

The Need for National Mortgage Servicing Standards

Written Testimony

of

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also on behalf of  
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## **I. Introduction**

Chairman Menendez, Ranking Member DeMint, and members of the Subcommittee, thank you for inviting me to testify today regarding the need for national mortgage servicing standards.

I testify here today on behalf of the National Consumer Law Center's low-income clients. On a daily basis, NCLC<sup>1</sup> provides legal and technical assistance on consumer law issues to legal services, government and private attorneys representing low-income consumers across the country. I also testify here today on behalf of the National Association of Consumer Advocates.<sup>2</sup>

I am an attorney, currently of counsel to the National Consumer Law Center. In my work at NCLC, I provide training and support to hundreds of attorneys representing homeowners from all across the country. In that role, I hear many, many reports of the difficulties encountered by advocates and homeowners in working with loan servicers. For nearly 13 years prior to joining NCLC, I represented low-income homeowners at Land of Lincoln Legal Assistance Foundation in East St. Louis, Illinois. In that capacity, I became intimately familiar with the lack of regulation, restraint, or rules governing servicer behavior. Servicers have been and remain largely unaccountable to all stake holders for their actions.

Servicers do not believe that the rules that apply to everyone else apply to them. This lawless attitude, supported by financial incentives and too-often tolerated by regulators, is the root cause of the failure of HAMP and the wrongful foreclosure of countless American families. Whether servicers' errors are the result of intentional wrongdoing or mere incompetence, the result is the same: homeowners, investors, and the communities we all live in suffer, while servicers

continue to profit. Only national servicing standards, imposed uniformly on all servicers across the country, will rein in the problem in.

Key to any national servicing standards is the evaluation of a homeowner for a loan modification prior to the initiation of a foreclosure proceeding. Homeowners must be evaluated for and, when appropriate, offered a loan modification before foreclosure. In order to prevent wrongful foreclosures while the homeowner is being evaluated for a loan modification, or even in a loan modification, the dual track system, of proceeding with a mortgage foreclosure and a loan modification at the same time, must be stopped and stopped absolutely.

Homeowners for decades have complained about servicer abuses that pushed them into foreclosure without cause, stripped equity, and resulted, all too often, in wrongful foreclosure. In recent months, investors have come to realize that servicers' abuses strip wealth from investors as well.<sup>3</sup> Unless and until servicers are held to account for their behavior, we will continue to see fundamental flaws in mortgage servicing, with cascading costs throughout our society. The lack of restraint on servicer abuses has created a moral hazard juggernaut that at best prolongs and deepens the current foreclosure crisis and at worst threatens our global economic security.

Servicers rely on extracting payments from borrowers as quickly and cheaply as possible; this model is at odds with notions of due process, judicial integrity, or transparent financial accounting. The current foreclosure crisis has exposed these inherent contradictions, but the failures and abuses are neither new nor isolated.

State regulators have attempted to rein in these abuses, but servicers have often thumbed their noses at state regulators and sought protective shelter in the preemption rulings issued by the Office of the Comptroller of the Currency. Recent consent orders announced by the federal

banking regulators are of limited reach and threaten to undermine the combined (and unprecedented) efforts of the Department of Justice and the Attorneys General of all fifty states. The GSEs, Fannie Mae and Freddie Mac, and their oversight agency, the Federal Housing Finance Authority, have failed to prioritize loan modifications over foreclosure. Even new guidance from the FHFA fails to end dual track.

In testimony before the Senate Banking committee in July 2009, I detailed widespread noncompliance with the Home Affordable Modification Program (HAMP). HAMP was a laudable attempt to overcome long standing reluctance by servicers to perform large numbers of sustainable loan modifications. While the permanent loan modifications offered under HAMP are performing well, with historically low redefault rates, only a very few of the potentially eligible borrowers have been able to obtain permanent modifications. Advocates continue to report that borrowers are denied improperly for HAMP, that servicers solicit opt-outs from HAMP, and that some servicers persistently disregard HAMP applications. HAMP sought to change the dynamic that leads servicers to refuse even loan modifications that would be in the investors' best interests by providing both servicers and investors with payments to support successful loan modifications. But, by failing to require that servicers perform modifications and by overlooking servicer accountability and transparency at every step of the process from application to evaluation to conversion, HAMP was set up to fail.

When servicers wrongfully foreclose, or fail to modify, or undermine the judicial process and imperil the legality of a foreclosure, homeowners, investors, and the American public at large all lose. The foreclosure rate is now more than three times what it was in 1933, at the height of the Great Depression.<sup>4</sup> The crisis has impacted every part of our country and most of the world. As



the chairman of the Federal Reserve Board has noted, the crisis threatens our national economy.<sup>5</sup> Losses to individual families foreclosed on are projected to exceed \$2.6 trillion,<sup>6</sup> with spillover effects on neighbors and communities in the trillions of dollars.<sup>7</sup>

Servicers, however, can make money from foreclosures. Forceplaced insurance and other excessive fees that push homeowners into default provide servicers with revenue. Modifications cost money in staffing that foreclosures do not. Robosigning can save servicers even more money.<sup>8</sup>

We are facing a foreclosure tsunami, which has destabilized our economy, devastated entire communities, and destroyed millions of families. Yet we have failed to take aggressive action to restore stability. Neither the government nor the private sector has responded to scale in addressing the crisis. Public and private response to the crisis has been anemic at best, causing millions of families to lose their homes unnecessarily, at great cost to all of us. Foreclosures continue to outpace modifications.<sup>9</sup>

We must take immediate action to rein in servicer abuses and restore transparency to our mortgage markets. To restore rationality to our market we must take the following steps:

- ❖ Eliminate the two-track system. Homeowners should be evaluated for a loan modification before a foreclosure is initiated or continued, and that evaluation (and offer of a loan modification, if the homeowner qualifies for a loan modification) should be completed before any foreclosure fees are incurred. Such a requirement could be imposed by legislation or by regulation.
- ❖ The failure to offer loan modifications to homeowners, where doing so is predicted to save the investor money under the Net Present Value test, must be made a clear and absolute defense to foreclosure, in both judicial and non-judicial foreclosure states.
- ❖ Net Present Value tests for modifications should be standardized and made public.
- ❖ Loan modifications for qualified homeowners facing hardship, including those in bankruptcy, should be permanent, affordable, assumable, and available without any

waiver of a homeowner's legal rights. Where appropriate, principal reduction should be prioritized and available in a modification as well through bankruptcy.

- ❖ Homeowners denied a loan modification should receive a written servicer communication documenting the NPV inputs, any relevant investor restrictions and efforts to obtain an exception, and the appeal process. Appeals should be processed before a foreclosure commences or continues.
- ❖ Borrowers should be provided with access to full documentation of any investor restrictions, as well as all servicer attempts to procure a waiver, upon any denial based on investor guidelines.
- ❖ Servicers must be required to seek, and investors should be encouraged to grant, waivers of any restrictions prohibiting modifications.
- ❖ Homeowners must be provided the tools to focus servicer attention on resolving individual cases.
- ❖ Quality mediation programs should be funded in every community to provide an opportunity to resolve disputes outside of litigation.
- ❖ Funding for legal services lawyers representing homeowners facing foreclosure must be increased to allow our adversarial justice system to function as designed.
- ❖ Principal reductions should be mandated where they return a net benefit to the investor and permitted via judicial modification.
- ❖ Fees to servicers must be limited to those both reasonable and necessary for them to carry out their legitimate activities. Default-related fees should not remain an unconstrained profit center for servicers.
- ❖ Force-placed insurance should be replaced by a default reliance on replacing the existing coverage at a reasonable price.
- ❖ Transfer notices and periodic statements should be used to increase servicing transparency.
- ❖ Application of payments and use of suspense accounts should be fair and reasonable.
- ❖ Foreclosure documentation and notice standards should be established.
- ❖ A national system for assisting unemployed homeowners should be established. Unemployed homeowners should be provided with substantial forbearance options and the nascent Emergency Homeowner Loan Program (EHLPP) must be made permanent and properly funded. In addition, the current funds for EHLPP should be distributed to the states on a timeline that allows maximum distribution.

Unemployed homeowners were promised assistance over a year ago and most of them are still waiting for a program where they live to be finalized.

- ❖ National standards must be a floor, not a ceiling, so states can play the traditional role of legal laboratories to further protect homeowners, investors, and communities.

## **II. The Need for National Servicing Standards Is Acute**

Servicing abuses are nothing new. Yet in this period of record foreclosure rates they can no longer be tolerated. The basic structure of the servicing industry has encouraged and facilitated the worst abuses; no market correction is available to restore rationality to the servicing industry. The interests of servicers are too distinct from those of homeowners, investors, and the national economy. While several states have taken action to limit the most egregious servicing abuses, the reach of state action is constrained by both the fears and reality of federal pre-emption. We are being buffeted because of our failure to curb predatory lending; we should not prolong our agony by permitting predatory servicing to flourish unchecked.

### **A. Servicing Abuses Are Endemic Throughout the Industry**

At every stage of the process, from modification evaluation through foreclosure, servicers have failed to serve either the interests of investors or to treat homeowners fairly and honestly. The errors by servicers are systematic and widespread. In the aggregate, they cannot be explained as good faith mistakes.

#### **1. Servicers Deny and Delay Loan Modification Requests Improperly**

Servicers routinely delay processing loan modification applications long past any reasonable time frames. For example, the average length of time homeowners spend seeking a HAMP loan

modification is 14 months.<sup>10</sup> Documents are lost; additional grounds for denial are advanced; prior agreements are disclaimed. Getting to a final modification remains difficult and, even once achieved, is no panacea. A recent informal survey conducted by Connecticut Fair Housing Center of thirteen legal services or nonprofit organizations and one private attorney representing homeowners found, in preliminary results, that nearly 20% of all permanent modifications (over 400, in this survey) run into some servicer-created problem, including additional post-modification fees, refusing to recognize the agreement, and, most devastatingly of all, new foreclosures.

Delay and deny remains many servicers' standard response to loan modification requests, as recent examples from advocates around the country illustrate:<sup>11</sup>

- ❖ One California family was only converted to a permanent modification (on their third modification agreement, despite having made all required payments) in April 2011, four months after the completion of the temporary modification, despite hundreds of phone calls by their attorney.
- ❖ One West Virginia family has been waiting two years for a permanent modification, after having made six months of payments on their first trial modification, and subsequently approved and denied multiple times for additional trial modifications.
- ❖ Chase put a New York family in foreclosure after they had successfully completed two separate trial modifications (Chase, in violation of HAMP guidelines, required them to re-apply for a modification after the first one because their income documentation was "stale," and required them to re-start the second modification because the family overpaid by \$62 over three months' time) and made several months of additional payments in accordance with the modification terms.
- ❖ One Minnesota family has spent over a year and a half in multiple trial modifications with Chase, without being converted to a permanent modification. After the family completed their payments under the first modification agreement, Chase first requested that the family resubmit all income documentation and then informed the family that it intended to foreclose, and sent the family two separate letters denying them (for different, and apparently erroneous, reasons). This family is now on their fifth HAMP application with Chase, in response to repeated solicitations from Chase to apply for HAMP.

- ❖ A New York family who fell behind on their mortgage payments in 2008 has still not received a permanent modification despite numerous mediation conferences and twelve months of consecutive trial modification payments.
- ❖ One Wisconsin family made 18 payments under their trial modification before the servicer, Bank of America, initiated foreclosure, even though the servicer had previously confirmed in writing that she had qualified for a permanent modification and the documents were “on the way.” One California family was denied a modification agreement because the servicer claimed the mortgage was in the name of the father only—despite the fact that the father was long dead, and only the mother’s name was on the deed and mortgage.
- ❖ Another California family was denied because the servicer, based on a credit report, had determined that the homeowner was dead. When the attorney called his client, she confirmed that she was alive and well. The notice of denial stated that the denial was on “investor guidelines,” but provided no further notice that would have enabled the homeowner to know that her vitality was in question.
- ❖ A North Carolina family has been trying to get a loan modification from Litton for over a year. Litton has denied the family multiple times for failing to provide documentation. Since neither the attorney nor her client had received any requests for additional documentation (although both had received other communications from Litton, including the denial notices), the attorney contacted HAMP escalations. HAMP escalations were able to determine that Litton was mailing the requests for additional documents to an address that corresponded to neither the homeowner’s nor the attorney’s—an address Litton apparently made-up.
- ❖ Last summer a Connecticut homeowner tried to obtain a modification of her Fannie Mae loan from CitiMortgage. She submitted all the requested paperwork, but learned that Citi planned to move forward with a foreclosure sale—because the pay stubs she had submitted in August were from June. The homeowner explained that she was a school bus driver and was off during the summer months. Citi nevertheless went forward with the sale.
- ❖ A Michigan homeowner, after making all the payments required by the terms of her HAMP modification with AHMSI for a year, was informed early this year that her modification date is incorrect, and she will need to execute entirely new documents, with a new, higher interest rate, and a new higher payment. AHMSI refuses to honor the terms of the original modification, and has been returning the homeowner’s payments to her.
- ❖ One New York homeowner accepted a proprietary permanent modification with Bank of America in January 2010, and has been making payments on it ever since. For the last year, since April 2010, Bank of America has repeatedly threatened foreclosure and disputed the existence of the permanent modification.

- ❖ An Illinois homeowner who entered into a trial modification with Chase in October 2010 had his third trial period payment rejected. Instead, Chase demanded and received payments nearly twice what the homeowner was required to pay under the modification agreement. When he went to a local Chase Homeownership Preservation office, he was told that he needed to reapply for a modification.
- ❖ Bank of America misapplied a California homeowner's payments under a repayment agreement and required her to capitalize the arrears to catch up on the repayment agreement (which she had, in fact, already completed). After the woman began sending payments that included her regular monthly payment and the improperly capitalized amounts, Bank of America rescinded the offer of a modification and initiated foreclosure proceedings, despite representations from high level bank employees to the homeowner's attorney that they would honor the modification.
- ❖ In early 2010, CitiMortgage offered a New York family a permanent modification, which they signed and sent back. Two months after the bank counter-signed the modification, Citi sent the family a new modification with payments that were nearly \$700 higher. The family called Citi, and Citi instructed them to ignore the new modification and continue making the lower payment, because the discrepancy was a result of a problem with Citi's computers, which hadn't been updated to reflect the July 2010 modification. Even though the family made all payments under the modification, which Citi had signed, Citi told the family in March that it was disregarding the modification agreement and filing a foreclosure action.
- ❖ After finally being converted from a temporary modification to a permanent modification in September 2010, more than a year after their initial application, a Staten Island, New York, family thought they were home free. However, Chase has started placing their regular payments in a suspense account and reporting them as delinquent to the credit bureaus. Chase also ceased sending the family monthly servicing statements. Because of the delinquency on their credit report, the family has been denied a car loan. When the homeowners call the number given them by Chase to resolve this situation, it goes to a voicemail inbox and their messages are unreturned.
- ❖ A Wisconsin family, after making payments under an oral trial modification for over a year, was placed into foreclosure when servicing was transferred.

As discussed more in II.B below, delay serves servicers' interests. During delay, fees and interest accrue. These fees and interest can quickly mount up. One New York family, upon finally receiving an offer for a permanent modification, found themselves faced with a bill for over \$9000 in foreclosure related fees and costs.

These fees will ultimately be paid to the servicer, either by the homeowner or from the proceeds of a foreclosure sale. If, ultimately, the loan is modified, and the fees are capitalized, the servicer's monthly servicing fee will increase since it is calculated as a percentage of the outstanding principal.

Of course, the servicer must also advance the borrower's principal and interest payments to the investors every month, and delay increases the servicer's overall costs to borrow funds to make these advances. But only when the costs of financing advances outstrip the additional accumulating fees do servicers have a meaningful incentive to end delay. At that point, the scales will often tilt toward a foreclosure rather than a modification—in part because investor restrictions on how long a loan can be in default before modification may have been exceeded, in part because the accumulated arrearages may make any modification unsustainable, and in part because the time to recover those fees and any legitimate advances will be much shorter in a foreclosure proceeding than in a modification.

Requiring homeowners to enter into multiple temporary modifications—and accepting their payments—offers all the advantages of delay, plus payments to offset the cost of advances. These serial temporary modifications keep income flowing in to the servicers; they keep the loan in the pool, so that the servicer can continue to draw down the monthly principal-based servicing fee; they generate late fees and other-default related-fees for the servicers. These serial temporary modifications also skew the HAMP statistics, making it look as if more homeowners are offered modifications than actually are and concealing servicers' failure to convert temporary modifications to permanent modifications. But they do not serve homeowners or investors well. Homeowners face accruing costs on their loan, which can place them in jeopardy of foreclosure or make the

conversion to a permanent modification impossible. Investors suffer, often, a loss of equity in the collateral as time passes and housing values decline,<sup>12</sup> fees are stripped from any ultimate foreclosure, and the reporting of temporary modifications instead of permanent modifications may upend the order of payments in the securitization pool, resulting in payments to lower-level tranches at the expense of senior tranches.<sup>13</sup>

## **2. The Loan Modification Process Is Dysfunctional**

The process seems designed to result in loan modification denials, in its Byzantine communications or lack thereof. Advocates report making hundreds of phone calls per each individual loan modification, and receiving multiple denials on most files. Who has authority to speak for the servicer to what extent is never clear. When a Wisconsin advocate finally reached a Bank of America case negotiator, after many attempts and over a month, the case negotiator stated that she could not negotiate any terms of a modification, but could only provide status updates. A California attorney was told by the SunTrust representative that not only could the attorney not speak directly to the case negotiator, but that the representative was also forbidden from having any direct contact with the negotiator—the best she could do to communicate to the case negotiator that the borrower had presented new information was to post a note in the closed file. In another California case, high-level Bank of America representatives agreed that no foreclosure sale would happen while a loan modification review was pending, yet one did. One Washington state woman was reduced to tears by the insistence of Chase employees that her house had not, in fact, been foreclosed on, even though the homeowner had received an eviction notice.

