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Before the U.S. House of Representatives
Committee on Financial Services

A Review of Mortgage Servicing Practices and Foreclosure Mitigation

July 25, 2008

Chairman Frank, Ranking Member Bachus, and members of the committee, thank you for holding this hearing on mortgage servicing practices and foreclosure mitigation. We applaud the committee for focusing on the crucial issues of how we handle today's distressed home loans and how we can prevent further deterioration in the market.

The U.S. economy faces significant challenges today, as 20,000 foreclosures take place every single week.[1] It is not an overstatement to say that the way we choose to deal with these issues today has implications for nearly every American. The negative spillover effects from these foreclosures are substantial: a single foreclosure causes neighborhood property values to drop, collectively adding up to billions of dollars of losses. Empty homes lead to higher crime rates. Lost property tax revenue hurts cities and counties that are already strapped. Millions of Americans who depend on a robust housing market are losing jobs and income. As foreclosures accelerate during the next two years, these economic effects will be felt even more strongly.

In announcing the Federal Reserve Board's new rules governing mortgage origination, Federal Reserve Board Chairman Ben Bernanke acknowledged that unfair and deceptive practices by lenders have played a major role in the current housing crisis. According to Bernanke, too many loans were "inappropriate or misled the borrower."[2] As a result, the Federal Reserve will now require all lenders to verify a consumer's ability to afford a mortgage before selling it, and will prohibit a variety of abusive and dangerous practices.

While it is too late to stop the housing crisis that has been caused by reckless lending, it is not too late to minimize the massive damage ahead. Skillful loan servicing can convert distressed mortgages into stable loans that generate revenue for investors, build ownership for families, and contribute to stronger and more stable communities. Ineffective or abusive loan servicing, on the other hand, can produce the opposite results. That is why national policies governing loan servicing ultimately will have enormous implications -- not only for people facing foreclosure, but for the future prosperity of our country.

In short, abusive and inappropriate loans were mass-marketed for years, and now, to prevent further damage to the economy, these bad loans must be mass-repaired. The most effective way to repair distressed loans is through loan "modifications" that alter the loan's terms in a way that allows homeowners to continue paying their debt and building equity. Unfortunately, as I will discuss in more detail, today even the best-intentioned loan servicers face major obstacles to making loan modifications, and others lack the incentive or motivation to fix mortgages so that people can stay in their homes. To put it bluntly, it is far harder to obtain an affordable loan modification for an unsustainable loan than it was to take out the loan in the first place. As a result, voluntary efforts aimed at increasing loan modifications have done little to stem the overwhelming tide of foreclosures that are dragging down our economy.

The House took an important step in addressing the foreclosure crisis earlier this week by passing H.R. 3221, the American Housing Rescue and Foreclosure Prevention Act of 2008. If enacted, the new law will encourage more loan modifications and provide badly needed assistance to damaged communities. Even assuming the bill becomes law within the week, however, it will still take time to fully expand the FHA's capacities, and – although some lenders have indicated their readiness to use the expanded FHA program – it will still depend on the voluntary participation of lenders and servicers.

Therefore, it is important to consider other legislative initiatives that will either assist the FHA expansion in reaching its goals or provide complementary additional solutions. We believe that revitalizing the housing market requires improving mortgage servicing practices, allowing more time for servicers and homeowners to be successful; and empowering homeowners to seek loan modifications on their own behalf through the court system.

In these comments, I will discuss the following points**:**

- We face a severe foreclosure crisis with substantial negative effects on entire communities and the broader economy. This crisis will not pass within the next year or two; rather, it is likely to last at least another five years.

- Efforts to encourage voluntary loan modifications have failed to keep up with the increase in foreclosures. The most recent HOPE NOW report shows that almost four times as many families lost their home or are in the process of losing their home as received loan modifications from servicers. To the extent that voluntary efforts are being made, many of the resulting workouts or modifications are not sustainable. Some have left homeowners worse off than before, and many homeowners have already re-defaulted.

- Excessive junk fees charged upfront for modifications and workouts are preventing many modifications from succeeding because homeowners are already completely tapped out even before the modification begins.

- In many cases, homeowners are being asked to permanently sign away their rights to all past, present, and future legal claims, including foreclosure defenses, even when the modifications or workouts are temporary and/or unsustainable.

- We are hopeful that the FHA expansion program contained in HR 3221 will result in many more voluntary and sustainable modifications. However, this program will likely take months or even a year to implement, and, once implemented, it can only be used at the request of lenders, not homeowners, and will still require parties to solve the problem of junior liens on the property. Moreover, even under the best-case scenario, the Congressional Budget Office estimates that the FHA could help prevent between 400,000 and 500,000 foreclosures. Our nation is now experiencing 8,000 foreclosures *every single day*, and 6.5 million foreclosures are predicted over the next five years.

- We support H.R 5679, the Foreclosure Prevention and Sound Mortgage Servicing Act of 2008, introduced by Chairwoman Waters. This bill establishes a sound framework for requiring mortgage servicers to evaluate a homeowner's situation and provide appropriate loss mitigation. It contains provisions that would likely improve communication between homeowners and their servicers; assist in crucial data collection and reporting; and strengthen the Real Estate Settlement Procedures Act.

