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HELPING FAMILIES SAVE THEIR HOMES: IS TREASURY'S STRATEGY REALLY WORKING?

HEARING

BEFORE A

SUBCOMMITTEE OF THE

COMMITTEE ON APPROPRIATIONS

UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

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THURSDAY, DECEMBER 4, 2008

U.S. SENATE,
SUBCOMMITTEE ON FINANCIAL SERVICES
AND GENERAL GOVERNMENT,
COMMITTEE ON APPROPRIATIONS,
Chicago, IL.

The subcommittee met at 10 a.m., in Courtroom 2525, E.M. Dirksen United States Courthouse, Chicago, IL, Hon. Richard J. Durbin (chairman) presiding.

Present: Senator Durbin.

STATEMENT OF SENATOR RICHARD J. DURBIN

Senator DURBIN. Good morning. I am pleased to welcome you to this hearing to examine the Department of the Treasury's implementation of the Emergency Economic Stabilization Act and other Government programs designed to minimize foreclosures and open up the flow of credit in the financial markets. Most importantly, this hearing will examine strategies for keeping families in their homes during this economic crisis, which is particularly important for us right here in Illinois and in the Chicago area.

About 2 years ago, I started hearing from a variety of people that, even though times were good and the economy was humming along, there was a looming problem in the housing markets. Wall Street veterans started mentioning the increasing risks that the mortgage banks were taking on. Community organizers in Chicago and around Illinois started calling me and telling me about the rising number of foreclosures that were beginning to hit neighborhoods as adjustable rate mortgages began to reset in large numbers and that property values were starting to crest.

Constituents called in even greater numbers to ask what they could do to save their homes. For example, I want to show you a chart that was provided to me by the Southwest Organizing Project in Chicago. This was just given to me a few days ago, and I've blown it up so that you might take a look at it. This is an amazing chart which shows a small section of the city of Chicago around Marquette Park and Midway Airport, and the number of mortgage foreclosures initiated since January 1 of this year.

Now let me show you a second chart that represents the homes in foreclosure in just one Zip Code in that area. If you will take a look at this in the most general way, it is hard to find a single block in this Zip Code where there isn't a home facing foreclosure.

I called, for example, Speaker Mike Madigan, who lives in the 13th ward, who told me they already have 50 homes boarded up in his ward and more to follow. He is a person who knows every nook and cranny, every alley, every neighborhood, and he understands the importance of this discussion.

The impact of these foreclosures on the future of the 13th ward and the city of Chicago could be profound if we don't do something. The red dots on that second chart are just one single Zip Code on the southwest side of Chicago. I want to thank again the Southwest Organizing Project for bringing these charts to our attention.

In response to what I see as a growing crisis which is made clear by these two charts, I have started working on a bill that I thought would help to minimize the number of foreclosures. Last fall, I introduced the Helping Families Save Their Homes in Bankruptcy Act, legislation that would make one simple change in the bankruptcy code in order to provide families with a bit of leverage as they tried to negotiate with their mortgage providers.

Meanwhile, last fall, Treasury and the mortgage banking industry unveiled their HOPE NOW Alliance, which created a framework for guiding servicers in reducing the number of avoidable foreclosures. Because the program was purely voluntary, however, the program really hasn't made a big difference, and the number of foreclosures continues to rise. HOPE NOW is not nearly—is not nearly enough—to relieve the impact that foreclosures would have on market.

Just 6 months into the program, in March of this year, Treasury and the Fed stepped in to prevent the failure of Bear Stearns. It was at this moment that two things became clear.

First, the massive number of mortgages going into default was no longer just a tragedy for the families affected and the communities affected, it had morphed into a systematic risk that threatened the entire financial industry in this country.

Second, the faster we could turn around the mortgage markets, the faster we could rebuild the health of investors' balance sheets which held mortgage-backed securities, and the faster we could avoid further damage to the economy as a whole.

And yet, as Treasury, the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC) and the Federal Housing Finance Agency (FHFA) continued over the next 6 months to aggressively bail out Fannie Mae and Freddie Mac, the American International]=Group (AIG), and others—using taxpayers' dollars—nothing to match that level of urgency was applied to the core of the crisis: the rapid rise in foreclosures which led to the meltdown of the mortgage-backed securities market.

Delinquency rates have risen each and every quarter since the beginning of last year, when I began working on legislation to address this crisis. As we all know now, what began as a problem 2 years ago in localized housing markets, has become part of a global economic crisis that has been identified correctly as a recession, and which rivals the worst economic circumstance we've seen in over 75 years.

So, 2 months ago when Congress wrote the Emergency Economic Stabilization Act, we specifically focused on the need to reduce the number of foreclosures. I can remember a conversation that took

place in a conference room with Speaker Nancy Pelosi. When the leaders in Congress—Democrats and Republicans, about 14 of us—gathered at a conference table, facing Ben Bernanke, the head of the Federal Reserve, Henry Paulson, Secretary of the Treasury, and Chris Cox, head of the Securities and Exchange Commission (SEC), when they disclosed to us some of the most frightening prospects that we faced if we didn't do something—and do it immediately—to deal with the looming economic crisis in America.

It was a sobering moment. There was silence in the room, as members of both political parties from the House and the Senate paused to try to grasp what we'd been told. That we were about to descend into a crisis of unimaginable proportions if we didn't act, and act quickly.

By the end of that conversation, when the input started from Members of Congress, the first issue raised was the issue of mortgage foreclosures—why hadn't we heard anything about that in the course of this rescue plan that was being proposed.

Finally, when the legislation was drafted, we included specific language to say that of the $700 million going into the rescue, a portion of it could and should be used for the mortgage foreclosure crisis. It's the right thing to do—not just for the people affected, but for the state of our economy, and it's a critical step, as far as I can see, for putting this economy back on its feet.

Yet, it appears that in implementing the economic—pardon me, Emergency Economic Stabilization Act, the Treasury Department has not taken full advantage of the authority granted to minimize the number of foreclosures.

Let me recognize for the record, the Treasury Department has been asked—under extraordinary economic circumstances—to attempt to accomplish an extremely difficult task—to put the American economy back on its feet. So, whatever criticism they may receive should not be attributed to lack of effort, or lack of good will; they're trying their best.

There's no chapter in the Department of the Treasury playbook that you turn to when you face this kind of crisis. They are trying to find a way to realistically turn this economy around. I would commend all of the people involved in the Treasury Department—Secretary Paulson, as well as some of the others—who've worked so hard to try to stabilize this economy.

But nonetheless, I think it's important for Congress, and the American people, to do all that we can to minimize the foreclosures that continue to devastate the entire American economy, and affect the global economy.

Today we're going to hear from Neel Kashkari, the Treasury's Interim Assistant Secretary for Financial Stability, who has roots in our State of Illinois, and is responsible for implementing the $700 billion plan regarding the Department's efforts to keep homeowners in their homes.

We'll get a second, unbiased opinion on Treasury's performance regarding foreclosure information so far, from the Government Accountability Office (GAO) and we'll hear from witnesses about what can be done outside of Treasury to address this crisis, including an innovative plan from the Federal Deposit Insurance Corporation, a landmark agreement, negotiated by our own State Attorney Gen-

eral, Lisa Madigan, and efforts underway by individual servicers and community housing counselors, addressing the crisis family by family.

I look forward to hearing honest and straightforward assessments from our witnesses about how current efforts are working to minimize foreclosures, and what changes we can make to do a better job.

I am pleased to welcome our first witness, via video conference from Washington, DC, Neel Kashkari. I had a chance to say hello to him on the phone this morning. He is the Interim Assistant Secretary for Financial Stability at the Department of the Treasury. He's been with the Department since 2006, and has overseen the Office of Financial Stability, including the Troubled Asset Relief Program, since October of this year.

Mr. Kashkari has previously served as Vice President at Goldman Sachs, has a bachelor's and a master's degree in engineering from the University of Illinois at Urbana-Champaign, and an MBA from the Wharton School.

Mr. Kashkari, I understand that your responsibilities in Washington make it difficult for you to travel back to Illinois, and to Chicago, but we certainly appreciate your willingness to testify by videoconference. The floor is yours, and after your statement, we will have another statement, Mr. Krimminger, and then ask questions of both of you.

So, please proceed, Mr. Kashkari.

STATEMENT OF NEEL KASHKARI, INTERIM ASSISTANT SECRETARY FOR FINANCIAL STABILITY, DEPARTMENT OF THE TREASURY

Mr. KASHKARI. Thank you, Chairman. I really appreciate the opportunity to speak today.

Chairman Durbin, members of the subcommittee, good morning, and thank you for this opportunity.

I would like to provide an update on the Treasury Department's actions to work through the financial crisis and restore the flow of credit to our economy.

We have taken action with the following three critical objectives: one, to provide stability to our financial markets; two, to support the housing market and avoid preventable foreclosures and support mortgage finance; and three, to protect the taxpayers.

Before we acted, we were at a tipping point. Credit markets were largely frozen, denying financial institutions, businesses and consumers access to vital funding and credit. Financial institutions were under extreme pressure, and investor confidence in our system was dangerously low.

We have acted quickly and creatively in coordination with the Federal Reserve, the FDIC, OTS, and the OCC to help stabilize the financial system, and it is clear that our coordinated actions have made an impact. Our effort to strengthen our financial institutions so they can support our economy is critical to working through the current economic downturn.

Strong financial institutions and a stable financial system will smooth the path to recovery and an eventual return to prosperity.

We have taken the necessary steps to prevent a financial collapse, and the authorities and flexibility granted to us by the Congress have been key to this.

I will briefly discuss some of Treasury's priorities, and have provided more detail in my submitted written testimony.

We have worked aggressively to avoid preventable foreclosures, to keep mortgage finance available, and to develop new tools to help homeowners. And here, I will briefly highlight three key accomplishments, to date:

First, in October 2007, Treasury helped establish the HOPE NOW Alliance, a coalition of mortgage servicers, investors and counselors, to help struggling homeowners avoid preventable foreclosures.

Through coordinated, industry-wide action, HOPE NOW has significantly increased the outreach and assistance provided to homeowners. They estimate the industry has helped nearly 2.7 million homeowners since July 2007, and is helping about 225,000 homeowners each month avoid foreclosure.

Second, we acted earlier this year to prevent the failure of Fannie Mae and Freddie Mac, the housing Government-sponsored enterprises (GSEs) that affect over 70 percent of mortgage originations. These institutions are systemically critical to financing and housing markets, and their failure would have materially exacerbated the recent market turmoil and profoundly impacted household wealth. We have stabilized the GSEs and limited systemic risk.

And third, on November 11—just last month—HOPE NOW, the Federal Housing Finance Agency and the GSEs achieved a major industry breakthrough with the announcement of a streamlined loan modification program that builds on the mortgage modification protocol developed by the FDIC for IndyMac. The adoption of this streamlined modification framework is an additional tool that servicers now have to help avoid preventable foreclosures. Potentially hundreds of thousands more struggling borrowers will be enabled to stay in their homes.

An important complement to those guidelines was the GSEs' announcement on November 20 that they will suspend foreclosures for 90 days. This will give homeowners and servicers time to utilize the new streamlined program, and make it possible for more struggling families to work out terms to stay in their homes.

Last week, on November 25, Treasury and the Federal Reserve announced another aggressive program aimed at making affordable credit available for consumers. Under the troubled asset relief program (TARP), Treasury will provide $20 billion to invest in a Federal Reserve facility that will provide liquidity to issuers of consumer asset-backed paper, enabling a broad range of institutions to step up their lending, and enabling borrowers to have access to lower-cost consumer finance, such as credit card loans, student loans, small business loans, and auto loans.

On December 1, Secretary Paulson underscored the critical priorities for the most effective deployment of the remaining TARP funds, and I will briefly discuss those priorities.

One, we continue to look at additional strategies are capital, and as we do so, we will assess the impact of the first capital program,

and also take into consideration existing economic and market conditions.

Two, we continue to aggressively examine strategies to mitigate foreclosures and maximize loan modifications, which are an important part of working through the necessary housing correction, and maintaining the strength of our families and communities.

And finally, as we consider potential new TARP programs, we must also maintain flexibility and firepower for this administration and the next administration, to address new challenges as they arise.

It is important that we recognize that a program as large and important as this, demands appropriate oversight and we are committed to transparency and oversight in all aspects of this program. We continue to take necessary measures to ensure compliance with both the letter and the spirit of the requirements established by the Congress, including regular briefings with the GAO, the Financial Stability Oversight Board, the inspector general, as well as the congressional oversight panel. We will also continue to meet all of the reporting requirements established by the Congress, on time.

Our system is stronger and more stable due to our actions. Although a lot has been accomplished, we have many challenges ahead. We will focus on the goals outlined by Secretary Paulson and develop the right strategies to meet those objectives.

Thank you again, and I would be happy to answer your questions.

Senator DURBIN. Mr. Kashkari, thank you for your testimony.

[The statement follows:]

PREPARED STATEMENT OF NEEL KASHKARI

Chairman Durbin, members of the subcommittee, good morning and thank you for the opportunity to appear before you. I would like to provide an update on the Treasury Department's actions to work through the financial crisis and restore the flow of credit to the economy. We have taken multiple actions with the following three critical objectives: one, to provide stability to financial markets; two, to support the housing market by preventing avoidable foreclosures and supporting the availability of mortgage finance; and three, to protect taxpayers. Before we acted, we were at a tipping point. Credit markets were largely frozen, denying financial institutions, businesses, and consumers access to vital funding and credit. Financial institutions were under extreme pressure, and investor confidence in our system was dangerously low.