Few attorneys and even fewer housing counselors have the persistence to negotiate such a system. Getting a loan modification should not be a trial by ordeal, with success predicated on a



miraculous intervention. Yet obtaining a permanent modification remains a matter of skill and luck and persistence, without much regard to the underlying cold, hard economic calculations. Relatively few of the reported HAMP denials are based on Treasury's Net Present Value test, which measures the economic return to an investor from a modification.<sup>14</sup> Far more often, the economic calculus of a loan modification is not considered in the denial.

### **3. Servicers' Errors Result in Wrongful Foreclosure**

We do not know—and cannot know—how many homeowners have been improperly foreclosed on. Poor documentation by servicers is not merely a “technical” error. Reported cases abound where servicers are unable to establish the amount of default<sup>15</sup> or where a servicer misapplication of payments leads to default.<sup>16</sup> Servicer errors can and do lead to foreclosure.

In an attempt to quantify the extent of the problem, the National Association of Consumer Advocates, in conjunction with NCLC, conducted a survey of attorneys representing homeowners in foreclosure. The ninety-six attorneys from thirty-four states reported representing over 1,200 homeowners who had been placed into foreclosure by a servicer when they were current on their payments. Those attorneys reported representing an additional 1,800 homeowners who had been placed into foreclosure by the servicer despite making payments as agreed under a plan.

Surprisingly often, servicers return or ignore homeowners' catch-up payments and institute foreclosure. Two examples from New York are illustrative:

- ❖ One New York homeowner fell behind in her payments in December 2010. When she tried to resume making payments in February, the servicer, Wells Fargo, returned her payments and referred her case to foreclosure. When the homeowner called Wells Fargo to ask how she could bring the account current, she was told that a payment in the amount of \$5,729.03, if made by the end of March, would cure her default and prevent foreclosure. Wells Fargo accepted the payment, placed it in a

suspense account, and instituted foreclosure proceedings against the homeowner the following week (Wells Fargo's counsel is seeking an additional amount in foreclosure related fees).

- ❖ Another New York family overnighed the funds—over \$8000—that their servicer represented was required to bring the account current. Yet the servicer, without explanation, returned the funds and instituted foreclosure. Only after more than a year of litigation and the intervention of Staten Island Legal Services was a permanent modification offered, but at the cost of over \$9000 in foreclosure related fees and costs.

Even more commonplace, as the following recent examples illustrate, is the institution of foreclosure on homeowners who are making payments under a plan:

- ❖ Bank of America foreclosed on a California homeowner who was making payments on a modification agreement that required the capitalization of arrears she did not, in fact owe, despite representations from high level bank employees to the homeowner's attorney that they would honor the modification and not foreclose.
- ❖ In early 2010, CitiMortgage offered a New York family a permanent modification, which they signed and sent back. Two months after the bank counter-signed the modification, Citi sent the family a new modification with payments that were nearly \$700 higher. The family called Citi, and Citi instructed them to ignore the new modification and continue making the lower payment, because the discrepancy was a result of a problem with Citi's computers, which hadn't been updated to reflect the July 2010 modification. Even though the family made all payments under the modification, which Citi had signed, Citi told the family in March that it was disregarding the modification agreement and filing a foreclosure action.
- ❖ A Wisconsin family, after making payments under an oral trial modification for over a year, was placed into foreclosure when servicing was transferred.
- ❖ Chase put a New York family in foreclosure after they had successfully completed two separate trial modifications (Chase, in violation of HAMP guidelines, required them to re-apply for a modification after the first one because their income documentation was "stale," and required them to re-start the modification because the family overpaid by \$62 over three months' time) and made several months of additional payments in accordance with the modification terms.
- ❖ Bank of America initiated foreclosure proceedings on an Illinois family after over a year of payments under their modification agreement. When the family's housing counselor called Bank of America, she was told that Bank of America had failed to process the final modification agreement.

- ❖ One Wisconsin family made 18 payments under their trial modification before the servicer, Bank of America, initiated foreclosure, even though the servicer had previously confirmed in writing that she had qualified for a permanent modification and the documents were “on the way.”
- ❖ A California family learned that, because of “a computer error,” Chase sold their home at a foreclosure sale, despite the fact that they were making regular payments under a modification agreement. This was a Freddie Mac loan.
- ❖ A Washington state family lost nearly \$200,000 in equity when the servicer proceeded to foreclosure while the family was making regular payments under a temporary modification agreement. The purchaser of the property succeeded in evicting the family, who are now living in an apartment.

As discussed II.B.2, servicers have substantial incentives to impose significant fees on homeowners because they are usually permitted under the pooling and servicing agreements to retain all of those fees. Forceplaced insurance in particular is often a locus of abuse,<sup>17</sup> with examples of forceplaced insurance leading to foreclosure reported around the country.<sup>18</sup> One New York homeowner was tipped into foreclosure by Chase’s improper and unnecessary placement of an escrow account on his second mortgage. Despite the intervention of the New York State Banking Department, Chase, nearly three years later has still not credited the homeowner for fees imposed wrongfully by Chase in connection with the escrow account.

The problems establishing ownership and chain of title demonstrated in the robo-signing scandal can make obtaining a loan modification impossible. One North Carolina homeowner was advised by BAC Home Loans Servicing in 2009 that she was not eligible for a modification since her loan was an FHA loan, and she did not meet the FHA loan modification requirements. A year later, after the woman found her way to a legal services attorney, FHA disclaimed any interest in the loan. Until this question is resolved, no loan modification can be processed, and the accumulating arrearage makes any loan modification increasingly unlikely. In another case, after offering a Brooklyn homeowner two separate permanent HAMP modifications over a period of seven months,

and after the homeowner had completed the terms of her trial modification, the servicer determined that investor restrictions prohibited modifications, apparently because the servicer had previously incorrectly identified the holder.

The cause may be a technical error, or a mistake by the servicer, but if the homeowner is pushed into default, denied a loan modification, or induced not to make payments in reliance on a loan modification, the result is the same: a wrongful foreclosure, at incalculable cost to the homeowners and likely loss to the investors.<sup>19</sup>

## **B. Servicers' Incentives Incline Them Towards Modifications with Increased Fees and Foreclosures over Sustainable Modifications.**

Once a loan is in default, servicers must choose to foreclose or modify. A foreclosure guarantees the loss of future income, but a modification will also likely reduce future income, cost more in the present in staffing, and delay recovery of expenses. Moreover, the foreclosure process itself generates significant income for servicers.<sup>20</sup>

Servicers do not make binary choices between modification and foreclosure. Servicers may offer temporary modifications, modifications that recapitalize delinquent payments, modifications that reduce interest, modifications that reduce principal or combinations of all of the above. Servicers may demand upfront payment of fees or waive certain fees. Or servicers may simply postpone a foreclosure, hoping for a miracle.

For servicers, the true sweet spot lies in stretching out a delinquency without either a modification or a foreclosure. Income from increased default fees and payments to affiliated entities can outweigh the expense of financing advances for a long time. This nether-world status also

boosts the monthly servicing fee and slows down servicers' largest non-cash expense, the amortization of mortgage servicing rights, since homeowners who are in default are unlikely to prepay via refinancing.<sup>21</sup> Finally, foreclosure or modification, not delinquency by itself, usually triggers loss recognition in the pool. Waiting to foreclose or modify postpones the day of reckoning for a servicer. But delay can cost a homeowner the opportunity to obtain a modification.

## **1. Influence of Advances**

Servicers have two main expenses when a loan is in default: advances of principal and interest to the trust and payments to third parties for default services, such as property inspections. Financing these costs is one of servicers' biggest expenses.<sup>22</sup> Recovery of these fees (but not the financing costs) is more certain and often swifter via a foreclosure than a modification. Only when a modification offers a faster recovery of advances than a foreclosure, might the financing costs incline a servicer toward a modification.<sup>23</sup>

### **a) Interest and Principal Advances to Investors**

Servicers, under their agreements with investors, typically are required to continue to advance interest on loans that are delinquent.<sup>24</sup> Unpaid principal may or may not be advanced, depending on the PSA.<sup>25</sup> The requirement for advances usually continues until a foreclosure is completed, a loan modification is reached, or the servicer determines that there is no realistic prospect of recovering the advances from either the borrower or the collateral.<sup>26</sup>

Servicers' advances are taken off the top, in full, at the post-foreclosure sale, before investors receive anything.<sup>27</sup> If advances of principal and interest payments remain beyond the sale value,

servicers can usually collect them directly from the trust's bank account (or withhold them from payments to the trust).<sup>28</sup>

In contrast, when there is a modification, the general rule, announced repeatedly by the rating agencies, is that servicers should only recover their expenses from modifying a loan from either payments made on the modified loan or principal-only payments to the pool.<sup>29</sup> If servicers follow this rule—and not all have,<sup>30</sup> it will take servicers longer to recover their advances post-modification than post-foreclosure.

### ***b)* Fee Advances to Third Parties**

In addition to interest advances, servicers advance expenses associated with default servicing, such as title searches, drive-by inspections, or foreclosure fees.<sup>31</sup> Taxes and insurance costs are also often advanced.<sup>32</sup> Some PSAs impose caps on these fee advances.<sup>33</sup>

These fee advances may or may not represent actual out-of-pocket expense to the servicer. In many cases, affiliates of the servicer, not true third parties, receive the fees, and the resulting profit wipes out any cost of financing the advance.<sup>34</sup> These fees may also be marked-up: in one case, Wells Fargo reportedly charged a borrower \$125 for a broker price opinion when its out-of-pocket expense was less than half that, \$50.<sup>35</sup> Such padding more than offsets the cost of financing the advance. Force-placed insurance is frequently placed either through or an affiliate or in exchange for a commission from the insurance company paid back to the servicer—again wiping out any true cost and turning the nominal advance into a profit center for the servicer.<sup>36</sup>

## **2. Fees Are a Profit Center for Servicers**

Most PSAs permit servicers to retain fees charged delinquent homeowners. Examples of these fees include late fees<sup>37</sup> and fees for “default management” such as property inspections.<sup>38</sup> The profitability of these fees can be significant.<sup>39</sup> Late fees alone constitute a significant fraction of many subprime servicers’ total income and profit.<sup>40</sup>

Servicers can collect these fees post-foreclosure before the investors receive any recovery.<sup>41</sup> This guaranteed recovery of fees strongly favors foreclosures over modifications that waive fees, including HAMP,<sup>42</sup> and encourages servicers to delay foreclosures in order to maximize the number of fees charged.<sup>43</sup> In a self-perpetuating cycle, the imposition of fees makes a foreclosure more likely, by pricing a modification out of a homeowners’ reach.<sup>44</sup>

In addition to pre-foreclosure fees, servicers are usually entitled to recover the costs of selling the home post-foreclosure, before investors are paid.<sup>45</sup> The sometimes substantial fees paid to servicers in foreclosure tend to be invisible to investors.<sup>46</sup>

### **3. Why Servicers Don’t Reduce Principal and Do Capitalize Arrearages**

In an era when one in four homeowners is underwater, principal reductions are key to stabilizing the housing market.<sup>47</sup> The double whammy of declining home values and job losses helps fuel the current foreclosure crisis.<sup>48</sup> Homeowners who could normally refinance their way out of a lost job or sell their home in the face of foreclosure are denied both options when they owe more on their home than it is worth. Without principal reductions, homeowners who lose their jobs, have a death in the family, or otherwise experience a drop in income are more likely to experience redefault and foreclosure.<sup>49</sup> Existing data on loan modifications shows that loan modifications with

principal reductions tend to perform better.<sup>50</sup> In order to bring down the redefault rate and make loan modifications financially viable for investors, principal reductions must be part of the package.<sup>51</sup>

Homeowners are underwater in large part as a result of systematic decisions made by lenders. Appraisal fraud was endemic in purchase money mortgages throughout the country in recent years.<sup>52</sup> Increased appraisal values on refinancings allowed lenders to strip equity from homes and increase their profits. The expansion of negatively amortizing products left additional homeowners further underwater and vulnerable to precisely the cratering of home values experienced in many parts of the country.

Investors have generally been receptive to the possibility of principal reductions, particularly when taken as direct write downs in refinancing.<sup>53</sup> In that case, the loss is distributed throughout the securitization as contemplated in the original waterfall design, and the higher-rated tranches receive their capital and are able to reinvest it elsewhere should they so choose. Refinancing is currently not a likely prospect for most homeowners, but even without refinancing, principal write downs restore rationality to the markets and, due to loss recognition rules embodied in most PSAs, result in the loss being distributed under the waterfall as anticipated at the inception of the securitization trust. At least some investors would prefer to see more principal reductions through modifications in the absence of refinancing.<sup>54</sup>

Nonetheless, servicers' incentives consistently skew against principal reductions. Without accounting sleight-of-hand, servicers are likely to suffer a loss by agreeing to a principal reduction, at least as compared to other forms of modifications. HAMP has failed to mandate principal reductions, even when doing so would be in the investors' best interests. Instead, HAMP mandates principal forbearance, which leaves homeowners facing large balloon payments. As a result of



HAMP's failure to mandate principal reductions (and account for servicer's disincentives to offer principal reductions, even when doing so makes economic sense for the investors), less than 3.3% of all the permanent modifications done under HAMP include principal reduction.<sup>55</sup>

**Effect of Servicer Incentives on Default Outcomes**

This chart shows whether specific elements of servicers' compensation and expenses create positive, negative, or neutral incentives for them pursue different types of outcomes for homeowners in default.

	Short-Term Forbearance or Repayment Agreement	Interest Rate Reduction	Principal Forbearance	Principal Reduction	Short Sale	Foreclosure
Repurchase Agreements	Positive	Negative	Negative	Negative	Neutral	Neutral
TDR Rules	Positive	Negative	Negative	Negative	Neutral	Neutral
Fees	Positive	Neutral	Negative	Negative	Negative	Positive
Float Interest Income	Neutral	Negative	Negative	Negative	Positive	Positive
Monthly Servicing Fee	Neutral	Neutral	Positive	Negative	Negative	Negative
Residual Interests	Positive	Negative	Negative	Negative	Negative	Negative
Advances	Positive	Neutral	Negative	Negative	Positive	Positive
Staff Costs	Neutral	Negative	Negative	Negative	Negative	Positive

All of servicers' incentives militate against principal reduction. Principal forbearance can be costly for servicers as well, but if servicers have a choice, they will choose forbearance over reduction, even though a forbearance does not provide for long-term sustainability as well as a principal reduction modification does. Principal forbearance, unlike principal reductions, stabilizes the monthly servicing fee because most PSAs appear to allow servicers to include in their calculation of the outstanding balance the amount of principal forbearance, while principal write-downs cannot be included in the amount of the outstanding balance.<sup>56</sup> For a servicer, principal forbearance is preferable to principal reduction: it preserves more monthly servicing fee income for longer.

Servicers, given their druthers, will choose capitalization modifications over either principal forbearance or principal reductions. In a capitalization modification, the homeowner's unpaid principal balance increases as arrearages are added to the outstanding balance. Thus, the servicer's largest source of income, the principal-based monthly servicing fee will increase. Additionally, capitalization modifications, unlike other forms of modification, may allow servicers to pull their advances and other expenses back out of the pool, thus reimbursing themselves faster than is possible under a conventional modification.<sup>57</sup> Unsurprisingly, modifications that include capitalization of arrearages are consistently the largest category of modifications,<sup>58</sup> yet they are harmful to both investors and homeowners. Investors lose because their interest income may be diverted to the servicer, to reimburse the servicer for expenses associated with modifying the loan.<sup>59</sup> Homeowners lose because modifications that capitalize arrearages increase their balances, leaving homeowners owing more than they did pre-modification. Both homeowners and investors lose, because modifications that increase the principal balance are more likely to re-default.<sup>60</sup> Servicers have made these modifications, harmful to both investors and homeowners, with impunity.<sup>61</sup>

## **C. Federal Baseline Protection Is Needed**

### **1. All Safety Fuses Limiting Servicer Abuses Have Been Blown**

We have long since abrogated the two traditional checks to ensure that homeowners cannot be deprived of their home by a stranger: the requirement that the original note be produced and the public recording of assignments. Without the public availability of those documents, it is impossible for most homeowners or any independent third party to verify a servicer's representations as to ownership. There are even fewer checks on the servicer's declaration of default.

