H.R. 5679, The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008

Written Testimony
of

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also on behalf of
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I. Introduction

Chairwoman Waters and members of the Subcommittee, thank you for inviting me to testify today regarding H.R. 5679, The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008. I am an attorney, currently of counsel to the National Consumer Law Center (NCLC).[1] Prior to joining NCLC, I was a Clinical Instructor at Harvard Law School where my practice focused on foreclosure prevention in the low-income communities of Boston.

I testify here today on behalf of the National Consumer Law Center's low-income clients. On a daily basis, NCLC 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.[2]

II. The Foreclosure Crisis Requires Substantial Action

We are facing the greatest foreclosure crisis since the Great Depression. As we know the statistics are grim. In February 2008, home foreclosures filings nationwide were up 60% over February 2007.[3] Nearly a quarter million properties were in some stage of foreclosure.[4] One in every 557 households faced the loss of their home.[5]

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[1] 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 sixteen practice treatises and annual supplements on consumer credit laws, including *Truth In Lending*, (5th ed. 2003) and *Cost of Credit: Regulation, Preemption, and Industry Abuses* (3d ed. 2005) and *Foreclosures* (1st ed. 2005), 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 Tara Twomey, Of Counsel, to NCLC.

[2] 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.

[3] Realty Trac, *New York City Foreclosure Activity Up 19 Percent In February* (Mar. 28, 2008), *available at* http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=4438&accnt=64847.

[4] *Id.* Foreclosure filings were reported for 1,285,873 discrete properties in 2007. *See* Realty Trac, U.S. Foreclosure Activity Up 75 Percent in 2007, *available at* http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=4303&accnt=64847.

[5] *Id.*

The trouble is not behind us. Foreclosures continue to surge in early 2008.[6] In both the prime and subprime markets, seriously delinquent[7] loans have continued to rise at an alarming rate, increasing two-fold since early 2006.[8] The figures for adjustable rate mortgages (ARMs) are more shocking. As the chart below demonstrates,[9] seriously delinquent ARMs have nearly quadrupled in the past two years. At the beginning of 2008, one in five subprime ARMs were more than 90 days late or in foreclosure. Nationwide, it is estimated that 2.2 million households with subprime mortgage loans have lost or will lose their home to foreclosure over the next several years.[10]

YEAR	**SERIOUSLY DELINQUENT ARMS: PRIME**	**SERIOUSLY DELINQUENT ARMS: SUBPRIME**
2006	Q1: .82 Q2: .92 Q3: 1.14 Q4: 1.45	Q1: 6.28 Q2: 6.52 Q3: 7.72 Q4: 9.16
2007	Q1: 1.66 Q2: 2.02 Q3: 3.12 Q4: 4.22	Q1: 10.13 Q2: 12.40 Q3: 15.63 Q4: 20.43

The consequences of this foreclosure crisis have not only ripped through Wall Street, they are taking a heavy toll on Main Street. Abuses in the subprime market have undermined the efforts of hardworking families to acquire and retain the dream of homeownership. Instead of building wealth, families are losing equity.[11] Renters suffer, too, as lenders quickly evict

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6 *See* Chris Reidy*, 2008 could be even worse for local foreclosures*, Boston Globe (Mar. 28, 2008)(estimating 2008 foreclosures to be at least 15 to 25 percent higher than the historic highs reached in 2007), *available at* http://www.boston.com/business/ticker/2008/03/report_2008_wil.html#

7 Seriously delinquent loans includes loans that are at least 90 days delinquent plus the loans in foreclosure inventory.

8 The seriously delinquent rate for subprime loans, both fixed and adjustable in the first quarter of 2006, was 6.22%. By the end of 2007 that number had grown to 14.44%. Similarly, in the prime market the number of seriously delinquent loans has climbed from .77% in the first quarter of 2006 to 1.67% in the last quarter of 2007.

9 This chart contains data from the Mortgage Banker's Delinquency Survey for each of the quarters listed.

10 Ellen Schlomer, et al., *Losing Ground, Foreclosures in the Subprime Market and Their Cost to Homeowners*, Center for Responsible Lending (Dec. 2006) at 3.

