



White Paper

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

January 2011

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

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

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

- 1.) ***Better Execution***: Resolving this crisis requires intermediaries to interact with consumers and distressed borrowers in a fair and productive manner. This will require a paradigm shift within the current mortgage servicing industry.
  - *Improve Servicing*. Collections operations should be staffed at consistent levels across the industry in the 120+ day delinquency bucket at not more than 100-150 accounts per employee. These accounts should be assigned to a single point of contact until they

become current or need to move to a more aggressive loan resolution. We also recommend the use of special servicers which offer the enhanced counseling and operational capacity to help consumers find a “right-sized” modification. This also gets around the numerous existing servicer conflicts of interest, including second lien and other consumer debt ownership, fees and representation and warranty issues. The unwillingness of the owners of these other consumer debts to participate in the modification/restructuring process is still a central issue.

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

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

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

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

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

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

- (1) an option for the homeowner to re-establish a payment under a 31% front-end debt-to-income ratio (DTI) (as determined by full documentation of current income and assets, as well as a verification of hardship );
  - (2) a refinance at 97.75% LTV into the FHA Short Refinance program;
  - (3) reduction of all junior liens at a minimum of a proportional write-down; and,
  - ***Most importantly***, all consumer debt should be restructured as part of the modification. This includes second liens, home equity loans, and credit card and auto debt. A sustainable mortgage will have combined loan-to-value (CLTV) no greater than 115% and a back-end DTI of no greater than 50%. Without a proper solution for high back-end DTI (consumer debt), it is inevitable that borrowers will re-default even after a modification and the housing crisis will continue.
- ***Bankruptcy/Binding Arbitration.*** Although mortgage investors are willing to participate in the restructuring, the other debt holders, including subordinate and unsecured debts, need to participate as well. This is a basic element of fixing a credit problem, whereby all debts are taken into account, not just the most senior secured debt. To date, the other debt holders have not participated. This is evident in the high modification re-default rates and continued broader consumer distress in the economy and housing sector.
  - A mechanism to ensure the other debt holders participate in the solution is critical to a successful outcome. Some potential mechanisms include bankruptcy (whereby mortgage investors agree to a “voluntary cramdown” – which will not require any congressional legislation) or binding arbitration (whereby banks and servicers agree to participate as part of settlement of past bad acts).
  - Where a sustainable modification does not work, the servicer and/or counselor should work with the borrower to efficiently avoid foreclosure, including completing a short sale or deed in lieu. If the second lien is underwater, there needs to be a mechanism to bypass their approval for these foreclosure avoidance measures.

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

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