We have acted quickly and creatively in coordination with the Federal Reserve, the FDIC, OTS, and the OCC to help stabilize the financial system and it is clear that our coordinated actions have made an impact. Our coordinated effort to strengthen our financial institutions so they can support our economy is critical to working through the current economic downturn. Strong financial institutions and a stable financial system will smooth the path to recovery and an eventual return to prosperity.

We believe we have taken the necessary steps to prevent a financial collapse and the authorities and flexibility granted to us by Congress are key to this. I will briefly discuss some of Treasury's policies and priorities today.

RECENT ACTIONS

First, I will start by discussing some of our most recent actions. Consistent with our commitment to stabilize the financial system and strengthen our financial institutions, while also protecting U.S. taxpayers, we took two recent actions in coordination with our regulators. On November 9, Treasury announced an investment to support the restructuring of the American Insurance Group (AIG), together with the Federal Reserve Bank of New York. On November 23, the U.S. Government—Treasury, the Fed, and the FDIC—entered into an agreement with Citigroup to provide a package of guarantees, liquidity, and capital. We will continue to take the nec-

essary steps to protect the financial system and believe these actions, together with others we have taken since the onset of the financial crisis, demonstrate a decisive use of tools to strengthen our financial institutions and increase confidence in our system.

EQUITY PROGRAM

Next, I will discuss the Capital Purchase Program, one of the most significant and effective programs we have implemented to stabilize financial markets and improve the flow of credit to businesses and consumers. As the markets rapidly deteriorated in October, it was clear to Secretary Paulson and Chairman Bernanke that the most timely, effective way to improve credit market conditions was to strengthen bank balance sheets quickly through direct purchases of equity. Secretary Paulson announced that we would commit $250 billion of the financial rescue package granted by Congress to purchase equity directly from a range of financial institutions. With a stronger capital base, our banks will be more confident and better positioned to continue lending which, although difficult to achieve during times like this, is essential to economic recovery. Moreover, a stronger capital base also enables banks to take losses as they write down or sell troubled assets.

In just over 1 month, Treasury has already disbursed an estimated $151 billion to 52 institutions and has pre-approved many additional applications from public depositories across the country. This progress is remarkable not only in its speed and efficacy but also in its scope. We have touched every banking market in the Nation already with applications representing small and large banks alike. Taking into account the needs of the range of institutions across the country, on November 17, Treasury released a term sheet for privately held institutions, and we have provided even more streamlined terms to facilitate capital investment into community development financial institutions. Regulators are already receiving and reviewing many applications from these private depositories, another important source of credit in our economy.

We feel very strongly that healthy banks of all sizes, both public and private, should use this program to continue making credit available in their communities. Therefore, Treasury strongly supports the statement issued by bank regulators on November 12 in support of this goal. The inter-agency statement emphasized that the extraordinary Government actions taken to stabilize and strengthen the banking system are not merely one-sided; all banks—not just those participating in the Capital Purchase Program—have benefited from the Government's actions to restore confidence in the U.S. banking sector. Banks, in turn have obligations to their communities, particularly in this time of economic disruption. They have an obligation to continue to make credit available to creditworthy borrowers and an obligation to work with borrowers who are struggling to avoid preventable foreclosures.

The statement also urges banks to carefully review their dividend and compensation policies during this time of scarce resources. We fully support this regulatory initiative and believe it is crucial to focus on prudent lending so that institutions do not repeat the poor lending practices that were a root cause of today's problems. Restoring a vibrant economy won't materialize as quickly as all of us would like, but it will happen much quicker as confidence in our financial sector is restored in part due to the TARP.

HOUSING/MORTGAGE FINANCE

Our other critical and related objective is to support the housing market and avoid preventable foreclosures. We have worked aggressively to avoid preventable foreclosures, keep mortgage financing available, and develop new tools to help homeowners. Here, I will briefly highlight three key accomplishments:

—In October 2007, Treasury helped establish the HOPE NOW Alliance, a coalition of mortgage servicers, investors, and counselors, to help struggling homeowners avoid preventable foreclosures. Through coordinated, industry-wide action, HOPE NOW has significantly increased the outreach and assistance provided to homeowners. HOPE NOW estimates that nearly 2.7 million homeowners have been helped by the industry since July 2007; the industry is now helping about 225,000 homeowners a month avoid foreclosure.

—We acted earlier this year before enactment of the EESA to prevent the failure of Fannie Mae and Freddie Mac, the housing GSEs that affect over 70 percent of mortgage originations. These institutions are systemically critical to financial and housing markets, and their failure would have materially exacerbated the recent market turmoil and profoundly impacted household wealth. We have stabilized the GSEs and limited systemic risk.

—On November 11, HOPE NOW, FHFA, and the GSEs achieved a major industry breakthrough with the announcement of a streamlined loan modification program that builds on the mortgage modification protocol developed by the FDIC for IndyMac. The adoption of this streamlined modification framework is an additional tool that servicers now have to help avoid preventable foreclosures. Potentially hundreds of thousands more struggling borrowers will be enabled to stay in their homes.

An important complement to those guidelines was the GSEs' announcement on November 20 that they will suspend all foreclosures for 90 days. The foreclosure suspension will give homeowners and servicers time to utilize the new streamlined loan modification program and make it possible for more families to work out terms to stay in their homes.

TERM ASSET-BACKED SECURITIES LOAN FACILITY

Next, I will discuss our most recent program, the Term Asset Backed Securities Loan Facility (TALF). As Secretary Paulson noted on November 12, support of the consumer finance sector is a high priority for Treasury because of its fundamental role in fueling economic growth. Like other forms of credit, the availability of affordable consumer credit depends on ready access to a liquid and affordable secondary market—in this case, the asset-backed credit market. Additionally, consumer finance relies on the non-bank financial sector as a source of finance. However, recent credit market stresses essentially brought this market to a halt in October, resulting in climbing credit card rates. As a result, millions of Americans cannot find affordable financing for their basic credit needs and everyday purchases.

Last week, on November 25, Treasury and the Federal Reserve announced an aggressive program aimed at supporting the normalization of credit markets and making available affordable credit for all consumers. Under the TARP, Treasury will provide $20 billion to invest in a Federal Reserve facility that will provide liquidity to issuers of consumer asset backed paper, enabling a broad range of institutions to step up their lending, and enabling borrowers to have access to lower-cost consumer finance and small business loans. The facility may be expanded over time and eligible asset classes may be expanded later to include other assets, such as commercial mortgage-backed securities, non-agency residential mortgage-backed securities or other asset classes.

PRIORITIES FOR TARP

On December 1, Secretary Paulson underscored the critical priorities for the most effective deployment of remaining TARP funds, foremost of which is to ensure our banking sector has the necessary capital base to continue lending to consumers and businesses and support economic growth, and to help homeowners avoid preventable foreclosures.

I will briefly discuss these priorities:

—In order to continue their critical role as providers of credit, both banks, and non-banks may need more capital given their troubled asset holdings, continued high rates of foreclosures, and stagnant global economic conditions. We continue to look at additional capital strategies and, as we do so, we will assess the impact of the first capital program and also take into consideration existing economic and market conditions.

—We continue to aggressively examine strategies to mitigate foreclosures and maximize loan modifications, which are a necessary part of working through the necessary housing correction and maintaining the strength of our communities. The new program which I highlighted above with the FHFA, the GSEs, and HOPE NOW is just one example and we will continue working hard to make progress here.

—As we consider potential new TARP programs, we must also maintain flexibility and firepower for this administration and the next, to address new challenges as they arise.

OVERSIGHT

Concurrently, we recognize that a program as large and important as the TARP demands appropriate oversight and we are committed to transparency and oversight in all aspects of the program. We continue to take necessary measures to ensure compliance with the letter and the spirit of the requirements established by the Congress, including regular briefings with the Government Accountability Office, the Financial Stability Oversight Board, the Inspector General and the Congressional Oversight Panel. We will also continue to meet all of the reporting requirements established by the Congress.

CONCLUSION

Our system is stronger and more stable due to our actions. Although a lot has been accomplished, we have many challenges ahead of us. We will focus on the goals outlined by Secretary Paulson and develop the right strategies to meet those objectives. Thank you and I would be happy to answer your questions.

Senator DURBIN. We'll have Michael Krimminger testify, and then have questions for both of you.

Our next witness is Michael Krimminger, who is the Special Advisor for Policy to the Chairman of the Federal Deposit Insurance Corporation. Mr. Krimminger has been the FDIC Chairman's advisor on mortgage and housing issues throughout the current mortgage and credit crisis, including the loan modification process used by the FDIC and IndyMac Federal Bank.

Mr. Krimminger is a graduate of the University of North Carolina, and has a J.D. from the Duke University School of Law.

Mr. Krimminger, welcome, the floor is yours.

STATEMENT OF MICHAEL KRIMMINGER, SPECIAL ADVISOR TO THE CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. KRIMMINGER. Good morning, and thank you, Chairman Durbin.

I appreciate the opportunity to testify on behalf of the FDIC's recent efforts to stabilize the Nation's financial markets and reduce foreclosures.

As you know, conditions in the financial market have deeply shaken the confidence of people around the world in their financial systems. As you've just heard from Assistant Secretary Kashkari, the Government has taken a number of extraordinary steps to bolster confidence in the U.S. banking industry.

Working with the Treasury Department and other bank regulators, FDIC Chairman Bair has stated that the FDIC will do whatever it takes to preserve the public's trust in the financial system.

But in spite of the current challenges, the bulk of the U.S. banking industry—while taking losses—is remaining well capitalized. However, there is a liquidity problem.

The liquidity squeeze was initially caused by uncertainty about the value of mortgage-related assets. Some of the actions the FDIC has taken in concert with the Treasury and the Federal Reserve include temporarily increasing deposit insurance coverage, and providing guarantees to new senior unsecured debt issued by banks, thrifts and holding companies.

The purpose of all of these programs, including the TARP and other programs offered by the Federal Reserve and the Treasury, is to increase bank lending, and minimize the impact of deleveraging on the American economy.

As a result of these efforts, the financial system is now more stable, while interest rate spreads have narrowed substantially. However, credit remains tight, and is a serious threat to the economic outlook.

In the meantime, the FDIC has also spent much time focusing on the borrower side of the equation. We think that foreclosure prevention is essential to help find a bottom for home prices, to stabilize mortgage credit markets, and restore economic growth.

The continuing trend of unnecessary foreclosures imposes costs, not only on borrowers and lenders, but also on the entire community and the economy as a whole. Foreclosures result in vacant homes that may invite crime, and diminish the market value of nearby property. The also create distressed sale prices, which places even more downward pressure on surrounding home values.

But everyone seems to agree that more needs to be done for homeowners. Now is the time for significant, decisive action to get at the root of our economic distress. We need to modify loans at a much faster pace. Much more aggressive intervention is needed, if we are to curb the damage to our neighborhoods, and to the broader economy.

Industry leaders have told me that we need to double the current pace of modifications in order to get a hold of the foreclosure problem.

My written statement gives the details of our loan modification program and experience as conservator of the failed IndyMac Federal Bank. The bottom line is, we have provided specific loan modification offers to more than 24,000 borrowers. So far, over 5,500 borrowers have accepted offers, verified their incomes, and are now making payments on their modified mortgages. Many more than this are making modified payments following work-through processes to verify their income.

Several weeks ago, we released the details of a foreclosure prevention plan that would use TARP funds, that we estimate would help 1.5 million homeowners avoid foreclosure by the end of next year.

Our program will require about $24 billion in Federal financing over the next 8 years. The plan is based on our practical experience at IndyMac. The plan would set loan modification standards, so that eligible borrowers could get lower interest rates, and in some cases, in order to make the loan affordable, longer amortization periods and potentially principal forbearance, to make their monthly payments affordable to support the long-term sustainability of the mortgage.

All modifications would be 31 percent debt-income ratios. This will transform bad mortgages into sustainable loans that will keep communities stable.

To encourage the lending industry to participate, a loan guarantee program would be established that would absorb up to one-half of the losses, if the borrower were to default on the modified loan. If this program, limited to loans secured by owner-occupied homes, can keep home prices from falling by just 3 percentage points, over half a trillion dollars would remain in homeowners' pockets. I think an important facet of this program that we must remember, is that it is designed to go after the main concern that investors in securituzations and lenders have about home loan modifications, and that's the losses that they would incur if the modification defaults. By addressing this concern, we think this will have the most significant impact upon incentivizing greater modification levels. Even a conservative estimate of the wealth effect on consumer spending would exceed $40 billion. That would be a big stimulus for the economy, and nearly double the Government's investment.

In conclusion, the FDIC has committed to achieving what has been a core mission since we were created 75 years ago—to protect depositors, and maintain public confidence in the banking system.

Thank you, Mr. Chairman, I'd be happy to respond to your questions.

Senator DURBIN. Mr. Krimminger, thank you very much.

[The statement follows:]

PREPARED STATEMENT OF MICHAEL H. KRIMMINGER

Chairman Durbin, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) regarding recent efforts to stabilize the Nation's financial markets and reduce foreclosures.

