AVOIDABLE FORECLOSURES CONTINUE DESPITE SERVICERS' "LOAN MODIFICATIONS"

New Report Describes How Little Noticed Incentives Prompt Banks to Deny Relief to Homeowners

BOSTON, MA///October 20, 2009///Why have several recent programs designed to encourage loan modifications failed to slow America's still-worsening home mortgage foreclosure crisis? A new report from the National Consumer Law Center (NCLC) discloses that mortgage servicers – including many large banks – have found it cheaper to foreclose on homeowners than to offer loan modifications that would benefit homeowners and investors.

The result: Americans who might be able to stay in their homes under a loan modification plan are being moved right past that option and on to foreclosure.

The new NCLC report, *"Why Servicers Foreclose, When They Should Modify, and Other Puzzles of Servicer Behavior,"* reveals that servicers, unlike investors or homeowners, generally don't risk losing money on foreclosures. In fact, servicers usually make money on foreclosures.

Report author Diane E. Thompson, an attorney with NCLC, said, **"The country is in the midst of a foreclosure crisis of unprecedented proportions. Millions of families have lost their homes and millions more are expected to lose their homes in the next few years. With home values plummeting and layoffs common, homeowners are crumbling under the weight of mortgages that were at best only marginally affordable when made. One common sense solution to the foreclosure crisis is to modify the loan terms in more instances. Foreclosures are a costly ordeal for the homeowner, the lender, and the community. Yet they continue to outstrip loan modifications because servicers have no incentive to help borrowers stay in their homes."**

Who are these servicers that profit from foreclosures? Servicers are the banks or financial companies that usually collect payments and administer mortgage loans. They play a key role in the current foreclosure crisis, since original lenders frequently sell loans to investment trusts that rely on servicers to carry out most day to day transactions. Homeowners seeking to save their homes by modifying unaffordable loans typically deal with servicers. That is why the financial interests of servicers have the potential to hurt homeowners.

And too many of those financial incentives encourage servicers to ignore the interests of homeowners. For example, the report found that servicers often deny homeowners principal and interest rate reductions because as servicers they find it profitable to offer repayment plans or forbearance agreements that do little to reduce homeowners' debt burdens.

The consequences of such choices can be grim for homeowners. As the NCLC report notes: **"Loan modifications inevitably cost the servicer something. A servicer deciding between a foreclosure and a loan modification faces the prospect of near certain loss if the loan is modified, and no penalty, but potential profit, if the home is foreclosed."**

The NCLC report also found that the lack of third-party oversight allows servicers to pursue foreclosure instead of effective loan modifications that would benefit homeowners as well as investors. While credit rating agencies and bond insurers do monitor servicers, their oversight too often encourages servicers to foreclose.

The NCLC report includes a detailed examination of loans in foreclosure from 1995-2009 and how components of servicer compensation affected the likelihood and speed of foreclosure. It also looks at the rise of the servicer industry as a by-product of securitization; and the limited, but only effective oversight of servicers by credit rating agencies and bond insurers.

RECOMMENDED REFORMS

Thompson said: **"The people who could change the way servicers are doing business – Congress, the Administration, and the Securities and Exchange Commission – and the market participants who set the terms of engagement – credit rating agencies and bond insurers – have failed to provide servicers with the necessary incentives to reduce foreclosures and increase loan modifications."**

The NCLC report outlines the following action steps:

- **Avoid irresponsible lending through regulation of loan origination**
- **Mandate loan modifications before a foreclosure**
- **Fund quality mediation programs**
- **Provide for principal reductions on existing loans in the Administration's Home Affordable Modification Program (HAMP) and through bankruptcy reform**
- **Increase automated and standardized loan modifications for borrowers in default and provide a safety net for borrowers for whom a standardized modification is not affordable or who later default, through no fault of their own, on a loan modification**
- **Ease accounting rules for modifications to facilitate standardized review, encourage long-term modifications, and enhance servicer recovery of the expenses incurred in performing a modification**
- **Require more transparency and uniformity in how servicers report loan modifications to investors**
- **Limit fees charged borrowers in default to reasonable and necessary ones**

ABOUT NCLC

The National Consumer Law Center is a non-profit organization that seeks marketplace justice on behalf of low-income and vulnerable Americans. NCLC works with, and offers training to, thousands of legal-service, government and private attorneys, as well as community groups and organizations representing low-income families. Our legal manuals and consumer guides are standards of the field. Learn more and find a link to the new report on our Web site: http://www.consumerlaw.org.

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EDITOR'S NOTE: A copy of the new NCLC report is available for download at http://www.consumerlaw.org.