11 *Id.* (estimating that foreclosures will cost homeowners as much as $164 billion, primarily in lost home equity).

tenants from foreclosed homes.[12] More and more Americans are being driven into bankruptcy.[13] And, neighborhoods are deteriorating as foreclosed homes are boarded up and left vacant.[14] Crime in high-foreclosure neighborhoods is on the rise.[15] Overgrown lawns and trash-strewn yards symbolize growing community abandonment and disinvestment.[16]

Numerous strategies have been proposed to address the current foreclosure crisis and its consequences. Loan modification consistently has been identified as one of the preferred strategies. Despite the potential benefits of loan modifications, the magnitude of the foreclosure crisis dwarfs the current response from the financial services industry.

III. Voluntary Loan Modifications Are Insufficient To Stem the Rising Tide of Foreclosures

A loan modification is a written agreement between the loan servicer and the homeowner that changes one or more of the original terms of the note in order to help the homeowner bring a defaulted loan current and prevent foreclosure. Loan modifications may be short-term (less than 5 years), long-term (more than 5 years), or for the life of the loan. Modifications may reduce the interest rate or principal amount of a mortgage loan, may change the mortgage product (for example, from an adjustable rate to a fixed rate), may extend the term of the loan, or may capitalize delinquent payments. While not a panacea for all that is ailing in the subprime mortgage market, long-term, sustainable loan modifications can provide significant relief to the nation's distressed homeowners.

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[12] It is estimated that 18% of the foreclosure started in the third quarter 2007 were not occupied by the owners. *See* Brinkmann, *infra* note 30 at 10. *See also* Testimony of Sheila Crowley to the Financial Services Committee, U.S. House of Representatives (April 10, 2008)(discussing the affects of the foreclosure crisis on renters), *available at* http://www.house.gov/apps/list/hearing/financialsvcs_dem/crowley041008.pdf; John Leland, *As Owners Feel Mortgage Pain, So Do Renters, New York Times* (Nov. 18, 2007);

[13] More than 90,000 consumer bankruptcies were filed during March 2008. This represents a 30% increase over filings from March 2007, and the highest number of filings since October 2005 when significant amendments to the Bankruptcy Code became effective. Bill Rochelle and Bob Willis, *Bankruptcies Jump 30% in March, Led by Housing-Bust States*, Bloomberg (Apr. 5, 2008), *available at* http://www.bloomberg.com/apps/news?pid=20601087&sid=aw8ifLmYMFlI&refer=home

[14] *See* Letter, Senator Dodd to Senator Reid (Jan. 22, 2008)(describing cycle of disinvestment, crime, falling property values and property tax collections resulting from foreclosures), *available at* http://dodd.senate.gov/multimedia/2008/012308_ReidLetter.pdf; Brad Heath and Charisse Jones, *Mortgage defaults force Denver exodus*, USA Today (Apr. 1, 2008)(in some Denver neighborhoods as many as one-third of residents have lost their homes).

[15] *See, e.g.,* J.W. Elphinstone, *After foreclosure, crime moves in*, Boston Globe (Nov. 18, 2007)(describing Atlanta neighborhood now plagued by house fires, prostitution, vandalism and burglaries).

[16] *See* Daphne Sashin and Vicki Mcclure, *Foreclosure leave painful ripple effect*, Orlando Sentinel (Oct. 15, 2007)(describing a once safe neighborhood now dotted with empty homes and overgrown lawns).

For nearly a year now, the financial services industry has been encouraged to meet this growing foreclosure crisis by scaling-up voluntary loan modifications efforts. In May 2007, Senate Banking Committee Chairman Dodd announced a set of servicing principles aimed at long-term affordability.[17] Those principles called, in part, for loan modifications that would "create a solution for the borrower to ensure that the loan is sustainable for the life of the loan."[18] In June 2007, Chairman Sheila Bair of the FDIC called for automatic loan modifications for borrowers with subprime ARMs.[19] Like Senator Dodd's servicing principles, Chairman Bair emphasized the importance of providing sustainable loan modifications. A report from the Joint Economic Committee also suggested that automatic loan modifications were needed.[20] In September 2007, the federal and state banking regulators issued a joint statement on loss mitigation strategies, referencing earlier guidance and encouraging use of loss mitigation authority available under pooling and servicing agreements.[21] In October 2007, Treasury Secretary Paulson sought voluntary commitments from servicers to contact borrowers and explore new loan modification approaches.[22] Then in December 2007, Secretary Paulson announced a plan for "fast track" loan modifications.[23]

Despite widespread efforts to encourage voluntary loan modifications, it is clear that the financial services industry has failed to implement a loan modification strategy on a scale commensurate with the problem. As Chairman Bair recently acknowledged, "[w]hile voluntary loan modifications have shown significant progress, at this point, it must be

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[17] Senator Dodd Unifies Industry Members, Consumer Representatives to Help Preserve the American Dream of Homeownership (May 2, 2007), *available at* http://dodd.senate.gov/index.php?q=node/3863/print

[18] Homeownership Preservation Summit Statement of Principles (May 2, 2007), *available at* http://dodd.senate.gov/multimedia/2007/050207_Principles.pdf.