The events of the past several months are unprecedented. Credit markets have not been functioning normally, contributing to a rising level of distress in the economy. In addition, high levels of foreclosures are contributing to downward pressure on home prices. The impact on confidence resulting from the cumulative impact of these events has required the Government to take extraordinary steps to bolster public confidence in our financial institutions and the American economy.

Achieving this goal requires a sustained and coordinated effort by Government authorities. Congress passed the Emergency Economic Stabilization Act of 2008 (EESA), which provides authority for the purchase of troubled assets and direct investments in financial institutions, a mechanism for reducing home foreclosures, and a temporary increase in deposit insurance coverage. Working with our colleagues at the Treasury Department and our fellow bank regulators, the FDIC is prepared to undertake all necessary measures to preserve confidence in insured financial institutions.

Despite what we hear about the credit crisis and the problems facing banks, the bulk of the U.S. banking industry is healthy and remains well-capitalized. What we do have, however, is a liquidity problem. This problem originally arose from uncertainty about the value of mortgage-related assets, but credit concerns have broadened over time, making banks reluctant to lend to each other or lend to consumers and businesses.

In my testimony, I will detail recent actions by the FDIC to restore confidence in insured financial institutions. I also will discuss the FDIC's continuing efforts to address the root cause of the current economic crisis—the failure to deal effectively with unaffordable loans and unnecessary foreclosures.

RECENT ACTIONS TO RESTORE CONFIDENCE

The FDIC has taken several actions in coordination with Congress, the Treasury Department, the Federal Reserve Board, and other Federal regulators, designed to restore confidence in insured financial institutions. These have included temporarily increasing deposit insurance coverage and providing guarantees to new, senior unsecured debt issued by banks, thrifts, or holding companies. These measures will help banks fund their operations.

Increased Deposit Insurance

With the enactment of the EESA, deposit insurance coverage for all deposit accounts was temporarily increased to $250,000, the same amount of coverage previously provided for self-directed retirement accounts. Temporarily raising the deposit insurance limits has bolstered public confidence and successfully provided additional liquidity to FDIC-insured institutions.

The FDIC implemented the coverage increase immediately upon enactment of EESA. The FDIC website and deposit insurance calculators were updated promptly to reflect the increase in coverage and ensure that depositors understand the change. It is important to note that the increase in coverage to $250,000 is temporary and only extends through December 31, 2009. The FDIC will work closely with Congress in the coming year to ensure that consumers are fully informed of changes to the deposit insurance coverage level, as well as the temporary nature of the increase, and understand the impact on their accounts.

Temporary Liquidity Guarantee Program

On October 14, the FDIC Board of Directors approved an interim final rule and on November 21 adopted a final rule for a new Temporary Liquidity Guarantee Program (TLGP) to unlock inter-bank credit markets and restore rationality to credit spreads. This voluntary program is designed to free up funding for banks to make loans to creditworthy businesses and consumers.

The program has two key features. The first feature is a guarantee for new, senior unsecured debt issued by banks, thrifts, bank holding companies, and most thrift holding companies, which will help institutions fund their operations. Eligible entities include: (1) FDIC-insured depository institutions; (2) U.S. bank holding companies; and (3) U.S. savings and loan holding companies that either engage only in activities that are permissible for financial holding companies under section 4(k) of the Bank Holding Company Act (BHCA) or have an insured depository institution subsidiary that is the subject of an application under section 4(c)(8) of the BHCA regarding activities closely related to banking. Bank and savings and loan holding companies must own at least one insured and operating depository institution. The FDIC may allow other affiliates of an insured depository institution to be eligible on a case-by-case basis, after written request and positive recommendation by the appropriate Federal banking agency.

The guarantee applies to all senior unsecured debt issued by participating entities on or after October 14, 2008, through and including June 30, 2009. Issuers will be limited in the amount of guaranteed debt they raise, which generally may not exceed 125 percent of senior unsecured debt that was outstanding as of September 30, 2008, and scheduled to mature before June 30, 2009. For eligible debt issued on or before June 30, 2009, coverage is only provided until the earlier of the date of maturity of the debt or June 30, 2012.

The debt guarantee will be triggered by payment default, as opposed to bankruptcy or receivership as provided in the interim rule. This improvement in the nature of the guarantee has enabled FDIC-guaranteed debt issued by participating institutions to attain the highest ratings for that class of investment and helped ensure wide acceptance of FDIC-guaranteed debt instruments within the investment community. Between issuance of the final rule and November 28, three institutions have issued approximately $17.3 billion in FDIC-guaranteed debt, with maturities ranging from 2 years to 3½ years. The lower costs and longer term maturities of this debt will provide banks with a stronger, more stable funding base to support increased lending. Other banking companies have plans to issue FDIC-guaranteed debt in coming weeks.

Under the final rule, premiums are charged on a sliding scale depending on the length of the debt maturity. The range will be 50 basis points on debt of 180 days or less, and a maximum of 100 basis points for debt with maturities of 1 year or longer, on an annualized basis. Short-term debt issued for 1 month or less, including overnight Federal funds, will not be eligible for the program.

The second feature of the new program provides insurance coverage for all deposits in non-interest-bearing transaction accounts, as well as NOW accounts that pay minimal interest, at insured depository institutions unless they choose to opt out. These accounts are mainly payment processing accounts such as payroll accounts used by businesses. Frequently, such accounts exceed the current maximum insurance limit of $250,000. Many smaller, healthy banks had expressed concerns about deposit outflows based on market conditions.

The temporary guarantee on non-interest bearing transaction accounts will expire December 31, 2009, consistent with the temporary statutory increase in deposit insurance. This aspect of the program allows bank customers to conduct normal business knowing that their cash accounts are safe and sound. The guarantee has helped stabilize these accounts, and helped the FDIC avoid having to close otherwise viable banks because of large deposit withdrawals.

A 10 basis point surcharge will be applied to deposits in non-interest bearing transaction deposit accounts not otherwise covered by the existing deposit insurance limit of $250,000. This surcharge will be added to the participating bank's existing risk-based deposit insurance premium paid on those deposits.

It is important to note that the TLGP does not rely on taxpayer funding or the Deposit Insurance Fund. Instead, both aspects of the program will be paid for by direct user fees as described above. Coverage for both parts of the program is initially automatic. An entity must make an election to opt in or opt out of the program by December 5. Participating institutions will be subject to supervisory oversight to prevent rapid growth or excessive risk-taking. The FDIC, in consultation with the entity's primary Federal regulator, will determine continued eligibility and parameters for use.

The TLGP is similar to actions by the international community. If the FDIC had not acted, guarantees for bank debt and increases in deposit insurance by foreign governments would have created a competitive disadvantage for U.S. banks. Along with Treasury's actions to inject more capital into the banking system, the combined coordinated measures to free up credit markets have had a stabilizing effect on bank funding.

Since these measures were implemented on October 14, we have seen steady progress in reducing risk premiums in money and credit markets. Short-term LIBOR (London Interbank Offer Rate) and commercial paper rates have moderated, as have short-term interest rate spreads including the Libor—Treasury (TED) spread and the Libor—Overnight Index Swap (OIS) spread. While it is clearly too early to declare the end of the crisis in our financial markets, as a result of the coordinated response of the Federal Reserve, the Treasury, the FDIC, and our counterparts overseas, we are making steady progress in returning money and credit markets to a more normal state.

The FDIC's action in establishing the TLGP is unprecedented and necessitated by the crisis in our credit markets, which has been fed by rising risk aversion and serious concerns about the effects this will have on the real economy. The FDIC's action is authorized under the systemic risk exception of the FDIC Improvement Act of 1991. In accordance with the statute, the Secretary of the Treasury invoked the systemic risk exception after consultation with the President and upon the recommendation of the Boards of the FDIC and the Federal Reserve. The systemic risk exception gives the FDIC flexibility to provide such guarantees which are designed to avoid serious adverse effects on economic conditions or financial stability.

TARP Capital Purchase Program

As a part of EESA, the Treasury also has developed a Capital Purchase Program (CPP) which allows certain financial companies to make application for capital augmentation of up to 3 percent of risk-weighted assets. As mentioned earlier, the Federal Government intervened to inject capital in banks and to guarantee a larger portion of their liabilities so they can better meet the credit needs of the economy. The ongoing financial crisis has already disrupted a number of the channels through which market-based financing is normally provided to U.S. businesses and households. Private asset-backed securitization remains virtually shut down, and the commercial paper market is now heavily dependent on credit facilities created by the Federal Reserve. In this environment, banks will need to provide a greater share of credit intermediation than in the past to support normal levels of economic activity. By contrast, a significant reduction in bank lending would be expected to have strong, negative procyclical effects on the U.S. economy that would worsen the problems of the financial sector.

Before the recent capital infusions, banks appeared to be on course to significantly reduce their supply of new credit as a response to an unusually severe combination of credit distress and financial market turmoil. Standard banking practice during previous periods of severe credit distress has been to conserve capital by curtailing lending. In the present episode, lending standards were likely to be tightened further due to higher funding costs resulting from overall financial market uncertainty. There was ample evidence in the Federal Reserve's Senior Loan Officer Survey in October that bank lending standards were being tightened to a degree that is unprecedented in recent history.[1]

Government intervention was essential to interrupt this self-reinforcing cycle of credit losses and reduced lending. We fully support the CPP as a means of countering the procyclical economic effects of financial sector de-leveraging. We see the TLGP as a necessary complement to this effort, and are looking at additional ways that we might structure our liquidity guarantees to enhance the incentive and capacity to lend on the part of FDIC-insured institutions.

The combined Federal policy response will make capital and debt finance more readily available to banks on favorable terms. The expectation is that banks will actively seek ways to use this assistance by making sound loans to household and business borrowers. Doing so will require a balanced perspective that takes into account the long-term viability of these borrowers and the fact that they may have unusual short-term liquidity needs.

We recognize that banks will need to make adjustments to their operations, even cutting back in certain areas, to cope with recent adverse credit trends. However, the goal of providing Government support is to ensure that such adjustments are made mostly in areas such as dividend policy and the management compensation, rather than in the volume of bank lending. These considerations are consistent with the precept that the highest and best use of bank capital in the present crisis is to support lending activity. Ongoing supervisory assessments of bank earnings and capital will take into account how available capital is deployed to generate income through expanded lending.

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[1] Federal Reserve Board, *Senior Loan Officer Opinion Survey on Bank Lending Practices*, October 2008, *http://www.federalreserve.gov/boarddocs/snloansurvey/200811/*.

In addition, we maintain that compensation programs must discourage excessive risk-taking and the pursuit of near-term rewards with long-term risks. Only compensation structures that create appropriate incentives for bank managers and reward long-term performance are consistent with the basic principles of safe-and-sound banking. The Federal banking regulators expect that all banks will compensate their managers in ways that will encourage the type of sustainable lending that leads to long-term profitability. Bank supervisors will consider the incentives built into compensation policies when assessing the quality of bank management.

Thus far, a number of the largest banking companies in the United States have taken advantage of the CPP, significantly bolstering their capital base during a period of economic and financial stress. In addition, over 1,200 community financial institutions have applied to this program. We understand that Treasury will soon finalize terms of the CPP program for the great majority of banks which are not actively traded public companies, including those organized as Subchapter S corporations and mutuals.

It is critically important that community banks (commonly defined as those under $1 billion in total assets) participate in this program. Although, as a group, community banks have performed somewhat better than their larger competitors, they have not fully escaped recent economic problems.

Community banks control 11 percent of industry total assets; however, their importance is especially evident in small towns and rural communities. Of the 9,800 banking offices located in communities with populations of under 10,000, 67 percent are community banks. In these markets, the local bank is often the essential provider of banking services and credit. Their contribution to small business and agriculture lending is especially important and disproportionate to their size. As of June 30, bank lending by community banks accounted for 29 percent of small commercial and industrial loans, 40 percent of small commercial real estate loans, 77 percent of small agricultural production loans, and 75 percent of small farm land loans.[2] Although the viability of community banks as a sector continues to be strong, the CPP offers an opportunity for individual institutions to strengthen their balance sheets and continue providing banking services and credit to their communities.

Also, on November 12, the FDIC issued an Interagency Statement on Meeting the Needs of Creditworthy Borrowers to all FDIC supervised institutions. The statement encourages financial institutions to support the lending needs of creditworthy borrowers, strengthen capital, engage in loss-mitigation strategies and foreclosure-prevention strategies with mortgage borrowers, and assess the incentive implications of compensation policies. Further, on November 20, the FDIC announced the availability of a comprehensive package of information, termed "mod-in-a-box" to give servicers and financial institutions all of the tools necessary to implement a systematic and streamlined approach to modifying loans. This approach is based on the FDIC loan modification program initiated at IndyMac Federal Bank, which is described in detail later in this testimony.

EFFORTS TO REDUCE UNNECESSARY FORECLOSURES

Minimizing foreclosures is essential to the broader effort to stabilize global financial markets and the U.S. economy. There were an estimated 1.5 million U.S. foreclosures last year, and another 1.2 million in the first half alone of 2008. Foreclosure is often a very lengthy, costly, and destructive process that puts downward pressure on the price of nearby homes. While some level of home price decline is necessary to restore U.S. housing markets to equilibrium, unnecessary foreclosures perpetuate the cycle of financial distress and risk aversion, thus raising the very real possibility that home prices could overcorrect on the downside.

