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Subcommittee on Financial Institutions and Consumer Credit and
Subcommittee on Oversight and Investigations

on

Mortgage Servicing: An Examination of the Role of Federal Regulators in Settlement Negotiations and the Future of Mortgage Servicing Standards

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2128 Rayburn House Office Building

Good morning, Chairwoman Capito, Chairman Neugebauer, Ranking Member Maloney, Ranking Member Capuano, and Members of the Subcommittees. Thank you for the invitation to testify on mortgage servicing and foreclosure mitigation.

I am President of the Center for Responsible Lending (CRL), a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, a nonprofit community development financial institution. For thirty years, Self-Help has focused on creating asset-building opportunities for low-income and minority families, primarily through financing safe, affordable home loans. In total, Self-Help has provided over $5.6 billion of financing to 64,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across America. Currently, Self-Help is grappling with many of the same issues encountered by other lenders, including servicer capacity limitations and homeowners who face serious economic challenges. Our testimony today is informed by this experience.

I. Background

Almost four years ago, CRL released a report warning that the reckless and abusive lending practices would lead to approximately two million subprime foreclosures. At the time, our report was denounced by the mortgage industry as absurdly pessimistic. Sadly, the system was even more larded with risk than we reported, and the damage has been far worse, spreading from the subprime to the prime sectors, catalyzing a housing-lead recession, and triggering historic levels of unemployment. Since housing prices began their precipitous decline in early 2007, 7.5 million homes have entered the foreclosure process.[1] Furthermore, the crisis shows no signs of abating, as 8.1 percent of all loans—representing about 4.2 million borrowers—are currently 90 days or more delinquent or in some stage of the foreclosure process.[2] The foreclosure crisis has had catastrophic consequences for families and communities, especially communities of color. A 2010 study by CRL estimated that among borrowers who received their loans between 2005 and 2008, nearly 8 percent of both African Americans and Latinos had lost their homes to foreclosures, compared to 4.5 percent of whites.[3]

It began when millions of homeowners ended up in dire straits owing to abusive mortgage originations, incompetent and predatory mortgage practices, ineffective government oversight, and a complex securitization system that lacked accountability all the way up and down the chain. This "round one" of the foreclosure crisis sparked a broader economic downturn that has resulted in very high levels of unemployment and lost wealth. This broader economic crisis brought about "round two" of the foreclosure crisis. Today, millions more families are expected to lose their homes owing to the toxic combination of underwater loans and unemployment that festers in so many parts of the country.

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[1] CRL calculations, based on Mortgage Bankers Association, National Delinquency Surveys 2007-2011, with numbers adjusted to reflect MBA's estimated 88% market coverage.

[2] Mortgage Bankers Association, National Delinquency Survey 1Q 2011.

[3] *See generally* Debbie G. Bocian, et al., *Foreclosures by Race and Ethnicity: The Demographics of a Crisis* (June 18, 2010), available at http://www.responsiblelending.org/mortgage-lending/research-analysis/foreclosures-by-race-and-ethnicity.pdf [hereinafter *Foreclosures by Race and Ethnicity*].

Servicers engage in a wide range of abusive practices, detailed below, which in many cases lead to unnecessary and sometimes wholly unwarranted foreclosures. The Urban Institute conservatively estimates that a single foreclosure costs $79,443 after aggregating the costs borne by financial institutions, investors, the homeowner, their next-door neighbors, and local governments.[4] However, this number probably understates the full cost, since it does not reflect the impact of the foreclosure epidemic on the nation's economy or the disparate impact on lower-income and minority communities.[5] The effects of this wealth drain are exacerbated by the larger economic downturn, with weakness in the housing sector slowing economic recovery and hampering efforts to create jobs and reduce unemployment.

Although serious delinquencies dropped in the first quarter of 2011, according to the Mortgage Bankers Association (MBA) Mortgage Delinquency Survey, 4.8 million borrowers (one in 11) remain at risk of foreclosure.[6] That is far worse than in the first quarter of 2007, when 1.6 million mortgage holders (one in 33) were at risk of losing their homes.[7]

Unfortunately, the bleak housing outlook is exacerbated by a mortgage servicing system ill-equipped to handle the volume and intensity of demands upon it. As a result, many servicers have failed to engage in reasonable loss mitigation efforts and borrowers have been subject to confusing, abusive, and sometimes illegal practices. My testimony will detail some of the most troubling abuses in the servicing industry and recommendations for basic ground rules that will enable the servicing system to operate more fairly and effectively and help stabilize the housing market.