[19] Remarks of FDIC Chairman Sheila C. Bair, American Securitization Forum (ASF) Annual Meeting (June 6, 2007).

[20] *The Subprime Lending Crisis: The Economic Impact on Wealth, Property Values and Tax Revenues, and How We Got Here*, Report and Recommendations by the Majority Staff of the Joint Economic Committee (Oct. 2007)(one of the key policy recommendations put forth in the report was to direct servicers and lenders to make safe and sustainable loan modifications).

[21] Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages (Sept. 2007), *available at* http://www.occ.treas.gov/ftp/bulletin/2007-38a.pdf.

[22] Associated Press, *Paulson to Mortgage Industry: Help Curb Defaults* (Oct. 31, 2007), *available at* http://money.cnn.com/2007/10/31/real_estate/paulson_housing.ap/.

[23] American Securitization Forum, "Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans", Executive Summary (Dec. 6, 2007), *available at* http://www.treas.gov/press/releases/hp706.htm.

acknowledged that the pace has not been sufficient to achieve the scale necessary to contain broader harm to communities and our economy."[24]

Housing counselors, attorneys and borrowers still report major problems in seeking loan modifications for unaffordable loans. In September 2007, Moody's Investor Services surveyed 16 mortgage servicers that accounted for 80 percent of the market for subprime loans and found that most of those companies had modified only about 1 percent of loans with interest rates that reset in January, April and July 2007.[25] In a December 17, 2007 update, Moodys reported that the number had only slightly increased to 3.5%.[26]

In October 2007, the California Reinvestment Coalition surveyed 33 percent of the California's mortgage counseling agencies that offer assistance to financially distressed borrowers and found that servicers were not consistently modifying loans for long-term affordability.[27] Instead most borrowers were being pushed into foreclosure or short sales.

The data available thus far support the conclusion that little is being done by the financial services industry to help homeowners facing foreclosure. The HOPE NOW program issued its first data in early 2008.[28] Although touted as showing substantial improvement, the HOPE NOW report actually demonstrates that little progress has been made. The same can be said about the Mortgage Bankers Association's report on loan modifications issued in January 2008.[29] Both reports confirm that servicers are relying heavily on repayment plans

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[24] Statement of Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation on Using FHA for Housing Stabilization and Homeownership Retention, Testimony before the Committee on Financial Services, U.S. House of Representatives (Apr. 9, 2008).

[25] Michael P. Drucker, et al., *Moody's Subprime Mortgage Servicer Survey on Loan Modifications*, Moody's Investor Services (Sept. 21, 2007), *available at* http://americansecuritization.com/uploadedFiles/Moodys_subprime_loanmod.pdf.

[26] Moody's, *U.S. Subprime Market Update: November 2007, Structured Finance, Special Report* (Nov. 2007). The Moody's report provides detailed definition of "workout agreements," however, it does not distinguish between short-term, long-term and life-of-loan modifications.

[27] California Reinvestment Coalition, *Survey Results Show Lenders not Helping Borrowers Keep their Homes* (October 10, 2007), *available at* http://www.calreinvest.org/news-room/2007-10-10.

[28] *See* HOPE NOW: Results in Helping Homeowners (Feb. 2008)(data covers 18 servicers representing 2/3 of the industry), *available at* http://www.fsround.org/hope_now/pdfs/JanuaryDataFS.pdf. The HOPE NOW data covers the period from July 1, 2007 to January 31, 2008. ***See also*** HOPE NOW Alliance Servicers, Prime and Subprime Residential Mortgages: 2007 Loss Mitigation Activities (February 2008), *available at* http://www.fsround.org/media/pdfs/NationaldataFeb.pdf.

[29] Jay Brinkmann, An Examination of Mortgage Foreclosures, Modifications, Repayment Plans and other Loss Mitigation Activities in the Third Quarter of 2007, Mortgage Bankers Association (Jan. 2008), *available at* http://www.mortgagebankers.org/files/News/InternalResource/59454_LoanModificationsSurvey.pdf.

rather than loan modifications. Repayment plans require homeowners to make increased monthly payments to cure arrears. They do not address payment affordability problems caused by high interest rates and resets.