The continuing trend of unnecessary foreclosures imposes costs not only on borrowers and lenders, but also on entire communities and the economy as a whole. Foreclosures may result in vacant homes that may invite crime and create an appearance of market distress, diminishing the market value of other nearby properties. Foreclosures add inventory and create distressed sale prices which place downward pressure on surrounding home values. In addition, the direct costs of foreclosure include legal fees, brokers' fees, property management fees, and other holding costs that are avoided in workout scenarios. These costs can total between 20 and 40 percent of the market value of the property.[3] The FDIC has strongly en-

[2] Small commercial and industrial loans and small commercial real estate loans are in amounts under $1 million. Small agricultural production loans and small farm land loans are in amounts under $500,000.

[3] Capone, Jr., C. A., *Providing Alternatives to Mortgage Foreclosure: A Report to Congress*, Washington, D.C.: United States Department of Housing and Urban Development, 1996.

couraged loan holders and servicers to adopt systematic approaches to loan modifications that result in affordable loans that are sustainable over the long term.

Emergency Economic Stabilization Act

The EESA, recently passed by Congress, provides broad authority to the Secretary of the Treasury to take action to ameliorate the growing distress in our credit and financial markets, as well as the broader economy. The EESA specifically provides the Secretary with the authority to use loan guarantees and credit enhancements to facilitate loan modifications to prevent avoidable foreclosures. We believe that it is essential to utilize this authority to accelerate the pace of loan modifications in order to halt and reverse the rising tide of foreclosures that is imperiling the economy.

The FDIC has proposed to Treasury the creation of a guarantee program based on the FDIC's practical experience in modifying mortgages at IndyMac Federal Bank in California. We believe this program could prevent as many as 1.5 million avoidable foreclosures by the end of 2009. As outlined in more detail below, we have proposed that the Government establish standards for loan modifications and provide for a defined sharing of losses on any default by modified mortgages meeting those standards. By doing so, unaffordable loans could be converted into loans that are sustainable over the long term. This proposal is authorized by the EESA and may be implemented under the authority provided to the Secretary under that statute. We have strongly advocated this type of approach to Treasury and continue to believe that it offers the best mechanism for providing appropriate protection for homeowners.

In recent months, the FDIC has demonstrated through our actions with the troubled loans owned or serviced by IndyMac Federal Bank that it is possible to implement a streamlined process to modify troubled mortgages into loans that are affordable and sustainable over the long-term. Not only can the approach used successfully at IndyMac serve as a model for the servicing and banking industry, but we believe it can provide the foundation for a loss sharing guarantee program under the EESA.

IndyMac Federal Bank Loan Modifications

As the Committee knows, the former IndyMac Bank, F.S.B., Pasadena, California, was closed July 11. The FDIC is conservator for a new institution, IndyMac Federal Bank, F.S.B. (IndyMac Federal), which continues the depository, mortgage servicing, and certain other operations of the former IndyMac Bank, F.S.B. As a result, the FDIC has inherited responsibility for servicing a pool of approximately 653,000 first lien mortgage loans, including more than 60,000 mortgage loans that are more than 60 days past due, in bankruptcy, in foreclosure, and otherwise not currently paying. As conservator, the FDIC has the responsibility to maximize the value of the loans owned or serviced by IndyMac Federal. Like any other servicer, IndyMac Federal must comply with its contractual duties in servicing loans owned by investors. Consistent with these duties, we have implemented a loan modification program to convert as many of these distressed loans as possible into performing loans that are affordable and sustainable over the long term. In addition, we are seeking to refinance distressed mortgages through FHA programs, including FHA Secure and HOPE for Homeowners, and have sent letters proposing refinancing through FHA to almost 2,000 borrowers.

On August 20, the FDIC announced a loan modification program to systematically modify troubled residential loans for borrowers with mortgages owned or serviced by IndyMac Federal. This program modifies eligible, delinquent mortgages to achieve affordable and sustainable payments using interest rate reductions, extended amortization and, where necessary, deferring a portion of the principal. By modifying the loans to an affordable debt-to-income ratio and using this menu of options to lower borrowers' payments for the life of their loan, the program improves the value of these troubled mortgages while achieving economies of scale for servicers and stability for borrowers. Of the more than 60,000 mortgages serviced by IndyMac Federal that are more than 60 days past due, in bankruptcy, in foreclosure, and otherwise not currently paying, approximately 40,000 are potentially eligible for our loan modification program.[4] Initially, the program was applied only to mortgages either owned by IndyMac Federal or serviced under IndyMac Federal's pre-existing securitization agreements. Subsequently, we have obtained agreements

[4] Loans not eligible for a modification proposal under the IndyMac Federal modification program include non-owner-occupied loans, loans subject to bankruptcy proceedings, completed foreclosures, and loans secured by properties held after a prior foreclosure.

to apply the program to many delinquent loans owned by Freddie Mac, Fannie Mae, and other investors.

It is important to recognize that securitization agreements typically provide servicers with sufficient flexibility to apply the IndyMac Federal loan modification approach. While some have argued that servicing agreements preclude or routinely require investor approval for loan modifications, this is not true for the vast majority of servicing agreements. In fact, the American Securitization Forum has repeatedly confirmed that most servicing agreements do allow for loan modifications for troubled mortgages that are delinquent or where default is "reasonably foreseeable" if the modification is in the best interest of securityholders as a whole.[5] If, as under the model applied at IndyMac Federal, the modification provides an improved net present value for securityholders as a whole in the securitization compared to foreclosure, the modification is permitted under the agreements as well as applicable tax and accounting standards. In fact, the agreements at IndyMac Federal were more restrictive than those that apply to many other securitizations as they limited modifications to mortgages that were "seriously delinquent" rather than permitting modification when default was "reasonably foreseeable." As a result, the model applied at IndyMac Federal can be applied broadly for securitized as well as for portfolio loans.

Using the model at IndyMac Federal to achieve mortgage payments for borrowers that are both affordable and sustainable, the distressed mortgages will be rehabilitated into performing loans and avoid unnecessary and costly foreclosures. By taking this approach, future defaults will be reduced, the value of the mortgages will improve, and servicing costs will be cut. The streamlined modification program will achieve improved recoveries on loans in default or in danger of default, and improve the return to uninsured depositors, the deposit insurance fund, and other creditors of the failed institution. At the same time, many troubled borrowers can remain in their homes. Under the program, modifications are only being offered where doing so will result in an improved value for IndyMac Federal or for investors in securitized or whole loans, and where consistent with relevant servicing agreements.

Applying workout procedures for troubled loans in a failed bank scenario is something the FDIC has been doing since the 1980s. Our experience has been that performing loans yield greater returns than non-performing loans. In recent years, we have seen troubled loan portfolios yield about 32 percent of book value compared to our sales of performing loans, which have yielded over 87 percent.

Through this week, IndyMac Federal has mailed more than 24,000 loan modification proposals to borrowers, and will mail over thousands more this week and next. We have contacted many thousands more in continuing efforts to help avoid unnecessary foreclosures. Already, over 5,400 borrowers have accepted the offers, verified their incomes, and are now making payments on their modified mortgages. Thousands more are making lower payments as we complete verification of incomes. I am pleased to report that these efforts have prevented many foreclosures that would have been costly to the FDIC and to investors. This has been done while providing long-term sustainable mortgage payments for borrowers who were seriously delinquent. On average, the modifications have cut each borrower's monthly payment by more than $380 or 23 percent of their monthly payment on principal and interest. Our hope is that the program we announced at IndyMac Federal will serve as a catalyst to promote more loan modifications for troubled borrowers across the country.

Loss-Sharing Proposal To Promote Affordable Loan Modifications

Although foreclosures are costly to lenders, borrowers, and communities, efforts to avoid unnecessary foreclosures are not keeping pace with delinquencies. By the end of 2009, more than 4.4 million non-GSE mortgages are estimated to become delinquent. While the HOPE for Homeowners refinancing program is part of the solution, the limitations inherent in refinancing mortgages out of securitization transactions indicate that other, more streamlined approaches are necessary.

A major acceleration in loan modifications is essential if we are to stem the growing flood of foreclosures. Yet today, only around 4 percent of seriously delinquent loans are being modified each month. While the FDIC's experience at IndyMac demonstrates that modifications provide a better return than foreclosure in the vast majority of mortgages today, many servicers continue to rely on slower custom modifications that are not focused on long-term affordability. Many servicers continue to argue that they are concerned about proving to investors that modifications provide a better return than foreclosure. As a result, far too many of the responses to trou-

[5] ASF Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans, Dec. 6, 2007; ASF *Statement of Principles, Recommendations and Guidelines for the Modification of Securitized Subprime Residential Mortgage Loans, June 2007.*

bled mortgages have focused on repayment plans, temporary forbearance, or short-term modifications often based on verbal financial information.

Today, the stakes are too high to rely exclusively on industry commitments to apply more streamlined loan modification protocols. The damage to borrowers, our communities, our public finances, and our financial institutions is already too severe. An effective remedy requires targeted, prudent incentives to servicers that will achieve sustainable modifications by controlling the key risk from the prior, less sustainable modifications—the losses on redefault. The FDIC's loss-sharing proposal addresses this risk directly by providing that the Government will share up to 50 percent of the losses with lenders or investors if a mortgage—modified under the sustainable guidelines used at IndyMac Federal—later redefaults. With the Government sharing the risk of future redefaults, we propose to reduce this risk even further by modifying the mortgages to an even more affordable 31 percent ratio of first mortgage debt to gross income. By controlling this risk, the greater net present value of many more modifications compared to foreclosure will be clear.

Over the next 2 years, an estimated 4 to 5 million mortgage loans will enter foreclosure if nothing is done. We believe that this program has the potential to reduce the number of foreclosures by up to 1.5 million, thereby helping to reduce the overhang of excess vacant homes that is driving down U.S. home prices. In addition, this approach keeps modified mortgages within existing securitization transactions, does not require approval by second lienholders, ensures that lenders and investors retain some risk of loss, and protects servicers from the putative risks of litigation by providing a clear benefit from the modifications.

The program, limited to loans secured by owner-occupied homes, would have a Government loss-sharing component available only after the borrower has made six payments on the modified mortgage. Some of the other features of the proposal include:

—*Standard Net Present Value (NPV) Test.*—In order to promote consistency and simplicity in implementation and audit, a standard test comparing the expected NPV of modifying past due loans compared to foreclosure will be applied. Under this NPV test, standard assumptions will be used to ensure that a consistent standard of affordability is provided based on a 31 percent borrower mortgage debt-to-income ratio.

—*Systematic Loan Review by Participating Servicers.*—Participating servicers would be required to undertake a systematic review of all of the loans under their management, to subject each loan to a standard NPV test to determine whether it is a suitable candidate for modification, and to modify all loans that pass this test.

—*Reduced Loss Share Percentage for "Underwater Loans".*—For loan-to-value ratios (LTVs) above 100 percent, the Government loss share will be progressively reduced from 50 percent to 20 percent as the current LTV rises. If the LTV for the first lien exceeds 150 percent, no loss sharing would be provided.

—*Simplified Loss Share Calculation.*—In general terms, the calculation would be based on the difference between the net present value of the modified loan and the amount of recoveries obtained in a disposition by refinancing, short sale or REO sale, net of disposal costs as estimated according to industry standards. Interim modifications would be allowed.

—*De Minimis Test.*—To lower administrative costs, a de minimis test excludes from loss sharing any modification that did not lower the monthly payment at least 10 percent.

—*Eight-year Limit on Loss Sharing Payments.*—The loss sharing guarantee ends 8 years after the modification.

Assuming a re-default rate of 33 percent, our plan could reduce the number of foreclosures initiated between now and year-end 2009 by some 1.5 million at a projected program cost of $24.4 billion.

This proposal efficiently uses Federal money to achieve an objective that is critical to our economic recovery—stability in our mortgage and housing markets. Mortgage loan modifications have been an area of intense interest and discussion for more than a year now. Meanwhile, despite the many programs introduced to address the problem, the problem continues to get worse. During the second quarter of this year, we saw new mortgage loans becoming 60 days or more past due at a rate of more that 700,000 per quarter—net of past due loans that returned to current status. No one can dispute that this remains the fundamental source of uncertainty for our financial markets and the key sector of weakness for our economy. We must decisively address the mortgage problem as part of our wider strategy to restore confidence and stability to our economy.

While the proposed FDIC program would require a cash outlay in the event of default, we must consider the returns this guarantee would deliver in terms of our

housing markets and, by extension, the economic well-being of our communities. While we support the various initiatives taken to date, if we are to achieve stability in our credit and financial markets we cannot simply provide funds to market participants. We must address the root cause of the financial crisis—too many unaffordable mortgages creating too many delinquencies and foreclosures. The time is overdue for us to invest in our homes and communities by adopting a program that will prudently achieve large-scale loan modifications to minimize the impact of foreclosures on households, lenders, and local housing markets.

CONCLUSION

The FDIC has engaged in unprecedented actions to maintain confidence and stability in the banking system. Although some of these steps have been quite broad, we believe that they were necessary to avoid consequences that could have resulted in sustained and significant harm to the economy. The FDIC remains committed to achieving what has been our core mission for the past 75 years—protecting depositors and maintaining public confidence in the financial system.

I will be pleased to answer any questions the Committee might have.

Senator DURBIN. Mr. Kashkari, I'm sorry you can't see the chart being presented here that shows one Zip Code in the city of Chicago, and mortgage foreclosures this year in that Zip Code.

