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TESTIMONY OF

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SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

And

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

Of the

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

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The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

Chairman Capito, Chairman Neugebauer, Ranking Member Maloney, Ranking Member Capuano, and members of the Subcommittees, I appreciate the opportunity to provide information on recent developments related to our enforcement actions against several large servicers to address defects in mortgage servicing and foreclosure processes and other concerns, and to describe the recent initiatives the Office of the Comptroller of the Currency (OCC) has undertaken related to mortgage servicing.

My testimony focuses on three areas. First, I will describe the examinations conducted by the OCC and other federal banking agencies to investigate irregularities in the foreclosure processes of several major mortgage servicers and the cease and desist orders that the OCC, Federal Reserve Board (FRB), Federal Deposit Insurance Corporation (FDIC), and Office of Thrift Supervision (OTS) issued following those examinations. The Cease and Desist Orders (Orders) contain a number of substantive provisions affecting mortgage servicing and foreclosure processes. They require detailed Action Plans that will revamp major aspects of the servicers' mortgage servicing and foreclosure operations. As part of that, the Orders also require a comprehensive independent review of foreclosure actions, and the establishment of a public complaint process, to identify and compensate borrowers who suffered financial harm. My statement will describe generally our examination findings and discuss the content and implementation of these Orders.

Second, I will discuss the relationship between implementation of our enforcement Orders and separate negotiations that are being conducted with servicers by other federal and state agencies and how these discussions and other developments affecting mortgage servicers will drive changes in mortgage servicing practices. New

requirements imposed by federal law and changes recently announced by the government sponsored enterprises (GSEs) also will be significant factors in shaping mortgage servicing practices going forward. My statement briefly describes these developments.

Finally, given the variety of initiatives underway by different parties to address defects in, and to improve, component parts of the mortgage servicing business, the OCC agrees that a public policy objective should be a coordinated effort to develop comprehensive, uniform national servicing standards that apply to all aspects of loan servicing, from loan closing to payoff, and that apply to all servicers. Lenders, servicers, investors, and consumers would benefit from strong national standards regulating mortgage servicing practices. Such an initiative currently is underway, and my statement reports on the actions being taken by the OCC and other federal agencies to develop uniform federal standards for mortgage servicing.

I. Foreclosure Processing Examinations and OCC Cease and Desist Orders

In the fall of 2010, following reports of irregularities in the foreclosure processes of several major mortgage servicers, the OCC directed the largest national bank servicers to conduct self-assessments to identify any problems related to foreclosure processing. Concurrently, the OCC, together with the FRB, FDIC, and OTS, coordinated efforts to conduct "horizontal" examinations of foreclosure processing at the 14 largest federally regulated mortgage servicers during fourth quarter 2010.[1]

[1] The federal banking agencies conducted foreclosure-processing examinations at Aurora Bank, Bank of America, Citibank, EverBank, GMAC/Ally Bank, HSBC, OneWest, JPMC, MetLife, PNC, Sovereign Bank, SunTrust, US Bank, and Wells Fargo.

The primary objective of the examinations was to evaluate the adequacy of controls and governance over bank foreclosure processes, including compliance with applicable federal and state law. Examiners also evaluated bank self assessments and remedial actions as part of this process, assessed foreclosure operating procedures and controls, interviewed bank staff involved in the preparation of foreclosure documents, and conducted an in-depth review of approximately 2,800 borrower foreclosure cases in various stages of foreclosure. Examiners focused on foreclosure policies and procedures; organizational structure and staffing; vendor management of third parties, including foreclosure attorneys; quality control and audits; accuracy and appropriateness of foreclosure filings; and loan document control, endorsement, and assignment. When reviewing individual foreclosure files, examiners checked for evidence that servicers were in contact with borrowers and had considered alternate loss mitigation efforts, including loan modifications, in addition to foreclosure.

In general, the examinations found that the loans in the sample were seriously delinquent. However, the examinations also found that there were critical deficiencies and shortcomings in foreclosure governance processes, foreclosure document preparation processes, and oversight and monitoring of third party law firms and vendors at each of these servicers. These deficiencies constitute unsafe and unsound banking practices, which also resulted in violations of foreclosure laws, regulations, or rules. By emphasizing timeliness and cost efficiency over quality and accuracy, examined institutions fostered an operational environment that is not consistent with conducting foreclosure processes in a safe and sound manner. All servicers exhibited some deficiencies, although the number, nature, and severity of deficiencies varied by servicer.