- We also support H.R. 6076, the Home Retention and Economic Stabilization Act. This bill, introduced by Representative Matsui, is a temporary deferment plan that provides a much-needed "timeout" for servicers to catch up with backlogs and for new federal and state programs – such as the FHA expansion program – to be implemented. Homeowners must continue to make monthly payments, must maintain the property, and must respond to servicer inquiries. Creditors may end the deferment period early by providing the homeowner with an affordable loan modification.

- We continue to support H.R. 3609, the Emergency Home Ownership and Mortgage Equity Protection Act of 2007. We believe that court-supervised loan modifications are a necessary complement to voluntary efforts. In many instances, court-supervised loan modifications provide the only available solution to some of the challenges servicers face, such as the presence of second mortgages, and the fear of lawsuits by investors.

Self-Help and Center for Responsible Lending

I am Policy Counsel at the Center For Responsible Lending (CRL), (www.responsiblelending.org), a not-for-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help (www.self-help.org), which consists of a credit union and a non-profit loan fund.

For close to thirty years, Self-Help has focused on creating ownership opportunities for low-wealth families, primarily through financing home loans to low-income and minority families who otherwise might not have been able to get home loans. In other words, we work to provide fair and sensible loans to the people most frequently targeted for predatory and abusive subprime mortgages. Self-Help has provided over $5 billion of financing to 55,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across America.

In addition to making direct loans, Self-Help encourages sustainable loans to borrowers with blemished credit through a secondary market operation. Self-Help buys these loans from banks, holds on to the credit risk, and resells them to Fannie Mae. Self-Help has used the secondary market to provide $4.5 billion of financing to 50,000 families across the country, loans that have performed well and increased these families' wealth.

Self-Help makes loans specifically to families and business with little borrowing experience and few external support resources. While our loans have had somewhat higher delinquency rates than the prime market, we have had extremely few loans end up in foreclosure. It has been our experience that while borrowers may fall behind temporarily on mortgage payments, they will make every effort to catch up and hold on to their home. By working closely with every delinquent customer and by providing affordable loan modifications aimed at keeping homeowners in their homes, Self-Help has successfully minimized foreclosures and has kept our loan losses to less than one percent per year.

I. We face a severe foreclosure crisis that will grow even worse without significant government action.

Just one year ago, some in the mortgage industry claimed that the number of coming foreclosures would be too small to have a significant impact on the overall economy.[3] No one makes that claim today. As foreclosures reach an all-time high and are projected to grow higher,[4] the "worst case is not a recession but a housing depression."[5] Projections by Fitch Ratings indicate that 43 percent of recent subprime loans will be lost to foreclosure,[6] and at least two million American families are expected to lose their homes to foreclosures initiated over the next two years.[7] What's more, industry projections forecast that by 2012, 1 in 8 mortgages – that's all mortgages, not just subprime mortgages – will fail.[8] Robert Schiller recently noted that the meltdown and resulting crisis has erased any gains in the homeownership rate made since 2001, and the rate stands to fall further yet.[9]

The negative effects of foreclosures are not confined to the families who lose their homes. Forty million of their neighbors – those who are paying their mortgages on time -- will see their property values decline as a result by over $350 billion.[10] Other ripple effects include a reduced tax base, increased crime, further downward pressure on housing prices, and loss of jobs in the industry. According to the IMF, direct economic losses stemming from this crisis will likely top $500 billion, and consequential costs will total close to a trillion dollars.[11]

Sadly, many of the families losing their homes to foreclosure today might not have found themselves in this position if they had been given the type of loan that they actually qualified for. Last December, the *Wall Street Journal* found that of the subprime loans originated in 2006 that were packaged into securities and sold to investors, 61 percent "went to people with credit scores high enough to often qualify for conventional [i.e., prime] loans with far better terms."[12] Even those borrowers who did not qualify for prime loans could have received sustainable, thirty-year, fixed-rate loans for -- at most -- 50 to 80 basis points above the "teaser rate" on the unsustainable exploding ARM loans they were given.[13]

Wall Street's appetite for risky loans incentivized mortgage brokers and lenders to aggressively market these highly risky ARM loans instead of the sustainable loans for which borrowers qualified. As former Federal Reserve Chair Alan Greenspan told Newsweek:

> The big demand was not so much on the part of the borrowers as it was on the part of the suppliers who were giving loans which really most people couldn't afford. We created something which was unsustainable. And it eventually broke. If it weren't for securitization, the subprime loan market would have been very significantly less than it is in size.[14]

Market participants readily admit that they were motivated by the increased profits offered by Wall Street in return for risky loans. After filing for bankruptcy, the CEO of one mortgage lender explained it this way to the New York Times, "The market is paying me to do a no-income-verification loan more than it is paying me to do the full documentation loans," he said. "What would you do?"[15] Even the chief economist of the Mortgage Bankers Association, when asked why lenders made so many loans that they knew were unsustainable, replied, "Because investors continued to buy the loans."[16]

Currently, 30 percent of families holding recent subprime mortgages owe more on their mortgage than their home is worth.[17] These families are at an increased risk of foreclosure because their negative equity (being "underwater") precludes the homeowner from selling, refinancing or getting a home equity loan or using any other mechanism for weathering short-term financial difficulty.[18] Regulators like the Chair of the Federal Reserve Board and other economists are increasingly cautioning that loan balances must be reduced to avoid unnecessary foreclosures that will further damage the economy.[19] Unnecessary foreclosures are those that could be avoided with an economically rational, sustainable loan modification that yields the creditor or investor pool at least as much as would be recovered in foreclosure.