As I mentioned at the outset, there's scarcely a block in this Zip Code that doesn't have at least one home facing foreclosure, and many of them, many more. This is just a section of our city, and clearly there are many other parts of the area facing even worse circumstances. Neighboring towns like Aurora is an example.

So, I'd like to start, if I could, to ask of you, Mr. Kashkari, do you believe that we have reached a true crisis level in mortgage foreclosures in America?

Mr. KASHKARI. Chairman, it's a very good question.

We absolutely have a crisis in our financial system that is rooted in housing. The Secretary has said for over 1 year, that housing is the ultimate source of the credit crisis, and it is a crisis, and we must take—continue to take—aggressive action, both to stabilize the financial system, but also to help homeowners avoid preventable foreclosures.

I personally have been working on this for about 1½ years, the Secretary asked me last August to focus my energy on this, to try to reach homeowners, to avoid foreclosure, so we do think it's a critical issue.

Senator DURBIN. Do you believe that it is possible for our economy to emerge from this recession without taking more aggressive steps to reduce mortgage foreclosures?

Mr. KASHKARI. I believe reducing mortgage foreclosures and taking additional steps is important. I also believe stabilizing the housing market as a whole is also very important, as well as the financial system as a whole—all three are very important to getting through this crisis.

Senator DURBIN. If I could ask you about this morning's Wall Street Journal front-page story, the Treasury Department's proposal to increase home sales, working with Fannie Mae and Freddie Mac for 4.5 percent mortgages. As I read this article, this news presentation, this is really focusing on new home purchases, is that correct?

Mr. KASHKARI. Chairman, the article is referencing one of several programs that we're looking at to try to help the housing market more broadly, which is separate, and complements work that we're doing on the foreclosure side.

There are different programs that are being considered to try to help people modify their mortgages and stay in their homes, and then we have other programs that we're focusing on to help the housing equality.

Senator DURBIN. Let me ask you this directly, do you feel that the Treasury Department has the authority under the Emergency Economic Stabilization Act to prevent foreclosures?

Mr. KASHKARI. Chairman, it's a very good question, it's something that we've—we have worked very hard on. If you permit me to take a step back—when we came—when the Secretary and the Chairman came to the Congress to ask for this profound legislation, it was first and foremost to stabilize the financial system to prevent a collapse of the system as a whole.

And we believe that we have done that with finite resources, to stabilize the system so that all Americans and all businesses can get the credit that they need. And so that's why we've led, focusing on stabilizing the system as a whole.

Now, there are definitely tools under the legislation that could be focused on foreclosures. So, for example, if we were to buy mortgages or mortgage-related services to work with servicers to modify those loans, but the Secretary made the decision that, given the crisis, how much it deepened in the course of September and October, where we had to lead with an equity program first, nonetheless, to continue with our very large mortgage foreclosure problems.

Let me give you an example, if you'll permit me, sir. We want to use every tool in the Federal Government's arsenal to get at these problems, and use the right tool for the right job. So, the TARP that the Congress provided us, is the only tool in the Federal Government that can purchase an equity in an institution. The Federal Reserve can't do it, the FDIC can't do it, the Treasury before the TARP couldn't do it.

But there are other tools and other programs that are also very important to housing. Housing and Urban Development, the FHA, the Hope for Homeless Program, there's a brand-new program that the Congress passed, just in July, it's just got up and running in October, we're working with HUD to help implement that program, that's a really good program.

And just a few weeks ago, the announcement by Fannie Mae and Freddie Mac and HOPE NOW to set a new industry standard for loan modifications, that has the potential to touch every mortgage in America. Because even the private mortgages that are not Fannie or Freddie loans refer to the GSE loan modification standards as their guiding principle.

So, we're trying to use every tool at our disposal to get to this problem, and to use the right tool for the right job. They don't all have to come from the TARP.

Senator DURBIN. If I could ask you this, you said in your testimony that you applauded the program for reworking Fannie Mae and Freddie Mac mortgages that, "builds on the mortgage modification protocol developed by the FDIC for IndyMac." Yet Treasury has refused to endorse the plan, which Mr. Krimminger has described, proposed by FDIC Chairwoman Sheila Bair, and I'm just wondering, why has Treasury not yet endorsed this FDIC plan, and implemented it with the funds given to you by Congress?

Mr. KASHKARI. Chairman, it's a very good question, again, it's a point that we're working very hard on.

We're not only evaluating the FDIC's proposed plan, we have other plans that we're also evaluating, we're trying to evaluate that can say—if I could take a step back, if you'll permit me.

This is a very hard problem to solve, because we're trying to target homeowners who need help without giving people who don't need help free assistance, or without creating a windfall for the banks. And so, with each of these programs, we're studying it very carefully to understand, who really benefits? Is it helping the homeowner? Is it helping the bank or the lender more? Is it efficient? And so, in each of these programs that we're studying, we're working on, and we are forming a transition team of the work that we're doing, and keeping them posted—we're trying to optimize against these different objectives of helping the homeowners without creating a payoff for the banks, and the lenders, and the investors.

Senator DURBIN. If I could interrupt you for a second. So, I understood Mr. Krimminger's testimony, though, if there is a refinancing that leads to a default, under the FDIC's provision, the lending institution is still on the hook for 50 percent of the loss.

So, to argue that this is a windfall for the banks, the FDIC approach would still leave the banks with a skinned knee, if I understand it.

Mr. KRIMMINGER. That's correct.

Senator DURBIN. Is that correct, Mr. Krimminger?

Mr. KRIMMINGER. Yes. It's at least 50 percent, there's a sliding scale of a higher LTV depending on the coverage the Government would be willing to pay.

Senator DURBIN. And what—Mr. Krimminger—what do you expect that this will cost, this FDIC proposal?

Mr. KRIMMINGER. Our estimate for the cost is around $24 billion; $24 billion in Federal funds, extended over a period of about 8 years. We're thinking we could probably help a lot of buyers avoid a foreclosure, in excess of 1.5 million loans.

Senator DURBIN. So, Mr. Kashkari, what is lacking in the FDIC approach under the standards that you've described to us, trying to find a reasonable way to renegotiate mortgages that are facing foreclosures, making sure that the lending institutions have at least 50 percent of the exposure if, in fact, there is a future default?

Mr. KASHKARI. It's a great question, Mr. Chairman. There are some programs we have seen that would potentially help as many homeowners at lower cost. There are some programs that we've seen that would keep the lending institutions on the hook for the full cost of foreclosure, whereas the Government assistance would be provided while the homeowners are able to maintain it.

So, there are different ways of going at this—you could pay for performance, where you're rewarding the bank and rewarding the homeowners who are able to keep their home, versus some programs that will reward the bank if the borrower goes into default.

We think the FDIC program has a lot of merit, and we're studying very carefully and trying to figure out which is the right combination of tools to help homeowners not create the wrong incentive

to banks, and also protect the taxpayers while also consulting the transition team.

Senator DURBIN. If I can ask you, Mr. Kashkari, do you know what percentage of the 2.7 million homeowners helped by HOPE NOW since July 2007 have received a modification that has created a sustainable mortgage over the long term? Through the principal reductions and other aggressive means, rather than just a temporary delay in mortgage default?

Mr. KASHKARI. I do not have the specific breakdown in front of me. I would say very few of them have been principal reductions, I know that. Principal reductions are very rare and we can talk about why that is.

I think most of those loan modifications are probably interest rate reductions, those are the most common tools. If you have a borrower who has an affordability problem, "I want to keep my house, I just can't afford to make the payment." Servicers—if they're doing their job right—should be looking at ways of reducing my payment that are the least cost to their investors, they have an obligation to their investors.

So, reducing interest rates can be a very effective way to lower my payment, while also not costing the investors or the lenders too much money. As a servicer, they're trying to find that sweet spot, and so that's why most of the loan modifications tend to be interest rate reductions, rather than principal forgiveness.

Senator DURBIN. Well, if you can provide me with more detailed information on that, I'd appreciate it.

But I'd like to ask as part of the follow-up, Mr. Krimminger stated that about 4 percent of seriously delinquent loans are being modified each month. Credit Suisse reported in September that 3.5 of subprime mortgages had been re-negotiated in the month of August.

Do you think that the response thus far to the foreclosure crisis has been sufficient, given that 96 percent of the seriously delinquent loans are not being modified?

Mr. KASHKARI. Chairman, it's a good question. I think the key—one of the keys to look at is the difference between small chart of time versus what's happening out there. So, picking any one month, and saying, "Well, only this many were modified this month," I'm not sure it captures the whole picture, but clearly we all need to do more. And that's why we're aggressively looking at these new programs.

If I could take a step back, and talk about the program we just announced with the GSEs. Some people have asked us, "Well, why would we modify loans as a loan modification strategy under the TARP?" If we spent $700 billion—all $700 billion buying home loans, we would have been able to buy 3 to 4 million homes, and modify those loans, potentially. Versus, by establishing a new industry standard, you know, all of the services around the country refer back to the GSE loan modification standards. By establishing a new industry standard, that could potentially touch, in theory, all 35 million Americans.

And so we're focused on doing more, working aggressively, but using the right tool for the right job, so that we can help as many homeowners as we can.

Senator DURBIN. Let me speak to the—Mr. Kashkari—let me speak to the tools for a moment.

The initial request by Secretary Paulson for the TARP funds was to buy mortgage bank securities, and it's my understanding, and I've heard Secretary Paulson say as much, that circumstances changed, facts changed, and they took a different approach—the Treasury took a different approach with the money, buying equity positions in banks, providing more capital to these banks.

There was a concern, however, that the banks haven't received the Federal taxpayers' money, or are hoarding this money and not lending it out. I'd like you to comment as to whether or not there has been any effort in the Treasury Department to impose any firm lending requirements on the firms and banks that are receiving these TARP funds. What more can you do to ensure that the taxpayers' money is not being hoarded by banks for other purposes, other than our goal of breathing some life into the credit markets?

Mr. KASHKARI. Chairman, that's a great question, and something which I personally have spent a lot of time on.

I'll say a few things. Number one, we have to recognize, about $160 billion of the $250 billion that we allocated, is now out the door. So, a little over one-half is out the door, it's going to take a couple of months to get the remaining funds out, so not all of it's in the system, yet, so it's going to take a little bit of time, number one.

Number two, we're still in a period of very low confidence in the system. And, until confidence starts to emerge, banks are going to be cautious about lending, and our consumers and our businesses are going to be cautious about taking new loans. So, we need to see confidence restored to see a big up-tick in lending.

But more directly to your question, what we've done. We've built in very specific contractual provisions in our investments that dictate what they can and cannot do with the funds. I'll give an example: We've required no increase in dividends, we've required no share re-purchases while we have our investment. The idea there is, we put taxpayer capital into the bank. If there were interest dividends through a share repurchase, that would take capital out of the system.

So, if you put capital in a bank, and they can't take it out, there are very strong economic incentives to make them want to lend. Because if you put more capital in the bank, the return on equity, their return on assets will go down. So, their own shareholders will demand that they put the capital to its best use, or they're going to watch their return suffer. So, we've designed very specific provisions to make sure that they had to use the funds the right way.

At the same time, we don't think it's realistic or reasonable to order them, "You must make *x* number of new loans." Because if they can't find—if they're uncomfortable making loans, we don't want them to make loans that they don't think are prudent. We don't want to push banks to return to the bad lending practices that got us here in the first place.

So, it's not going to happen overnight.

Senator DURBIN. Well, let me ask you this. At this point, to comment on the recent GAO report, because the GAO—at the direction of Congress—took a look at how these funds have been managed,

this massive infusion of money into the Treasury Department to try to get our economy moving again.

The GAO reports it's not clear how Treasury and the regulators have been monitored to be sure that commitments are being met. Treasury has not instituted—according to the GAO—any reporting requirements on the institutions that, to date, have $200 billion in taxpayer investments.

In fact, according to GAO, 50 of the 52 institutions receiving assistance reported that they did not intend to track or report the use of these capital injections separately from the rest of their operations.

Treasury disagreed with the recommendations in GAO's report, calling for determining reporting in a timely matter, whether the actions of national institutions were generally consistent with the purpose of the program. Without explicit reporting requirements and tracking on how institutions plan, and actually use these Federal funds, how can Treasury possibly ensure compliance with these agreements?

Mr. KASHKARI. Chairman, that's a—let's talk about that, it's a very important point.

We are putting in place processes and procedures to make sure that they are meeting the requirements of the agreement, in terms of dividends, share re-purchases, ensuring compliance.

So, we can talk about the GAO report some more, that's another very important topic that I'm glad you brought up. In terms of the use of the funds itself, here's the tough part—we thought a lot about this, it's very hard to track, because all dollars are green as the saying goes—it's very hard to track where a specific dollar went to.

For example, if I had received the stimulus check last summer—did that money go to pay my rent? Did that money go to pay for my dinner? Did that money go to buy something that I bought at the grocery store, or did that money go into my bank account, increasing my bank account and supporting all of those activities?

And so it's very hard to say—it's impossible to say—if you put an investment into a bank, did those $10 go to make a loan? Did they go to pay corporate expenses? Or for some other purpose?

Since that's very hard to measure, and I haven't heard anyone suggest how we can actually track that, what we're focused on is, the system as a whole. Always seeing cutting conditions get better, and we are. A lot of the progress has been made since we first announced the capital purchase program, and I can walk you through some statistics.

If interest rates have come down for borrowers, for banks, as confidence is restored, we can definitely measure if that, overall in the system—that's our highest priority. And we're focused on making sure the banks are meeting their own compliance requirements for the terms that we set.