Only about half the states follow a judicial foreclosure process, where a judge reviews the documents. In the other states, foreclosure is conducted extra-judicially, with few if any verifications of a servicer's representation as to default and ownership. Even the extra protection afforded by judicial process is spotty, at best, however, particularly in this era of historically high volumes of foreclosure cases.<sup>62</sup> Judges, in foreclosure cases as in other cases, rely on the adversarial process to bring to light problems in either party's case. Where one side is systematically unrepresented, as the vast majority of homeowners are, the process skews away from a balanced review of the equities. Judges are unlikely to detect errors in a servicer's documentation where the homeowner goes unrepresented. In many courtrooms, the foreclosure process resembles a factory assembly line far more than our images of a court of law.

We know from the success of the New York City and Philadelphia mediation programs that where servicers and their lawyers are compelled to treat resolution of a foreclosure dispute as an individual case, and not an assembly line, many foreclosures can be prevented. Those programs consistently report that in at least half of all cases the parties reach a loan modification and the foreclosure is prevented. But servicers have not shown an inclination to provide that careful case-by-case review outside mandatory programs, and standard judicial resources are overwhelmed by the scale of the crisis.

As successful as these local models have been, we cannot rely on either scattered municipalities or even whole states to solve our national foreclosure crisis. For that, we must look to our national government.

## **2. State Action Is Limited by the Federal Regulatory Agencies**

One reason that state action alone is insufficient to address the foreclosure crisis is that the federal banking agencies, particularly the Office of the Comptroller of the Currency (OCC), which charters national banks, have been zealous about exercising their preemption authority.

From 2000 to 2004, the OCC worked with increasing aggressiveness to prevent the states from enforcing state consumer protection standards against national banks. For example, the OCC openly instructed banks that they “should contact the OCC in situations where a State official seeks to assert supervisory authority or enforcement jurisdiction over the bank,”<sup>63</sup> and warned states that national banks need not comply with state laws.<sup>64</sup> The OCC’s efforts culminated in 2004, when the agency adopted a regulation preempting all state laws unless their effect on national bank powers was “only incidental.”<sup>65</sup> The regulation allows national banks to ignore state laws regarding licensing, terms of credit, disclosure and advertising, solicitations, billing, and other topics.

The OCC also asserted that the subsidiaries of national banks and federal thrifts—though they are creatures of state law, are not banks, and do not have a federal charter—can ignore state law to the same extent that their parents can.<sup>66</sup> The Supreme Court upheld this regulation in 2007.<sup>67</sup> This exercise of preemption authority by the OCC and other federal banking agencies has limited the scope of what state actors can do to contain the current crisis.

The preemption of state laws in the mortgage area by the federal agencies is a significant cause of the current crisis. Bank domination was heaviest in the most dangerous, nontraditional interest-only and payment-option adjustable rate mortgage (ARM) markets: they held 51% of the total market in 2006.<sup>68</sup> Though these loans were nominally made to borrowers with prime-level credit scores, the loans were toxic.<sup>69</sup> Overall, in 2006, national banks, federal thrifts, and their operating subsidiaries were responsible for over \$700 billion of the riskiest loans.<sup>70</sup>

Even if the federal banking agencies took a more restrained approach, however, many of the large servicers are national banks, whose primary regulator is the Office of the Comptroller of the Currency.<sup>71</sup> Unsurprisingly, then, many of these servicers are often unresponsive to state regulators or enforcement agencies. For example, in one case handled by Staten Island Legal Services, it took Chase a year after a complaint to the New York State Banking Department to remove an improper and unnecessary escrow account on a second mortgage, and Chase has still not credited the homeowner's account for unnecessary fees. In another case, a Milwaukee advocate, in desperation after Bank of America had failed to respond to her phone calls for months, contacted the Wisconsin Attorney General's office for assistance. In response to the inquiry from the Attorney General's office, Bank of America assigned a case negotiator, but that case negotiator closed the case after failing to respond to more than 50 phone calls and emails from the homeowner's attorney over a six month period. Bank of America agreed to assign a new case negotiator, in response to a second inquiry from the Wisconsin Attorney General's office, but when the homeowner's attorney finally reached the case negotiator, after many attempts and over a month, the case negotiator stated that she is unable to negotiate any terms of a modification, but can only provide status updates. State regulators and enforcement agencies are limited in the clout they can bring to bear against a recalcitrant servicer: they cannot, for example, revoke the charter.

In order to ensure parity and prevent a race to the bottom, minimum federal servicing standards are needed. A federal baseline standard allows states to respond to emerging local trends by providing, for example, mediation programs, or requiring disclosure of the efforts made to modify a loan as a condition precedent to the servicer's seeking to avail itself of the state law foreclosure remedy.

### **III. Existing Standards Are Inadequate**

#### **A. HAMP's Lack of Transparency and Accountability Has Prevented the Program from Delivering on Its Promise**

As detailed in my prior testimony before the Senate Banking Committee in July 2009 and November 2010, as well as in numerous reports by the Special Inspector General for TARP, the Government Accountability Office, and the Congressional Oversight Panel, HAMP has failed to live up to its promise.

There are many good features of the HAMP program. HAMP has shown that sustainable loan modifications can be made. The re-default rate for HAMP loan modifications is dramatically lower than for any other form of loan modification.<sup>72</sup> The program has improved incrementally in allowing borrowers in bankruptcy to qualify, in moving significantly towards ending dual-track processing, and in providing an appeals process for borrowers. But the program has remained frustrating for homeowners and their advocates because it remains an essentially voluntary program.

Moreover, HAMP is time-limited, and will expire at the end of next year. Servicing abuses, unfortunately, are not time-limited. The foreclosure crisis has thrown these abuses into sharp relief and afforded us a rare window of opportunity for correcting the market dysfunction that has plagued our mortgage servicing market for decades.

#### **B. Existing and Proposed Guidelines from Fannie Mae, Freddie Mac, and the Federal Housing Finance Authority Promote Foreclosures over Modifications**

While Fannie Mae and Freddie Mac have generated a variety of servicing guidelines for loss mitigation over the years, they have not been uniform and, more importantly, they have not ensured that loan modification reviews occurred prior to foreclosure. Instead, the timelines for foreclosure have been the tail that wags the loss mitigation dog. Moreover, noncompliance by servicers with GSE guidelines has not been adequately addressed.

The GSEs, Fannie Mae and Freddie Mac, have each adopted their own, slightly different, versions of HAMP. In three areas the GSE policies have lagged significantly behind HAMP: the lack of an appeals process; the failure to end dual track; and creating hurdles to modifications for homeowners in bankruptcy. The GSE's continuing ban on principal reductions in loan modifications is contradicted by the facts and is the primary barrier to implementing this essential policy change in the industry. Each of these policies results in unnecessary and expensive foreclosures, foreclosures for which the taxpayers must ultimately bear the burden.

### **1. The Lack of an Appeals Process for GSE Loans Prevents Modifications**

Even the new FHFA guidance, discussed below, does not provide redress for homeowners nor does it hold servicers publicly and monetarily accountable if they fail to follow the guidance. Foreclosures and evictions may still proceed while any review is under way, and there is still no clear route of appeal for homeowners wrongfully denied a loan modification or wrongfully foreclosed while in a loan modification.

Neither Freddie nor Fannie has a direct, well-publicized number for homeowners or their advocates to call to resolve disputes regarding loan modifications. Freddie Mac's website entirely defers to servicers, advising homeowners that they "will be contacted by their mortgage servicer" if

they are eligible for a modification.<sup>73</sup> A Nevada advocate reports that certified mail sent to the address on Freddie Mac's website came back unclaimed. Advocates in Colorado, Connecticut, and Maryland report that phone calls to Fannie Mae's Resource Center are not always answered and seldom, if ever, result in any review of the servicer's action. In one case, a Colorado advocate appealed OneWest's denial of a HAMP modification to both the HAMP Solutions Center (HSC) and to Fannie Mae's Resource Center. The representative at HSC attempted several times to contact Fannie with the escalation, and never received a response, as the foreclosure sale date drew ever-closer. The homeowners ended up filing Chapter 13 bankruptcy to prevent the sale from going forward, which, under Fannie's servicing guide, gives OneWest the discretion not to consider them for HAMP. Finally, after the homeowners had filed for bankruptcy, Fannie Mae responded to the HSC representative by summarily repeating OneWest's reason for denial, even though the homeowners had documented that OneWest's denial was based on double counting of the wife's income. A homeowner, or a homeowner's advocate, who wishes to raise a servicer's noncompliance with the GSEs has no reliable, formal channel with which to do so.

The lack of clear, direct access to review by the GSEs for homeowners and their advocates allows servicers to claim plausibly that their hasty and wrongful foreclosures are a result of GSE guidance that pushes foreclosures, forbids certain modifications, particularly modifications involving principal reduction, and puts homeowners squarely in the middle of fights between the GSEs and servicers.

## **2. Dual Track Problems Are Rife in GSE Loans**

Reports of servicers conducting foreclosure sales while a consumer is making payments under a loan modification are epidemic for loans owned by the GSEs. The plight of one Maryland



homeowner made the front pages of The Washington Post last October.<sup>74</sup> Ms. Stovall had been making payments under a loan modification since April when she received an eviction notice in July. She had received warnings of the foreclosure, but when she called, both her servicer and the foreclosure attorney handling the case for the servicer, she was told not to worry, that, “The loan modification and foreclosure programs run parallel with each other and as long as you're in the loan modification process, nothing will happen,” and that no sale would be held. Although not reported in the article, Ms. Stovall’s loan was owned by Fannie Mae.

Ms. Stovall, like many other homeowners with GSE-owned loans, was foreclosed on despite regular payments and persistent attempts to clarify a confusing situation. Ten months after she received an eviction notice tacked to her door, not much has changed, as the following examples from around the country attest:

- ❖ In one California case, Chase has failed to rescind a wrongful foreclosure (due, according to Chase representatives, to a “computer error”) that occurred in September 2009, because of a dispute between Chase and Freddie Mac as to whether Chase will repurchase the loan.
- ❖ A Staten Island case involving a loan owned by Fannie Mae has a homeowner in foreclosure despite having successfully completed two separate trial modifications (Chase, the servicer, required the homeowner to re-apply for a modification after the first one because the income documentation was “stale,” and required them to re-start the second modification because the homeowner overpaid by \$62 over three months’ time).
- ❖ In a Connecticut case, Fannie Mae representatives approved Citimortgage’s foreclosure sale of a home and refusal to evaluate a homeowner for a mortgage modification because she had no pay stubs from July or August (the homeowner, a school bus driver, does not get paid during July and August, but has steady income the rest of the year).
- ❖ In two recent cases from California, Bank of America foreclosed on GSE loans while a loan modification review was under way.

It is not enough to say, as the GSE policies currently say, that no foreclosure sale may happen while a loan modification is under review. The foreclosure process, once initiated, takes on

a life of its own. The attorney fees mount up; the court timelines must be met. The only way to prevent continued foreclosures while a loan modification review is under way is by halting the foreclosure process entirely while the loan modification application is being reviewed. That means no new foreclosures, no new advertising, no scheduling of the sale, no court hearings, and no motion practice. Only stopping the foreclosure sale absolutely will protect the interests of both homeowners and investors to have the least costly loan modification offered as quickly and efficiently as possible.

The recent announcement by the Federal Housing Finance Authority regarding new servicing standards does not go far enough since it will permit a foreclosure to proceed to the point of sale if the foreclosure is in process when the loan modification application is received. Given the lack of any enforcement mechanism to ensure review prior to the initiation of foreclosure, and the widespread failure of servicers to properly review homeowners for a modification, servicers will continue to initiate foreclosures before conducting the modification review.

### **3. Fannie Mae Penalizes Homeowners Who Exercise Their Right to File Bankruptcy**

For over a year, servicers reviewing homeowners for non-GSE HAMP modifications have been required to consider borrowers in bankruptcy. This policy is in accord with HAMP's general prohibition on waiver clauses and explicit protection for homeowners in litigation. Freddie Mac has largely brought its guidance into line with the standard HAMP guidance, with one exception, but Fannie Mae has not. The current Fannie Mae servicing guide chapter VII section 610.01 still says that for borrowers actively involved in a bankruptcy proceeding the HAMP eligibility is at servicer discretion. While the FAQs offer borrowers some protection, by providing that a borrower cannot

be terminated from a trial modification merely for filing bankruptcy, the FAQs reiterate that if a borrower files bankruptcy prior to the trial modification, the servicer may refuse to consider the borrower's HAMP application.<sup>75</sup> Servicer discretion is seldom exercised in favor of borrowers; in general, the exercise of servicer discretion means denial.

Particularly when combined with the lack of meaningful oversight, homeowners are placed in a terrible catch-22: file a bankruptcy to give the servicer and the escalations process time to complete their review of an erroneous HAMP denial and lose the right to a HAMP modification (for filing the bankruptcy) or accept the servicer's erroneous denial. In many cases, servicers are able to manipulate this dynamic to their advantage by offering a homeowner desperate to halt the foreclosure sale a less-advantageous proprietary modification. As reported by one Colorado advocate, the price of accepting that proprietary modification may be waiver of all rights to obtain a HAMP modification, regardless of eligibility.

Fannie Mae should revise its guidance to permit borrowers in bankruptcy to access HAMP modifications:

- ❖ A borrower in an active chapter 7 or chapter 13 bankruptcy case must be considered for HAMP if the borrower, borrower's counsel or bankruptcy trustee submits a request to the servicer.
- ❖ A borrower who has received a chapter 7 discharge of personal liability on the mortgage is eligible for HAMP even if the borrower has not reaffirmed the debt (appropriate language shall be added to the Modification Agreement to make clear that the borrower is not assuming personal liability on the debt).
- ❖ If a debtor in an active chapter 13 case is in a trial period plan and makes postpetition payments in the amount required by the trial plan, the servicer may not object to confirmation, move for stay relief, or move for dismissal of the bankruptcy case on the grounds that the debtor did not pay the non-modified mortgage payments.

Freddie Mac should address the one area where it deviates from the standard HAMP guidance. Freddie Mac requires the mortgage to be “released” from a chapter 13 bankruptcy as a condition of the modification.<sup>76</sup> This is both unclear and a poor policy decision.

Resolving the problems with GSE loans is of key importance. The GSEs have long been dominant in the private market; with FHA, they now account for 90% of all new originations.<sup>77</sup> Moreover, losses on GSE loans now come out of taxpayer’s pockets. We must get loan modification standards right for the GSEs.

#### **4. FHFA’s Recent Announcement of Alignment of GSE Servicing Guidelines Makes Some Progress But Leaves Substantial Gaps**

On April 28, 2011, the Federal Housing Finance Agency (FHFA) announced a new initiative to align the servicing models of both GSEs.<sup>78</sup> The updated framework is intended to establish uniform servicing requirements as well as monetary incentives and penalties for servicer performance. Primary features of the program include:

- ❖ A new loan modification protocol for homeowners who do not qualify for HAMP or in some circumstances for those who fail or default on a HAMP modification. Homeowners will be required to file a hardship affidavit and may be eligible for a new non-HAMP proprietary modification;
- ❖ A requirement for servicers to contact borrowers upon delinquency regarding potential assistance;
- ❖ A focus solely on homeowner assistance prior to the actual filing of a foreclosure—with a bar to commencing a foreclosure if good-faith efforts to resolve the delinquency are ongoing;
- ❖ A formal review before referral to foreclosure that foreclosure alternatives have been pursued;

- ❖ Greater incentives to servicers to modify a loan within the first four months of delinquency rather than later; and
- ❖ Financial incentives after a foreclosure has commenced for servicers to find alternatives to foreclosure.

The new articulation of a requirement to review a homeowner for a modification prior to foreclosure, and to actively seek out the homeowner for such a review, is an important step forward. Yet there do not appear to be any similar protections for homeowners who seek a modification after foreclosure has been initiated. Many homeowners today are facing such a situation and need a respite from the costs and coercions associated with foreclosure in order to obtain a sustainable loan modification. As discussed above, too often servicers, including perhaps particularly servicers of GSE loans, foreclose when they should be reviewing for a modification. A failure to stop the foreclosure during modification review exacerbates that problem.

In addition, many details of this program still have not been announced. The strength of the alignment is, in great part, dependent on how those issues are resolved. Details (not yet announced) about how the new proprietary modification program will work are essential for determining whether this program will mitigate foreclosures.<sup>79</sup> These concerns are of heightened importance for the GSE loans because their standards have effectively become the industry standards for acceptable servicer behavior. What the GSEs decree for their loan modifications will likely become, without other legislative or regulatory intervention, the de facto ceiling on what kinds of modifications a homeowner can get.

The new rules on communication are important, but the ultimate determining factor is whether the rules result in affordable modifications for homeowners facing hardship. For example, how will it be determined whether a homeowner and servicer are in good faith modification

negotiations and thus that the foreclosure-filing deadline will be extended? If a homeowner has submitted paperwork but the servicer has lost it (perhaps repeatedly, which is not uncommon), the servicer's lapse should not result in the homeowner's foreclosure. The record of servicers losing homeowner documentation or wrongfully denying modifications makes it imperative that the pre-foreclosure review and subsequent foreclosure initiation for failed modification efforts be a rigorous process. Additionally, a modification denial should not trigger the initiation of the foreclosure until the escalation process has completed and denials should be accompanied by full documentation of the servicer's reasoning including NPV inputs and outputs and any relevant investor restrictions and efforts to obtain an exception to such restrictions.