II. Voluntary loan modifications have proven insufficient to prevent the foreclosure crisis from continuing to escalate.

To date, Congress and the regulatory agencies have responded to this crisis largely by encouraging voluntary efforts by servicers to reduce the number of foreclosures. Yet despite the loss mitigation encouragement by HOPE NOW, the federal banking agencies, and state agencies, voluntary efforts by lenders, servicers and investors have failed to stem the tide of foreclosures. Seriously delinquent loans are at a record high for both prime and subprime loans.[20] The number of families in danger of losing their homes continues to be near record highs: in May, an estimated 1,977,000 loans were 60 days or more delinquent or had entered foreclosure, the second highest number since the program began reporting data last July. This is an astonishing 43 percent increase since July of last year.[21]

There is an emerging consensus that half-measures in the private sector are not working. FDIC Chairman Sheila Bair recently said that the current economic situation calls for a stronger government response, since voluntary loan modifications are not sufficient.[22] The necessity of government action also is gaining recognition among Wall Street leaders. In April, a senior economic advisor at UBS Investment Bank stated that, "when markets fail, lenders and borrowers need some sort of regulatory and legislative framework within which to manage problems, rather than be forced to act in the chaos of the moment."[23] Moreover, as former Federal Reserve Board Vice Chairman Alan Blinder recently noted, the fact that most of the mortgages at issue have been securitized and sold to investors across the globe "bolsters the case for government intervention rather than undermining it. After all, how do you renegotiate terms of a mortgage when the borrower and the lender don't even know each other's names?"[24]

While the HOPE NOW initiative claims to be making significant progress, its most recent data report reveals that the current crisis in the housing market dwarfs the servicing industry's response**.** According to their most recent report, almost four times as many families lost their home or are in the process of losing their home as received loan modifications from servicers.[25] The State Foreclosure Prevention Working Group, made up of state Attorneys General and Banking Commissioners, found that seven out of ten seriously delinquent borrowers are *still* not on track for any loss mitigation outcome that could lead to preventing a foreclosure.[26]

There are a number of reasons for this lack of loss mitigation activity. One reason is that the way servicers are compensated by lenders creates a bias for moving forward with foreclosure rather than engaging in foreclosure prevention. As reported in *Inside B&C Lending*, "Servicers are generally dis-incented to do loan modifications because they don't get paid for them but they do get paid for foreclosures." In fact, "it costs servicers between $750 and $1,000 to complete a loan modification."[27] Even when a loan modification would better serve investors and homeowners, some loan servicers have an economic incentive to proceed as quickly as possible to foreclosure.

But even those servicers who want to engage in effective loss mitigation face significant obstacles. One such obstacle is the fear of investor lawsuits, because modifying loans typically affects various tranches of securities differently. Another obstacle is the existence of junior liens on many homes. When there is a second mortgage, the holder of the first mortgage has no incentive to provide modifications that would free up borrower resources to make payments on the second mortgage. At the same time, the holder of the second mortgage has no incentive to support an effective modification, which would likely cause it to face a 100 percent loss; rather, the holder of the second is better off waiting to see if a homeowner can make a few payments before foreclosure. A third to a half of the homes purchased in 2006 with subprime mortgages have second mortgages as well.[28]

It is also important to note the gap between rhetoric and reality about how easy it is to get a loan modification.[29] Servicers coming before Congress often excuse the paucity of loan modifications by claiming that their efforts to modify loans are stymied by homeowners' refusal to respond to servicers' calls and letters. While this no doubt happens in some cases, the bigger problem by far is the reverse. We repeatedly hear from homeowners and housing counselors that the numerous homeowners who actively reach out to their servicers face the same problem: despite repeated calls to the servicer and many hours of effort, they cannot get anyone on the phone with the authority or ability to help. Many professional housing counselors are demoralized by the servicers' practice of incessantly bouncing the caller around from one "on hold" line to another, such that desperate homeowners never reach a live person or one with decision-making authority.

III. When modifications and other workouts are made, they are frequently temporary or unsustainable, leading to re-default and placing homeowners in an even worse economic position than when they started.

More than a year ago, leading lenders and servicers publicly and unanimously endorsed a set of principles announced at the Homeownership Preservation Summit hosted by Senate Banking Committee Chairman Christopher Dodd, which called upon servicers to modify loans to "ensure that the loan is sustainable for the life of the loan, rather than, for example, deferring the reset period."[30]

Unfortunately, many of the modifications now being made have not adhered to this pledge. To date, neither HOPE NOW nor the Mortgage Bankers Association has been willing to disclose what proportion of the loan modifications entail reductions of principal or long-term reductions of interest rates, what proportion simply entail the capitalization of arrearages or short-term adjustments, and what proportion require the payment of fines and fees as a precondition to getting any modification at all. However, it is clear that most loan modifications or workouts have not fundamentally changed the unsustainable terms of the mortgage by reducing the principal or lowering the interest rate, but instead just add fees and interest to the loan balance and amortize them into the loan, add them to the end of the loan term, or provide a temporary forbearance.