But to be able to track an individual dollar as it flows—we don't know how to do that.

Senator DURBIN. I understand that. But you can understand—from the taxpayers' point of view—this massive infusion of taxpayers' money at a time when most families and businesses are

making sacrifices, we expect to at least see accountability, if not results.

One particular area of concern that I hear over and over is executive compensation. You know, we put provisions in this law to limit the deductibility of certain levels of executive compensation. And our belief is, that if you have an institution that is struggling, that is not doing well, you certainly don't want infusion of taxpayers' dollars to result in multi-million-dollar bonuses and compensation packages for the executives who haven't been managing very well.

What steps is the Treasury taking to institute a clear process to monitor compliance with the executive compensation provisions?

Mr. KASHKARI. Thank you, Chairman. Let me just start by saying, in each of the programs that we have rolled out, we have in place very specific, aggressive executive compensation requirements in the spirit of the letter of the legislation.

In terms of compliance, first of all, the banks have all had to sign contracts with the Treasury committing to meet those requirements. Their own executives who these requirements apply to have all had to agree to these and we are, right now, building processes and procedures for subsequent verification, be it on a quarterly basis, or an annual basis, that they continue to meet these requirements.

We don't want them just to meet them when we first make the investment, we want to make sure they continue to meet them on a go-forward basis. We're committed to this, and we're working very hard on it.

Senator DURBIN. I said that was the last question but there's one other one I want to include here before we let you get back to work, here. GAO also made a point of contractors' compensation. Contracts for implementing this law include the primary large contract with the asset manager, the Bank of New York, Mellon, as well as smaller contracts for tasks, legal and accounting tasks.

These contracts had for the most part a price on a time and materials basis, meaning the Treasury and the contractors agreed to set labor rates, where the contractors simply bill hours worked and the cost of materials. GAO has warned that such time and materials contracts are high-risk contracts for taxpayers, because unlike fixed-price contracts, the structure of time and materials provides no incentive for contractors to control costs.

Considering the $700 billion price tag of the stabilization package, added to a blank check to the Treasury to administer it, how is the Treasury ensuring the strict management and oversight processes are in place to protect taxpayers' dollars?

Mr. KASHKARI. Sir, this is something that I get with a team of people, led by our chief compliance officer, focus just on this.

We are—if I could take a step back for a moment, it's been just over 60 days, since the Congress passed and the President signed the law, we have built an organization, and executed, and designed the programs, all at the same time, and our work is far from completed. We've had a very open dialogue with GAO, and I personally was briefed by the GAO in advance of the release of their report.

I felt their report was very constructive because they identified several important areas that we're already working on. So, we have

a team of people working to make sure that we have the proper oversight of these contractors.

One of the first steps we took is when we designed and signed the contracts with these contractors, was that we built in provisions that enabled us to design a much more complex and aggressive oversight into those operations, so we took initial steps early to build in the places where we could connect and really manage these contracts to help protect the taxpayers. We've been sprinting, and in parallel to that, we're setting up the operation to do exactly what you're saying.

Senator DURBIN. Mr. Krimminger, I'd like to ask you if you could tell me—this proposal of the FDIC, that you believe would provide incentives, national incentives and others for renegotiations of mortgages. So far, what has been the response from your point of view, from the FDIC's point of view, by the Treasury Department?

Mr. KRIMMINGER. I think we've had, in the past, some very constructive discussions with Treasury about the elements of the program. As Assistant Secretary Kashkari mentioned, there are different views on the costs, and I think we're very confident of our views of the costs of the program, and what the—how the program would be implemented.

I think it's clearly not a subsidy, in any sense, for the banks, it is simply trying to ensure that we can provide adequate incentives to get what we need to have done, done. And that is simply—more modifications at a much greater pace.

At this point, I think the Treasury is considering a number of different alternatives. I think it's fair to say that we're not—we are not having current discussions with them about how to implement this proposal.

Senator DURBIN. I can tell you that Mr. Kashkari and Mr. Krimminger, that the second panel will include testimony about what's happening, on the ground, in the neighborhoods. As I mentioned earlier, the Southwest Organization Project came in to meet with me with the pastor of a local Catholic church, St Nicholas of Tolentine, they talked about the fact that many people in that neighborhood are reluctant to talk about this until it gets into a very sad and dangerous situation, and then if they can bring themselves to sit down with a counselor, they go through the grim reality that they can no longer make the mortgage payment that they're facing.

And many of these service providers try to figure out at that moment in time whether it's hopeless, or if there's hope. And if there's any hope there, where a person has, for example, a steady income, and can make a mortgage payment, they're ready to sit down with the lender. The person who did the original mortgage and now is initiating foreclosure. And too many times, they can't find any place or anybody to sit down with. No one will sit down across the table from them, and say, "All right, if you can't pay $1,900 a month, is it conceivable to stay in this home for $1,200 a month? Is there a way to renegotiate the terms in any way that $1,200 will do it?" If they can't even pay $1,200, they can't pay $1,900. But they can't find someone at the other side of the table to get that job done.

Some of the banks in these areas that we're talking about, here, are banks—out-of-State banks—some in foreign countries—that made the loans, initially, and now don't even have branch offices nearby. So, these folks are frustrated, you know? They see the possibility of losing their homes, they know that foreclosure procedure is not only devastating to the homeowner, but to the bank, as well, and to the neighborhood, and they just can't find any place to turn to get people to sit down and talk to them.

Do you think the FDIC proposal would change this dynamic?

Mr. KRIMMINGER. I think that—from our review, and this is based on the experience of IndyMac, as well as discussions with literally dozens and dozens of servicers, lenders, homeowner counselor agencies in Chicago and other places around the country—is that one of the fundamental problems that the servicers are facing, and these servicers are doing their best, but their resources are very stretched. Their compensation, if you will, was designed for a time in which we did not have the level of industry that we have now.

So, we think that the FDIC proposal would have a major impact because it would help you to do a triage, if you will, for troubled borrowers, in the sense that you would use this model that we've developed at IndyMac, and is being used now, by giving other servicers—as Assistant Secretary Kashkari noted—is the basis for the turnaround in the FHFA and GSE approach—and even now is adopting new developments. We think this approach will allow you to take those mortgages that can be helped through this model, do them much more rapidly, much more efficiently with regard to the servicer's resources, so that you can focus the servicer's resources on more difficult mortgages that are going to need far more customized work.

I think that's the best way of dealing with the volume of delinquencies that we have today.

Another issue is that part of the problem, I think, is that servicers clearly had been concerned about the reaction of investors. And one of our points that we've made—tried to make very clearly—based on our experiences with IndyMac, and again, talking with many dozen servicers, is that most of the contracts allow servicers to do the modifications that we're talking about. The best way of clarifying the rules, and making sure that servicers can take the action they need to take vis-á-vis investors is to have the incentive structure effectively skewed toward the modification. By providing the loss to be shared here, as we were talking about, using the TARP funds, you would skew that incentive and the analysis of what the cost of the defaulting modification would be, much more toward modification. That's where we must clarify what servicers can do, and allow them to take action much more aggressively.

The bottom line is, they've been doing a lot, but it's not been enough.

Senator DURBIN. Mr. Kashkari, why was Citi required to follow the FDIC in that model to modify mortgages, yet Treasury has not required other of its recipients to do so?

Mr. KASHKARI. Chairman, in the Capital Purchase Program, we designed it to be a program for healthy institutions to volunteer for

the program. We wanted banks across the country of all sizes to apply and to get capital on equal terms. And so we wanted to make it easy for them to access, easy for them to want to take the capital, because healthy banks are in the best position to step up and lend. If we gave a dollar to a healthy bank versus a dollar to a struggling bank, that healthy bank is going to be much more likely to turn around and extend credit.

And so, it was very important for us to make the terms attractive, to encourage participation. In the case of Citibank, that was a very important effort that we worked closely with the FDIC and the Federal Reserve, to make sure that that institution was stable. That's very different than broad, general capital purchase program.

Senator DURBIN. I want to thank you, Mr. Kashkari——

Mr. KASHKARI. I'm sorry, I didn't hear you, pardon me?

Senator DURBIN. I just said, I want to thank you very much for your testimony, and joining us by teleconference, and battling the BlackBerry interference during the course of your testimony. I wish you the best in your efforts, and look forward to working with you.

Mr. Krimminger, thank you, as well, for your testimony.

I thank both of you on the first panel, and I'd like, at this point, to invite the second panel to take the table.

STATEMENT OF MATHEW SCIRE, DIRECTOR, FINANCIAL MARKETS AND COMMUNITY INVESTMENT, GOVERNMENT ACCOUNTABILITY OFFICE

Mr. SCIRE. Mr. Chairman, thank you for the opportunity to be here today to update our analysis of home mortgage defaults and foreclosures and to discuss recent efforts to preserve home ownership.

There is over $10 trillion in mortgage debt outstanding in the United States, representing tens of millions of home mortgages. Last year we reported that default and foreclosure rates had risen dramatically. Since then the increase has accelerated. Last year we reported that based on data from thesecond quarter of 2007, just over 1 in 100 mortgages were in default—an increase of almost 30 percent over the previous 2-year period. This year mortgage default rates increased another 64 percent. Put another way, default rates have more than doubled over the 3 years. The percentage of mortgages entering the process of foreclosure grew even more rapidly. Last year we reported that this foreclosure start rate had increased by 55 percent over the same quarter 2 years earlier. One year later the foreclosure start rate increased an additional 83 percent. States such as Arizona, California, Florida, and Nevada had the highest percentage increases. These States also had some of the highest percentages of mortgages in the process of foreclosure, as did States such as Ohio, Michigan, Indiana, and Illinois, all exceeding the national average.

This sharp downturn in the housing market has precipitated severe stresses in U.S. financial markets. Defaults and foreclosures have affected not only those losing their homes, but also the neighborhoods where houses now stand empty.

Likewise, defaults and foreclosures have imposed significant costs on borrowers, lenders and mortgage investors, and have contributed to increased volatility in the United States and global financial markets.

Two months ago, the Congress passed and the President signed the Emergency Economic Stabilization Act of 2008, creating the Troubled Asset Relief Program. The act authorizes Treasury to purchase troubled mortgages, and mortgage-related assets.

The Secretary initially intended to use the position of owning such assets to influence loan servicers and achieve aggressive mortgage modification standards. But in order to effectively stabilize financial markets, the Treasury decided, instead, to focus on directly injecting capital into financial institutions, under its Capital Purchase Program.

In light of his decision, the Treasury is now considering a number of options to preserve home ownership, a purpose of the act. This includes establishing an Office of Home Ownership Preservation, and encouraging financial institutions who are receiving the capital injections to modify the terms of existing residential mortgages.

However, the Treasury has not yet determined how it will impose reporting requirements on the participating financial institutions, which would enable Treasury to monitor, to some extent, whether the capital infusions are achieving intended goals.

As a result, we recommended in our first TARP oversight report that Treasury work with the bank regulators to establish a systematic means for reviewing and reporting on whether financial institutions' activities are consistent with the purposes of the program.

Mr. Chairman, Congress, financial regulators and others have taken a number of actions to preserve homeownership. You heard earlier about the FDIC's actions to stabilize financial markets, and its efforts to reduce unnecessary foreclosures.

The Federal Reserve announced last week that it would purchase up to $100 billion of direct obligations of the GSEs, and up to $500 billion of mortgage-backed securities backed by Fannie Mae, Freddie Mac, and Ginnie Mae.

Earlier in November, the financial regulators issued a joint statement underscoring their expectation that all banking organizations fulfill their fundamental role in lending. The Federal Housing Finance Agency announced a streamlined loan modification program for mortgages controlled by the GSEs. Also, HUD put in place the HOPE for homeowners program, authorized by the Housing and Economic Recovery Act of 2008.

In summary, Mr. Chairman, the dramatic increases in defaults and foreclosures across the Nation underscore the importance of efforts to protect home values and preserve homeownership. Today, there are many efforts being planned, or are underway. Going forward, it will be important to ensure that the tools and resources of Government are effectively used to address this daunting challenge.

We are committed to providing the Congress with effective oversight of the Treasury's TARP program, including its efforts to preserve homeownership. We look forward to supporting this subcommittee's oversight efforts.

That concludes my opening remarks, thank you again for the opportunity to speak today, I'd be glad to take any questions you may have.

Senator DURBIN. Thanks, Mr. Scire.

[The statement follows:]

PREPARED STATEMENT OF MATHEW J. SCIRE

TROUBLED ASSET RELIEF PROGRAM

STATUS OF EFFORTS TO ADDRESS DEFAULTS AND FORECLOSURES ON HOME MORTGAGES

Why GAO Did This Study

A dramatic increase in mortgage loan defaults and foreclosures is one of the key contributing factors to the current downturn in the U.S. financial markets and economy. In response, Congress passed and the President signed in July the Housing and Economic Recovery Act of 2008 and in October the Emergency Economic Stabilization Act of 2008 (EESA), which established the Office of Financial Stability (OFS) within the Department of the Treasury and authorized the Troubled Asset Relief Program (TARP). Both acts establish new authorities to preserve homeownership. In addition, the administration, independent financial regulators, and others have undertaken a number of recent efforts to preserve homeownership. GAO was asked to update its 2007 report on default and foreclosure trends for home mortgages, and describe the OFS's efforts to preserve homeownership.