II. Overview of Mortgage Servicing Abuses

Widespread mortgage delinquencies have laid bare many of the abuses and failures that have existed within the mortgage servicing industry even before the current crisis. For at least a decade, community-based organizations, housing counselors and advocates around the country have documented a pattern of shoddy, abusive, and illegal practices by many mortgage servicers, whose staff are trained for collection activities rather than loss mitigation, whose infrastructure cannot handle the present level of demand, and whose business records are a mess.[8]

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[4] Thomas G. Kingsley, et al., *The Impact of Foreclosures on Families and Communities* (The Urban Institute 2009), available at www.urban.org/UploadedPDF/411909_impact_of_forclosures.pdf.

[5] *Foreclosures by Race and Ethnicity* at 3 ("As the foreclosure crisis threatens the financial stability and mobility of families across the country, it will be particularly devastating to African-American and Latino families, who already lag their white counterparts in terms of income, wealth and educational attainment.")

[6] Center for Responsible Lending, *Delinquency and Foreclosure Trends: Housing Market Remains Shaky -- A Bigger Picture Look at the 2011 Q1 MBA Delinquency Survey*, Issue Brief (May 27, 2011), available at http://www.responsiblelending.org/media-center/press-releases/archives/Delinquency-and-Foreclosure-Trends-Housing-Market-Remains-Shaky.html (citing MBA Delinquency Survey for 2011 Q1 with numbers adjusted to reflect MBA's estimated 88% market coverage).

[7] *Id.*

[8] *See, e.g., In re Ocwen Loan Servicing, LLC Mortg. Servicing Litigation,* 491 F.3d 638 (7th Cir. 2007) (allegations by a class of homeowners that Ocwen systematically charged late fees for payments that were sent on time); *Federal Trade Commission (FTC) Settlement* (2003) resulted in $40 million for consumers harmed by illegal loan servicing practices, *available at* http://www.ftc.gov/fairbanks (FTC alleged, among other things, that Fairbanks illegally charged homeowners for "forced placed insurance" and violated the Fair Debt Collection Practices Act); and *FTC Settlement with Countrywide, available at* http://www.ftc.gov/countrywide (Countrywide agreed to pay $108 million dollars to homeowners in

These practices have become so ingrained in the servicing culture that they are now endemic in the industry. The harm to which borrowers have been subjected as a result of these abuses cannot be overstated. Numerous homeowners are burdened with unsupported and inflated mortgage balances or have been subjected to unnecessary and/or wrongful foreclosures before loss mitigation measures have been fully considered. These abuses include the following:

- *Dual track.* Servicers actively pursue foreclosure even when they are already working with homeowners on a modification, often leading to unnecessary foreclosures before a decision on the loan modification has been made.
- *Foreclosing even when investors would receive more from a sustainable modification.* It is in the best interests of investors and borrowers, and a requirement under the Home Affordable Modification Program (HAMP), that servicers modify a mortgage loan when it is net present value (NPV) positive, *i.e.*, when the expected return to investors from a modified loan is greater than the expected return from a foreclosure. Unfortunately, this is not happening systematically.
- *Improper denial and delay of loan modification requests.* Delay is in servicers' interests because fees, which eventually flow directly to servicers (either from the homeowner directly or through the proceeds of a foreclosure sale down the road), continue to accrue. A ProPublica study highlights the problems this creates for distressed borrowers: The homeowners interviewed spent an average of more than 14 months waiting for a HAMP modification (a process that should only take a few months), and "as a result of the delays, homeowners fall further behind, putting them in danger of foreclosure and making it less likely they'll qualify for a modification. About two-thirds of these homeowners were still current on their mortgages when they began the process, but most have now fallen behind."[9]
- *Forcing homeowners into multiple temporary modifications.* All modifications are not created equal. Extended temporary modifications are good for servicers' interests but harm those of borrowers. Temporary modifications can represent a "best of both worlds" situation for servicers, who continue to charge fees as if the borrower is in default but without the cost of having to finance principal and interest advances to investors. Many borrowers go from one temporary modification to another, continuing to accrue high fees that drive them even further underwater.
- *Force-placed insurance.* Servicers too often force-place very expensive hazard or other insurance and charge the borrower's account when the borrower's insurance has not lapsed (or is not needed as may be the case with flood insurance), often driving an otherwise current borrower into delinquency and even foreclosure.
- *Improper fees.* Servicers sometimes charge unlawful default- and delinquency-related fees for property monitoring and broker price opinions.
- *Requiring borrowers to give up legal rights in order to receive a modification.* This is even more egregious considering that some temporary modifications are not in borrowers' interests, making legal rights the only effective bargaining chip for such borrowers to enter

response to the FTC's allegations that Countrywide charged illegal fees to homeowners during Chapter 13 bankruptcy proceedings).