Baseline requirements for the new modifications should include:

- ❖ Prioritization of interest rate reductions over term extensions. Such an approach favors the accrual of home equity—a core requirement for stable neighborhoods and fewer defaults.
- ❖ No arbitrary floor for interest rate reductions. Interest rates should be allowed to move down to as low as the HAMP rates of 2%, if needed to produce an affordable payment and if the ensuing modification returns a net present value over a foreclosure for taxpayers, the ultimate investors in GSE loans. An arbitrary cutoff guarantees that unnecessary and expensive foreclosures will happen, at a high cost to homeowners who are experiencing severe financial hardship and investors who would have profited from a loan modification.
- ❖ Principal reduction, and not just forbearance, when doing so produces a positive return for taxpayers.
- ❖ No floor on LTV values. Seniors, in particular, will often have accumulated equity in their homes. They should not be denied a loan modification and forced to seek a refinancing or a reverse mortgage just because they have equity that could be extracted by a predatory lender. They may be forced to a refinancing or reverse mortgage by the exigencies of the net present value test, which will value the foreclosure option more highly than a modification when there is significant equity, but that is no reason to create an absolute bar.

- ❖ Modifications for homeowners at risk of imminent default, including a broad understanding of the factors that can push a family into default, including reduction in family income, death or illness of a family member, or predatory lending.
- ❖ Automatic conversions to permanent modifications upon payment of the trial period payments, with backdating of the permanent modification so that interest arrears do not accrue during the trial period.<sup>80</sup>

Finally, GSE rules do not explicitly provide a homeowner with an express right to enforce them. National servicing standards must ensure that homeowners facing foreclosure—with a servicer who has not complied with servicing guidelines—can raise that defense to save their homes.

### **C. The Enforcement Actions by the Federal Banking Agencies are Vague, Establish No Meaningful Standards, and Leave Enforcement to Agencies with a Poor Record on Consumer Protection**

On April 13, 2011, the federal banking agencies announced enforcement actions against mortgage servicers and other firms relating to problems with foreclosures.<sup>81</sup> While each agency issued its own consent orders, there are some significant weaknesses shared among the different consent orders.

First, the reviews are time limited by focusing only on 2009 and 2010. Abuses occurring before or after this time will not be looked at. National servicing standards could fill the gap by providing protection on a going forward basis.

Second, the settlements provide few details of required standards. The consent orders provide no guidelines on loss mitigation or on evaluations for core servicing abuses, including application of payments, assessment of fees, or force placed insurance. The lack of detail allows the servicers, the perpetrators of the illegalities recognized by the banking agencies in issuing the consent decrees, to control the independent review process and obscure many violations. In

combination, the lack of detail and the unusual deference extended to the servicers, undercuts the possibility of meaningful change going forward.

Third, the agencies fail to address dual track, one of the most pressing problems that must be solved to control the foreclosure crisis. Although the agencies purport to address the typical dual track of pursuing foreclosure at the same time as any loss mitigation, they only require a foreclosure action to stop where a homeowner has already obtained a trial or permanent loan modification. This turns the need for a stop to foreclosures during loan modification reviews on its head. The establishment of a foreclosure stop in these circumstances is a routine part of how modifications are administered; if you are paying on your loan, then you should not be subject to foreclosure. (Of course, this is a part of the routine that servicers often honor in the breach, as discussed above). This foreclosure stop does not address the root of dual track: allowing an evaluation for a loan modification to occur simultaneously with the foreclosure, resulting all too often in unnecessary and expensive foreclosures, as discussed above.

Fourth, the consent decrees have no provisions for transparency in their implementation. Sadly, the banking agencies have historically failed to protect homeowners. Without transparency, there cannot be accountability for promises of an improved performance in the future.

Fifth, homeowners have no express right to enforce these agreements. It is unclear what, if anything, will happen if the servicer in conducting the review finds that a homeowner has been or is being wrongfully foreclosed on. Even homeowners whom the servicers acknowledge, after conducting their review, are being wrongfully foreclosed on, may find themselves turned out of their homes. Homeowners can not rely solely on the outcome of a secret, vague process to ensure they do not lose their homes.



Finally, while the Federal Reserve and the FDIC have clearly stated that these actions in no way are intended to interfere with the actions currently underway by the U.S Department of Justice and the state Attorneys General, the OCC has not made such a statement. The OCC's history of seeking to interfere with state enforcement of consumer protection laws does not inspire confidence that the agency will allow the work of the Attorneys General to go forward unimpeded. As discussed above, during the years leading up to the current foreclosure crisis, the OCC aggressively tried to block state enforcement actions that could have dealt effectively with many of the industry practices that are wreaking havoc upon the American public today. These consent orders appear to continue that pattern of attempting to block effective action at the state level, while permitting abusive practices by federally-regulated institutions to continue unchecked.

Millions of homeowners have been victimized by the fraudulent and abusive practices of 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. The federal agency consent orders do not begin to adequately address these issues. They do not provide the accountability and rigor required to right this foreclosure crisis. National servicing standards with rigor and accountability are still needed.

#### **D. The Proposed U.S. Department of Justice and State Attorneys General Settlement with the Servicers Has Promise, But Leaves Enforcement and Regulatory Gaps**

The potential settlement between the US Department of Justice and Attorney Generals has great promise, but many unanswered questions. The details of the settlement have not been revealed, if they have been finalized. Enforcement of the settlement remains a key concern, as does

the possibility that servicers may rely on their agreements with the OCC to argue preemption of any settlement with state authorities, despite the presence of DOJ. The extent to which this settlement can muster the level of detail and accountability necessary to reform the servicing industry is an open question.

The Attorney Generals in this action are filling a vacuum created by Congress's silence. As elected officials, responsive to their state constituencies, the AG's have stepped in where Congress has been afraid to go.

#### **IV. National Servicing Standards Should Be Established To Promote Sustainable Homeownership, Protect Investors, and Preserve Communities.**

The nation urgently needs national servicing standards that prioritize loan modifications over foreclosure and rein in abuses in fees, insurance, and payment processing. Two Senate bills introduced in the current Congress seek to address these issues: Preserving Homes and Communities Act of 2011, S. 489, introduced by Senator Reed of Rhode Island, and the Foreclosure Fraud and Homeowner Abuse Prevention Act of 2011, S. 824, introduced by Senator Brown of Ohio. The Foreclosure Prevention and Sound Mortgage Servicing Act of 2011, H.R. 1567, introduced in the House by Representative Waters similarly seeks to hold the servicers accountable. In addition, Senator Whitehouse has introduced S. 222, the Limiting Investor and Homeowner Loss in Foreclosure Act, to clarify that bankruptcy courts have the authority to set up loss mitigation programs including foreclosure mediation.

Bold legislation like these would change the dynamic between servicers and homeowners, by aligning the interests of all the affected parties, rather than allowing servicers to line their pockets at the expense of homeowners, investors and communities. Such legislation also would provide a key tool to homeowners: a defense to foreclosure where a homeowner has been denied a proper loan modification review. Even if mortgage servicing regulation improves, homeowners must be able to save their own homes where servicers violate core loan modification rules.

## **A. National Servicing Standards Must End the Dual Track Processing of Loan Modifications and Foreclosures**

### **1. The Two-track System Increases Foreclosures**

Processing loan modifications and foreclosures at the same time inevitably leads to accidental foreclosures and accompanying financial and emotional tolls on homeowners. Foreclosure and loan modification are handled by different departments at the servicer, with only imperfect communication, as exemplified by the homeowner's experiences discussed in II.A.2.<sup>82</sup> Once a foreclosure is put in place, even high-level bank officials may not be able to stop it, as happened with a California homeowner and Bank of America employees recently. Homeowners assured that they will be receiving a loan modification by one department may nonetheless find themselves facing a foreclosure.<sup>83</sup>

In part because loan modifications often require more deviations from the norm, loan modifications often take more time to work out than foreclosures do. But the two-track system pushes the foreclosure forward regardless, with the result that foreclosures frequently occur while

homeowners are negotiating a loan modification, sometimes even after they have been approved for a loan modification, with sometimes devastating results, as these examples illustrate:

- ❖ Bank of America foreclosed immediately after accepting the first payment on a repayment agreement from a California homeowner. After rescinding that sale and re-starting the modification review process, Bank of America refilled a new notice of default, effectively restarting the foreclosure process. The new sale date is May 27, 2011.
- ❖ A New Jersey couple who were attempting to negotiate a loan modification ended up being foreclosed on by the servicer. The judge in their case refused to set aside the default judgment aside, and let the foreclosure stand, even though the loan was in violation of federal law. That case is now on appeal, and the homeowners remain in limbo and at risk of losing their home, even though documents in the case indicate that a modification would provide a better return to the investor than a completed foreclosure.
- ❖ An Illinois homeowner applied for a trial modification with Bank of America in January 2011. While he was still awaiting approval or denial, and having re-supplied documents numerous times, Bank of America initiated foreclosure proceedings in early May.
- ❖ A California couple was foreclosed on twice while awaiting loan modification review from Bank of America. Bank of America rescinded the first foreclosure sale, and asked the homeowners to re-apply, but proceeded to foreclosure sale without ever resending the application packet.
- ❖ A California family learned that, because of “a computer error,” Chase has sold their home at a foreclosure sale, despite the fact that they were making regular payments under a modification agreement.
- ❖ A Washington state family lost nearly \$200,000 in equity when the servicer proceeded to foreclosure while the family was making regular payments under a temporary modification agreement. The homeowner learned of the foreclosure sale from a realtor; representatives from the servicer, Chase, insisted at first that the foreclosure sale had not happened when the homeowner contacted them. Nonetheless, the purchaser of the property succeeded in evicting the family, who are now living in an apartment.
- ❖ In one unusual case in West Virginia, a foreclosure trustee refused to proceed with a sale and referred the homeowners to legal counsel when Bank of America attempted to foreclose on homeowners while they were under review for a loan modification.

Even if a foreclosure never happens, the cost of the modification increases as the servicer imposes various foreclosure-related (and often improper) fees on the homeowner,<sup>84</sup> and the homeowner suffers the financial, credit, and emotional toll of defending a foreclosure. These fees are lucrative to the servicer, but can price a modification out of a homeowner's reach.<sup>85</sup> For example, one New York homeowner has been trying to get a mortgage modification since 2008 to resolve problems occasioned by a \$1100 increase in her monthly payments, probably due to force-placed insurance. In May 2010, the homeowner appeared to qualify for a HAMP modification but by December 2010, the accrued interest on her loan placed her unpaid principal balance beyond HAMP guidelines. The two-track system was instituted to encourage servicers to minimize delay,<sup>86</sup> but it does not in the current market even serve investors' interests well, since it does not reduce the costs skimmed by the servicer from the foreclosure sale.

Regardless of when the loan modification application is received with respect to the foreclosure filing, the simultaneous processing of a loan modification and a foreclosure results in many unnecessary and expensive foreclosures. Fees mount during the pendency of the foreclosure case: attorneys appear in court; advertising is ordered; title searches are prepared; fees are incurred for service. Foreclosures must be stopped during the pendency of a loan review whether the application (or what the servicer has denominated as the application) is received before or after the servicer initiates foreclosure. To do otherwise encourages servicers to rush to foreclose (since once in foreclosure, they can proceed to sale) and to issue summary denials. Ultimately, a rush to foreclosure is costly for investors and homeowners.

A Washington Post article from October of last year highlighted several Maryland homeowners whose homes were foreclosed on while they were making payments on a

modification.<sup>87</sup> Homeowners reported selling family heirlooms to hire lawyers to undo the foreclosure, as well as panic attacks and crying jags. Ending with a foreclosure after a modification attempt is worse for most homeowners than no modification. Most homeowners would prefer the clean denial to the crazy rollercoaster ride of yeses and nos—a clean denial allows homeowners to move on with their lives; a yes, followed by a no, followed by a yes, followed by an eviction, exhausts homeowners financially and emotionally and destroys their credit.

It is time to stop dual track processing.

## **2. Loan Modification Review Should Occur Before Foreclosure Has Been Initiated and Before Any Foreclosure-related Fees Have Been Incurred**

Homeowners should be reviewed for a modification prior to the initiation of a foreclosure in order to contain fees, expedite processing, and reduce the opportunities for error. This is not an open-ended or indefinite proscription: rather, it provides clear guidance to servicers that they can no longer continue to sit on loan modification applications indefinitely. Servicers are free to initiate the foreclosure as soon as they conduct the review; specific guidance as to necessary outreach and strict timelines should help to constrain servicers to expedite loan modification review.

## **3. If A Foreclosure Has Been Started at the Time of a Loan Modification Application or Review, Both Judicial and Nonjudicial Foreclosures Must Be Frozen During Review**

For many homeowners, the initiation of foreclosure proceedings is the motivating force to apply for a loan modification. Sometimes, the initiation of foreclosure proceedings is the first time the homeowner understands that the servicer believes that the homeowner is in default. Not

infrequently, homeowners believe that they are current or have brought their loans current recently, often on the advice of the servicer, at the time of foreclosure. A homeowner who believes she is current is not going to apply for a loan modification. Often, the need for a loan modification becomes apparent only after the foreclosure is initiated.

Servicers' use of serial trial modifications further complicates matters, since the servicer may initiate foreclosure after one trial modification and before the second. Many of the homeowners foreclosed upon while undergoing a loan modification review were placed by servicers in multiple trial modifications, complicating any attempts to unravel when the modification review was completed with respect to the foreclosure filing.

Staying all foreclosures during the pendency of a loan modification review would encourage servicers to expedite their reviews, rather than delaying them, and would provide transparency and fairness to homeowners.

**B. National Servicing Standards Must Require the Servicer to Offer the Homeowner a Modification, Where a Modification Exists that Provides a Net Present Value to the Investor Over a Modification.**

**1. A Standardized Net Present Value Test Provides for Screening of Loan Modifications that Benefit the Investor.**

Homeowners obviously lose when servicers wrongfully foreclose. They lose their homes, they lose their equity, they lose their social networks. Homeowners facing foreclosure experience stress and strain, to say the least. Even if homeowners pushed into foreclosure are able to obtain a modification, their resources may well be exhausted by the struggle to obtain a modification, and the modification may leave them only slightly better off than they were before the modification.

But investors lose as well. Particularly in a market where no equity cushion exists to absorb servicers' excesses, the fees and costs come out of the supposed security for the investors' money. According to some data, investors are now losing nearly 60% of the loan value on each foreclosure, over \$145,000 per foreclosure.<sup>88</sup> In that context, the failure to perform modifications—and the corrosive effect of excess fees—eats away at any return investors could hope to have.<sup>89</sup> Reporting in the American Banker has illustrated the detrimental impact of force-placed insurance in particular on investor returns.<sup>90</sup>

HAMP only mandates loan modifications when the Net Present Value test predicts that the loan modification will return money to the investors compared to doing nothing. It weighs the odds of cure (vanishingly small in the current market), the chances of redefault (lower than you might expect with a HAMP mod), and the expected return on any ultimate foreclosure. When servicers fail to convert trial plans to permanent HAMP modifications, or wrongly deny HAMP modifications, they are costing investors money—hard money in the form of incentive payments from the government and hard money in the form of lost future payments from the homeowner.

A standardized NPV test should be required under any national servicing standards to ensure that servicers are modifying loans where and when they should.

**a) Modifications should have an optimization model**

HAMP currently allows servicers to input terms into the Net Present Value test. The NPV test then spits out a pass or a fail. This allows servicers to potentially stack the deck against a modification by presenting terms that will never be approved. The current HAMP NPV test does not inquire as to whether there is a modification that would work for both homeowner and investor, even if the modification presented by the servicer does not.



The NPV test should be designed so that a homeowner who fails the NPV test is reviewed for a modification with different terms. Switching between forbearance, principal reduction, and interest rate reduction, or permitting term extension before the interest rate reduction can all change the outcome on the NPV test. While the standard order should be mandated so that interest rate and principal reduction are considered early in the process, trading a lesser amount of principal reduction for a modification is a positive outcome for both homeowners and investors.

Any optimization model must be automated. It cannot be subject to servicer discretion. Servicer discretion has resulted in many, many homeowners being denied a modification, to the detriment of both homeowners and investors.

**b) The NPV Test must be public**

Many advocates and mediators, lacking access to Treasury's NPV test, continue to rely on the FDIC's Loan Mod in a Box spreadsheet. Maine, Hawaii, and Washington State all require that foreclosure mediation programs use the FDIC's Loan Mod in a Box spreadsheet to determine whether a loan modification should occur or not (Washington State only requires the use of the FDIC's Loan Mod in a Box if the loan is not HAMP-eligible).

The FDIC Loan Mod in a Box is likely a good approximation of the HAMP NPV test. The HAMP NPV test was based, in part, on the FDIC Loan Mod in a Box. But it is only an approximation. In one case, Chase claimed that the homeowner had failed the NPV test by \$17,000, while the FDIC Loan Mod in a Box spreadsheet produced a pass on the NPV test in excess of \$30,000. Often, it appears that, even using the servicer's inputs, the homeowner should pass the NPV. In another case, a New Jersey advocate received in discovery a document that appears to show that the present value of a modification exceeds the present value of a foreclosure, even

though the servicer denied the modification on the basis of the NPV test. Without access to the actual NPV calculation, homeowners, judges, and mediators are left without any means to resolve these disputes.