GAO analyzed quarterly default and foreclosure data from the Mortgage Bankers Association for the period 1979 through the second quarter of 2008 (the most recent quarter for which data were available). GAO also relied on work performed as part of its mandated review of Treasury's implementation of TARP, which included obtaining and reviewing information from Treasury, Federal agencies, and other organizations (including selected banks) on home ownership preservation efforts. To access GAO's first oversight report on Treasury's implementation of TARP, click on GAO–09–161.

What GAO Found

Default and foreclosure rates for home mortgages rose sharply from the second quarter of 2005 through the second quarter of 2008, reaching a point at which more than 4 in every 100 mortgages were in the foreclosure process or were 90 or more days past due. These levels are the highest reported in the 29 years since the Mortgage Bankers Association began keeping complete records and are based on its latest available data. The subprime market, which consists of loans to borrowers who generally have blemished credit and that feature higher interest rates and fees, experienced substantially steeper increases in default and foreclosure rates than the prime or Government-insured markets, accounting for over half of the overall increase. In the prime and subprime market segments, adjustable-rate mortgages experienced steeper growth in default and foreclosure rates than fixed-rate mortgages. Every State in the Nation experienced growth in the rate at which loans entered the foreclosure process from the second quarter of 2005 through the second quarter of 2008. The rate rose at least 10 percent in every State over the 3-year period, but 23 States experienced an increase of 100 percent or more. Several States in the "Sun Belt" region, including Arizona, California, Florida, and Nevada, had among the highest percentage increases.

OFS initially intended to purchase troubled mortgages and mortgage-related assets and use its ownership position to influence loan servicers and to achieve more aggressive mortgage modification standards. However, within 2 weeks of EESA's passage, Treasury determined it needed to move more quickly to stabilize financial markets and announced it would use $250 billion of TARP funds to inject capital directly into qualified financial institutions by purchasing equity. In recitals to the standard agreement with Treasury, institutions receiving capital injections state that they will work diligently under existing programs to modify the terms of residential mortgages. It remains unclear, however, how OFS and the banking regulators will monitor how these institutions are using the capital injections to advance the purposes of the act, including preserving homeownership. As part of its first TARP oversight report, GAO recommended that Treasury, among other things, work with the bank regulators to establish a systematic means for reviewing and reporting on whether financial institutions' activities are consistent with program goals. Treasury also established an Office of Homeownership Preservation within OFS that is reviewing various options for helping homeowners, such as insuring troubled mortgage-related assets or adopting programs based on the loan modification efforts of FDIC and others, but it is still working on its strategy for preserving homeownership. While Treasury and others will face a number of challenges in undertaking loan modifications, including making transparent to investors the analysis supporting the value of modification versus foreclosure, rising defaults and foreclosures

on home mortgages underscore the importance of ongoing and future efforts to preserve homeownership. GAO will continue to monitor Treasury's efforts as part of its mandated TARP oversight responsibilities.

Mr. Chairman and members of the Committee: I am pleased to be here today to provide an update on our 2007 report on default and foreclosure trends for home mortgages and to discuss the Department of the Treasury's efforts to preserve homeownership as part of its implementation of the Troubled Asset Relief Program (TARP).[1] My statement is grounded in recent work we did to update our 2007 report and in our ongoing review of Treasury's implementation of TARP as authorized by the Emergency Economic Stabilization Act of 2008, TARP's enabling legislation.[2]

Today the U.S. financial markets are undergoing stresses not seen in our lifetime. These stresses were brought on by a fall in the price of financial assets associated with housing, in particular mortgage assets based on subprime loans that lost value as the housing boom ended and the market underwent a dramatic correction.[3] Defaults and foreclosures have affected not only those losing their homes but also the neighborhoods where houses now stand empty. They have imposed significant costs on borrowers, lenders, and mortgage investors and have contributed to increased volatility in the U.S. and global financial markets.

The Emergency Economic Stabilization Act, which Congress passed and the president signed on October 3, 2008, in response to the turmoil in the financial and housing markets, established the Office of Financial Stability (OFS) within the Department of the Treasury and authorized the Troubled Asset Relief Program (TARP), which gave OFS authority to purchase and insure troubled mortgage-related assets held by financial institutions. One of the stated purposes of the act is to ensure that the authorities and facilities provided by the act are used in a manner that, among other things, preserves homeownership. Additionally, to the extent that troubled mortgage-related assets were acquired under TARP, Treasury was required to implement a plan that sought to "maximize assistance to homeowners" and use the Secretary's authority to encourage the use of the HOPE for Homeowners Program or other available programs to minimize foreclosures. The HOPE for Homeowners program was created by Congress under the Housing and Economic Recovery Act of 2008 (HERA). The program, which was put in place in October 2008, is administered by the Federal Housing Administration within the Department of Housing and Urban Development. It is designed to help those at risk of default and foreclosure refinance into more affordable, sustainable loans. HERA also made a number of other significant changes to the housing finance system, including creating a single regulator for the Government-sponsored enterprises (GSEs)—Fannie Mae, Freddie Mac, and the Federal Home Loan Banks—and giving Treasury authority to purchase obligations and securities of the GSEs.

To update information contained in our 2007 report on default and foreclosure trends, we analyzed data from the Mortgage Bankers Association's quarterly National Delinquency Survey (NDS), which covers about 80 percent of the mortgage market. The survey provides information dating back to 1979 on first-lien purchase and refinance mortgages on one- to four-family residential properties.[4]

For the period 1979 through the second quarter of 2008 (the most recent quarter for which data were available for the dataset we were using), we examined national and State-level trends in the numbers and percentage of loans that were in default, starting the foreclosure process, and in the foreclosure inventory each quarter. For the second quarter of 2005 through the second quarter of 2008, we disaggregated the data by market segment and loan type, calculated absolute and percentage increases in default and foreclosure measures, compared and contrasted trends for each State, and compared default and foreclosure start rates at the end of this period to historical highs. In our previous report, we assessed the reliability of the NDS data by reviewing existing information about the quality of the data, performing electronic testing to detect errors in completeness and reasonableness, and interviewing MBA officials knowledgeable about the data. We determined that the data were sufficiently reliable for purposes of the report. To describe Treasury's efforts to develop a homeownership preservation program as part of its TARP implementation efforts, we relied on the work that we performed as part of our mandated

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[1] GAO, *Information on Recent Default and Foreclosure Trends for Home Mortgages and Associated Economic and Market Developments*, GAO–08–78R (Washington, DC: October 16, 2007).

[2] Public Law 110–343, 122 Stat. 3765 (October 3, 2008).

[3] Subprime loans are loans generally made to borrowers with blemished credit that feature higher interest rates and fees than prime loans.

[4] The National Delinquency Survey presents default and foreclosure rates (i.e., the number of loans in default or foreclosure divided by the number of loans being serviced).

review of Treasury's implementation of TARP.[5] Specifically, we obtained and reviewed available information, including public statements by Treasury officials, terms for participation in the Capital Purchase Program (CPP), data on loan modification program efforts of other agencies and organizations, and OFS organization charts. Additionally, we interviewed Treasury officials to obtain information on actions taken to date and to discuss their planned actions and priorities regarding homeownership preservation. We also held discussions with the first eight financial institutions that received TARP funds under its Capital Purchase Program.

The work on which this testimony is based was performed in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our finding and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

SUMMARY

Default and foreclosure rates for home mortgages rose sharply from the second quarter of 2005 through the second quarter of 2008, reaching a point at which more than 4 in every 100 mortgages were in the foreclosure process or were 90 or more days past due.[6] These levels are the highest that have been reported in the 29 years since the Mortgage Bankers Association began keeping complete records. The subprime market experienced substantially steeper increases in default and foreclosure rates than the prime or Government-insured markets, accounting for over half of the overall increase in the number of loans in default or foreclosure during this time frame. In both the prime and subprime market segments, adjustable-rate mortgages experienced relatively steeper growth in default and foreclosure rates compared with fixed-rate mortgages, which had more modest increases. Every State in the Nation experienced growth in the rate at which foreclosures started from the second quarter of 2005 through the second quarter of 2008. By the end of that period, foreclosure start rates were at their 29-year maximums in 17 States. The foreclosure start rate rose at least 10 percent in every State over the 3-year period, but 23 States experienced an increase of 100 percent or more. Several States in the "Sun Belt" region, such as Arizona, California, Florida, and Nevada, had among the highest percentage increases in foreclosure start rates.

In light of its initial decision not to conduct large-scale purchases of troubled mortgage-related assets held by financial institutions, Treasury's OFS has been considering different approaches to preserving homeownership. OFS had initially intended to purchase troubled mortgage-related assets and use its ownership position to influence loan servicers and achieve more aggressive mortgage modification standards, which would help meet the purposes of the act. Instead, OFS chose to use $250 billion of TARP funds to inject capital directly into qualified financial institutions through the purchase of equity. According to OFS, this shift in strategy was intended to have an immediate impact on the health of the U.S. financial and housing markets by ensuring that lenders had sufficient funding and encouraging them to provide credit to businesses and consumers, including credit for housing. Treasury also has indicated that it intends to use its Capital Purchase Program (CPP) to encourage financial institutions to work to modify the terms of existing residential mortgages. However, Treasury has not yet determined if it will impose reporting requirements on the participating financial institutions, which would enable Treasury to monitor, to some extent, whether the capital infusions are achieving the intended goals. As a result, we recommended in our first TARP oversight report that Treasury work with the bank regulators to establish a systematic means for reviewing and reporting on whether financial institutions' activities are consistent with the purposes of CPP.[7] Treasury is taking additional steps toward the act's goal of preserving homeownership. It has established an Office of Homeownership Protection within OFS that is considering various options, such as insuring troubled mortgage-related assets or adopting programs based on the loan modification efforts of FDIC and others. These include recent efforts announced by the GSEs and their regulator to streamline loan modifications. While loan modification presents a number of challenges, rising defaults and foreclosures on home mortgages underscore the importance of ongoing and future efforts to preserve homeownership. We will continue to

[5] GAO, *Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency*, GAO–09–161 (Washington, DC: December 2, 2008).

[6] Although definitions vary, a mortgage loan is commonly considered in default when the borrower has missed three or more consecutive monthly payments (i.e., is 90 or more days delinquent).

[7] GAO–09–161.

monitor Treasury's efforts to preserve home ownership as part of our TARP oversight responsibilities.

BACKGROUND

As of June 2008, there were approximately 58 million first-lien home mortgages outstanding in the United States. According to a Federal Reserve estimate, outstanding home mortgages represented over $10 trillion in mortgage debt. The primary mortgage market has several segments and offers a range of loan products:

—The prime market segment serves borrowers with strong credit histories and provides the most competitive interest rates and mortgage terms.

—The subprime market segment generally serves borrowers with blemished credit and features higher interest rates and fees than the prime market.

—The Alternative-A (Alt-A) market segment generally serves borrowers whose credit histories are close to prime, but the loans often have one or more higher-risk features, such as limited documentation of income or assets.

—The Government-insured or -guaranteed market segment primarily serves borrowers who may have difficulty qualifying for prime mortgages but features interest rates competitive with prime loans in return for payment of insurance premiums or guarantee fees.

Across all of these market segments, two types of loans are common: fixed-rate mortgages (FRM), which have interest rates that do not change over the life of the loans, and adjustable-rate mortgages (ARM), which have interest rates that change periodically based on changes in a specified index.

Delinquency, default, and foreclosure rates are common measures of loan performance. Delinquency is the failure of a borrower to meet one or more scheduled monthly payments. Default generally occurs when a borrower is 90 or more days delinquent. At this point, foreclosure proceedings against the borrower become a strong possibility. Foreclosure is a legal (and often lengthy) process with several possible outcomes, including that the borrower sells the property or the lender repossesses the home. Two measures of foreclosure are foreclosure starts (loans that enter the foreclosure process during a particular time period) and foreclosure inventory (loans that are in, but have not exited, the foreclosure process during a particular time period).

One of the main sources of information on the status of mortgage loans is the Mortgage Bankers Association's quarterly National Delinquency Survey. NDS provides national and State-level information on mortgage delinquencies, defaults, and foreclosures back to 1979 for first-lien purchase and refinance mortgages on one-to-four family residential units.[8] The data are disaggregated by market segment and loan type—fixed-rate versus adjustable-rate—but do not contain information on other loan or borrower characteristics.

In response to problems in the housing and financial markets, the Housing and Economic Recovery Act of 2008 was enacted to strengthen and modernize the regulation of the Government-sponsored enterprises (GSEs)—Fannie Mae, Freddie Mac, and the Federal Home Loan Banks—and expand their mission of promoting homeownership.[9] The act established a new, independent regulator for the GSEs called the Federal Housing Finance Agency, which has broad new authority, generally equivalent to the authority of other Federal financial regulators, to ensure the safe and sound operations of the GSEs. The new legislation also enhances the affordable housing component of the GSEs' mission and expands the number of families Fannie Mae and Freddie Mac can serve by raising the loan limits in high-cost areas, where median house prices are higher than the regular conforming loan limit, to 150 percent of that limit. The act requires new affordable housing goals for Federal Home Loan Bank mortgage purchase programs, similar to those already in place for Fannie Mae and Freddie Mac.