[9] *See, e.g.*, Paul Kiel & Olga Pierce, "Homeowner Questionnaire Shows Banks Violating Gov't Program Rules," *ProPublica* (Aug. 16, 2010), available at http://www.propublica.org/article/homeowner-questionnaire-shows-banks-violating-govt-program-rules.

into permanent and affordable modifications.

- *Misapplication of borrower payments.* This results in inappropriate and unauthorized late fees and other charges, as well as misuse of borrower funds improperly placed in "suspense" accounts, which creates income for servicers.
- *Mismanaged escrow accounts.* Servicers sometimes improperly manage borrower accounts for real estate tax and insurance escrows, including by failing to disburse payments for insurance and taxes on time, causing cancellation and then improper force-placing of insurance, as well as tax delinquencies and tax sales.
- *Failing or refusing to provide payoff quotations to borrowers.* This may prevent borrowers from obtaining a refinance loan or a short sale.
- *Abuses in the default and delinquency process.* Servicers sometimes fail to properly send notices of default; prematurely initiate foreclosures during right-to-cure periods and immediately following transfer from another servicer, and they do so without proper notices to borrowers; initiate foreclosure when a borrower is not in default or when borrower has cured the default by paying the required amount; and fail to adhere to loss mitigation requirements of investors.

III. The Role of the Private Marketplace in Regulating Mortgage Servicing Abuses

In today's housing market, when millions of families are in default and at risk of losing their homes, servicers should work to minimize the number of foreclosures by offering modifications for borrowers who have "NPV positive" cases – that is, the expected return to investors from a modified loan is greater than the expected return from a foreclosure. This requires servicers to distinguish between necessary (NPV negative) and unnecessary (NPV positive) foreclosure cases so that servicers can proceed swiftly with the necessary foreclosures and offer sustainable, long-term modifications when foreclosure is unnecessary.

Instead, the servicing system is compounding the problem by proceeding with many unnecessary foreclosures, which harms not only investors and homeowners, but also neighborhoods and communities through spillover effects and other negative externalities. Perverse financial incentives in pooling and servicing contracts illustrate why servicers press forward with foreclosures when other solutions are more advantageous for investors. Servicers are generally paid a fixed percentage of the outstanding balance on a loan for servicing a mortgage when payments are being made on the loan. The traditional mortgage servicing paradigm was marked by a collections mentality, and compensation reflected that mentality. The foreclosure crisis, however, created a need for massive underwriting of loan modifications, and as a result, fees paid for servicing a non-delinquent loan are much too low.[10] According to Amherst Securities, with a typical servicing fee of 25 basis points per year ($625/year on a $250,000 loan), servicers are overpaid for traditional servicing (which costs servicers only about $48 per year) and

[10] Testimony of Laurie Goodman of Amherst Securities Group to the Subcommittee on Housing Transportation, and Community Development of the Senate Committee on Banking, Housing, and Urban Affairs, National Mortgage Servicing Standards and Conflicts of Interest (May 11, 2011), available at http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=484c5b2b-6924-459f-898e-3ae075feeb15.

underpaid for loss mitigation on non-performing loans (which costs about $900/year).[11] On the flip side, servicers may charge and collect a variety of fees after the homeowner goes into default and can recover the full amount of those fees from the foreclosure proceeds, providing strong incentives for proceeding with foreclosure.[12]

Although foreclosing when the case is NPV positive can be in servicers' interests, it is certainly not in the interests of investors. In fact, recent CRL research that used loan level data and simulated NPV outcomes under a variety of scenarios, found that under most conditions, payment-reducing loan modifications would return more value to the investor than a foreclosure, even at high projected modification re-default rates.[13] These beneficial loan modifications are not occurring in large part owing to misaligned incentives for servicers, including that in many cases the servicers own the second mortgages associated with the first mortgages that they are servicing but do not own.