The sample of foreclosures reviewed as part of the interagency horizontal examination was adequate to expose serious flaws and unsafe or unsound practices in banks' foreclosure processes and provided a basis for enforcement actions. It could not, of course, identify the universe of borrowers that might have been financially harmed by those deficiencies. Identification of and providing financial remediation to those borrowers is a primary objective of the recent enforcement actions issued against the mortgage servicers by the OCC and the other federal banking agencies.

On April 13, 2011, the OCC, along with the FRB, FDIC, and OTS, announced the issuance of Cease and Desist Orders against each of the 14 servicers subject to our respective jurisdictions, and two service-providers reviewed as part of the horizontal examinations. The Orders are intended to correct the deficiencies the agencies found both in mortgage servicing and foreclosure processing, which the OCC found to be unsafe and unsound banking practices. The OCC's enforcement actions address the full range of deficiencies found during the horizontal examination and require remedial actions by the banks to ensure that the foreclosure process, from beginning to end, is administered in a transparent, fair, and safe and sound manner. While the Orders are geared toward fixing what is broken, they also contain measures requiring bank servicers to identify and compensate borrowers who suffered financial harm as a result of deficiencies in past foreclosure practices.

The OCC's Orders are broad in scope and require real reform to restore integrity to the foreclosure process. They require national bank mortgage servicers to implement a comprehensive revision of their loan modification and foreclosure processes. The Orders address the elimination of dual tracking, once a modification has been approved, and the

establishment of a single point of contact system to ensure borrowers can contact a live person throughout the process. The Orders require robust oversight and controls of third-party vendors, including outside legal counsel and vendors who provide default and foreclosure processing services to ensure that those who act on their behalf comply with these obligations as well as all laws and regulations, both state and federal.

It is important to understand that while the Orders themselves impose comprehensive requirements, the Orders are structured to require detailed Action Plans to be submitted by each servicer to implement those requirements. Thus, while the Orders set forth a substantial framework, that framework will be filled in with the plans submitted by the servicers. Those Action Plans must be acceptable to each servicer's primary banking regulator. In several important areas, those Action Plans cover activities that are also the subject of negotiations being led by the Department of Justice (DOJ), involving other federal and state agencies. Thus, as discussed below, the OCC has maintained a regular dialogue with DOJ to facilitate, where possible, synchronization of the implementation of our Orders with the results of those negotiations.

One of the more significant aspects of the Orders are the "look-back" provisions, which require a comprehensive, independent review of foreclosure actions for borrowers who completed, or were in the process of, a foreclosure during the period of January 1, 2009 through December 31, 2010 ("in-scope borrowers"). The look-back requires mortgage servicers to identify those borrowers that suffered financial harm as a result of foreclosure processing deficiencies and to compensate them for financial injury. This is an open-ended obligation, with no dollar cap, and the OCC is supervising compliance with the foreclosure review very closely.

The look-back work will be done by independent firms under plans contained in detailed engagement letters submitted to and which must be approved by the appropriate federal banking agency. These firms must have sufficient expertise and resources to conduct the foreclosure reviews. In addition, these firms are required to operate independently and avoid interests or priorities that conflict with areas addressed in the Orders such as, for example, prior representation of the servicer on the same matters under review. As a condition of OCC approval, firms seeking to perform the independent foreclosure review work also are required to specify in their engagement letters with the servicer that their foreclosure review work will be subject to the direction of the OCC and not the direction, control, or influence of the servicer. We have required specific terms in each engagement letter to assure this.

Pursuant to the requirements of the Orders, the independent review will achieve identification of harmed borrowers covered by the look-back period through two distinct means: 1) a public complaint process which will provide in-scope borrowers who believe they may have suffered financial harm as result of the banks' foreclosure process with the opportunity to have their complaint reviewed by the independent consultant; and 2) a sampling of loans to uncover, for example, borrowers in high risk segments, as discussed below.

The requirements of the OCC's look-back build upon techniques normally undertaken in remedying financial harm to victims as part of a class action lawsuit. The OCC intends to require mortgage servicers to deliver notice letters to every in-scope borrower covered by the look-back period to inform them of their right to have their complaint reviewed by an independent consultant. Skip tracing methods will be used to

locate borrowers and multiple attempts to reach borrowers will be required for any returned notices. Servicers will be required to undertake a broad range of efforts to reach borrowers through methods such as national and local advertising campaigns and outreach efforts to community organizations. There will also be outreach to state attorneys general, Department of Justice (DOJ), and other federal regulatory agencies to solicit information about borrowers who may have filed foreclosure-related complaints with those authorities in the 2009 and 2010 time period. All borrower complaints will be logged in, and documented, and their resolution reported to these agencies at the conclusion of the review.

