOs. It was the ability to fund the riskiest portion of subprime mortgage loans that made possible the explosive growth of subprime lending. See Pershing Square Capital Management, L.P., "Who's Holding the Bag," presentation, May 2007, available at http://www.designs.valueinvestorinsight.com/bonus/pdf/IraSohnFinal.pdf.

[34] See David Goldstein and Kevin G. Hall, "Private sector loans, not Fannie or Freddie, triggered crisis," McClatchy Newspapers (Oct. 11, 2008) ("Between 2004 and 2006, when subprime lending was exploding, Fannie and Freddie went from holding a high of 48 percent of the subprime loans that were sold into the secondary market to holding about 24 percent, according to data from Inside Mortgage Finance, a specialty publication. One reason is that Fannie and Freddie were subject to tougher standards than many of the unregulated players in the private sector who weakened lending standards, most of whom have gone bankrupt or are now in deep trouble. During those same explosive three years, private investment banks—not Fannie and Freddie—dominated the mortgage loans that were packaged and sold into the secondary mortgage market. In 2005 and 2006, the private sector securitized almost two thirds of all U.S. mortgages, supplanting Fannie and Freddie, according to a number of specialty publications that track this data.") available at http://www.mcclatchydc.com/251/story/53802.html.

[35] Fannie Mae, Investor presentation, "Fannie Mae 2008 Q2 10-Q Investor Summary," (Aug. 6, 2008), p.36, available at: http://www.fanniemae.com/media/pdf/webcast/080808transcript.pdf. By the middle of 2008, Alt-A loans accounted for roughly 10% of Fannie Mae and Freddie Mac's risk exposure, but 50% of their combined losses. Federal National Mortgage Association, United States Securities and Exchange Commission Form 10-Q, for the quarterly period ended June 30, 2008, p.6, available at http://www.fanniemae.com/ir/pdf/earnings/2008/q22008.pdf; Federal Home Loan Mortgage Corporation, United States Securities and Exchange Commission Form 10-Q, for the quarterly period ended June 30, 2008, p.71, available at http://www.freddiemac.com/investors.

[36] Kevin Park, "Fannie, Freddie and the Foreclosure Crisis," University of North Carolina Center for Community Capital (Sept. 2010), available at http://www.ccc.unc.edu/documents/FannieFreddieForeclosure.pdf at 4.

[37] Staff Analysis of the Relationship between the CRA and the Subprime Crisis, Nov. 21, 2008, Board of Governors of the Federal Reserve, Division of Research and Statistics (available at http://www.federalreserve.gov/newsevents/speech/20081203_analysis.pdf).

[38] For further discussions of how CRA has aided rather than harmed communities, *see* Janet L. Yellen, Opening Remarks to the 2008 National Interagency Community Reinvestment Conference, San Francisco, California (March 31, 2008) (noting that studies have shown that the CRA has increased the volume of responsible lending to low- and moderate-income households); Ann F. Jaedicke, Testimony Before the Committee on Financial Services, US House of Representatives (February 13, 2008) ("over half of subprime mortgages of the last several years—and the ones with the most questionable underwriting standards—were originated through mortgage brokers for securitization by nonbanks, including major investment banks"); Michael S. Barr, *Credit Where It Counts: Maintaining a Strong Community Reinvestment Act,* Brookings Institution Research Brief (May 2005) ("encouraged by the law, banks and thrifts have developed expertise in serving low-income communities.").

[39] Federal Register Vol. 75, No. 47 (Mar. 11, 2010) at 11652 ("As a general rule, mortgage backed securities and municipal bonds are not qualified investments because they do not have as their primary purpose community development, as defined in the CRA regulations.")

[40] See Traiger & Hinckley LLP, The Community Reinvestment Act: A Welcome Anomaly in the Foreclosure Crisis: Indications that the CRA Deterred Irresponsible Lending in the 15 Most Populous U.S. Metropolitan Areas, Jan. 8, 2008, *available at* http://www.traigerlaw.com/publications/traiger_hinckley_llp_cra_foreclosure_study_1-7-08.pdf.

[41] Board of Governors of the Federal Reserve System, "The Performance and Profitability of CRA-Related Lending, A report submitted to Congress pursuant to Section 713 of the Gramm-Leach-Bliley Act of 1999." (July, 17, 2000) at 45-46, www.federalreserve.gov/boarddocs/surveys/craloansurvey/cratext.pdf; see also "CRA Special Lending Programs," Avery, Bostic and Canner, Federal Reserve Bulletin (Nov. 2000) at 723, www.federalreserve.gov/pubs/bulletin/2000/1100lead.pdf (Ninety-three percent of responding CRA-covered institutions so reported).