The MBA report finds that in the third-quarter of 2007, mortgage servicers worked out 183,000 repayment plans and 54,000 loan modifications,[30] while starting 384,000 new foreclosures.[31] Repayment plans outnumbered loan modifications by an 8 to 1 ratio for subprime ARMs as compared with 3 to 1 for all mortgages. Clearly, the "mortgages most in need of modifications are being modified the least."[32] For the HOPE NOW participants, repayment plans also outnumbered loan modifications by a ratio of almost 3 to 1.[33] The most recent HOPE NOW press release heralded an increase in the loan modification rate for subprime loans in January and February 2008.[34] However, a close look at the numbers show that only 4% of borrowers with outstanding subprime ARMs resetting during that period received loan modifications lasting five or more years.[35] Three weeks ago Fitch released its revised loss expectations for 2006 and 2007 subprime loans.[36] The report finds that "[d]espite initial indications of growing borrower participation in the streamlined modification and other outreach loan workout programs initiated by the Hope Now

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30 Notably, the MBA does not distinguish between short-term modifications, such as 6-month interest rate freezes, and long-term or life of loan modifications. There is presently little data available on the types of modifications servicers are providing. However, anecdotal information suggests that a majority of "modifications" are short-term, often providing interest-rate freezes for a period of six month to two years.

31 *See* Brinkmann, *supra* note 29 (Table 9)

32 Comments of Professor Alan M. White, Valparaiso University School of Law, *Mortgage Modifications: More Data*, January 17, 2008, available at: http://pubcit.typepad.com/clpblog/2008/01/mortgage-modifi.html.

33 Press Release: HOPE NOW New Data Released : More Than Half-Million Subprime Mortgage Holders Helped, (Feb. 6, 2008), *available at* http://www.fsround.org/hope_now/pdfs/10-6FebruaryRelease.pdf. The February HOPE NOW report indicates that for subprime ARMs repayment plans outnumbered loan modification by a 2 to 1 ratio. The discrepancy between the subprime numbers in the HOPE NOW report (2 to 1) and the higher ratio in the MBA report (8 to 1) likely results from less robust data collection by the HOPE NOW Alliance from subprime loan servicers. Fully one-third of the servicing industry has opted-out of the HOPE NOW initiative. *See* HOPE NOW: Results in Helping Homeowners (Feb. 2008)(data covers 18 servicers representing 2/3 of the industry), *available at* http://www.fsround.org/hope_now/pdfs/JanuaryDataFS.pdf.

34 Press Release, HOPE NOW: Servicers Provided Nearly 1.2 million Loan Workouts Since July '07, *available at* http://www.hopenow.com/media/press_releases/pdf/25-3_April_Release.pdf.

35 The HOPE NOW press release states that 140,652 subprime 2/28 and 3/27 loans were scheduled to adjust in January or February 2008. Of that number, 60,000 were paid in full through refinancing or sale leaving 80,652 outstanding loans. Of these remaining loans, 5,607 loans were modified and 60% (3,334) of those loans were modified for a period of five or more years.

36 Fitch Ratings, *Structured Finance: Revised Loss Expectations for 2006 and 2007 Subprime Vintage Collateral* (Mar. 25, 2008).

Alliance…Fitch has seen little evidence to date that these alternatives have helped mitigate foreclosure rates."

Repayment plans and short-term modifications do not solve homeowners' long-term affordability problems. The MBA report demonstrates that repayment plans are ineffective at solving the serious foreclosure problems associated with subprime loans. Of the foreclosures started in the third quarter of 2007, 40% were on subprime ARMs, and 37% were on subprime fixed rate loans, in which the borrower had failed on a repayment plan.[37]

In response to limited voluntary loan modifications to date, Chairmen Frank and Dodd have proposed similar plans to refinance unaffordable loans through the Federal Housing Administration. Like previous calls for large-scale loan modifications, the focus of these FHA refinancing programs is on ensuring affordable and sustainable homeownership. And, like previous calls for loan modifications, servicer/lender participation in the program is *voluntary*.

We appreciate Congressional leadership on this issue and this Committee's continuing persistence in seeking solutions to the foreclosure crisis. While voluntary measures may be able to help some borrowers, structural barriers inherent in the mortgage servicing industry hamper the effectiveness of voluntary programs. Accordingly, we believe that an essential component of any mortgage crisis solution involves enhanced obligations on the part of servicers to communicate with borrowers and seek reasonable loss mitigation prior to foreclosure.