As one investor commented, "It pays for banks to keep mortgages in a state of suspended animation, because they can collect late fees while also protecting second mortgages that are in the bank's portfolio. The misalignment of economic interests between the owners of mortgages and those who service them is the single reason why the mortgage problem has become a crisis and a massive economic drain on this country."[14] Our recent analysis suggests that many more loan modifications should have been made since the foreclosure crisis began, and this failure is to the detriment of both homeowners and investors. Why, then, are investors not able to hold servicers fully accountable for not modifying enough loans?

As Professor Adam Levitin and Tara Twomey highlight in the *Yale Journal on Regulation,*[15] a key principal-agent problem exists between investors and servicers:

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[11] *See* Laurie Goodman, et al, "Alternative Compensation Arrangements for Mortgage Servicing – The Debate Begins," *Amherst Mortgage Insight* (Feb. 2, 2011): "[T]here is widespread awareness that the current system (in which a minimum servicing fee is part of the mortgage rate) was not designed for current market conditions. This minimum servicing fee is far too high for performing loans, and way too low for non-performing loans. To put it into perspective, a 25 bp servicing fee on a $250,000 loan is $625/year or $53/month per loan. One servicer we spoke with estimated his costs of servicing a performing loan at $4/month or $48/year. By contrast, the costs of servicing a nonperforming loan were about $900/year."

[12] For a thorough discussion of the servicing incentive structure, see Testimony of Diane Thompson before the Senate Banking Committee (Nov. 16, 2010), *available at* http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Testimony&Hearing_ID=df8cb685-c1bf-4eea-941d-cf9d5173873a&Witness_ID=d9df823a-05d7-400f-b45a-104a412e2202; *see also* Diane Thompson, "Why Servicers Foreclose When They Should Modify and Other Puzzles of Servicer Behavior," (National Consumer Law Center Oct. 2009), available at http://www.nclc.org/images/pdf/foreclosure_mortgage/mortgage_servicing/servicer-report1009.pdf.

[13] *See generally* Wei Li & Sonia Garrison, *Fix or Evict? Loan Modifications Return More Value than Foreclosures* (Mar. 22, 2011), available at http://www.responsiblelending.org/mortgage-lending/research-analysis/fix-or-evict.pdf.

[14] Press Release, "Banks' Foreclosure Bias Hurts Investors" (Mar. 23, 2011) (citing Bill Frey, President of Greenwich Financial Services and a longtime investor advocate), available at http://www.responsiblelending.org/media-center/press-releases/archives/Banks-Foreclosure-Bias-Hurts-Investors.html.

[15] Adam J. Levitin & Tara Twomey, "Mortgage Servicing," *Yale Journal on Regulation* Vol. 28, No. 1 (2011), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1324023.

> Mortgage investors are unlikely to bargain for adequate servicing because of the information asymmetries and risk allocations involved in securitization. … [Investors] cannot accurately value the quality of loss mitigation provided by a servicer; they lack sufficient information, and even if they had full information, evaluation is difficult because servicing decisions are highly qualitative and contextual. Lacking such information, … [investors] are likely to undervalue the quality of servicing and therefore be unconcerned with the principal-agent cost.[16]

The problem of misaligned incentives is further compounded by a lack of adequate resources, management, and quality control, as identified by the Interagency Review of Foreclosure Policies and Practices earlier this year.[17]

Finally, lack of information and coordination limits the ability of disparate investors to monitor and enforce their interests relative to servicers. Where investors have attempted to assert these rights, as in their present dispute with Bank of America, they have sought servicing benchmarks along the lines that we are discussing today, including thorough review of loss mitigation options and the modification of loans where possible.

If investors have little ability to rein in servicers, borrowers have absolutely no ability to do so. From the borrower's perspective, there is a failure of market choice when it comes to servicing. Homeowners are not allowed to select their servicers, and servicing rights are regularly bought and sold, with borrowers stuck with whomever the investor has selected. Borrowers have no authority to "fire" their servicer for bad service. Because servicers lack a contractual (or duty-bound) relationship with borrowers, and because borrowers are already "locked in" to the relationship, servicers have little incentive to provide adequate customer service.

In short, the current system serves as an impediment to a competitive market. The creation of basic ground rules in servicing that apply to all, and that are enforced as to all, will allow the servicing market to function more effectively, to the benefit of all.

IV. Recommended National Mortgage Servicing Standards

Servicing standards should address two general areas: First, pre-foreclosure loss mitigation, requiring a transparent NPV analysis to determine which foreclosures are avoidable and which are inevitable; and second, a baseline level of required servicer duties, restrictions and requirements to remediate the broad servicing abuses outlined earlier. Our recommendations cover both of these areas.