[42] The CDFI Data Project, Fiscal Year 2007, Seventh Edition, "Providing Capital, Building Communities, Creating Impact" http://www.opportunityfinance.net/industry/industry_sub1.aspx?id=248.

[43] Press release issued on November 19, 2008, quoting Mr. Dugan in a speech to the Enterprise Annual Network Conference.

[44] *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).

[45] For a thorough discussion of the servicing incentive structure, see Testimony of Diane Thompson before the Senate Banking Committee (Nov. 16, 2010), *available at* http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Testimony&Hearing_ID=df8cb685-c1bf-4eea-941d-cf9d5173873a&Witness_ID=d9df823a-05d7-400f-b45a-104a412e2202 ; *see also* Diane Thompson, "Why Servicers Foreclose When They Should Modify and Other Puzzles of Servicer Behavior," National Consumer Law Center (Oct. 2009), *available at* http://www.nclc.org/images/pdf/foreclosure_mortgage/mortgage_servicing/servicer-report1009.pdf.

[46] 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, *Bradbury et al v. GMAC Mortgage, LLC* (Civil Action, Docket CV-2010-494, U.S. Dist. ME). In a related individual case, US Bank v. James (Civil Action, Docket CV-2009-0084, U.S. Dist. ME, Doc. 196 1/31/11), the court recently awarded sanctions against GMAC to a homeowner required to defend against a motion for summary judgment supported by a falsely sworn affidavit (robo-signing) ruling, "Stephan's actions in this case strike at the heart of any court's procedures, are egregious under the circumstances, and must be deemed worthy of sanctions."

[47] Testimony of Adam Levitan before the Senate Banking Committee (Nov. 16, 2010), *available at* http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Testimony&Hearing_ID=df8cb685-c1bf-4eea-941d-cf9d5173873a&Witness_ID=2ada1da6-e7cc-4eca-99a4-03584d3748af*; see also In re Agard*, Docket No. 810-77338-reg (EDNY Bnkr. Slip Op. at 31, 2/10/11)("naming MERS a 'nominee,' and/or 'mortgagee of record' did not bestow authority upon MERS to assign the Mortgage.").

[48] In the Senate, Senator Jack Reed also introduced legislation in the 111th that would mandate loss mitigation (S. 1431).

[49] 2009 HMDA data.

[50] The Federal Reserve, "The 2009 HMDA Data: The Mortgage Market in a Time of Low Interest Rates and Economic Distress," Dec. 2010.

[51] http://bucks.blogs.nytimes.com/2010/01/05/how-loan-modifications-impact-credit-scores/?hp.

[52] 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.

[53] Surprisingly, the Treasury Department has concluded that HHF funds can be used for housing counselors but not for attorneys. While an interpretation of EESA that denies its use for either purpose may be colorable, there is no credible reason for funding one but not the other.

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

[55] 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.

[56] 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.

[57] *Supra* Note 55 at 394.

[58] 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).

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

[60] 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.

[61] 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.

[62] 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.

[63] NY and NC in particular.

[64] For a comparison of modification parameters pre- and post-HAMP, see OCC/OTS Mortgage Metrics reports *available at* http://www.ots.treas.gov/?p=Mortgage%20Metrics%20Report. See also State Foreclosure Prevention Working Group reports *available at* http://www.csbs.org/regulatory/Pages/SFPWG.aspx.

[65] 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.

[66] The Office of the Homeowner Advocate would have been established by S. 3793, the Job Creation and Tax Cuts Act of 2010, introduced by Senator Max Baucus (D-MT); "Franken Homeowner Advocate Amendment Passes" (June 15, 2010), *available at* http://senatus.wordpress.com/2010/06/15/franken-homeowner-advocate-amendment-passes.

[67] 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."

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

[69] S*upra* note 3.

[70] "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

[71] 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.

[72] 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).

[73] *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.

[74] 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.

[75] See SIGTARP Jan. 2011 Quarterly Report to Congress, p. 45, *available at* http://www.sigtarp.gov/reports/congress/2011/January2011_Quarterly_Report_to_Congress.pdf.

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

[77] HAMP Supplemental Directive 10-15, *available at* https://www.hmpadmin.com/portal/programs/docs/hamp_servicer/sd1015.pdf.

[78] 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.)

[79] *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.).

[80] *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.).