IV. The Servicing Industry Is Fundamentally Broken When It Comes To Meeting The Needs of Borrowers.

Mortgage servicers provide the critical link between mortgage borrowers and the mortgage owners. Since the 1990s, mortgage servicing has become an increasingly specialized and lucrative industry, driven in part by the need for one party to coordinate the distribution of mortgage revenues to the investors in securitized loans. The rights to service mortgage loans are routinely sold or transferred independently of the loans themselves. The servicers' goals in managing loans are generally two-fold: 1) to maximize its own profits and 2) to maximize the returns to the owner of the loan.[38]

[37] *See* Brinkmann, *supra* note 29 (Tables 2 and 3).
[38] When loans are in default these goals may be in conflict as the servicer's attempts to minimize its cost and maximize its revenues may not result in the highest possible returns to investors.

Servicers are generally responsible for account maintenance activities such as sending monthly statements, accepting payments, keeping track of account balances, handling escrow accounts, calculating interest rate adjustments on adjustable rate mortgages, reporting to national credit bureaus, and remitting monies to the owners of the loans. Servicers also are responsible for engaging in loss mitigation activities and prosecuting foreclosures.

Despite the important functions of mortgage servicers, borrowers have few market mechanisms to employ to ensure that their needs are met. While borrowers must be notified about any change in servicer,[39] they cannot choose the servicer that handles their loan or change servicers if they are dissatisfied. Recent headlines and court decisions around the country have called into question servicer and holder conduct with respect to borrowers in default.[40] For some time now homeowners and consumer advocates have struggled with servicers who have no interest in helping families stay in their homes. Rather, in the interest of maximizing profits servicers have engaged in a laundry list of bad behavior and exacerbated foreclosure rates.[41] The most common abuses in loan servicing include misapplication of payments, use of suspense accounts, failure to make timely escrow disbursements, and cascading fees imposed upon homeowners in default.[42] These abuses exist because there are market incentives, rather than deterrents, for this type of behavior.[43]

A. Voluntary Loan Modifications Are Hampered By Industry Structure

Cutting Cost, Cutting Service. As with all businesses, servicers add more to their bottom line to the extent that they can cut costs. Servicers have cut costs by relying more on voicemail systems and less on people to assist borrowers, by refusing to respond to borrowers' inquires and by failing to resolve borrower disputes. Recent industry efforts to "staff-up" loss mitigation departments have been woefully inadequate. As a result, servicers remain unable to provide affordable and sustainable loan modifications on the scale needed

[39] *See* 12 U.S.C. § 2605 (detailing transfer notice requirements).
[40] *See, e.g.,* Gretchen Morgensen, *Dubious Fees Hit Borrowers in Foreclosures,* New York Times (Nov. 6, 2007); Porter, Katherine M., *Misbehavior and Mistake in Bankruptcy Mortgage Claims* (November 6, 2007). University of Iowa College of Law Legal Studies Research Paper Series Available at SSRN: http://ssrn.com/abstract=1027961 (describing the systematic failure of mortgage servicers to comply with bankruptcy law and fees and charges that are poorly identified and do not appear to be reasonable); *In re Foreclosure Cases*, 2007 WL 3232430 (October 31, 2007)(dismissing 14 foreclosure cases because purported holder could not demonstrate ownership of the loan at the time the foreclosure action were filed).
[41] *See* National Consumer Law Center, *Foreclosures*, Ch. 6 (2d ed. 2007)(describing the most common mortgage servicing abuses).
[42] *Id.*
[43] *See* Kurt Eggert, *Comment on Michael A. Stegman et al.'s "Preventive Servicing Is Good Business and Affordable Homeownership Policy": What Prevents Loan Modifications?,* 18 Housing Pol'y Debate 279 (2007).

to address the current foreclosure crisis. Instead borrowers are being pushed into short-term modifications and unaffordable repayment plans. These "kick the can" approaches to solving the foreclosure crisis do not provide real solutions for those affected borrowers. Instead, they merely postpone the day of reckoning.[44]