Reduction in interest rates is a key way to provide relief for homeowners whose interest rates jumped significantly – far above market rates -- as a result of rate resets. Modification of principal is particularly important for the approximately 30 percent of recent subprime loans whose owners now owe more than the house is worth by reducing principal. In calling for more loan modifications that reduce principal, Chairman Bernanke recently noted that such loan modifications involving have been "quite rare."[31] The State Foreclosure Prevention Working Group agrees.[32]

Unsurprisingly, given the minimal relief these "modifications" frequently provide, a report just released by Moody's has found a high number of re-defaults among the modified loans. Of the servicing companies surveyed by Moody's (accounting for roughly 50 percent of the total US subprime servicing market), fully 42 percent of the loans modified in the first half of 2007 were at least 90 days delinquent as of March 31, 2008. The vice chair of Washington Mutual, who helps run HOPE NOW, admits that many of the homeowners who have sought their assistance "will not receive long-term relief and could ultimately face higher total costs."[33]

Another obstacle to sustainable modifications is the common servicer practice of charging exorbitant fines and "junk" fees. The reasonableness of most default fees is highly doubtful, with many of the "costs" unjustifiable and vastly exceeding the prevailing market rates in a community. Indeed, the fact that mortgage servicers systematically charge unreasonable fees is well-documented by courts.[34] A recent analysis of over 1,700 foreclosures across the country showed that questionable fees were added to borrowers' bills in almost half the loans.[35] Servicers often require that these fees be paid in full before the homeowner receives a loan modification or workout, thereby depleting whatever limited funds the financially strapped homeowner can scrape together and leaving no cushion for short-term cash-flow needs, which results in a much higher possibility of re-default.

Compounding the problem, servicers frequently misapply monthly mortgage payments first to the fees, rather than to the principal and interest owed. In this way, a homeowner who is timely repaying interest and principal nevertheless falls further behind on the mortgage and accumulates still more fees, continuing a vicious cycle.

IV. In many cases, voluntary loan modifications or workouts are further disadvantaging homeowners in trouble because the servicer forces homeowners to waive all their rights, even those unrelated to the workout.

As a precondition to modifications and workout, lenders have been requiring shockingly broad waivers that strip homeowners of fundamental legal rights. These waivers threaten almost all of the borrowers' legal defenses to a foreclosure if the modification is unsustainable. Thus, if the modification fails, the lender can argue the borrower waived all of his federal (such as Truth in Lending or HOEPA) and state law defenses to foreclosure. The waivers also could be read to prevent claims questioning the reasonableness of fees charged.

Indeed, some releases go so far as to waive future claims that have not arisen, including seeking a free pass for future violations of such important federal laws as the Fair Credit Reporting Act, the Fair Housing Act, and Fair Debt Collection Practices Act, and some even ask homeowners to waive rights that are deemed unwaivable under state law. For example, here is one such waiver required by Countrywide:

> In consideration for Countrywide entering into this Agreement, you agree to release and discharge Countrywide, and all of its investors, employees, and related companies, from any and all claims you have or may have against them concerning the Loan. Although California law (specifically Section 1542 of the California Civil Code) provides that "[a] general release does not extend to claims which the creditor does not know or suspect to exist in his favor at the time of executing the release, which if known by him must have materially affected his settlement with the debtor," you agree to waive that provision, or any similar provision under other state or federal laws, so that this release shall include all and any claim whatsoever of every nature concerning the Loan, regardless of whether you know about or suspect such claims including, but not limited to, claims arising under the Mortgage Disclosure Act, Electronic Fund Transfer Act, Truth in Lending Act, Real Estate Settlement Procedures Act, Fair Credit Reporting Act, Fair Housing Act, and Fair Debt Collection Practices Act. This release shall remain effective even if this Agreement terminates for any reason.[36]

Other institutions include similar clauses in their loan modification agreements.[37] One Option One agreement even forces the homeowner to "admit" that "the Arrearage is the Borrowers' full responsibility and was produced solely by the actions or inactions of the Borrowers."[38]

Given that these waivers are typically signed when a family's only other choice is to lose their home, and given that they are required not just for life-of-the-loan modifications but even for temporary forbearances, we believe they risk compounding the foreclosure crisis. A homeowner should not be coerced into giving up potential defenses if a foreclosure ultimately takes place. As noted below, HR 5679 would prohibit these waivers. However, in the absence of legislative action, we strongly recommend that servicers stop requiring such waivers as a condition of modification and that HOPE Now require its participating servicers to refrain from requiring such waivers. The servicers also should publicly state they will not seek to enforce the waiver clauses in the modifications they have made to date

V. HR 5679, the Foreclosure Prevention and Sound Mortgage Servicing Act of 2008 will help prevent foreclosures, improve servicing practices, and enhance data collection.

Earlier this year, Representative Maxine Waters introduced HR 5679, the Foreclosure Prevention and Sound Mortgage Servicing Act of 2008. This bill requires loan servicers to engage in loss mitigation efforts prior to foreclosure, although it does not mandate any particular outcome or result.