Section 1482 of the Dodd-Frank Act mandated that Treasury make available to the public a portal so that homeowners, their advocates, and mediators could check the accuracy of servicers' NPV calculations. We are nearly 10 months past the enactment of Dodd-Frank, and Treasury has still not made such a portal available to the public. Any national servicing standards must mandate a public NPV test.

## **2. Modifications Must Be Sustainable and Fair**

### **a) Loan modifications must be affordable**

#### ***(1) Reduction to 31% of Income***

HAMP modifications have re-default rates roughly half that of other loan modification programs.<sup>91</sup> Their re-default rate is low because they are driven by a payment reduction down to an affordable level. Future standards should build on HAMP's success in this area.

#### ***(2) Allow for Deeper Reductions If People Have High Back End DTI***

For some homeowners, payments at 31% are not affordable. For those homeowners, monthly payments below 31% should be offered. Second mortgages or high medical debt can render a first mortgage payment of 31% or less unaffordable. Homeowners' actual, reasonable living expenses may mean that 31% is not, in fact, a sustainable and affordable payment when the total

dollars available are quite low. Treasury should require and subsidize modifications below 31% where the homeowner has low residual income or high fixed expenses.

### ***(3) Second Liens Must Be Accounted For***

Servicers will often service both the first and second liens. Frequently, servicers themselves hold the second lien. Servicers who hold second liens may prefer to gamble on a market recovery rather than accept the incentive payments under HAMP and recognize their losses now. Many servicers have chosen not to participate in the second lien program absent a federal mandate.

Failure to deal the second lien results in unsustainable loan modifications and invites gamesmanship and moral hazard on the part of servicers.

#### **b) Modification should be based on a waterfall that prioritizes principal reduction**

Practically, principal reductions may be key to the success of any foreclosure mitigation program. Being “underwater” increases the risk of default, particularly when coupled with unaffordable payments.<sup>92</sup> Built into the HAMP NPV calculations is an assumption that default increases as a function of how far underwater the homeowner is. In order to bring down the redefault rate and make loan modifications financially viable for investors, principal reductions must be part of the package.

HAMP permits principal reductions, but does not mandate them, not even in the most extreme cases. HAMP does require forbearance, but only as a method for reducing payments. While forbearance provides affordable payments, it prevents a homeowner from selling or refinancing to meet a needed expense, such as roof repair or college tuition, and sets both the homeowner and the

loan modification up for future failure. For all of these reasons, future loan modification programs must mandate principal reduction where it produces a net benefit to the investors.

**c) Modifications should reduce the interest rate before extending the term**

While HAMP requires that the interest rate be reduced before the term is extended, many proprietary modifications do not. Inverting the order of the waterfall produces loan modifications that are more costly to the homeowner and more risky for the investor.

Term extension may provide homeowners with immediate payment relief, but it does so at the cost of pushing those payments—plus interest—out into the future. One result is that homeowners with term extensions will take much longer to pay down principal—meaning that homeowners who are underwater will stay underwater for perhaps decades longer. Another result is that the interest risk—that future rates will be lower than present rates—is exacerbated. Particularly since mortgage rates are near record lows, yet refinancing options are few and far between, homeowners should not be locked into high rates for an extended period of time. Switching the waterfall so term extensions are offered before interest rate reductions gives homeowners the illusion of payment relief, but locks them into debt service for much longer.

That increased period of debt service increases the risk for investors. While a term extension, on paper, does not change the return to the investor (since interest will continue to accrue on the deferred payments), the increased length of time to repay increases the risk that the investor will not get repaid. To take one example, homeowners in their 30's are likely to repay a 30-year mortgage before hitting their retirement years, but are less likely to be able to repay a 40-year mortgage before hitting their retirement years, and thus more likely to default.

While term extensions are preferable to capitalization modifications, they suffer, long-term, from some of the same risks posed by a failure to reduce the principal balance. Term extensions leave homeowners owing more for longer, and paying more over the life of the loan. Reversing the waterfall does not protect investors from losses incurred through too great an interest rate reduction; the Net Present Value test already does that. Reversing the waterfall reduces the benefit for homeowners of a loan modification and increases the investor's risk.

**d) Modifications should be permanent**

Many proprietary modifications are limited to a period of a few years, requiring the homeowner and the servicer to revisit the modification process again. Given servicers' difficulties in getting the modification review correct in the first instance, homeowners should not be subjected to a second review.

Permanent modifications allow all parties to the modification to adjust their financial expectations accordingly. Homeowners need and deserve the stability of fixed and predictable payments. The financial markets are notorious for loathing uncertainty. Permanent modifications provide predictability for all parties.

**e) Additional modifications should be available where homeowner faces additional unexpected hardship**

Even after a loan modification is done successfully and is performing, homeowners may still become disabled, lose their jobs, or suffer 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 modification is punitive to homeowners already suffering a loss and does not serve the interests of investors.

Some servicers provide modifications upon re-default as part of their loss mitigation program. This approach should be standard and mandated.

**f) Spouses, children, and ex-spouses should be offered a modification in accord with existing federal law.**

The Garn-St Germain Act provides that mortgages should be freely assumable between family members living in the home, whether they acquire title through death or divorce or devise. Servicers currently routinely block modifications when family members seek to assume the mortgage. But if a modification in those circumstances passes the NPV test, there is no reason not to allow it, and the weight of existing federal law to support the assumption of the mortgage and the curing of the default.

**g) Bankruptcy should not be a bar to modification**

Any national servicing standards should allow modifications for homeowners in bankruptcy. For over a year, HAMP has required that modifications be allowed for borrowers in bankruptcy who are otherwise eligible. National servicing standards should, like the revised HAMP guidelines, explicitly provide that servicers must consider a homeowner seeking a modification even if the homeowner is a debtor in a pending bankruptcy proceeding.

Some servicers have explained their reluctance to do loan modifications in bankruptcy by citing a fear of violating the automatic stay in bankruptcy. Neither the automatic stay nor the discharge order should be a bar to offering an otherwise eligible homeowner a loan modification.

HUD, in guidance to FHA servicers, has explicitly recognized that offering a loan modification does not violate the automatic stay or a discharge order.<sup>93</sup>

Servicers should be required, upon receipt of notice of a bankruptcy filing, to send information to the homeowner's counsel indicating that a loan modification may be available. Upon request by the homeowner and working through homeowner's counsel, servicers should offer appropriate loan modifications in accordance with the national servicing standards prior to discharge or dismissal, or at any time during the pendency of a chapter 13 bankruptcy, without requiring relief from the automatic stay, and, in the case of a chapter 7 bankruptcy, without requiring reaffirmation of the debt. The bankruptcy trustee should be copied on all such communications. All loan modifications offered in pending chapter 13 cases should be approved by the Bankruptcy Court prior to final execution, unless the Court determines that such approval is not needed. If the homeowner is not represented by counsel, information relating to the availability of a loan modification should be provided to the homeowner with a copy to the bankruptcy trustee. The communication should not imply that it is in any way an attempt to collect a debt.

Additionally, payment rules under national servicing standards should take into account the fact that payments may be passed through the bankruptcy trustee, rather than directly from homeowner to servicer. There is often an initial lag between passing the payments from the bankruptcy trustee to the servicer; homeowners should not be penalized for a delay over which they have no control and which is occasioned solely by their exercise of their right to file bankruptcy.

Finally, the modification documents should explicitly prohibit servicers from requiring homeowners to reaffirm mortgage debts. Because reaffirmations of home mortgages have the potential to deny homeowners a fresh start, many bankruptcy judges refuse to approve them.

Congress recognized this concern with an amendment to the Bankruptcy Code in 2005 that permits mortgages to be serviced in the normal course after bankruptcy even if the mortgage has not been reaffirmed. These purported reaffirmation agreements made outside the mandatory notice and review procedures of section 523(c) and (d) of the Bankruptcy Code have no effect, are not enforceable, and the government should not be involved in encouraging the practice.

**h) Waiver should be forbidden in modifications**

HAMP has forbidden waiver from its inception and even explicitly authorized loan modifications for homeowners engaged in active litigation with their servicer. Waivers of legal rights may not always be enforceable, but they have a chilling effect on homeowners' exercise of their rights. There is no reason to authorize servicers to require a get out of jail free card from homeowners in order to process a loan modification that is in the best financial interests of the investors. Permitting such waivers will encourage abusive servicer behavior and will impede loan modification processing for homeowners savvy enough to seek legal counsel as to the extent of their waiver.

Despite HAMP's prohibition, waiver continues to be a significant problem.<sup>94</sup> Recent reporting by ProPublica has found that several servicers continue to request waiver, particularly, but not exclusively, in non-HAMP, or proprietary, modifications.<sup>95</sup> In recent months, Bank of America has asked homeowners in New York, Maine, Indiana, Connecticut and North Carolina to waive all legal defenses in order to obtain a loan modification.<sup>96</sup> Bank of America employees have claimed both that such waivers occur when non-standard modifications are done and that such waivers are part of a standard package and cannot be removed.<sup>97</sup> Increasingly, homeowners in both HAMP and



non-HAMP modifications are being asked to sign waivers of specific claims, often related to allegations of robo-signing or standing.<sup>98</sup>

Servicers continue to press homeowners to waive their rights to a HAMP modification. A Colorado homeowner was told by Bank of America employees that waiver of her rights to a HAMP review was a condition of suspension of the foreclosure sale, despite the fact that there was an ongoing review of the denial of her HAMP application.

National servicing standards must follow HAMP's lead and clearly prohibit waivers.

### **3. The Application Process Must Be Simplified**

Any discussion of the loan modification process indicates a structure so Byzantine as to be Kafka-esque. Rube Goldberg designs appear simple (and filled with a gentle humor) compared to the grim bureaucracy involved in obtaining a loan modification. Countless loan modifications are denied because of this needless complexity.

#### **a) National servicing standards should require minimum levels of outreach pre-foreclosure**

Mail can get lost; voice mail messages can be accidentally deleted. Families go on vacation or have medical emergencies. Standards for minimum acceptable levels of outreach, akin to those in HAMP, should be set forth.

#### **b) Single point of contact and document tracking must be mandated**

Servicers lose documents, over and over and over again. Homeowners call endlessly, and are shuffled from person to person. From the homeowner's perspective, one of the biggest obstacles to

loan modification is finding a live person who can provide reliable information about the loan account and who has authority to make loan modification decisions. Federal law should require that mortgage servicers provide homeowners with contact information for a real person with the information and authority to answer questions and fully resolve issues related to loss mitigation activities for the loan. Requiring a single person to have custody of a loan modification application from start to finish might ease some of the confusion experienced by homeowners. Document tracking might help homeowners demonstrate that they have, in fact, submitted documents and prevent unnecessary denials for failure to submit documents.

Neither of these procedural steps are panaceas, as illustrated by the case of a Wisconsin homeowner whose attorney finally got a single point of contact, only to have that single point of contact fail to return phone calls or emails for a month. And document tracking systems are subject to both computer and human error. Many proposed and in-place document tracking systems rely on access to housing counselors, computers and the Internet, or both. There are parts of the country where there are no HUD-certified housing counselors operating, and even if most homeowners have some Internet access through public libraries, at least, the digital divide remains real.<sup>99</sup>

Nonetheless, these procedural steps, if implemented and enforced, would improve servicer's efficiency in processing loan modification applications and reduce inappropriate denials.

**c) Automatic conversion to permanent modifications should be required**

The numbers and narratives both tell the same story. Tens of thousands of homeowners are faithfully making monthly trial modification payments with the understanding that a permanent

modification will be the reward, yet that final modification is still elusive. The only way to ensure that homeowners obtain finalized agreements—and receive them on time so they can avoid additional increases in arrears and further damage to their credit—is to make conversions from trial modifications to permanent agreements an automatic process. Even homeowners who receive permanent modification offers in the mail find that this does not mean the process is over, since servicers often delay by weeks or months the countersigning of the document. One Bank of America representative recently told an Illinois housing counselor that Bank of America never returns signed permanent modification documents to homeowners. Where the servicer initiates foreclosure after the homeowner has entered a permanent modification, as many do,<sup>100</sup> servicers often find themselves scrambling to prove that there was an agreement. Automatic conversions will streamline this last step in the process and reduce litigation.

#### **4. Transfer of Servicing Should Not Impede Modifications**

New servicers must accept and continue processing prior loan modification requests; new servicers must honor loan modification agreements entered into by prior servicers. These are requirements under the HAMP Servicer Participation Agreements, but a source of frequent wrongful foreclosure, as illustrated by the following examples:

- ❖ An Illinois homeowner received a modification from Citi in March of 2010. When the servicing of his loan was transferred to LBPS in November of 2010, LBPS told him they had no record of the modification agreement with Citi, and that he should continue to make regular payments, which they would place in a suspense account pending their receipt of the agreement from Citi. In March of 2011, LBPS begins rejecting his payments and then sends him a new modification proposal, on significantly worse terms (instead of a fixed interest rate, the new modification would have an adjustable rate).
- ❖ A Wisconsin family, after making payments under an oral trial modification for over a year, was placed into foreclosure when servicing was transferred from CitiMortgage to Vericrest Financial.

Homeowners and consumers are expected to honor the terms of their contracts; servicers must ensure that they do not breach their contracts with homeowners through a transfer of servicing.

## **C. Fees Must Be Limited**

As discussed in II.B.2 above, fees serve as a profit center for many servicers and their affiliates. They increase the cost to homeowners of curing a default. They encourage servicers to place homeowners in default and can doom modifications. Fees cost both borrowers and investors.

Borrowers are not in a position to police default fees. The fees may be relatively small in an individual case. Moreover, a desperate borrower may agree to pay even an unaffordable fee, only to end up quickly back in foreclosure. Such a result is costly for everyone but the servicer.

### **1. Foreclosure Related Fees Must Be Reasonable**

Fees include late fees, valuation, home inspection, force-placed insurance, attorney fees, title insurance, auction, legal, property preservation fees, and REO sales fees, among others. All of these fees should be reasonably related to the actual cost of providing the service. There should be no fee for home preservation services if payment submitted to the servicer within 60 previous days: it is unreasonable in those circumstances to assume that the homeowner has departed for parts unknown and property preservation services are needed.

Servicers should be limited to one reasonable appraisal fee before an evaluation for a loan modification is completed. Additional valuations should be limited to no more than one every six months, absent a compelling change in circumstances. Title work should be limited to that reasonably necessary, and foreclosure attorney fees must be restricted to work actually performed.

## **2. Payments Should Be Applied to the Homeowner's Account**

Payments should be credited as of the date received. Payments should be applied first to principal and interest. The use of suspense accounts should be curtailed.

## **3. Fees Should Be Disclosed**

No fee should be charged unless advanced notice of such type of fee and circumstances has been provided. Also, the servicer should be required to comply with contract and not charge fees k doesn't allow for. Mandatory disclosure should occur on monthly and annual statements of the fees incurred. Mandatory disclosure of fees that may be charged should be provided at transfer of servicing and annually. This notice should not include wide ranges that are meaningless but meaningful notice regarding the amount and circumstances in which the fee may be imposed.

## **4. Late Fees Should Be Regulated As They Are Under the Uniform Consumer Credit Code**

Sec. 2.502(2) of the Uniform Consumer Credit Code (1974 version) reads: "A delinquency charge under subsection (1) may be collected only once on an installment however long it remains in default." This is a broader reach than under the FTC Credit Practices Rule. Under the Credit Practices Rule, you can't charge late fees on late fees--that is, if one payment is late, and a late charge is assessed but not paid, you can't charge late fees on all subsequent payments until the late fee is paid. The UCCC standard is broader than that, and forbids pyramiding of late fees even if the underlying payment itself is not made (instead of charging separate late fees on each of the subsequent payments, which were timely made, as is often done now). That is, being late once should result in one late fee.

Sixteen states have already adopted this language.

## **5. Force-Placed Insurance**

Servicers should be required to continue an existing policy or reestablish a policy if there is a lapse in payment. Premium payment information should be provided to the creditor/servicer at closing, and updated if the policy changes, whether or not there is an escrow, so that the existing policy can be continued in the event of a lapse. If there is no escrow, the servicer should advance the fee to pay the premium and collect the premiums in increments of 1/12 per month or through creation of an escrow account under RESPA. This entire process should be disclosed at the outset.

### **D. National Servicing Standards Should Restrict Robosigning & Ensure that Homeowners Have Actual Notice of Any Foreclosure Proceeding**

The recent report issued by the Government Accountability Office recognizes the perpetual under regulation of mortgage servicing and highlights the importance of establishing national servicing standards.<sup>101</sup> We appreciate the letter sent by Senator Menendez and other requesters of the GAO report to the federal banking regulators urging action on national servicing standards.

The state foreclosure process should remain a creature of state law, but federal measures could and should ensure servicer compliance with such state requirements. Foreclosure notices should be personally served and default notices should be signed under penalty of perjury.