Obtaining Timely, Accurate and Consistent Information Is Difficult. The widespread use of automated voice response systems and the decline in "live" assistance for borrowers may improve the servicers' profits, but it is enormously frustrating and counterproductive for borrowers in need of help. 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. Stories abound of exasperated homeowners attempting to navigate vast voice mail systems, being bounced around from one department to another, and receiving contradictory information from different servicer representatives.[45] For example, an October 2007 survey from the Neighborhood Housing Services of Chicago found that "countless counselors shared stories of having a client in the office ready to begin dealing with long-deferred financial problems, but then having to wait 30 minutes or more in order to talk to an appropriate loss mitigation staff person."[46] Unfortunately, things have not improved in recent months as servicers struggle to keep up with the increased workload caused by the foreclosure crisis.[47]

Finding a Decision Maker Is Not Straightforward. Borrowers have no ability to call upon the owners of their loans to make decisions about loss mitigation options. In fact, most borrowers do not know who owns their loan and find it difficult to discover the true owner.

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[44] *See* Brinkmann, *supra* note 30 (Tables 2 and 3 showing that a large number of foreclosures result from failed repayment plans).

[45] *See, e.g.,* Gretchen Morgensen, *Can These Mortgages Be Saved?,* New York Times (Sept. 30, 2007)(describing one homeowner who identified 670 calls relating to her home foreclosure in the previous three months and who received nine different answers about how best to proceed from 14 different people at the company); *Miller v. McCalla*, Raymer, 214 F.3d 872, 875 (7th Cir. 2000)(describing the process of trying to get through to an 800 number as a "vexing and protracted undertaking").

[46] Neighborhood Housing Services of Chicago, Inc., *Lessons from the Front Lines: Counselor Perspectives on Default Intervention*, p.6 (Oct. 29, 2007).

[47] *See* Kate Berry, *The Trouble with Loan Repayment Agreements*, American Banker (Jan. 9, 2008)(noting that servicers push repayment plans instead of modifications because they "need twice the staff, and in part they can't manage the volume").

Instead, borrowers are forced to rely on middlemen—the servicers.[48] Even if borrowers can get through to a servicer representative, there may be no one within the servicer operation who has the authority to negotiate a loan modification. In a response to FDIC Chairwoman Bair's call for automated loan modifications, the Consumer Mortgage Coalition described a structure devoid of decision-makers.[49] For private securitizations, the CMC complained that there is simply no active manager the servicer can call to get approval on a loan modification or a waiver of restrictions on modifications found in the pooling and servicing agreements (PSAs). The CMC stated: "While this passive structure may appear to give the servicer more discretion, in fact, because of the lack of an active decision-maker from which the servicer could obtain waivers of the usual requirements, no entity exists with the authority to grant waivers." An industry structure that provides no decision maker to deal with loan modifications is of little value to financially distressed borrowers trying to save their homes from foreclosure.

Unanswered Requests and Unresolved Disputes Are the Norm. Responding to borrowers' written requests for information or written disputes is also time-consuming and costly for servicers. Currently, the Real Estate Settlement Procedures Act (RESPA) requires servicers to respond to such requests within 60 days.[50] However, anecdotally consumer advocates describe large-scale non-compliance with this RESPA requirement. Borrowers' remedies for the servicers' disregard are limited. As a result, many borrowers' requests simply go unanswered.[51] In fact, under current law, even if borrowers dispute the servicers' loan accounting, servicers may nevertheless continue a foreclosure proceeding without resolving the dispute.[52] It appears that the cost of compliance outweighs the cost of non-compliance.

Getting to Affordable Loan Modifications Takes Work. Creating affordable and sustainable loan modifications for distressed borrowers is labor intensive.[53] The borrower's financial circumstances must be evaluated. Property valuations and debt service levels must be

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[48] See In re Schuessler, No. 07-35608 (Bankr. E.D.N.Y. April 10, 2008)(describing conflicting pleadings and testimony regarding the true owner of the note; "It is not possible to tell from any of the documents submitted, or from testimony whether or not JPMorgan Chase Bank is still the owner of the Note, whether the Note was sold to Chase Home Finance, or someone else, or whether Chase Home Finance is the Loan Servicer, the purchaser of the Note, or something else.").

[49] Sam Garcia, *Group Warns on Large Scale Modifications: Consumer Mortgage Coalition sends letters to the FDIC*, Mortgage Daily News (Oct. 9, 2007).

[50] 12 U.S.C. § 2605(e).

[51] See, e.g., Maxwell v. Fairbanks Capital Corp., 281 B.R. 101 (Bankr. D. Mass. 2002).