In addition to this step, the federal banking agencies are requiring the independent consultants to conduct a targeted review of high risk segments, so that borrowers who either cannot be reached or fail to respond to the bank's notice letters might still have an opportunity to be captured under the look-back and to have the independent consultant determine if actions taken by the bank inflicted financial harm upon them. The sampling methodology must be robust and be targeted to detect borrowers most at risk of harm. This involves the segmentation of different borrower populations for separate reviews using statistically sound sampling techniques. Such segments would include, for example, a review of covered borrowers who were denied a loan modification, whose foreclosures were handled by law firms suspected to operate as "foreclosure mills," who were handled by a particular processing center, or who submitted a foreclosure-related complaint to the servicer. Certain borrower segments will require 100 percent review including, but not limited to, borrowers protected by the Servicemembers Civil Relief Act and borrowers in bankruptcy whose mortgage was foreclosed upon and whose home was

sold. Independent consultants that conduct this review will be required to make a number of determinations including, but not limited to, whether the servicer properly documented ownership of the loan, whether foreclosures complied with applicable state and federal law, whether the borrower was charged fees in excess of those that are reasonable and customary and permissible under the terms of the note and applicable law, and whether any applicable loan modification and loss mitigation requirements were followed.

The OCC will oversee this process to ensure that the look-back process is conducted in an independent manner. In addition, the OCC will take all steps necessary to ensure that any foreclosure problems identified through our examinations, the look-back process, and the public complaint process are rectified, and that the banks address financial injury suffered by borrowers as a direct result of such foreclosure deficiencies. We expect to provide a public interim report on the look-back process once the details the look-back are finalized, and then to provide a public report on the results at the end of the process.

II. Interagency Coordination and the Changing Landscape Affecting Mortgage Servicing

From the beginning of the horizontal examination, to the issuance of the enforcement Orders, and to the implementation of the corrective action under the Orders, the OCC has been in regular communication with other federal and state agencies, including the DOJ. As you know, the DOJ is coordinating efforts of a group of other federal agencies and state attorneys general who are seeking a settlement with the bank servicers to address a variety of servicing issues.

In April, the federal banking agencies concluded that it was necessary to issue their enforcement Orders to address the serious safety and soundness concerns identified during the horizontal examinations and get the processes started for providing financial remediation to harmed borrowers. We determined that to delay the enforcement actions further might expose additional borrowers to harm, and leave these safety and soundness concerns unaddressed.

We recognized, however, and discussed with the DOJ, how the detailed Action Plans required under the Orders, particularly for mortgage servicing and foreclosure procedures, had the potential to synchronize with elements of the settlement being discussed involving the same bank servicers, state attorneys general, and certain other federal agencies. It was understood that the timing for submission of the detailed Action Plans required under our Orders had the potential to coordinate with – and could encourage – resolution of issues in areas where the scope of our Orders overlapped with matters in the settlement discussions being led by DOJ. Most recently, on June 13, 2011, the OCC, FRB, and OTS announced a 30-day extension of certain timelines under the Orders – at the request of DOJ to allow that process of coordination of servicer actions to continue. We continue a constructive dialogue with DOJ on these subjects. On other aspects of the settlement discussions being led by DOJ, our communications have focused on conveying any safety and soundness issues that raised concerns.

A key goal here ought to be to arrive at a common set of detailed servicing and foreclosure procedures that are consistent with safe and sound banking practices and fair to borrowers. We expect that our Orders and any agreements that may be entered into by servicers with other federal or state authorities will change servicing procedures for

millions of mortgage loans. These initiatives guarantee that servicers will be subject to more rigorous standards and that borrowers will receive substantially more protections.

Therefore, in our interagency consultations, we have strongly urged that the discussions produce a common set of standards that servicers can follow to meet the terms of these agreements as well as any other applicable requirements, such as GSE standards described below – rather than result in multiple, conflicting, or inconsistent standards. That result would raise concerns of execution risk on the part of servicers and confusion on the part of borrowers. In addition, the newly announced GSE standards are particularly important to take into account in this regard, since those standards, for the foreseeable future, will govern an overwhelming preponderance of the mortgage market.