### **E. National Servicing Standards Must Provide for Accountability and Transparency**

## **1. Transparency in Loan Modification Process**

### **a) The Net Present Value analysis should be available to the public, and inputs and outputs should be provided to the homeowner**

As discussed in section B.1.b), the NPV test itself must be made public. The inputs themselves must also be disclosed to the homeowner at the time of denial. Homeowners often find, when the NPV inputs are revealed, that there are gross inaccuracies in the numbers. For example, a Minnesota family's disclosed NPV inputs revealed fluctuating expenses thousands of dollars in excess of the family's actual expenses as well as significant underreporting of income. A Brooklyn family found that their income was overstated by thousands of dollars. Revealing the numbers at the time of denial expedites review and reduces unnecessary disputes.

### **b) The amount of the unpaid principal balance should be disclosed**

Disputes over the amount included in the capitalization of arrears are legion. Servicers frequently present the homeowner with an unpaid principal balance that is thousands or tens of thousands of dollars more than the homeowner's records indicate it should be. Inflated principal balances line servicers' pockets at the expense of both homeowners and investors, as discussed in II.B.3 above.

Servicers should be required to disclose the components of the unpaid principal balance, affording homeowners a chance to correct discrepancies.

### **c) Denials should also include documentation of relevant investor contracts and correspondence regarding any related limitations and efforts to modify otherwise**

As I have discussed elsewhere,<sup>102</sup> investor denials are often pretextual. Recently, a California homeowner was denied based on investor restrictions, only to find out when her advocate called for clarification that the servicer believed the homeowner to be dead. Even when the grounds for denial are more clearly related to the investor contracts and not mistaken facts, a review of the relevant investor contracts frequently reveals that there are no restrictions on modifications or the restrictions are other than the servicer has represented. Providing homeowners documentation of the basis of the investor denial will expedite dispute resolution and provide a powerful incentive for servicers to check their facts before issuing a denial based on investor restrictions.

**d) Servicers should be required to make publicly available detailed information about loan modifications**

Despite their central role in the debate over foreclosures, little data is publicly available on the nature or extent of loan modifications, or who receives them. This information should be available by servicer at the census tract level, and should include the race of the borrower, as well as the salient characteristics of the modifications. Such public disclosure could be modeled after the disclosures mandated under the Home Mortgage Disclosure Act. Loan modifications are too important to leave concealed from public debate.

**e) Deadlines and appeals will promote fairness**

National servicing standards should set time deadlines for review and response on both sides. Moreover, there should be an appeals process available to homeowners denied modifications prior to initiation of foreclosure. Homeowners should not be foreclosed upon while they are awaiting the results of an appeal.



## **2. Transparency in Servicing Could Be Improved Through Transfer Notices and Periodic Statements**

### **a) Transfer notices should advise if the homeowner is current and whether there are any unpaid fees**

Transfer notices should advise if the homeowner is current and whether there are any unpaid fees. If a fee is not in the “goodbye letter” and “hello letter” to homeowner as having been incurred, it should be waived. Where the notice indicates the homeowner is not current or fees/late charges have been incurred, the servicer must provide to the homeowner a payment history at transfer of servicing. At transfer of servicing, the servicer must indicate to the homeowner whether a loan modification is pending. If a loan modification was entered into prior to transfer, the servicer must acknowledge the loan modification is in effect.

Additionally, if a fee is not on a monthly statement as having been incurred, it should be considered to have been waived. Monthly statements should also advise of the dispute procedure for contesting fees or other servicer abuses.

### **b) Periodic statements, servicing transfer notices, and escrow account statements should be provided notwithstanding delinquency or default status**

If a homeowner is 30 days or more in arrears or in default, she should still receive a periodic statement. When homeowners don't receive their monthly statements, they and their advocates have more difficulty unraveling where things went wrong. Reports from California, Wisconsin, and New York confirm that many homeowners who believe they have a permanent modification and are making payments under what they understand the terms of that modification to be are caught off

guard by servicer's refusal of payments, claimed arrearages, and foreclosure action due to the non-receipt of monthly servicing statements.

### **3. Dispute Procedures for All Servicer Disputes**

While the Real Estate Settlement Procedures Act currently requires servicers to respond to homeowners' request for information and disputes within 60 days (and this time frame has been shortened under the Dodd-Frank Act), in practice many such inquiries go unanswered. Despite this failure to respond, servicers are still permitted to proceed to collection activities, including foreclosure. Essential changes to this law governing servicers should ensure that homeowners facing foreclosure would no longer be at the mercy of their servicer. There should be transparency in the servicing process by allowing the homeowner to obtain key information about the loan and its servicing history. Servicers should be prohibited from initiating or continuing a foreclosure proceeding during the period in which an outstanding request for information or a dispute is pending, if the request for information or dispute is connected to the basis for foreclosure. Basic fairness mandates that no one should lose their home because the servicer has not yet corrected an error. Tight timeframes for the servicer's response should keep the dispute resolution process from being a source of endless delay in the foreclosure process.

Key provisions of any dispute procedure include the following:

- ❖ The homeowner must have the right to dispute any act or omission of the servicer, and any failure to comply with the servicing standards.
- ❖ The response time periods should be those provided under Dodd-Frank.
- ❖ All foreclosures should be suspended during the pendency of the dispute, if the dispute is connected to the basis for foreclosure (such as a dispute over payments).

#### **4. Funding for mediation programs with standards and legal representation of homeowners**

All too often servicers deny a modification, add fees, or institute a foreclosure without cause. Most of the time when servicers do those things, homeowners have no effective means of challenging the illegality of the servicers' actions or even bringing the servicer to focus on the individual facts and circumstances of the particular loan in order to reach a resolution. Court-supervised mediation and legal representation can even the playing field.

Court-supervised mortgage mediation programs help borrowers and servicers find outcomes that benefit homeowners, communities and investors. Evidence indicates that mediation programs can cut in half the number of completed foreclosures—a far more impressive result than that achieved under HAMP. The quality of programs varies widely, however, and most communities don't yet have mediation available. Government funding for mediation programs would expand their reach and help develop best practices to maximize sustainable outcomes.

Servicer excesses have come to light only through the diligent work of a small and dedicated group of attorneys. Homeowners need legal help to navigate complex and inaccurate paperwork and court filings hastily processed by banks. Yet the vast majority of homeowners go unrepresented. No legal services program has sufficient staff to represent all homeowners with meritorious defenses to foreclosure. Few have sufficient staff to represent even a third of the applicants for service.

Funding for foreclosure defense is particularly hard hit. The Institute for Foreclosure Legal Assistance (IFLA), a nonprofit organization, has been the major source of private foreclosure-

related grants for legal services programs, but it will run out of funding in 2011. Many state and local funding sources are also drying up.

The Dodd-Frank Wall Street Reform Act, HR 4173 Sec. 1498, authorizes \$35 million in funding for legal services programs to assist low- and moderate-income homeowners and tenants in foreclosure, but the money has not been appropriated.

## **5. Violation of the Servicing Standards Should Constitute a Defense to Foreclosure**

The servicing standards, to be meaningful, must be self-enforcing. Servicers should not be allowed to violate servicing standards and deprive a family of their home. Homeowners must be allowed to raise a violation of the servicing standards as a defense to foreclosure, either judicial or nonjudicial. Failure to comply with any of the loan modification provisions, whether failure to offer a loan modification, or offering a noncompliant loan modification, or instituting foreclosure while the homeowner is under review for a loan modification, should serve as defense to judicial or nonjudicial foreclosure. As another lever for enforcement, certification with the local recorder of deeds office should be required before foreclosure filing.

The servicing standards should also address the deeply problematic situation that arises when a servicer has indisputably foreclosed in clear violation of servicing rules and the house has been sold to a bona fide purchaser before the error can be rectified. In many states, the house cannot be taken back from the BFP and restored to its rightful owner. For this reason, the guidelines should address appropriate compensation to the homeowner. Otherwise, the law will leave injured homeowners without a meaningful remedy.

## **F. National Servicing Standards Should Be a Floor, Not a Ceiling, and Should Not Preempt Stronger State Laws**

As discussed earlier, the history of federal regulatory preemption of state efforts to protect homeowners is one reason today's crisis is as severe as it is. States have been productive laboratories for homeowner protections and any federal servicing standard should continue to allow for state innovation.

## **G. National Servicing Standards Should Apply to All Servicers, Including Those of Government-Insured Loans**

The federal government insures loans for certain market segments, in order to encourage lending. These loans—made or insured by the Federal Housing Administration (FHA), the Veteran's Administration (VA), and the Rural Housing Services (RHS)—are by and large made to vulnerable populations, who may have restricted access to alternative credit. Abuses in these products are unfortunately, not unknown.<sup>103</sup>

Although the baseline servicing standards are generally higher for these products, enforcement is lax. Servicers of government-insured mortgage routinely foreclose on homeowners without conducting the prescribed pre-foreclosure loss mitigation activity or sometimes even any loss mitigation activity.<sup>104</sup> Homeowners who seek help from the administrative oversight bodies seldom receive help.<sup>105</sup> The National Servicing Center for FHA loans has told homeowners' advocates that it disclaims any role in forcing servicers to comply with the guidelines.

## **V. Conclusion**

Thank you for the opportunity to testify before the Committee today. The foreclosure crisis continues to swell. Servicers have exacerbated the crisis, as they profit from foreclosures. As revealed in the recent robo-signing scandal, servicers' lawless behavior threatens the integrity of our legal and economic systems. The need to act is great. Dual track must be ended, once and for all. Homeowners who qualify must have the right to be offered a sustainable loan modification prior to foreclosure. Passage of legislation or adoption of regulations to reform the servicing industry, to allow for loan modifications in bankruptcy, and to address the tax consequences of loan modifications also would aid in protecting homeowners from indifferent and predatory servicing practices and reducing the foreclosure surge. Together, these measures would save many homes and stabilize the market. We look forward to working with you to address the economic challenges that face our nation today.

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<sup>1</sup> The **National Consumer Law Center, Inc.** (NCLC) is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of eighteen practice treatises and annual supplements on consumer credit laws, including *Truth In Lending* (6th ed. 2007) and *Cost of Credit: Regulation, Preemption, and Industry Abuses* (3d ed. 2005) and *Foreclosures* (2d ed. 2007), as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low-income people, conducted training for thousands of legal services and private attorneys on the law and litigation strategies to deal predatory lending and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. This testimony was written by Alys Cohen, Staff Attorney, and Diane E. Thompson, Of Counsel.

<sup>2</sup> The **National Association of Consumer Advocates** (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.

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<sup>3</sup> Cf. Jody Shenn, *Mortgage Investors with \$500 Billion Urge End of Practices, Lawyer Says*, Bloomberg News, July 23, 2010, <http://www.bloomberg.com/news/2010-07-23/mortgage-investors-with-500-billion-urge-end-of-practices-lawyer-says.html> (reporting on letters sent to trustees of mortgage pools on behalf of a majority of the investors in the pool); Letter from Kathy D. Patrick to Countrywide Home Loans Servicing, Oct. 18, 2010 (notifying a trust and master servicer of breaches in the master servicer's performance).

<sup>4</sup> The U.S. foreclosure rate (percentage of outstanding mortgage loans in foreclosure) at the end of the second quarter of 2010 was 4.57%. Mortgage Banker's Ass'n, National Delinquency Survey Q2 2010, at 3. The foreclosure rate for non-farm mortgages peaked in 1933, below 1.4%. David C. Wheelock, *The Federal Response to Home Mortgage Distress: Lessons from the Great Depression*, 90 Federal Reserve Bank of St. Louis Rev. 133, 138–39 (2008).

<sup>5</sup> See, e.g., Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System, Speech at the Federal Reserve System Conference on Housing and Mortgage Markets: Housing, Mortgage Markets, and Foreclosures (Dec. 4, 2008) [hereinafter Bernanke, Speech at Federal Reserve], *available at* <http://www.federalreserve.gov/newsevents/speech/bernanke20081204a.htm> (“Despite good-faith efforts by both the private and public sectors, the foreclosure rate remains too high, with adverse consequences for both those directly involved and for the broader economy.”).

<sup>6</sup> Staff of the Joint Economic Comm., 110th Cong., 2d Sess., State by State Figures: Foreclosure and Housing Wealth Losses (2008), *available at* [http://jec.senate.gov/index.cfm?FuseAction=Reports.Reports&ContentRecord\\_id=392cb915-9c45-fa0d-5a46-f61f6e619381&Region\\_id=&Issue\\_id=](http://jec.senate.gov/index.cfm?FuseAction=Reports.Reports&ContentRecord_id=392cb915-9c45-fa0d-5a46-f61f6e619381&Region_id=&Issue_id=).

<sup>7</sup> See, e.g., Ctr. for Responsible Lending, *Soaring Spillover: Accelerating Foreclosures to Cost Neighbors \$502 Billion in 2009 Alone; 69.5 Million Homes Lose \$7,200 on Average* (2009), *available at* <http://www.responsiblelending.org/mortgage-lending/research-analysis/soaring-spillover-accelerating-foreclosures-to-cost-neighbors-436-billion-in-2009-alone-73-4-million-homes-lose-5-900-on-average.html> (estimating losses to neighboring property values due to the foreclosure crisis at \$1.86 trillion dollars); Staff of the Joint Economic Comm., 110th Cong., 1st Sess., *The Subprime Lending Crisis: The Economic Impact on Wealth, Property Values and Tax Revenues, and How We Got Here* (2007), *available at* [http://jec.senate.gov/index.cfm?FuseAction=Reports.Reports&ContentRecord\\_id=c6627bb2-7e9c-9af9-7ac7-32b94d398d27&Region\\_id=&Issue\\_id=](http://jec.senate.gov/index.cfm?FuseAction=Reports.Reports&ContentRecord_id=c6627bb2-7e9c-9af9-7ac7-32b94d398d27&Region_id=&Issue_id=) (projecting foreclosed home owners will lose \$71 billion due to foreclosure crisis, neighbors will lose \$32 billion, and state and local governments will lose \$917 million in property tax revenue); William Apgar & Mark Duda, *Collateral Damage: The Municipal Impact of Today's Mortgage Foreclosure Boom*, at 4 (May 11, 2005), *available at* [www.hpfonline.org/PDF/Apgar-Duda\\_Study\\_Final.pdf](http://www.hpfonline.org/PDF/Apgar-Duda_Study_Final.pdf) (estimating costs to the City of Chicago per foreclosure upwards of \$30,000 for some vacant properties).

<sup>8</sup> Servicers may have been able to use robo-signing allegations to reduce their obligation to make advances—thus saving them money while shifting more of the risk of failure to the top-rated tranches held by pension funds and other large institutional investors. Kate Berry, *Pipeline: A Roundup of Credit Market News and Views*, Am. Banker, Nov. 11, 2010 (citing research by Amherst securities). The requirement to make advances can be suspended when the servicer judges that losses are irrecoverable. If exposure of robo-signing requires additional expense and time, servicers may claim that the losses are now irrecoverable. This is an exception to the usual rule that servicers never stop making advances.

<sup>9</sup> Compare Comptroller of the Currency & Office of Thrift Supervision, OCC and OTS Mortgage Metrics Report: Disclosure of National Bank and Federal Thrift Mortgage Loan Data, 4<sup>th</sup> Quarter 2010 at 22

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(2010) <http://www.ots.treas.gov/files/490069.pdf> (reporting 473,415 “home retention actions,” including HAMP modifications and payment plans, initiated in the fourth quarter of 2010) with Mortgage Banker’s Ass’n, National Delinquency Survey Q2 2010, at 4 (reporting that 4.63% of 43,579,051, or 2,017,711, mortgage loans in the U.S. were in foreclosure in the 4<sup>th</sup> quarter of 2010). The OCC-OTS Mortgage Metrics report puts a positive spin on these numbers by comparing the total home retention actions started to the number of new foreclosures. But the goal of modifications should be to stop existing foreclosures as well as prevent new ones, and, as the National Delinquency numbers show, the number of existing foreclosures far outstrips the efforts at modification. Indeed, this nearly 5:1 ratio understates the scope of the problem, since most modification programs aim at loans 60 days or more delinquent. Looking at the 60+ day delinquency rates, we see that, as of the 4<sup>th</sup> quarter of 2010, the eligible pool of loans to be modified is approaching 4.4 million loans, almost ten times the number of new home retention actions.

<sup>10</sup> See <http://www.propublica.org/article/homeowner-questionnaire-shows-banks-violating-govt-program-rules>.

<sup>11</sup> Additional examples can be found in my November testimony before the entire committee. *Problems in Mortgage Servicing From Modification to Foreclosure: Hearing Before the S. Comm. on Banking, Housing, & Urban Affairs*, 111th Cong. 9-10 (2010) (statement of Diane E. Thompson, Of Counsel, Nat’l Consumer Law Center).

<sup>12</sup> Megan McArdle, *Housing Prices Still in Steep Decline*, Atlantic (May 9, 2011), <http://www.theatlantic.com/business/archive/2011/05/housing-prices-still-in-steep-decline/238619/>

<sup>13</sup> Cf. Matthew Tomiak & William Berliner, *The Complex New World of RMBS Shortfalls*, Am Securitized J, Winter-Spring 2010, at 16, 17

<sup>14</sup> Cong. Oversight Panel, December Oversight Report: A Review of Treasury’s Foreclosure Prevention Programs 30 (2010).