On the servicing front, the states have again taken the lead in addressing the abuses and shortcomings that are evident. Several states have implemented meaningful servicer regulations over the past several years that are worth reviewing as possible models for federal action. Potential preemption in some areas and other limitations, however, call for strong baseline

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[16] *Id.*

[17] Federal Reserve System, Office of the Comptroller of the Currency, and Office of Thrift Supervision. Interagency Review of Foreclosure Policies and Practices. Washington, D.C. (April 2011), available at http://www.occ.treas.gov/news-issuances/news-releases/2011/nr-occ-2011-47a.pdf.

national standards to ensure that all mortgage loan servicers are covered by the requirements and that such requirements can be effectively enforced.

Perhaps the most comprehensive effort at state regulation – and the most useful model for emulation – comes from the New York State Department of Banking.[18] Effective October 2010, the New York regulator issued far-ranging servicing regulations that include detailed loss mitigation requirements, imposing a general duty "to engage in appropriate loss mitigation options, including loan modifications, to avoid foreclosure," as well as requiring "adequate staffing, written procedures, resources and facilities," requiring that a loan modification be offered where the borrower is at imminent risk of default or in default and the modification would be NPV positive, and including detailed requirements about timing for communications with borrowers, escalation process, and other procedures. Importantly, these regulations seek to end the dual track problem by providing that servicers avoid initiating foreclosure action if the borrower is being considered for a loan modification, or is in a trial or permanent modification.

In addition to addressing loss mitigation, the New York regulations tackle the following servicer issues, among others: (1) impose and define a servicer duty of good faith and fair dealing to the borrower; (2) require accurate payment from and accounting of escrow accounts; (3) specify proper crediting of payments; (4) mandate annual statement of accounts and, when requested, payment histories; (5) require clear, understandable and accurate payoff balances within five business days of a request; (6) provide limitations and transparency around fees; (7) authorize the Superintendent of Banks to require quarterly reporting on mortgage loans and loss mitigation efforts; and (8) include prohibitions on improper force-placed insurance.

North Carolina was an early adopter of mortgage servicing standards.[19] These standards are less detailed than those in New York, including, for example, a generalized loss mitigation standard, which requires:

> In the event of a delinquency or other act of default on the part of the borrower, the mortgage servicer shall act in good faith to inform the borrower of the facts concerning the loan and the nature and extent of the delinquency or default and, if the borrower replies, to negotiate with the borrower, subject to the mortgage servicer's duties and obligations under the mortgage servicing contract, if any, to attempt a resolution or workout to the delinquency.[20]

This law also requires servicers to report to the Commissioner of Banks on its mortgage loans and loss mitigation activities.

The North Carolina law also puts in place other general duties, requiring that a mortgage servicer do the following: (1) safeguard and account for any money handled for the borrower; (2) follow

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[18] New York Banking Department Law, Regulations & Interpretations. Part 419. Servicing Mortgage Loans: Business Conduct Rules, available at http://www.banking.state.ny.us/legal/ar419tx.htm.
[19] N.C. Gen. Stats. 53-244.110 (2009), available at http://law.justia.com/codes/north-carolina/2009/Chapter_53/GS_53-244_110.html.
[20] *Id.* at 53-244.110(7).

reasonable and lawful instructions from the borrower; (3) act with reasonable skill, care, and diligence; and (4) file periodically with the Commissioner a complete, current schedule of the ranges of costs and fees it charges borrowers for its servicing-related activities.[21]

In May of this year, Montana passed legislation that is substantially similar to North Carolina's legislation to regulate mortgage servicers.[22]

Federal policymakers should move forward with similar servicing standards, based on the progress made in the states. The Federal standards should at a minimum include the following:

1) Mandatory Loss Mitigation <u>Before</u> the Start of the Foreclosure Process

Mandatory loss mitigation before foreclosure is in the interest of both investors[23] and homeowners. Prior to a servicer initiating foreclosure, every loan should receive a good-faith review of foreclosure alternatives by using an NPV analysis to determine whether re-amortization, interest rate reduction, term extension and/or principal reduction of the loan will reduce payments to a sustainable level.

An NPV analysis such as the one required by servicers participating in HAMP assesses whether the investor receives more revenue from a loan modification or a foreclosure. This calculation compares the cash flow anticipated from future mortgage payments to the cash flow anticipated from foreclosing on the property, based on inputs that include the homeowner's income, credit score, current payment status, debt-to-income ratio, and property value, plus factors relating to the property's future value and likely resale price.