I describe those standards, and several other developments that will meaningfully impact the mortgage business going forward, below.

Changes in Federal Law: Dodd-Frank Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) has several provisions that will affect mortgage servicing practices. For example, the Dodd-Frank Act made several amendments to the Truth in Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA) that will change a variety of mortgage servicing practices. TILA and RESPA are among the "enumerated consumer laws" for which rulemaking authority will be transferred to the Consumer Financial Protection Bureau (CFPB) on July 21, 2011.

TILA has new provisions requiring that periodic notices be provided to borrowers disclosing information related to the servicing of the loan, such as a statement of

remaining principal balance and the amount of any prepayment penalty that may be imposed. Under the amendments, TILA also prohibits the imposition of a fee to provide a statement of balance due or to modify a high cost mortgage; imposes new requirements concerning the establishment and disclosure of escrow accounts for a variety of mortgages; requires creditors and servicers to provide timely payoff notices; and requires that payments be credited as of the date of receipt.

RESPA has new provisions regulating the force-placement of hazard insurance; requiring servicers to respond to borrower complaints about servicing errors in a timely manner; and requiring servicers to provide contact information for the owner or assignee of the mortgage. RESPA also has been amended to prohibit a servicer from failing to comply with "any obligation found by the [CFPB] to be appropriate to carry out the consumer protection purposes of [RESPA]."

Another provision of the Dodd-Frank Act requires the Secretary of HUD and the Director of the CFPB, in consultation with the federal banking agencies, to create and maintain a new database containing information reported by servicers about delinquent loans and loan foreclosures on a census tract basis. Finally, the Dodd-Frank Act authorizes the CFPB to issue regulations that identify as unlawful "unfair, deceptive, or abusive" acts and practices in connection with mortgage servicing.

Changes in GSE Guidelines

In addition to these new requirements under federal laws, Fannie Mae and Freddie Mac have announced two major initiatives related to servicing that will have widespread market impact. The first, announced in January, is a joint initiative with the FHFA and

HUD to develop new servicing compensation structures that improve the system for paying servicers of single-family loans in mortgage-backed securities pools. According to the GSEs, the current structure for servicer compensation has resulted in generous levels of compensation for work related to servicing pools of performing loans, but insufficient compensation when the servicing pool includes a significant number of non-performing loans. The stated objectives of this initiative are to align compensation structures to improve service for borrowers, reduce financial risk, provide flexibility in servicing non-performing loans, and promote liquidity in the mortgage securities market.

The second GSE initiative, announced in June, is to develop uniform policies for servicing delinquent loans that will enhance and streamline outreach to delinquent borrowers and establish performance-based monetary incentives for compliance. This initiative also will address the "dual track" issue by requiring servicers to focus solely on remediation of a loan delinquency and foreclosure prevention prior to initiation of a foreclosure action. Pursuant to this initiative, Fannie Mae issued new servicer requirements on June 6, 2011 (effective on September 1, 2011), and Freddie Mac issued its new servicing requirements on June 30, 2011 (effective on October 1, 2011). When these guidelines take effect, a foreclosure will not be permitted on a mortgage owned or guaranteed by Fannie Mae or Freddie Mac until after the servicer has conducted a formal review of the borrower's eligibility under all available foreclosure alternatives, including loan modifications, short sales, and deeds in lieu of foreclosure. A servicer of a mortgage that is in foreclosure also will be expected to continue to help these borrowers qualify for a foreclosure alternative. Given the significance of the GSEs to the mortgage market,

these new standards will act as the catalyst for conforming changes in servicing standards for delinquent loans nationwide.

Changes in Capital Rules

The new Basel III framework also may affect the mortgage servicing business in significant ways by requiring that servicing rights beyond relatively modest levels must be deducted from capital for regulatory capital calculations. Under current capital rules, mortgage servicing assets can be included in Tier 1 capital up to a maximum of 100 percent of Tier 1 capital, subject to certain limitations. Under Basel III, however, the maximum amount of mortgage servicing assets that may be included in Tier 1 common equity capital – a new regulatory capital measure – will be capped at 10 percent, subject to certain limitations, and any assets in excess of 10 percent will be deducted from Tier 1 common equity capital. This change will have the effect of increasing the capital requirements for mortgage servicers and will thereby change to some degree the economics of the mortgage servicing business for firms that are subject to these capital standards. How this will affect the participants in and pricing of this business remains to be seen.