<sup>15</sup> See, e.g., *Schlosser v. Fairbanks Capital Corp.*, 323 F.3d 534 (7th Cir. 2003); *Maxwell v. Fairbanks Capital Corp.* (*In re Maxwell*), 281 B.R. 101 (Bankr. D. Mass. 2002).

<sup>16</sup> See, e.g., *Chu v. Green Point Sav. Bank*, 628 N.Y.S. 2d 527 (2<sup>nd</sup> App. Dist. 1995) (finding servicers’ conduct in foreclosing “frivolous” and imposing sanctions).

<sup>17</sup> See, e.g., Jeff Horwitz, Ties to Insurers Could Land Mortgage Servicers in More Trouble: Force-Placed Policies Impose Costs on Both Homeowner, Investor, Am. Banker, Nov. 10, 2010.

<sup>18</sup> See, e.g., Kate Berry, *Pipeline: A Roundup of Credit Market News and Views*, Am. Banker, Nov. 11, 2010 (citing research by Amherst securities) (reporting on a Florida case)

<sup>19</sup> Cf. Jody Shenn, *Mortgage Investors with \$500 Billion Urge End of Practices, Lawyer Says*, Bloomberg News, July 23, 2010, <http://www.bloomberg.com/news/2010-07-23/mortgage-investors-with-500-billion-urge-end-of-practices-lawyer-says.html> (reporting on letters sent to trustees of mortgage pools on behalf of a majority of the investors in the pool); Letter from Kathy D. Patrick to Countrywide Home Loans Servicing, Oct. 18, 2010 (notifying a trust and master servicer of breaches in the master servicer’s performance).

<sup>20</sup> A fuller treatment of servicer incentives may be found in Diane E. Thompson, Nat’l Consumer L. Center, *Why Servicers Foreclose When They Should Modify and Other Puzzles of Servicer Behavior* (Oct. 2009), available at <http://www.nclc.org/issues/general-mortgage-servicing-policy-analysis.html>.

<sup>21</sup> See, e.g., Ocwen Fin. Corp., Annual Report (Form 10-K) 30 (Mar. 12, 2009):



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Servicing continues to be our most profitable segment, despite absorbing the negative impact, first, of higher delinquencies and lower float balances that we have experienced because of current economic conditions and, second, of increased interest expense that resulted from our need to finance higher servicing advance balances. Lower amortization of MSR[s] [mortgage servicing rights] due to higher projected delinquencies and declines in both projected prepayment speeds and the average balance of MSR[s] offset these negative effects. As a result, income . . . improved by \$52,107,000 or 42% in 2008 as compared to 2007.

<sup>22</sup> Ocwen Fin. Corp., Annual Report (Form 10-K) 5 (Mar. 12, 2009); Mary Kelsch, Stephanie Whited, Karen Eissner, Vincent Arscott, Fitch Ratings, *Impact of Financial Condition on U.S. Residential Mortgage Servicer Ratings 2* (2007).

<sup>23</sup>*Cf.* Wen Hsu, Christine Yan, Roelof Slump, FitchRatings, U.S. Residential Mortgage Servicer Advance Receivables Securitization Rating Criteria 4 (Sept. 10, 2009) (finding that modifications do not appear to accelerate the rate of recovery of advances, in part because of high rates of redefault).

<sup>24</sup>Larry Cordell, Karen Dynan, Andreas Lehnert, Nellie Liang, & Eileen Mauskopf, Fed. Reserve Bd. Fin. & Econ. Discussion Series Div. Research & Statistical Affairs, *The Incentives of Mortgage Servicers: Myths and Realities 16* (Working Paper No. 2008-46).

<sup>25</sup>*See, e.g.*, Ocwen Fin. Corp., *supra* note 21, at 4 (advances include principal payments); Brendan J. Keane, Moody's Investor Services, *Structural Nuances in Residential MBS Transactions: Advances 4* (June 10, 1994) (stating that Countrywide was in some circumstances only advancing interest, not principal).

<sup>26</sup>Keane, *supra* note 25, at 3.

<sup>27</sup>Cordell et al., *supra* note 24, at 11; Ocwen Fin. Corp., *supra* note 21, at 4 (advances are “top of the waterfall” and get paid first); Wen Hsu, Christine Yan, Roelof Slump, FitchRatings, U.S. Residential Mortgage Servicer Advance Receivables Securitization Rating Criteria 1 (Sept. 10, 2009) (same); Prospectus Supplement, IndyMac, MBS, Depositor, IndyMac INDX Mortgage Loan Trust 2007-FLX5, at 71 (June 27, 2007) [hereinafter Prospectus Supplement, IndyMac et al.] (servicers repaid all advances when foreclosure is concluded); Letter from Kathy D. Patrick to Countrywide Home Loans Servicing, Oct. 18, 2010 (notifying a trust and master servicer of breaches in the master servicer's performance)..

<sup>28</sup>*See, e.g.*, Ocwen Fin. Corp. *supra* note 21 at 11 (“[I]n the majority of cases, advances in excess of loan proceeds may be recovered from pool level proceeds.”); Prospectus Supplement, IndyMac et al., *supra* note 27, at 71 (permitting principal and interest advances to be recovered from the trust's bank account); Prospectus, CWALT, INC., Depositor, Countrywide Home Loans, Seller, Countrywide Home Loans Servicing L.P., Master Servicer, Alternative Loan Trust 2005-J12, Issuer 47 (Oct. 25, 2005) (limiting right of reimbursement from trust account “to amounts received representing late recoveries of the payments for which the advances were made).

<sup>29</sup> *See, e.g.*, MONICA PERELMUTER, WAQAS SHAIKH & MICHAEL STOCK, STANDARD & POOR'S, CRITERIA: REVISED GUIDELINES FOR U.S. RMBS LOAN MODIFICATION AND CAPITALIZATION REIMBURSEMENT AMOUNTS 3 (Oct. 11, 2007); Jeremy Schneider & Chuye Ren, Standard & Poor's, Ratings Direct, *Analysis of Loan Modifications and Servicer Reimbursements for U.S. RMBS Transactions with Senior/Subordinate Tranches* (Apr. 10, 2008).

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<sup>30</sup> See Jeff Horwitz, *A Servicer's Alleged Conflict Raises Doubts About 'Skin in the Game' Reforms*, Am. Banker (Feb. 25, 2011).

<sup>31</sup>Cordell et al., *supra* note 24 at 17; *cf.* American Securitization Forum, Operational Guidelines for Reimbursement of Counseling Expenses in Residential Mortgage-Backed Securitizations (May 20, 2008), *available at* [http://www.americansecuritization.com/uploadedFiles/ASF\\_Counseling\\_Funding\\_Guidelines%205%2020\\_0\\_08.pdf](http://www.americansecuritization.com/uploadedFiles/ASF_Counseling_Funding_Guidelines%205%2020_0_08.pdf) (stating that payments of \$150 for housing counseling for borrowers in default or at imminent risk of default should be treated as servicing advances and recoverable from the general securitization proceeds).

<sup>32</sup>*See, e.g.*, Ocwen Fin. Corp., *supra* note 21 at 4.

<sup>33</sup>Marina Walsh, *Servicing Performance in 2007*, Mortgage Banking 72 (Sept. 2008).

<sup>34</sup>*See* Complaint ¶ 15, Fed'l Trade Comm'n v. Countrywide Home Loans, Inc., No. CV-10-4193 (C.D. Cal. Jun. 7, 2010), *available at* <http://www.ftc.gov/os/caselist/0823205/100607countrywidemcpt.pdf> (alleging that Countrywide's "countercyclical diversification strategy" was built on its subsidiaries funneling the profits from marked-up default fees back to Countrywide); Peter S. Goodman, *Homeowners and Investors May Lose, But the Bank Wins*, N.Y. Times, July 30, 2009; Peter S. Goodman, *Lucrative Fees May Deter Efforts to Alter Troubled Loans*, N.Y. Times, July 30, 2009; Letter from Kathy D. Patrick to Countrywide Home Loans Servicing, Oct. 18, 2010 (notifying a trust and master servicer of breaches in the master servicer's performance). Letter from Kathy D. Patrick to Countrywide Home Loans Servicing, Oct. 18, 2010 (notifying a trust and master servicer of breaches in the master servicer's performance).

<sup>35</sup>*In re* Stewart, 391 B.R. 327, 346 (Bankr. E.D. La. 2008), *aff'd*, 2009 WL 2448054 (E.D. La. Aug. 7, 2009); *see also* Complaint ¶ 18, *Fed'l Trade Comm'n v. Countrywide*, *supra* note 34 (alleging a subsidiary of Countrywide routinely marked up property preservation fees by 100%); Jeff Horwitz, *Ties to Insurers Could Land Mortgage Servicers in More Trouble: Force-Placed Policies Impose Costs on Both Homeowner, Investor*, Am. Banker, Nov. 10, 2010 (reporting on fee markups in force-placed insurance).

<sup>36</sup> *See, e.g.*, Jeff Horwitz, *Ties to Insurers Could Land Mortgage Servicers in More Trouble: Force-Placed Policies Impose Costs on Both Homeowner, Investor*, Am. Banker, Nov. 10, 2010.

<sup>37</sup>*See, e.g.*, Prospectus, CWALT, INC., Depositor, Countrywide Home Loans, Seller, Countrywide Home Loans Servicing L.P., Master Servicer, Alternative Loan Trust 2005-J12, Issuer 56 (Oct. 25, 2005) ("In addition, generally the master servicer or a sub-servicer will retain all prepayment charges, assumption fees and late payment charges, to the extent collected from mortgagors). *But see* Prospectus Supplement, IndyMac et al., *supra* note 27 at S-11 (late payment fees are payable to a certificate holder in the securitization).

<sup>38</sup>*See, e.g.*, Prospectus Supplement, IndyMac et al., *supra* note 27 at S-73:

#### Default Management Services

In connection with the servicing of defaulted Mortgage Loans, the Servicer may perform certain default management and other similar services (including, but not limited to, appraisal services) and may act as a broker in the sale of mortgaged properties related to those Mortgage Loans. The Servicer will be entitled to reasonable compensation for providing those services, in addition to the servicing compensation described in this prospectus supplement.

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<sup>39</sup>See *In re Stewart*, 391 B.R. 327, 343, n.34 (Bankr. E.D. La. 2008) (“While a \$15.00 inspection charge might be minor in an individual case, if the 7.7 million home mortgage loans Wells Fargo services are inspected just once per year, the revenue generated will exceed \$115,000,000.00.”), *aff’d*, 2009 WL 2448054 (E.D. La. Aug. 7, 2009); Complaint ¶ 15, *Fed’l Trade Comm’n v. Countrywide*, *supra* note 34.

<sup>40</sup>See, e.g., Ocwen Fin. Corp., *supra* note 21, at 34 (revenue from late charges reported as \$46 million in 2008 and made up almost 18% of Ocwen’s 2008 servicing income); Kurt Eggert, *Limiting Abuse and Opportunism by Mortgage Servicers*, 15 Housing Pol’y Debate 753, 758 (2004); Gretchen Morgenson, *Dubious Fees Hit Borrowers in Foreclosures*, N.Y. Times (Nov. 6, 2007) (reporting that Countrywide received \$285 million in revenue from late fees in 2006).

<sup>41</sup>See, e.g., Prospectus Supplement, Chase Funding Loan Acquisition Trust, Mortgage Loan Asset-Backed Certificates, Series 2004-AQ1, at 34, (June 24, 2004), *available at* <http://www.sec.gov/Archives/edgar/data/825309/000095011604003012/four24b5.txt> (“[T]he Servicer will be entitled to deduct from related liquidation proceeds all expenses reasonably incurred in attempting to recover amounts due on defaulted loans and not yet repaid, including payments to senior lienholders, legal fees and costs of legal action, real estate taxes and maintenance and preservation expenses.”); Letter from Kathy D. Patrick to Countrywide Home Loans Servicing, Oct. 18, 2010 (notifying a trust and master servicer of breaches in the master servicer’s performance).

<sup>42</sup>See Manuel Adelino, Kristopher Gerardi, and Paul S. Willen, Fed. Reserve Bank of Boston, *Why Don’t Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitizations* 6 (Public Pol’y Paper No. 09-4, July 6, 2009), *available at* <http://www.bos.frb.org/economic/ppdp/2009/ppdp0904.pdf>. (“In addition, the rules by which servicers are reimbursed for expenses may provide a perverse incentive to foreclose rather than modify.”). Under the Department of the Treasury’s Home Affordable Modification Program, servicers are required to waive unpaid late fees for eligible borrowers, but all other foreclosure related fees, including, presumably, paid late fees, remain recoverable and are capitalized as part of the new principal amount of the modified loan. See Home Affordable Modification Program, Supplemental Directive 09-01 (Apr. 6, 2009).

<sup>43</sup>Peter S. Goodman, *Lucrative Fees May Deter Efforts to Alter Troubled Loans*, N.Y. Times, July 30, 2009 (“So the longer borrowers remain delinquent, the greater the opportunities for these mortgage companies to extract revenue—fees for insurance, appraisals, title searches and legal services.”).

<sup>44</sup>See Katherine Porter, *Misbehavior and Mistake in Bankruptcy Mortgage Claims*, 87 Tex. L. Rev. 121 (2008) ; *Jones v. Wells Fargo Home Mortg. (In re Jones)*, 366 B.R. 584 (Bankr. E.D. La. 2007), *aff’d* *Wells Fargo v. Jones*, 391 B.R. 577, 595 (diversion” of mortgage payments to cover inspection charges led to increased deficiency and imperiled bankruptcy plan).

<sup>45</sup>See, e.g., Prospectus Supplement, IndyMac et al., *supra* note 27 at S-73 (noting that the servicer is entitled to retain the costs of managing the REO property, including the sale of the REO property).

<sup>46</sup>Peter S. Goodman, *Lucrative Fees May Deter Efforts to Alter Troubled Loans*, N.Y. Times, July 30, 2009.

<sup>47</sup>First American Core Logic Negative Equity Report Q22010, *available at* [http://www.corelogic.com/uploadedFiles/Pages/About\\_Us/ResearchTrends/CL\\_Q2\\_2010\\_Negative\\_Equity\\_FINAL.pdf](http://www.corelogic.com/uploadedFiles/Pages/About_Us/ResearchTrends/CL_Q2_2010_Negative_Equity_FINAL.pdf).

<sup>48</sup>*Preserving Homeownership: Progress Needed to Prevent Foreclosures: Hearing Before the Senate Comm. on Banking, Housing & Urban Affairs*, 111th Cong. 4–5 (July 16, 2009) (testimony of Paul Willen).

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<sup>49</sup>This is especially so since the HAMP modification program does not permit a second HAMP modification for any reason, even if there is a subsequent, unavoidable drop in income. *See* Making Home Affordable<sup>SM</sup> Program, Handbook for Servicers of Non-GSE Mortgages v.1.0, at 17 (2010).

<sup>50</sup>Roberto G. Quercia, Lei Ding, & Janneke Ratcliffe, Center for Community Capital, Loan Modifications and Redefault Risk: An Examination of Short-Term Impact (Mar. 2009), *available at* [http://www.ccc.unc.edu/documents/LM\\_March3\\_%202009\\_final.pdf](http://www.ccc.unc.edu/documents/LM_March3_%202009_final.pdf); Diane Pendley & Thomas Crowe, Fitch Ratings, U.S. RMBS Servicers' Loss Mitigation and Modification Efforts 9 (May 26, 2009), at 2, 10–11 (redefault rate is lowest for modifications with a greater than 20% principal reduction); Zhiqin Huang, Witold Czubala, Jipil Ha, Peter McNally, *Modified Current Loans Are Three Times as Likely to Default as Unmodified Current Loans*, Moody's Resi Landscape 9, 10 (Feb. 1, 2011); Hassan Shamji & Bulat Mustafin, *Measure of Modifications: A Look Across Servicers*, Moody's Resi Landscape 11, 12 (Feb. 1, 2011); Diane Pendley, Thomas Crowe, Stephanie Whited, Margaret Sweeney, Michael Laidlaw, Shasi Srikantan, Fitch Ratings, U.S. RMBS Servicers Loss Mitigation and Modification Efforts Update II at 16 (June 2010); ROD DUBITSKY, LARRY YANG, STEVAN STEVANOVIC & THOMAS SUER, CREDIT SUISSE, SUBPRIME LOAN MODIFICATIONS UPDATE 6-7 (2008); Andrew Haughwout, Ebiere Okah, and Joseph Tracy, Second Chances: Subprime Mortgage Modification and Re-Default (Fed. Res. Bank of NY Staff Reports No. 417, Aug. 2010), *available at* [http://www.newyorkfed.org/research/staff\\_reports/sr417.pdf](http://www.newyorkfed.org/research/staff_reports/sr417.pdf).

<sup>51</sup>*See, e.g.*, Bernanke, Speech at Federal Reserve, *supra* note 5 (“[P]rincipal write-downs may need to be part of the toolkit that servicers use to achieve sustainable mortgage modifications.”); James R. Hagerty, *Mortgage Mess Breeds Unlikely Allies*, Wall St. J. (Feb. 9, 2010) (quoting Laurie Goodman, senior managing director at mortgage-bond trader Amherst Securities Group LP, “Principal reduction is the only answer.”).