- *Modifications Offered for NPV Positive Loans.* When a sustainable loan modification is a better financial deal for the investor than a foreclosure, the servicer should be required to offer the borrower the loan modification, including request of a waiver in the case of investor or pooling and servicing agreement (PSA) restrictions.

- *"Soft Landing" Alternatives in the Case of NPV Negative Loans.* If a sustainable loan modification is not NPV positive, the servicer should be required to consider a short sale or deed-in-lieu-of-foreclosure if the borrower chooses to pursue these options.

- *Unemployment Forbearance Options.* Servicers should proactively engage with homeowners at risk of foreclosure owing to loss of income attributable to unemployment or underemployment to determine whether an unemployment forbearance program may allow homeowners to avoid foreclosure while they actively seek employment.

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[21] *Id.* at 53-244-110(1)-(4).

[22] *See* Montana HB 90 (McNutt) (signed by Governor May 5, 2011), available at <u>http://data.opi.mt.gov/bills/2011/billhtml/HB0090.htm</u>.

[23] *See* Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP), *Factors Affecting Implementation of the Home Affordable Modification Program* at 8 (Mar. 25, 2010), available at <u>http://www.sigtarp.gov/reports/audit/2010/Factors_Affecting_Implementation_of_the_Home_Affordable_Modification_Program.pdf</u> ("According to Treasury, the NPV model increases investors' confidence that the modifications under HAMP are in their best financial interests and helps ensure that borrowers are treated consistently under the program by providing a transparent and externally derived objective standard for all loan servicers to follow.").

- *Borrowers Should Retain their Legal Rights Upon Entering into a Modification*. Today, many modifications are neither affordable nor permanent, highlighting the need for borrower legal rights.

2) Transparency in the Net Present Value Determination

In May of this year, Treasury launched www.checkmyNPV.com, a free public online NPV calculator to assist homeowners in understanding the NPV evaluation process under HAMP and in conducting an NPV evaluation of their mortgages.[24]

Mortgage servicers should be required to make the NPV analysis for proprietary loan modifications equally accessible to homeowners. As a result, any errors or discrepancies in the inputs and assumptions used by the servicer could be addressed and resolved promptly. As noted by the Association of Mortgage Investors, because only servicers have access to the loan file, transparency is vital both in allowing borrowers to verify the information and ensuring investors have access.[25]

In addition, borrowers whose denial is based on investor restrictions notwithstanding a determination that their loan is NPV positive should receive basic information, including the investor or guarantor's name, identification of the controlling document, and a summary of efforts taken to secure investor approval so that borrowers are in a position to escalate their matter to the investors rather than exclusively relying on communication with their servicer.

3) Elimination of Dual Track

Dual track first gained notoriety in association with HAMP, when servicers moved forward with widespread foreclosure sales before determining borrowers' eligibility for HAMP. This was an important factor in loss of confidence in the program. In response to criticism, the Department of the Treasury issued Supplemental Directive 10-02, which requires servicers to provide borrowers not yet in the foreclosure process with a HAMP review and answer before the servicer could "refer any loan to foreclosure."[26] Notwithstanding this language, some servicers have claimed that, in non-judicial foreclosure states, they can begin the foreclosure process by filing a notice of default. For those borrowers who submit a HAMP request after a loan has entered the foreclosure process, HAMP requires that the servicer make all efforts to halt foreclosure activity

[24] This was made available pursuant to Section 1482 of the Dodd Frank Wall Street Reform and Consumer Protection Act (2010).

[25] Association of Mortgage Investors (AMI), *The Future of the Housing Market after the Crisis: Remedies to Restore and Stabilize America's Mortgage and Housing Markets*, White Paper (January 2011), available at http://the-ami.com/wp-content/uploads/2011/01/AMI_State_AG_Investigation_Remedy_Recommendations_Jan_2011.pdf.