III. Need for Uniform Mortgage Servicing Standards

Against the backdrop of these changes in the regulatory landscape affecting mortgage servicing, which arise from multiple sources – including enforcement actions, changes in the law, and changes in GSE requirements – a key public policy objective should be the coordinated development of uniform mortgage servicing standards. Recent

experience highlights the need for uniform standards for mortgage servicing that apply to all facets of servicing the loan, from loan closing to payoff or foreclosure. To be meaningful and effective, the OCC believes that mortgage servicing standards should apply to all mortgage servicers and provide the same safeguards for consumers, regardless of the size or business structure of the servicer or whether a mortgage has been securitized.

A number of months ago, to further this effort and initiate interagency discussions, we developed a framework for comprehensive mortgage servicing standards that we shared with other agencies, and other agencies put forward their recommendations as well. There is now underway an active interagency effort to develop a set of comprehensive, nationally applicable mortgage servicing standards. Participating agencies in the effort include the OCC, the FRB, the FDIC, the OTS, the Federal Housing Finance Agency, the Department of Housing and Urban Development (including the Government National Mortgage Association (Ginnie Mae)), the CFPB, and the Department of the Treasury. The agencies' objective is to develop uniform standards that govern processes for:

- Handling borrower payments, including applying payments to principal, interest, taxes, and insurance before they are applied to fees, and avoiding payment allocation processes designed primarily to increase fee income;
- Providing adequate borrower notices about their accounts and payment records, including a schedule of fees, periodic and annual statements, and notices of payment history, payoff amount, late payment, delinquency, and loss mitigation;

- Providing an easily accessible single point of contact for borrower inquiries about loss mitigation and loan modifications;
- Responding promptly to borrower inquiries and complaints, and promptly resolving disputes;
- Providing an avenue for escalation and appeal of unresolved disputes;
- Effective incentives to work with troubled borrowers, including early outreach and counseling;
- Making good faith efforts to engage in loss mitigation and foreclosure prevention for delinquent loans, including modifying loans to provide affordable and sustainable payments for eligible troubled borrowers;
- Implementing procedures to ensure that documents provided by borrowers and third parties are maintained and tracked so that borrowers generally will not be required to resubmit the same documented information;
- Notifying borrowers of the reasons for denial of a loan modification, including information on the NPV calculation;
- Implementing strong foreclosure governance processes that ensure compliance with all applicable legal standards and documentation requirements, and oversight and audit of third party vendors;
- Eliminating "dual track" processes where legal steps to foreclose on a property or conduct a foreclosure sale go forward even when a borrower has completed an application for a loan modification or is in a trial or permanent modification and is not in default on the modification agreement; and

- Ensuring appropriate levels of trained staff to meet current and projected workloads.

Staff from the participating agencies meet on a weekly basis to discuss different facets of mortgage servicing. Most of the meetings to date have been focused on monitoring the various new initiatives I described above relating to servicing of non-performing loans and foreclosure prevention. In this regard, it seems clear to all participants in this project that these initiatives, as well as any servicing-related obligations arising from the terms of any agreements between servicers and federal or state authorities, will influence the contours and content of any national standards we propose.

Going forward, we hope standards will be issued to address all aspects of mortgage servicing in the form of enforceable regulations that apply to all servicers. These rules could be supplemented with interagency compliance guidelines that can be used to fill in details and provide illustrations of practices that comply with the regulatory standards. Any proposed new regulatory standards will be published for public comment.

Our objective is to establish rigorous, uniform "rules of the road" for responsible servicer conduct that will be effective in this market as well as in the future. It is vital that any standards that the agencies adopt apply to and are implemented by all firms engaged in mortgage servicing – not just federally regulated depository institutions -- and that there is strong oversight of all servicers' compliance.

IV. Conclusion

The OCC is committed to ensuring that defects in servicing practices identified through our examinations are rectified, and that, through the look-back process, servicers address financial injury suffered by borrowers as a result of those defective practices. However, issues with the mortgage servicing business extend beyond defects in procedures with respect to foreclosure processing or non-performing loans. The OCC therefore strongly supports the development of national servicing standards that will significantly improve customer treatment in all aspects of mortgage servicing. We are actively working on an interagency basis to accomplish that objective.

I appreciate the opportunity to appear before the Subcommittees this morning, and I look forward to addressing your questions.