Legislation establishing minimal servicing standards is needed because loan servicing is not an industry subject to typical economic incentives. As Tara Twomey of the National Consumer Law Center notes, homeowners "cannot choose the servicer that handles their loan and cannot change servicers if they are dissatisfied."[39] Instead, servicers are driven by the desire to maximize their own profits and to maximize returns to the investors who now stand in the shoes of the original lender.[40]

By requiring loan servicers to engage in loss mitigation prior to foreclosure, this legislation will assist homeowners, lenders, investors, and communities. The bill prioritizes continued homeownership as the highest goal of servicers. It requires that homeowners be able to reach a live person with decision-making authority, and it prohibits the coercive waivers described in Section IV above.

Perhaps most important, the legislation requires that any agreement reached through loss mitigation be affordable by the homeowner. We think careful consideration of the borrower's income as well as any expenses, including debt and residual income left over for other living expenses, is critical in determining the affordability of any solution intended to keep homeowners in their home.

We are also supportive of the bill's efforts to require that servicers provide advance notice by telephone and in writing to homeowners with ARMs of upcoming payment increases; refer homeowners who are late on their mortgage payments to HUD-certified housing counselors; and respond to homeowner inquiries and requests for information in a timely way, providing payment histories, loan documents, and loss mitigation documents as requested.

Another important aspect of this legislation is its requirement that servicers report various loss mitigation efforts disaggregated by activity and geographical designation. This simple and important requirement will ensure that policymakers and stakeholders have an accurate understanding of the kinds of loss mitigation being provided, so that policy responses can be appropriately tailored to address current needs.

Finally, the bill provides a long overdue update to the Real Estate Settlement Procedures Act (RESPA) by allowing individuals to enforce violations of RESPA servicing provisions and by updating RESPA remedies. These changes will significantly enhance consumer protection and enforcement of the RESPA provisions.

If it is made applicable to existing loans, the Foreclosure Prevention and Sound Mortgage Servicing Act provides servicers with a mechanism for maximizing returns to the investors as a whole, while reducing the harm to the family and the community. Indeed, many of the bill's requirements – that the servicers contact borrowers, provide direct access to loss mitigation personnel, and refer delinquent borrowers to HUD-certified housing counselors – are measures that industry representatives have committed to undertake and claim to be doing now. Furthermore, it will enable policymakers to assess the extent to which these steps are occurring, so that they can properly evaluate the progress and effectiveness of solutions to date.

VI. H.R. 6076, the Home Retention and Economic Stabilization Act, will provide a necessary timeout for overburdened servicers and homeowners with unsustainable loans.

Given the extensive nature of the foreclosure crisis and the fact that servicers have been unable to reduce foreclosures sufficiently, more time is needed to develop and implement strategies to keep homeowners in their homes. H.R. 6076, the Home Retention and Economic Stabilization Act, is a temporary deferment plan that provides a much-needed "timeout" that will enable lenders and servicers to increase their capacities to meet current need, for credit markets to stabilize, and for legislative solutions, such as the FHA refinancing program under consideration in Congress, to take effect.

In short, H.R. 6706 allows struggling homeowners to delay a foreclosure sale of their principal residence by up to nine months when they continue to make specified payments and meet other requirements. During the nine-month period, homeowners must continue to make payments equal to the lower of the original minimum monthly payment, i.e., at the "teaser" rate, on an adjustable rate mortgage, or a payment based on a market interest rate plus a 1 percent risk premium applied to the principal owed. Any amounts owed beyond these payments will be amortized and paid over the life of the loan, beginning at the end of the deferment period (in other words, these payments are not forgiven).

To take advantage of this opportunity, homeowners must have an income below 200% of area median income and also must live in their home and certify that they will remain there. Furthermore, the proposed deferment only applies to subprime and negative amortization mortgages -- the type of products that banking regulators have identified as potentially dangerous.

The bill gives creditors and servicers a "safe harbor" from the deferment period if they negotiate an affordable modification plan with the homeowner. The bill further protects creditors by permitting them to end the deferment plan if the homeowner fails to make monthly payments, fails to maintain the property, or fails to respond to servicer outreach efforts.

We support this bill because we believe it will help encourage affordable loan modifications and prevent foreclosures. Avoiding unnecessary foreclosures is urgently needed not only for the sake of the families immediately impacted, but for the good of their neighbors, communities, state and local governments, the housing market and the economy nationwide.

VII. Court-supervised loan modifications are a necessary complement to any voluntary efforts.

Even if all of the legislation and other suggestions described above are enacted, a significant proportion of troubled homeowners will ultimately face foreclosure because the loan servicer cannot modify the loan due to a conflict between multiple lienholders or other constraints. In those cases, the failure to modify will be to the clear detriment of investors as a whole. It is critical, as a last alternative to foreclosure, to permit a bankruptcy court to adjust the mortgage if the borrower can afford a market rate loan that will be preferable to foreclosure for the creditor or investor pool and the homeowner alike.

Currently, bankruptcy courts can modify any type of loan, including mortgages on yachts and vacation homes, with the exception of one type: primary residences. Removing this exclusion would help homeowners (not speculators) who are committed to staying in their homes, without bailing out investors and without costing taxpayers a dime. The Emergency Home Ownership and Mortgage Equity Protection Act (HR3609) provides a narrow, time-limited mechanism for enabling court-supervised loan modifications to break the deadlock that is forcing families who can afford a market rate loan into foreclosure.[41] The bill has been marked up in both Chambers, and is an important part of any effective solution to the foreclosure crisis.