[52] Reg. X, 24 C.F.R. § 3500.21(e)(4)(ii)(servicer not prohibited from pursuing collection activities during 60-day response period).

[53] Joseph R. Mason, *Mortgage Loan Modification: Promises and Pitfalls*, at 7(Oct. 3, 2007), *available from SSRN at* papers.ssrn.com/sol3/papers.cfm?abstract_id=1027470.

considered. In many respects, reaching affordable results requires servicers to requalify the loan.[54] Under many pooling and servicing agreements, additional labor costs incurred by servicer's engaged this process are not compensated by the loan owner. By contrast, most servicers are reimbursed for costs associated with foreclosure. Under this cost and incentive structure, it is no surprise that servicers continue to push borrowers into less labor-intensive repayment plans or towards foreclosure. As Moody's has noted "[i]t is not advantageous to modify a loan without knowing if the borrower can afford the modified obligations. If they can't, it may simply serve to postpone an eventual foreclosure and increase, rather than decrease, the ultimate loss on the loan."[55] Despite this obvious proposition, the financial services industry continues to oppose a duty to consider affordable alternatives to foreclosure.

B. Maximizing Income is a Servicer's Main Goal

Unpaid Principal Loan Balance Is the Key to Servicer Income. Customarily, the servicer collects a monthly fee in return for the services provided to the trust (or investors). The servicing fee is the largest of the three income streams for servicers. The fee is based on the unpaid principal loan balance and typically ranges from 25 basis points (prime loans) to 50 basis points (subprime loans). A PSA with a 50 basis point servicing fee and a principal balance of $2 billion would result in a servicing fee of just over $9.5 million per year. Reductions in principal cut directly into the servicers' primary source of income. It is no wonder that "[t]o date, permanent modification that have occurred typically involved a reduction in the interest rate, while reductions of principal balance have been quite rare."[56] Chairman Bernanke recently speculated that servicers preference for interest rate reductions could reflect greater familiarity with that technique.[57] More likely, however, it is basic economic principles driving choices in loss mitigation techniques.

Unreasonable and Unearned Fees Boost Servicer Income. Ancillary fees are imposed on borrowers to compensate servicers for the occurrence of particular events. The most common ancillary fee is a late fee, although a variety of other "servicer" fees exist. Such fees are a crucial part of the servicers' income because servicers are typically permitted under PSAs to retain such fees. Ocwen Financial Corporation reported that in 2007 nearly 12%

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[54] Moody's, *U.S. Subprime Mortgage Market Update* (Apr. 2007), *available at* http://www.americansecuritization.com/uploadedFiles/US%20Subprime%20Mortgage%20Market%20Update%20%20April%202007.pdf
[55] *Id.* at 3.
[56] Chairman Ben S. Bernanke, *Reducing Preventable Mortgage Foreclosures* (Mar. 4, 2008), *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20080304a.htm.
[57] Id.

(just over $40 million) of its servicing income was derived from late fees and other loan collection fees.[58] In 2006, Countrywide reported $285 million in revenue from late fees alone.[59] Because servicers are permitted to retain these ancillary fees, they have a strong incentive to charge borrowers as much in fees as they can. Just one improper late fee of $15 on each loan in one average size loan pool (3500 loans) would generate an additional $52,500 in income for the servicer. The profit potential of retained fee income gives servicers a financial incentive to overreach in imposing ancillary fees and to load up accounts with such fees even when doing so may lower the ultimate return to investors.

C. New Opportunities for Abuse Must Be Curbed.

Loan modifications present new opportunities for servicer abuse. The information asymmetry often critiqued in the loan origination context is even worse in the loss mitigation process.[i] The disclosure of information is entirely one-sided. The borrower is required to provide much of the same documentation related to their financial status as is required (or should have been required) at the origination stage. The servicer produces nothing except a "take-it-or-leave-it" agreement.

Often loan modification or forbearance agreements contain a waiver of claims provision that purports to release the servicer and holder from any past or future claims that the borrower may have. For example, in a December 2007 case from North Carolina, Ocwen Federal Bank asserted that the borrower's claims should be dismissed because she released "all of her claims against Ocwen Federal" when she entered into a forbearance agreement.[60] Similarly, in a recently reviewed forbearance agreement the borrower upon execution of the agreement released the "lender" from any claims or damages, including those that were unknown, including "tort claims, demands, actions and causes of action of any nature whatsoever arising under or relating to the Loan Documents or any of the transactions related thereto, prior to the date hereof, and borrowers waive application of California Civil Code Section 1542."[ii] Broad release language potentially cuts off all claims the borrower may have related to the origination or servicing of the loan and is simply inappropriate in the context of a loan modification or forbearance agreement.