<sup>52</sup>National Consumer Law Center, *The Cost of Credit: Regulation, Preemption, and Industry Abuses* § 6.1 (4th ed. 2009), 11.6.6.

<sup>53</sup>*Preserving Homeownership: Progress Needed to Prevent Foreclosures: Hearing Before the Senate Comm. on Banking, Housing & Urban Affairs*, 111th Cong. (July 16, 2009) (testimony of Curtis Glovier, on behalf of the Mortgage Investors Coalition); *see also* Karen Weise, *When Denying Loan Mods, Servicers Often Wrongly Blame Investors*, ProPublica, July 23, 2010, <http://www.propublica.org/article/when-denying-loan-mods-loan-servicers-often-blame-investors-wrongly> (quoting managing director of brokerage securities firm as saying investors would prefer to see more modifications).

<sup>54</sup>*See* Karen Weise, *When Denying Loan Mods, Servicers Often Wrongly Blame Investors*, ProPublica, July 23, 2010, <http://www.propublica.org/article/when-denying-loan-mods-loan-servicers-often-blame-investors-wrongly> (quoting managing director of brokerage securities firm as saying investors would prefer to see more modifications).

<sup>55</sup>Comptroller of the Currency & Office of Thrift Supervision, OCC and OTS Mortgage Metrics Report: Disclosure of National Bank and Federal Thrift Mortgage Loan Data 25(3dQuarter 2010), [http://www.ots.treas.gov/\\_files/490058.pdf](http://www.ots.treas.gov/_files/490058.pdf) (reporting that of 289,226 permanent HAMP modifications made through September 30, 2010, 9537 involved principal reductions) (calculated by adding the number of modifications reported for each quarter, reported immediately underneath the date in the rightmost set of columns, and adding the number of modifications reported with principal reductions, as reported in the fifth row of the leftmost columns).

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<sup>56</sup> See American Securitization Forum, Discussion Paper on the Impact of Forborne Principal on RMBS Transactions 8-9 (June 18, 2009), *available at* [http://www.americansecuritization.com/uploadedFiles/ASF\\_Principal\\_Forbearance\\_Paper.pdf](http://www.americansecuritization.com/uploadedFiles/ASF_Principal_Forbearance_Paper.pdf).

<sup>57</sup> See Jeff Horwitz, *A Servicer's Alleged Conflict Raises Doubts About 'Skin in the Game' Reforms*, Am. Banker (Feb. 25, 2011).

<sup>58</sup> Comptroller of the Currency & Office of Thrift Supervision, OCC and OTS Mortgage Metrics Report: Disclosure of National Bank and Federal Thrift Mortgage Loan Data, 4th Quarter 2010 at 50 (2010), <http://www.ots.treas.gov/files/490069.pdf>.

<sup>59</sup> See Jeremy Schneider & Chuye Ren, Standard & Poor's, Ratings Direct, Analysis of Loan Modifications and Servicer Reimbursements for U.S. RMBS Transactions with Senior/Subordinate Tranches (Apr. 10, 2008) (indicating that servicer use of capitalization modifications to reimburse servicers for modification expenses is a suspect accounting practice and may subject the pool to a credit rating downgrade)..

<sup>60</sup> Zhiqin Huang, Witold Czubala, Jipil Ha, Peter McNally, *Modified Current Loans Are Three Times as Likely to Default as Unmodified Current Loans*, Moody's Resi Landscape 9, 10 (Feb. 1, 2011); Hassan Shamji & Bulat Mustafin, *Measure of Modifications: A Look Across Servicers*, Moody's Resi Landscape 11, 12 (Feb. 1, 2011) (“ If this capitalization is large enough, it can outweigh benign changes such as rate reductions and term extensions.”); Diane Pendley, Thomas Crow, Stephanie Whited, Margaret Sweeney, Michael Laidlaw, Shasi Srikantan, Fitch Ratings, U.S. RMBS Servicers Loss Mitigation and Modification Efforts Update II at 16 (June 2010); ROD DUBITSKY, LARRY YANG, STEVAN STEVANOVIC & THOMAS SUER, CREDIT SUISSE, SUBPRIME LOAN MODIFICATIONS UPDATE 6-7 (2008); Andrew Haughwout, Ebiere Okah, and Joseph Tracy, *Second Chances: Subprime Mortgage Modification and Re-Default* (Fed. Res. Bank of NY Staff Reports No. 417, Aug. 2010), *available at* [http://www.newyorkfed.org/research/staff\\_reports/sr417.pdf](http://www.newyorkfed.org/research/staff_reports/sr417.pdf).

<sup>61</sup> See Jeff Horwitz, *A Servicer's Alleged Conflict Raises Doubts About 'Skin in the Game' Reforms*, Am. Banker (Feb. 25, 2011).

<sup>62</sup> See, e.g., Complaint, *Merrigan v. Bank of New York*, No. 09-CA-05578 (Fla. Dist. Ct. App. Apr. 6, 2011), *available at* [https://www.aclu.org/files/assets/florida\\_foreclosure\\_20110407\\_0.pdf](https://www.aclu.org/files/assets/florida_foreclosure_20110407_0.pdf) (challenging Florida's foreclosure “rocket docket” on due process grounds).

<sup>63</sup> Office of the Comptroller of the Currency, Interpretive Letter No. 957 n.2 (Jan. 27, 2003) (citing OCC Advisory Letter 2002-9 (Nov. 25, 2002)) (viewed June 19, 2009, at <http://www.occ.treas.gov/interp/mar03/int957.doc>, and available at 2003 OCC Ltr. LEXIS 11).

<sup>64</sup> See, e.g., Office of the Comptroller of the Currency, Preemption Determination and Order, 68 Fed. Reg. 46,264, 46,264 (Aug. 5, 2003).

<sup>65</sup> 12 C.F.R. §§ 7.4007(c), 7.4008(e), 7.4009(c)(2).

<sup>66</sup> 12 C.F.R. § 7.4006 (OCC).

<sup>67</sup> *Watters v. Wachovia Bank, N.A.*, 127 S. Ct. 1559 (2007).

<sup>68</sup> Lauren Saunders, Nat'l Consumer L. Ctr., Preemption and Regulatory Reform: Restore the State's Traditional Role as “First Responder” 13 (Sept. 2009).

<sup>69</sup> See, e.g., Allen J. Fishbein & Patrick Woodall, Consumer Federation of America, *Exotic or Toxic? An Examination of the Non-Traditional Mortgage Market for Consumers and Lenders* (May 2006), *available at*

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[http://www.consumerfed.org/pdfs/Exotic\\_Toxic\\_Mortgage\\_Report0506.pdf](http://www.consumerfed.org/pdfs/Exotic_Toxic_Mortgage_Report0506.pdf); *Mortgage Lending Reform: A Comprehensive Review of the Current Mortgage System*, H. Subcomm. Fin. Institutions and Consumer Credit, H. Fin. Services Comm., at 7-10 (Mar. 11, 2009) (statement of Margot Saunders, Of Counsel, Nat'l Consumer L. Ctr.) (describing dangers of payment-option adjustable rate mortgages).

<sup>70</sup>Lauren Saunders, Nat'l Consumer L. Ctr., *Preemption and Regulatory Reform: Restore the State's Traditional Role as "First Responder"* 13 (Sept. 2009).

<sup>71</sup>Six of the top ten servicers in 2009 were national banks, whose primary regulator was the Office of the Comptroller of the Currency. Those six are Bank of America, Wells Fargo, Chase, Citi, U.S. Bank, and PNC Mortgage. Numbers 11 and 12 on the 2009 list, HSBC and Metlife, are also national banks. 1 *Inside Mortgage Finance*, The 2010 Mortgage Market Statistical Annual 174 (listing top 50 mortgage servicers in 2009).

<sup>72</sup>Comptroller of the Currency & Office of Thrift Supervision, OCC and OTS Mortgage Metrics Report: Disclosure of National Bank and Federal Thrift Mortgage Loan Data, 4<sup>th</sup> Quarter 2010 at 6 (2010) <http://www.ots.treas.gov/files/490069.pdf>.

<sup>73</sup>[http://www.freddiemac.com/singlefamily/service/mha\\_modification.html](http://www.freddiemac.com/singlefamily/service/mha_modification.html), last visited May 11, 2011.

<sup>74</sup>Dina ElBoghdady, *Amid mortgage mess, owners blindsided*, Wash. Post., Oct. 30, 2010, at A1.

<sup>75</sup>See also FAQ 1305, <https://www.efanniemae.com/sf/guides/ssg/relatedservicinginfo/pdf/hampfaqs.pdf>.

<sup>76</sup>Freddie Mac, Seller-Servicer Guide, C657.1.

<sup>77</sup>*Inside Mortgage Finance*, Apr. 29, 2011, at 4.

<sup>78</sup>Press Release, Federal Housing Finance Agency, *Fannie Mae and Freddie Mac to Align Guidelines for Servicing Delinquent Mortgages*, available at <http://www.fhfa.gov/webfiles/21190/SAI42811Final.pdf> (April 28, 2011).

<sup>79</sup>Many of these recommendations are similar to those discussed later in our views on national servicing standards but are stated here because they demonstrate the potential limitations in the FHFA alignment.

<sup>80</sup>Homeowners who fail any trial modification should be given a chance to repay the arrears through a term extension rather than through a lump sum payment.

<sup>81</sup>See, e.g., <http://www.occ.gov/news-issuances/news-releases/2011/nr-occ-2011-47.html>.

<sup>82</sup>See, e.g., Elizabeth Renuart, Odette Williamson & Mark Benson, *Foreclosure Prevention Counseling: Preserving the American Dream* 102-103 (2<sup>nd</sup> ed. 2009).

<sup>83</sup>See, e.g., *Problems in Mortgage Servicing From Modification to Foreclosure: Hearing Before the S. Comm. on Banking, Housing, & Urban Affairs*, 111th Cong. 28-29 (2010) (statement of Diane E. Thompson, Of Counsel, Nat'l Consumer Law Center).

<sup>84</sup>See Katherine Porter, *Misbehavior and Mistake in Bankruptcy Mortgage Claims*, 87 Tex. L. Rev. 121, 144-68 (2008) (reporting that servicers appear to be imposing often improper default-related fees on borrowers in bankruptcy proceedings).

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<sup>85</sup> As fees rise, they are added to the principal balance that must be repaid. The result often is that homeowners can no longer afford the monthly payment necessary to repay the loan. Additionally, servicers sometimes demand payment of these fees upfront, which request becomes impossible to satisfy as the fees mount into the thousands of dollars. Finally, many modification programs put a limit on how far in arrears a homeowner may be, including the capitalized fees. See, e.g., *Problems in Mortgage Servicing From Modification to Foreclosure, Part II: Hearing Before the S. Comm. on Banking, Housing, & Urban Affairs*, 111th Cong. 8 (2010) (statement of Donald Bisenius, Executive Vice President, Freddie Mac) (noting that it is harder to bring a borrower current the more delinquent the borrower is); *Problems in Mortgage Servicing From Modification to Foreclosure: Hearing Before the S. Comm. on Banking, Housing, & Urban Affairs*, 111th Cong. 10-11, 14 (2010) (statement of Diane E. Thompson, Of Counsel, Nat'l Consumer Law Center). Cf. Hassan Shamji & Bulat Mustafin, *Measure of Modifications: A Look Across Servicers*, Moody's Resi Landscape 11, 12 (Feb. 1, 2011) (noting that capitalization of fees can doom a modification to re-default).

<sup>86</sup> See *Problems in Mortgage Servicing From Modification to Foreclosure, Part II: Hearing Before the S. Comm. on Banking, Housing, & Urban Affairs*, 111th Cong. 8 (2010) (statement of Donald Bisenius, Executive Vice President, Freddie Mac) ("The dual track process enables the commencement of the foreclosure process, so that . . . the servicer can move forward with the foreclosure as expeditiously as possible . . ."). Cf. Diane Pendley, Kathleen Tillwitz, Karen Eissner, Thomas Crowe, Stephanie Whited, Fitch Ratings, *Rating U.S. Residential Mortgage Servicers 11-12* (2006) (discussing the importance of timelines for processing a foreclosure and a "parallel track" for loan modifications and foreclosures).

<sup>87</sup> Dina ElBoghdady, *Amid mortgage mess, owners blindsided*, Wash. Post., Oct. 30, 2010, at A1.

<sup>88</sup> See Alan M. White, Sept. 26, 2010 Columbia Collateral File Summary Statistics, [http://www.valpo.edu/law/faculty/awhite/data/sep10\\_summary.pdf](http://www.valpo.edu/law/faculty/awhite/data/sep10_summary.pdf).

<sup>89</sup> See, e.g., Jody Shenn, *Mortgage Investors with \$500 Billion Urge End of Practices, Lawyer Says*, Bloomberg News, July 23, 2010, <http://www.bloomberg.com/news/2010-07-23/mortgage-investors-with-500-billion-urge-end-of-practices-lawyer-says.html> (reporting on letters sent to trustees of mortgage pools on behalf of a majority of the investors in the pool); Letter from Kathy D. Patrick to Countrywide Home Loans Servicing, Oct. 18, 2010 (notifying a trust and master servicer of breaches in the master servicer's performance, including the imposition of excessive fees).

<sup>90</sup> Jeff Horwitz, *Ties to Insurers Could Land Mortgage Servicers in More Trouble: Force-Placed Policies Impose Costs on Both Homeowner, Investor*, Am. Banker, Nov. 10, 2010.

<sup>91</sup> Comptroller of the Currency & Office of Thrift Supervision, OCC and OTS Mortgage Metrics Report: Disclosure of National Bank and Federal Thrift Mortgage Loan Data, 4<sup>th</sup> Quarter 2010 at 6 (2010) <http://www.ots.treas.gov/files/490069.pdf>.

<sup>92</sup> See, e.g., Kristopher Gerardi, Christopher L. Foote, & Paul S. Willen, *Negative Equity and Foreclosure: Theory and Evidence* (Fed. Reserve Bank of Boston Pub. Pol'y Paper No. 08-3, June 2008); Andrey Pavlov & Susan Wachter, *Aggressive Lending and Real Estate Markets* (Dec. 20, 2006), available at <http://realestate.wharton.upenn.edu/newsletter/pdf/feb07.pdf>.

<sup>93</sup> HUD Mortgagee Letter 2008-32, October 17, 2008.

<sup>94</sup> See, e.g., *Problems in Mortgage Servicing From Modification to Foreclosure: Hearing Before the Senate Comm. on Banking, Housing & Urban Affairs*, 111th Cong. 29 (Nov. 16, 2010) (statement of Diane E. Thompson) (describing waiver in a PNC loan modification); *Preserving Homeownership: Progress Needed to Prevent Foreclosures:*

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*Hearing Before the S. Comm. on Bank., Hous. & Urban Affairs*, 111th Cong. 22 (July 16, 2009)(statement of Diane E. Thompson)(describing problems with waivers in HAMP modifications).

<sup>95</sup> Paul Kiel, *Borrowing Trouble: Some lenders are modifying mortgages only after homeowners waive their right to sue*, ProPublica, May 8, 2011, <http://www.slate.com/id/2293391/>.

<sup>96</sup> *Id.*

<sup>97</sup> *See, e.g., id.*

<sup>98</sup> *See, e.g., id.*

<sup>99</sup> While 57% of households with less than \$30,000 annual income access the internet from home, only 42% own a desktop computer and 38% a laptop computer. Jim Jansen, Pew Research Ctr., *Use of the Internet in Higher-Income Households*, 2, 9 (2010), *available at* <http://pewinternet.org/~media/Files/Reports/2010/PIP-Better-off-households-final.pdf>.

<sup>100</sup> *See* II.A.1, *supra*.

<sup>101</sup> Government Accountability Office, *Mortgage Foreclosures: Documentation Problems Reveal Need for Ongoing Regulator Oversight* (May 2011), *available at* <http://www.gao.gov/new.items/d11433.pdf>.

<sup>102</sup> *Problems in Mortgage Servicing From Modification to Foreclosure: Hearing Before the S. Comm. on Banking, Housing, & Urban Affairs*, 111th Cong. 8-17 (2010) (statement of Diane E. Thompson, Of Counsel, Nat'l Consumer Law Center).

<sup>103</sup> *See, e.g.,* *United States v. Sloan*, 505 F. 3d 685 (7<sup>th</sup> Cir. 2007); *United States v. Agboola*, 417 F. 3d 860 (8<sup>th</sup> Cir. 2005); *Vaughn v. Consumer Home Mortg.*, 293 F. Supp. 2d 206 (E.D. N.Y. 2003).

<sup>104</sup> *See generally* National Consumer Law Center, *Foreclosures* 3.2.2, 3.3..3, 3.4.2.5 (3d ed. 2010) (collecting cases involving FHA, VA, and RHS loans, respectively).

<sup>105</sup> *See, e.g.,* Amended Complaint, *Tone, et al., v. Vilsack*, No. 10-CV-00891 (S.D. Ohio Feb. 10, 2011) (allegations involving failure to enforce servicing requirements for RHS loans).