We believe that the court-supervised loan modifications bill is a necessary complement to the Foreclosure Prevention and Sound Mortgage Servicing Act because it provides an important backstop for families who cannot get a sustainable loan modification due to junior liens or for whatever other reason. Moreover, as loans get modified through the bankruptcy process, these modifications will effectively create a “template” for modification that will ease the process of loss mitigation for servicers, as all parties involved will have a better idea of how the courts would handle a particular situation.[42]

Together, the Foreclosure Prevention and Sound Mortgage Servicing Act and the Emergency Home Ownership and Mortgage Equity Protection Act will help stem the tide of coming foreclosures and provide urgently needed relief to struggling homeowners, the communities they live in, and the economy as a whole.

Conclusion

The foreclosure crisis is far from over. Already we have seen the tremendous costs imposed by this crisis. Yet it is not too late to take action to prevent many more foreclosures and a much higher cost. By moving homeowners from abusive loans into sustainable ones, we can keep families in their homes, ensure a continued stream of income to investors, and prevent the neighborhood and societal costs of mass foreclosures.

We applaud the committee for focusing on this national crisis and for the steps that this committee and this chamber have already taken to help ameliorate its impact. We urge the committee to implement additional common-sense solutions to prevent the problems from deepening even further. If timely implemented, these solutions will break the downward spiral of losses, help put a floor under market declines, and return stability and liquidity to the housing and mortgage markets.

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[1] *See Moody’s Economy.com: Hearing before House Subcommittee on Commercial and Administrative Law* (January 28, 2008), (written testimony of Mark Zandi) *available at*

http://judiciary.house.gov/media/pdfs/Zandi080129.pdf; *See also* Center for Responsible Lending , *Subprime Spillover*, (Rev. Jan. 18, 2008) http://www.responsiblelending.org/issues/mortgage/research/subprime-spillover.html [hereinafter Subprime Spillover].

[2] Statement of Chairman Ben S. Bernanke, Federal Reserve Board, commenting on new FRB regulatory amendments on mortgage lending (July 14, 2008) at http://www.federalreserve.gov/newsevents/press/bcreg/bernankeregz20080714.htm.

[3] *See, e.g.*, Statement of John M. Robbins, CMB, Chairman, Mortgage Bankers Association at the National Press Club's Newsmakers Lunch – Washington, DC (May 22, 2007) (Speaking of predicted foreclosures, Mr. Robbins stated: "As we can clearly see, this is not a macro-economic event. No seismic financial occurrence is about to overwhelm the U.S. economy."); Julia A. Seymour, *Subprime Reporting, Networks blame lenders, not borrowers for foreclosure 'epidemic,'* Business & Media Institute, Mar. 28, 2007 ("[T]here are experts who say the subprime 'meltdown' is not the catastrophe reporters and legislators are making it out to be. 'We don't believe it will spill over into the prime market or the U.S. economy,' said [Laura] Armstrong [Vice President, Public Affairs] of the Mortgage Bankers Association.").

[4] Renae Merle, *Home Foreclosures Hit Record High*, Washington Post, March 6, 2008.

[5] David M. Herszenhorn and Vikas Bajaj, *Tricky Task of Offering Aid to Homeowners*, The New York Times, Apr. 6, 2008 (quoting Susan M. Wachter, a real estate finance professor at the Wharton School of the University of Pennsylvania. According to Professor Wachter, "In the market that we have in front of us, prices decline and supply increases, driving prices down further.").

[6] Fitch Ratings estimates total losses of 25.8 percent of original balance in Q4 2006 loans placed in MBS they rated, and that loss severity will be at 60 percent, which means that 43 percent of the loans are projected to be lost to foreclosure (25.8/60); lack of home price appreciation said to increase defaults. Glenn Costello, Update on U.S. RMBS: Performance, Expectations, Criteria, Fitch Ratings, at 17-18 (not dated, distributed week of February 25, 2008). According to Michael Bykhovsky, president of Applied Analytics, an estimated 40 percent of outstanding subprime mortgage loans could go into default over the next three years; the dire outlook due to declining home values (press briefing at the Mortgage Bankers Association's National Mortgage Servicing Conference, February 27, 2008).

[7] *See Moody's Economy.com Hearing before House Subcommittee on Commercial and Administrative Law* (January 28, 2008) (written testimony of Mark Zandi) *available at* http://judiciary.house.gov/media/pdfs/Zandi080129.pdf.

[8] Rod Dubitsky et al., *Foreclosure Trends – A Sobering Reality*, Credit Suisse, Fixed Income Research, Apr. 28, 2008.

[9] Robert J. Schiller, *The Scars of Losing a Home*, New York Times, May 18, 2008 (noting that the homeownership rate has fallen from 69.1 percent in 2005 to 67.8 percent in the first quarter of 2008, nearly the 67.5 percent rate at the beginning of 2001).

[10] See Center for Responsible Lending, *The Impact of Court-Supervised Modifications on Subprime Foreclosures*, (Feb. 25, 2008), *available at* http://www.responsiblelending.org/pdfs/us-info-with-fc-starts.pdf; for CRL's methodology for computing spillover, *see Subprime Spillover*, *supra* note 1 (Rev. Jan. 18, 2008), *available at* http://www.responsiblelending.org/issues/mortgage/research/subprime-spillover.html.