[26] U.S. Treasury Dept., Making Home Affordable, *Home Affordable Modification Program -- Borrower Outreach and Communication*, Supplemental Directive 10-02 (March 24, 2010), available at https://www.hmpadmin.com/portal/programs/docs/hamp_servicer/sd1002.pdf. These guidelines are now found in Section 3 of Chapter II of the Making Home Affordable Program Handbook for Servicers of Non-GSE Mortgages: Version 3.2 (June 1, 2011), available at https://www.hmpadmin.com/portal/programs/docs/hamp_servicer/mhahandbook_32.pdf.

once a borrower accepts a trial period plan.[27] If a sale date has already been scheduled, the borrower must submit a request for HAMP consideration so that it is received at least seven days before the sale date in order to require the servicer to suspend the foreclosure sale.[28]

Despite this Treasury directive, issues with dual track have persisted within HAMP, whether because of lack of compliance or the limitations of the standards themselves. In May 2011, the California Reinvestment Coalition surveyed 55 California housing counselors who serve thousands of borrowers every month, and found that a full 94 percent of counselors reported having worked with clients who lost their homes while under review for a loan modification.[29]

On June 30, the OCC issued supervisory guidance related to bank foreclosure practices that purported to address the dual track problem.[30] Unfortunately, this guidance took a step back from the HAMP requirements, directing bank management to "suspend foreclosure proceedings for successfully performing trial period modifications where they have the legal ability to do so under servicing contracts." The two tracks of "dual track" are, first, the loan modification application and approval process, and second, the foreclosure process. Ending dual track would require halting the foreclosure process when a borrower is *applying* for a loan modification in good faith. The OCC guidance inadvertently provides incentives for delays and loan modification denials by providing that a foreclosure need not be suspended unless and until there is a "successfully performing trial period modification."

While these developments acknowledge the tremendous challenges presented by dual track, potential ambiguities and conflicts among the different rules call for a clear, strong standard that prohibits any initiation of or movement in the foreclosure process, whether in a judicial or non-judicial state, when a borrower is applying for a loan modification. Without a clear, consistent and strong standard, loss mitigation efforts will continue to be significantly undermined by this practice, which prioritizes expediency over accuracy and, in many cases, homeowners' ability to retain their homes.

4) Single Point of Contact or Case Manager Model

The drastic increase in the number of delinquent borrowers has required servicers to scramble to hire and train new staff. Not surprisingly, industry observers have noted that this strain on servicing capacity has coincided not just with problems related to the foreclosure process, but

[27] *Id.*
[28] *Id.*
[29] *See* Paul Kiel, "Bank Errors Continue to Cause Wrongful Foreclosures" *ProPublica* (June 24, 2011) (referring to the forthcoming report, California Reinvestment Coalition, *Race to the Bottom: An Analysis of HAMP Loan Modification Outcomes by Race and Ethnicity for California*), available at http://www.propublica.org/article/bank-errors-continue-to-cause-wrongful-foreclosures. The survey from the California Reinvestment Coalition (CRC) will be its seventh, and the problem appears to be getting worse. In its last survey, CRC found that over 60% of counselors responded that they had clients who lost their home while negotiating with their servicer. *See* California Reinvestment Coalition, *Chasm Between Words and Deeds VI: HAMP Is Not Working* at 3 (July 2010), available at http://calreinvest.org/publications/crc-reports. Only 20% of counselors had not seen clients either lose their home or have a sale date scheduled while negotiating. *Id.*
[30] Office of the Comptroller of the Currency, Foreclosure Management Supervisory Guidance, OCC 2011-29 (June 30, 2011), available at http://www.occ.gov/news-issuances/bulletins/2011/bulletin-2011-29.html

also with a surge in borrower complaints related to the loss mitigation process and servicer communications.

A recent survey of foreclosure-intervention counselors found a multitude of servicer obstacles to successful loan modifications, including lack of qualified personnel and communication inefficiencies that confuse and even drive borrowers away.[31] These inefficiencies include lost paperwork, inadequate follow-up during the evaluation process, and the borrower being directed to numerous different representatives who often have different information for the borrower or are incapable of offering appropriate assistance.

For borrowers attempting to navigate the loss mitigation process, lack of access to personnel who are knowledgeable about their matter and who can provide reliable information continues to be a tremendous impediment. Requiring that servicers identify a case manager who has the authority to resolve issues and serve as the borrower's single point of contact would ensure both access and accountability as borrowers work to provide servicers with the information necessary for a meaningful evaluation of foreclosure alternatives.

5) Third Party Review of Denials of Loan Modifications

Given the high frequency of errors that have occurred in the processing of requests for loan modifications and the critical importance of these decisions, borrowers should have the right of independent third party review of denials loan modifications. This both protects the interests of individual borrowers and investors, it provides monitoring of the overall servicing process and can detect systemic problems that develop.