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[58] Ocwen Financial Corporation, Form 10-K (March 13, 2008), at 27 available at http://www.sec.gov/Archives/edgar/data/873860/000101905608000419/ocn_10k07.htm

[59] *See* Gretchen Morgenseon, *Dubious Fees Hit Borrowers in Foreclosures*, New York Times (Nov. 6, 2007).

[60] *See In re Tetterton*, 379 B.R. 595 (Bankr. E.D.N.C. 2007).

V. H.R. 5679 Aligns Mortgage Servicers' Interests with Those of Homeowners Seeking to Prevent Foreclosure.

Because of systemic problems in the mortgage servicing industry, large-scale, affordable loan modifications are an aspiration rather than a reality. We applaud the Chairwoman for recognizing these industry shortcomings and proposing a bill that will align mortgage servicers' interests with those of borrower trying to save their homes.

Mandating Borrower Access to a Decision Maker. 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. H.R. 5679, section 2(a) requires mortgage servicers to provide borrowers with contract 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 Information and Dispute Resolution Prior to Foreclosure. While the Real Estate Settlement Procedures Act currently requires servicers to respond to borrowers' request for information and disputes within 60 days, in practice many such inquires go unanswered. Despite this failure to respond, servicers are still permitted to proceed to collection activities, including foreclosure. H.R. 5679 ensures that borrowers facing foreclosure are no longer at the mercy of their servicer. Section 2(c) provides transparency to the servicing process by allowing the homeowner to obtain key information about the loan and its servicing history. The section also prohibits a servicer from initiating or continuing a foreclosure proceeding during the period in which an outstanding request for information or dispute is pending.

Getting to Affordable Loan Modifications Takes Work. Creating affordable and sustainable loan modifications for distressed borrowers is labor intensive. It is no surprise, then, that servicers continue to push borrowers into less costly repayment plans and short-term modifications. H.R. 5679 would align mortgage servicer incentives with those of the homeowner seeking to prevent a foreclosure. Section 2(a) of the bill creates a duty to provide reasonable loss mitigation prior to any foreclosure and prioritizes "home-saving" loss mitigation options over those that result in loss of the home. Any loss mitigation must be based on an affordability analysis that considers the borrowers debt to income ratio and residual income—to ensure enough actual dollars for non-housing expenses—as well inclusion of the borrower's full debt profile, including junior liens on the property.

Curbing Opportunities for Abuse. Loan modification or forbearance agreements often contain a waiver of claims provision that purports to release the servicer and holder from any past or future claims that the borrower may have. Broad release language potentially cuts off all claims the borrower may have related to the origination or servicing of the loan and is inappropriate in the context of a loan modification or forbearance agreement. H.R. 5679, Section 2(a) nips this pernicious practice in the bud by banning such waiver of rights in loan modification or forbearance agreements. The section also prohibits the equally abusive practice of forcing borrowers to arbitrate any disputes with the lender or servicer.

VI. Conclusion

The foreclosure crisis is real, it is big, and it is growing. To date, the financial industry has failed to voluntarily scale up their loss mitigation activities to address the magnitude of the problem. The structure of the mortgage servicing industry is simply not designed to meet the needs of borrowers. Borrowers need to have access to someone that can provide timely and reliable information about their loans. Borrowers need to be able to discuss their situations with someone that has authority to make necessary loan modifications. And, borrowers need some protection from the abusive behavior of servicers. A right to reasonable loss mitigation that promotes home-saving options over home-losing options is not too much to ask from an industry that has failed to implement sufficient voluntary measures. Without a bill such as H.R. 5679 that aligns the interest of mortgage servicers and borrowers, we are unlikely to see any real progress in the numbers of affordable and sustainable loan modifications. We look forward to working with Representative Waters and the Committee to help financially distressed borrowers save their homes.

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[i] *See* Mason, *supra* note 53, at 9-10 (noting that the modification proposal and acceptance by the consumer are not required to generate any of the records, disclosure, and restrictions placed on loan originations).

[ii] Section 1542 of California's Civil Code provides that: "A general release does not extend to claims which the creditor does not know or suspect to exist in his favor at the time of executing the release, which if known by him must have materially affected his settlement with the debtor."