[11] Christopher Swann, *IMF Says Financial Losses May Swell to $945 Billion,* April 8, 2008, *available at* http://www.bloomberg.com/apps/news?pid=email_en&refer=home&sid=aK1zAj5FZ9Io.

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

[13] Letter from CFAL to Ben S. Bernanke, Sheila C. Bair, John C. Dugan, John M. Reich, JoAnn Johnson, and Neil Milner (January 25, 2007) at 3.

[14] Jon Meacham and Daniel Gross, *The Oracle Reveals All*, NEWSWEEK, Sept. 24, 2007, at 32, 33.

[15] Vikas Bajaj and Christine Haughney, *Tremors At the Door -- More People with Weak Credit Are Defaulting on Mortgages*, The New York Times, Jan. 26, 2007, at C1, C4.

[16] Les Christie, *Subprime Loans Defaulting Even Before Resets*, CNNMoney.com, February 20, 2008, http://money.cnn.com/2008/02/20/real_estate/loans_failing_pre_resets/index.htm.

[17] Edmund Andrews, *Relief for Homeowners is Given to a Relative Few*, New York Times, March 4, 2008 (loans originated in 2005 and 2006).

[18] Kristopher Gerardi, Adam Hale Shapiro & Paul S. Willen, *Subprime Outcomes: Risky Mortgages, Homeownership Experiences, and Foreclosures*, 3-4 (Federal Reserve Bank of Boston, Working Paper No 07-15, Dec. 3, 2007) (this otherwise good article misses the fact that certain loans themselves can create the cash flow shortfall that causes underwater loans to fail, when they are structured with initial low payments that are scheduled to rise, such as subprime 2/28 hybrid ARMs, and that certain loan terms have been statistically demonstrated to increase foreclosures, such as prepayment penalties).

19 Federal Reserve Chairman Ben Bernanke recently said, "When the mortgage is 'underwater,' a reduction in [loan] principal may increase the expected payoff by reducing the risk of default and foreclosure." "Preventable foreclosures" could be reduced, he said, by enabling loan servicers to "accept a principal writedown by an amount at least sufficient to allow the borrower to refinance into a new loan from another source." This would "remove the downside risk to investors of additional writedowns or a re-default." See Chair Ben S. Bernanke, "Reducing Preventable Mortgage Foreclosures" (March 4, 2008), http://www.federalreserve.gov/newsevents/speech/bernanke20080304a.htm; see also, Edmund L. Andrews, Fed Chief Urges Breaks for Some Home Borrowers, The New York Times, Mar. 4, 2008; John Brinsley, Bernanke Call for Mortgage Forgiveness Puts Pressure on Paulson, Bloomberg.com, Mar. 5, 2008; Phil Izzo, Housing Market Has Further to Fall, The Wall Street Journal, Mar. 13, 2008 ("Last week, Federal Reserve Chairman Ben Bernanke suggested that lenders could aid struggling homeowners by reducing their principal — the sum of money they borrowed — to lessen the likelihood of foreclosure. Some 71 percent of respondents [i.e., economists surveyed by the NYT] agreed with the suggestion."").

[20] Press Release, Center for Responsible Lending, Statement on HOPE Now, (July 2, 2008), *available at* http://www.responsiblelending.org/press/releases/statement-hope-now-numbers-show-foreclosure-crisis-worsening.html.

[21] *Id*.

[22] FDIC Chairwoman Sheila Bair (stating ""We've got a real problem. And I do think we need to have more activist approaches. And I think it will be something we need to be honest with the American public about. We do need more intervention. It probably will cost some money."), Real Time Economics, The Wall St. Journal (April 7, 2008) available at: http://blogs.wsj.com/economics/2008/04/07/fdic-chairwoman-calls-for-activism/?mod=google_newsThe.

[23] George Magnus, *Large-scale action is needed to tackle the credit crisis*, Financial Times, Apr. 8, 2008.

[24] Alan S. Blinder, *From the New Deal, a Way Out of a Mess*, The New York Times, Feb. 24, 2008.

[25] Furthermore, the data provided by HOPE NOW understates the number of loans in foreclosure, as it only includes those homes that entered foreclosure and those that completed foreclosure during the month, not the total number currently in the foreclosure process. In fact, 1.1 million families were in foreclosure at the end of March.

[26] Conference of State Bank Supervisors, *Analysis of Subprime Servicing Performance, Data Report No. 2*, (April 2008), at 1 *available at* http://www.csbs.org/Content/NavigationMenu/Home/StateForeclosureApril2008.pdf [hereinafter *Analysis of Subprime Servicing*].

[27] Center for Responsible Lending, *Inside Mortgage Finance Reprints, Subprime Debt Outstanding Falls, Servicers Pushed on Loan Mods* (Nov. 16, 2007) *available at* http://www.responsiblelending.org/pdfs/paulson-brief-final.pdf (quoting Karen Weaver, a managing director and global head of securitization research at Deutsche Bank Securities).

[28] Credit Suisse Report, *Mortgage Liquidity du Jour: Underestimated No More* (March 12, 2007) at 5.

[29] *See generally*, Gretchen Morgenson, *Silence of the Lender: Is Anyone Listening?* New York Times, July 13, 2008.