6) Changes in Servicer Compensation

As discussed previously in this testimony, servicers' compensation is not aligned with the work that they need to do; they are currently overpaid for performing loans and underpaid for those in default. Because loss mitigation work is complicated, case-specific, and time-intensive, servicer compensation for troubled loans should be more aligned with how specialty servicers are paid.

7) Standards to Address More General Servicing Abuses

In addition to addressing problems in the loss mitigation and foreclosure processes, servicing standards should address the other abuses outlined earlier in this testimony, federal banking regulators, the Consumer Financial Protection Bureau (CFPB), and the states should work in partnership to vigorously enforce these servicing standards. Indeed, the existence of these widespread servicing abuses and failings that have gone unchecked for so many years (together with the borrower's inability to use the market to do anything about them) highlights the necessity of the CFPB.

Solutions to these other more general abuses include requiring the proper application of borrower payments; requiring servicers to verify lack of insurance before force-placing it and ensuring that

[31] David A. Smith, Louise Perwien, & Janneke Ratcliffe, UNC Center for Community Capital, *Mortgage Servicers Response to Borrowers in Crisis: A Report from the Front Lines*, (2009).

the cost of such insurance is reasonable and proportional to the cost of providing it; providing for real penalties for mismanaging escrow accounts; and requiring servicers to provide payoff quotations to borrowers to facilitate refinancings and short sales.

V. Conclusion

In summary, deep-seeded problems in the servicing industry are harming borrowers, investors, and the economy as a whole. Putting in place fair, basic ground rules for mortgage servicing is critical to addressing the housing crisis that continues to plague our economy. Today, servicers too often engage in a wide range of abuses related to the foreclosure/loss mitigation process and more broadly. These include failure to properly engage in loss mitigation, which results in foreclosure on NPV positive borrowers who could actually afford to pay more in a loan workout than the revenues an investor would yield from foreclosures. If servicers routinely engaged in proper loss mitigation prior to foreclosure, more distressed homeowners would be able to stay in their homes, paying more through sustainable modifications than investors would receive through foreclosure.

Federal policymakers should put in place and robustly enforce strong baseline servicing standards, the most important of which is to require loss mitigation, with third-party review prior to the start of the foreclosure process, thus eliminating dual track. In addition, to ensure accountability, servicers should be required to be transparent in the NPV calculation, even for portfolio loans. Borrowers in default should have a single point of contact who can provide reliable information and ensure that paperwork necessary for loss mitigation is properly processed. Servicers should also be prohibited from engaging in other abusive practices, such as failure to pay escrowed taxes and insurance, misapplying payments, and force-placing insurance when it is not warranted (while charging exorbitant rates nowhere near the actual cost of the insurance), among others.

Equally important to imposing strong servicing standards is ensuring that those standards are vigorously enforced. Federal banking regulators, the CFPB, and the states should robustly enforce the standards to ensure that servicers have every incentive to comply with them.

Indeed, the current failure of many servicers to engage in loss mitigation underscores the importance of maintaining a strong and independent CFPB. The Dodd-Frank Act transferred key responsibilities related to mortgage servicing to CFPB, including, effective July 21, 2011, rulemaking, supervision, and enforcement authority under the Real Estate Settlement Procedure Act (RESPA). RESPA includes a range of servicing provisions, most recently amended through Dodd-Frank, to strengthen protections around escrows, force-placed insurance, and responses by servicers to qualified written requests from borrowers. Dodd-Frank also gives CFPB the authority to address unfair, deceptive, and abusive practices in the mortgage market. And CFPB's statutory role in mortgage servicing began even prior to July 21: Section 1025(e) of Dodd-Frank gives CFPB immediate authority to coordinate with the prudential regulators in supervision of large banks, which includes their servicing activities.

Given CFPB's immediate and ongoing responsibilities with respect to mortgage servicing, its engagement in the ongoing settlement negotiations between the Attorneys General and mortgage servicers is only appropriate; in fact, the CFPB's failure to be engaged would constitute a breach of its statutory duties.

I look forward to answering any questions you may have for me. Thank you for the opportunity to testify.

United States House of Representatives
Committee on Financial Services

"TRUTH IN TESTIMONY" DISCLOSURE FORM

Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name:	**2. Organization or organizations you are representing:**
Michael D Calhoun	Center for Responsible Lending
3. Business Address and telephone number:	
[redacted]	
4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?	**5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?**
☐ Yes ☑ No	☐ Yes ☑ No
6. If you answered .yes. to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.	
7. Signature:	

Please attach a copy of this form to your written testimony.