[30] Homeownership Preservation Summit Statement of Principles (May 2, 2007), *available at* http://dodd.senate.gov/index.php?q=node/3870/print (The Principles were announced by Senator Dodd, and endorsed by the Mortgage Bankers Association, CitiGroup, Chase, Litton, HSBC, Countrywide, Wells, AFSA, Option One, Freddie Mac, and Fannie Mae).

[31] Statement of Federal Reserve Chairman Ben Bernanke on March 4, 2008, reprinted by Bloomberg.com and available at http://www.bloomberg.com/apps/news?pid=newsarchive&sid=apeU.0IaETdM ("Bernanke statement").

[32] *Analysis of Subprime Servicing*, *supra* note 26, at 9 (the majority of servicers are not reporting significant levels of modifications that reduce principal alone, although principal reductions may be combined with other modifications and therefore may not evidenced in our reporting).

[33] David Cho and Renae Merle, *Merits of New Mortgage Aid Are Debate – Critics Say Treasury Plan Won't Bring Long-Term Relief*, The Washington Post, Mar. 4, 2008 (citing remarks of Bill Longbrake, senior policy adviser for the Financial Services Roundtable and vice chair of Washington Mutual).

[34] Court have repeatedly found servicers' inspection fees, broker price opinions, forced place insurance, and legal fees either unreasonable or unjustifiable. See e.g., *In re Stewart*, 2008 WL 2676961, No. 07-11113 (Bankr. E.D. La. July 9, 2008) (Wells Fargo charging unnecessary inspection fees, unnecessary broker price opinions, and requiring excessively priced forced-place insurance); *In re Payne*, 387 B.R. 614, 628 (Bankr. D. Kan. 2008) (Everhome charging unjustified inspection fees, late fees, and foreclosure costs); *In re Jones*, 366 B.R. 584, 597-98 (Bankr. E.D. La. 2007) (Wells Fargo charging unreasonable inspection fees, unreasonable attorney's fees).

[35] Gretchen Morgenson & Jonathan D. Glater, *Foreclosure Machine Thrives on Woes*, The New York Times, Mar. 30, 2008 (citing Katherine Porter, Misbehavior and Mistake in Bankruptcy Mortgage Claims, University of Iowa College of Law Legal Studies Research Paper Series, *Misbehavior and Mistake in Bankruptcy Mortgage Claims*, (Nov. 7, 2007), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1027961.

[36] Countrywide, Repayment Plan Agreement (February 5, 2007) (on file with Center for Responsible Lending).

37 *Id*; Countrywide, Loan Modification Agreement (June 17, 2008); Homecomings Financial, Foreclosure Repayment Agreement, July 18, 2007; Ocwen Loan Servicing LLC, Forbearance Agreement (May 16, 2008); Ocwen Loan Servicing LLC, Proposed Modification Agreement (June 26, 2008); Option One Mortgage Corporate, Forbearance Agreement (August 24, 2007); NovaStar, Repayment Plan Agreement, (January 2008) (on file with Center for Responsible Lending).

Ocwen: By executing this modification, you forever irrevocably waive and relinquish any claims, action or causes of action, statute of limitation or other defense, counterclaims or setoffs of any kind which exist as of the date of this modification, whether known or unknown, which you may now or hereafter assert in connection with the making, closing, administration, collection or the enforcement by Ocwen of the loan documents, this modification or any other related agreements.
By executing this modification, you irrevocably waive all right to a trial by jury in any action, proceeding or counterclaim arising out of or relating to this modification and any related agreement or documents or transactions contemplated in this modification. Ocwen Loan Servicing LLC, Proposed Modification Agreement, June 26, 2008 (on file with Center for Responsible Lending).

Customer expressly relinquishes and waives any rights, claims, and defenses Customer may have under any of the Code of Civil Procedure Sections or under the Loan with regard to any whole or partial payment, whether current, pass or future. Homecomings Financial, Foreclosure Repayment Agreement, July 18, 2007 (on file with Center for Responsible Lending).

[38] Option One Mortgage Corporate, Forbearance Agreement (August 24, 2007). (on file with Center for Responsible Lending).

[39], *Hearing before the U.S. House of Representatives Subcommittee on Housing and Community Opportunity*, 8 (April 16, 2007) (testimony of Tara Twomey, National Consumer Law Center).

[40] *Id*. at 7 (Cutting costs is one reason for heavy reliance on often frustrating voicemail and touch tone menu options, as well as for the lack of adequate staff to handle requests for negotiation or information.).

[41] CRL Issue Brief, *Solution to Housing Crisis Requires Adjusting Loans to Fair Market Value through Court-Supervised Modifications*, (Apr. 1, 2008), *available at* http://www.responsiblelending.org/pdfs/senate-bankruptcy-support-brief-feb27.pdf.

[42],*Straightening Out the Mortgage Mess: How Can WE Protect Homeownership and Provide Relief to Consumers in Financial Distress: Hearing before the House Judiciary Committee, Subcommittee on Commercial and Administrative Law* 5 (Oct. 30, 2007) (Testimony of Richard Levin, Partner, Cravath, Swaine & Moore LLP, on behalf of the National Bankruptcy Conference) *available at* http://judiciary.house.gov/media/pdfs/Levin071030.pdf.