The act also established the HOPE for Homeowners program, which the Federal Housing Administration (FHA) will administer within the Department of Housing and Urban Development (HUD), to provide federally insured mortgages to distressed borrowers. The new mortgages are intended to refinance distressed loans at a significant discount for owner-occupants at risk of losing their homes to foreclosure. In exchange, homeowners share any equity created by the discounted restructured loan as well as future appreciation with FHA, which is authorized to insure up to $300 billion in new loans under this program. Additionally, the borrower

[8] NDS data do not separately identify Alt-A loans but include them among loans in the prime and subprime categories. State-level breakouts are based on the address of the property associated with each loan. The NDS presents default and foreclosure rates (i.e., the number of loans in default or foreclosure divided by the number of loans being serviced).

[9] Public Law 110–289, 122 Stat. 2654 (July 30, 2008).

cannot take out a second mortgage for the first 5 years of the loan, except under certain circumstances for emergency repairs. The program became effective October 1, 2008, and will conclude on September 30, 2011. To participate in the HOPE for Homeowners program, borrowers must also meet specific eligibility criteria as follows:

—Their mortgage must have originated on or before January 1, 2008.
—They must have made a minimum of six full payments on their existing first mortgage and must not have intentionally missed mortgage payments.
—They must not own a second home.
—Their mortgage debt-to-income ratio for their existing mortgage must be greater than 31 percent.
—They must not knowingly or willfully have provided false information to obtain the existing mortgage and must not have been convicted of fraud in the last 10 years.

The Emergency Economic Stabilization Act, passed by Congress and signed by the President on October 3, 2008, created TARP, which outlines a troubled asset purchase and insurance program, among other things.[10] The total size of the program cannot exceed $700 billion at any given time. Authority to purchase or insure $250 billion was effective on the date of enactment, with an additional $100 billion in authority available upon submission of a certification by the President. A final $350 billion is available under the act but is subject to congressional review. The legislation required that financial institutions that sell troubled assets to Treasury also provide a warrant giving Treasury the right to receive shares of stock (common or preferred) in the institution or a senior debt instrument from the institution. The terms and conditions of the warrant or debt instrument must be designed to (1) provide Treasury with reasonable participation in equity appreciation or with a reasonable interest rate premium, and (2) provide additional protection for the taxpayer against losses from the sale of assets by Treasury and the administrative expenses of TARP. To the extent that Treasury acquires troubled mortgage-related assets, the act also directs Treasury to encourage servicers of the underlying loans to take advantage of the HOPE for Homeowners Program. Treasury is also required to consent, where appropriate, to reasonable requests for loan modifications from homeowners whose loans are acquired by the Government. The act also requires the Federal Housing Finance Agency, the Federal Deposit Insurance Corporation (FDIC), and the Federal Reserve Board to implement a plan to maximize assistance to homeowners, that may include reducing interest rates and principal on residential mortgages or mortgage-backed securities owned or managed by these institutions.

The regulators have also taken steps to support the mortgage finance system. On November 25, 2008, the Federal Reserve announced that it would purchase up to $100 billion in direct obligations of the GSEs (Fannie Mae, Freddie Mac, and the Federal Home Loan Banks), and up to $500 billion in mortgage-backed securities backed by Fannie Mae, Freddie Mac, and Ginnie Mae. It undertook the action to reduce the cost and increase the availability of credit for home purchases, thereby supporting housing markets and improving conditions in financial markets more generally. Also, on November 12, 2008, the four financial institution regulators issued a joint statement underscoring their expectation that all banking organizations fulfill their fundamental role in the economy as intermediaries of credit to businesses, consumers, and other creditworthy borrowers, and that banking organizations work with existing mortgage borrowers to avoid preventable foreclosures. The regulators further stated that banking organizations need to ensure that their mortgage servicing operations are sufficiently funded and staffed to work with borrowers while implementing effective risk-mitigation measures. Finally, on November 11, 2008, the Federal Housing Finance Agency announced a streamlined loan modification program for home mortgages controlled by the GSEs.

Most mortgages are bundled into securities called residential mortgage-backed securities that are bought and sold by investors. These securities may be issued by GSEs and private companies. Privately issued mortgage-backed securities, known as private label securities, are typically backed by mortgage loans that do not conform to GSE purchase requirements because they are too large or do not meet GSE underwriting criteria. Investment banks bundle most subprime and Alt-A loans into private label residential mortgage-backed securities. The originator/lender of a pool of securitized assets usually continues to service the securitized portfolio. Servicing includes customer service and payment processing for the borrowers in the securitized pool and collection actions in accordance with the pooling and servicing agreement. The decision to modify loans held in a mortgage-backed security typically resides with the servicer. According to some industry experts, the servicer may

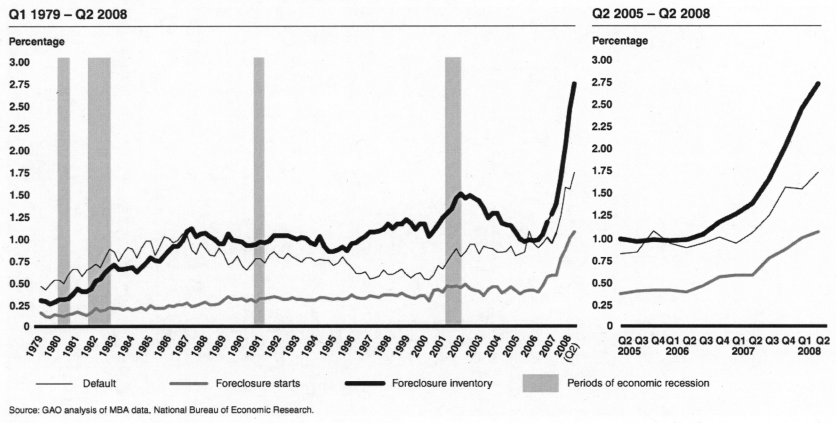
[10] Public Law 110–343.

be limited by the pooling and servicing agreement with respect to performing any large-scale modification of the mortgages that the security is based upon. However, others have stated that the vast majority of servicing agreements do not preclude or routinely require investor approval for loan modifications. We have not assessed how many potentially troubled loans face restrictions on modification.

DEFAULT AND FORECLOSURE RATES HAVE REACHED HISTORICAL HIGHS AND ARE EXPECTED TO INCREASE FURTHER

National default and foreclosure rates rose sharply during the 3-year period from the second quarter of 2005 through the second quarter of 2008 to the highest level in 29 years (fig. 1).[11] More specifically, default rates more than doubled over the 3-year period, growing from 0.8 percent to 1.8 percent. Similarly, foreclosure start rates—representing the percentage of loans that entered the foreclosure process each quarter—grew almost three-fold, from 0.4 percent to 1 percent. Put another way, nearly half a million mortgages entered the foreclosure process in the second quarter of 2008, compared with about 150,000 in the second quarter of 2005.[12] Finally, foreclosure inventory rates rose 175 percent over the 3-year period, increasing from 1.0 percent to 2.8 percent, with most of that growth occurring since the second quarter of 2007. As a result, almost 1.25 million loans were in the foreclosure inventory as of the second quarter of 2008.

Figure 1: National Default and Foreclosure Trends, 1979 – June 2008



Source: GAO analysis of MBA data, National Bureau of Economic Research.

Default and foreclosure rates varied by market segment and product type, with subprime and adjustable-rate loans experiencing the largest increases during the 3-year period we examined. More specifically:

—In the prime market segment, which accounted for more than three-quarters of the mortgages being serviced, 2.4 percent of loans were in default or foreclosure by the second quarter of 2008, up from 0.7 percent 3 years earlier. Foreclosure start rates for prime loans began the period at relatively low levels (0.2 percent) but rose sharply on a percentage basis, reaching 0.6 percent in the second quarter of 2008.

—In the subprime market segment, about 18 percent of loans were in default or foreclosure by the second quarter of 2008, compared with 5.8 percent 3 years earlier. Subprime mortgages accounted for less than 15 percent of the loans being serviced, but over half of the overall increase in the number of mortgages in default and foreclosure over the period. Additionally, foreclosure start rates for subprime loans more than tripled, rising from 1.3 percent to 4.3 percent (see fig. 2).

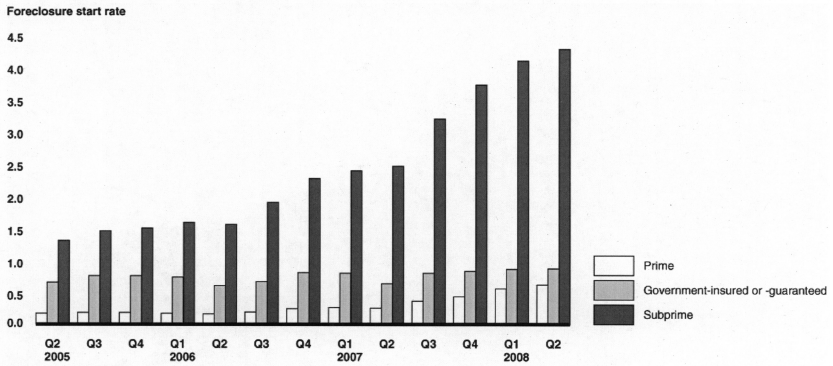
[11] In the second quarter of 2005, foreclosure rates began to rise after remaining relatively stable for about 2 years.

[12] We calculated the number of foreclosure starts and the foreclosure inventory by multiplying foreclosure rates by the number of loans that the National Delinquency Survey showed as being serviced and rounding to the nearest thousand. Because the survey does not cover all loans being serviced, the actual number of foreclosures is probably higher than the amounts we calculated.

—In the Government-insured or -guaranteed market segment, which represented about 10 percent of the mortgages being serviced, 4.8 percent of the loans were in default or foreclosure in the second quarter of 2008, up from 4.5 percent 3 years earlier. Additionally, foreclosure start rates in this segment increased modestly, from 0.7 to 0.9 percent.

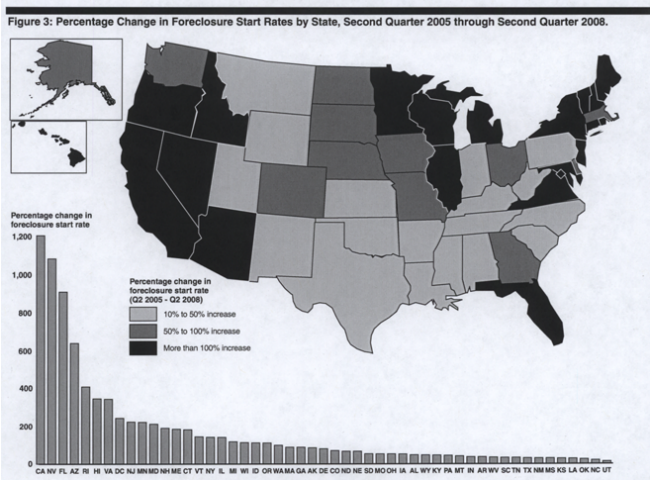
—ARMs accounted for a disproportionate share of the increase in the number of loans in default and foreclosure in the prime and subprime market segments over the 3-year period. In both the prime and subprime market segments, ARMs experienced relatively steeper increases in default and foreclosure rates, compared with more modest growth for FRMs. In particular, foreclosure start rates for subprime ARMs more than quadrupled over the 3-year period, increasing from 1.5 percent to 6.6 percent.

Figure 2: Foreclosure Start Rates by Market Segment, Second Quarter 2005 through Second Quarter 2008



Source: GAO analysis of MBA data.

Default and foreclosure rates also varied significantly among States. For example, as of the second quarter of 2008, the percentage of mortgages in default or foreclosure ranged from 1.1 percent in Wyoming to 8.4 percent in Florida. Other States that had particularly high combined rates of default and foreclosure included California (6.0 percent), Michigan (6.2 percent), Nevada (7.6 percent), and Ohio (6.0 percent). Every State in the Nation experienced growth in their foreclosure start rates from the second quarter of 2005 through the second quarter of 2008. By the end of that period, foreclosure start rates were at their 29-year maximums in 17 States. As shown in figure 3, percentage increases in foreclosure start rates differed dramatically by State. The foreclosure start rate rose at least 10 percent in every State over the 3-year period, but 23 States experienced an increase of 100 percent or more. Several States in the "Sun Belt" region, such as Arizona, California, Florida, and Nevada, had among the highest percentage increases in foreclosure start rates. In contrast, 7 States experienced increases of 30 percent or less, including North Carolina, Oklahoma, and Utah.



Some mortgage market analysts predict that default and foreclosure rates will continue to rise for the remainder of this year and into next year. The factors likely to drive these trends include expected declines in home prices and increases in the unemployment rate. The Alt-A market, in particular, may contribute to future increases in defaults and foreclosures in the foreseeable future. According to a report published by the Office of the Comptroller of the Currency and the Office of Thrift Supervision, Alt-A mortgages represented 200 percent of the total number of mortgages at the end of June 2008, but constituted over 20 percent of total foreclosures in process.[13] The seriously delinquent rate for Alt-A mortgages was more than four times the rate for prime mortgages and nearly twice the rate for all outstanding mortgages in the portfolio. Also, Alt-A loans that were originated in 2005 and 2006 showed the highest rates of serious delinquency compared with Alt-A loans originated prior to 2005 or since 2007, according to an August 2008 Freddie Mac financial report.[14] This trend may be attributed, in part, to Alt-A loans with adjustable-rate mortgages whose interest rates have started to reset, which may translate into higher monthly payments for the borrower.

TREASURY IS EXAMINING OPTIONS FOR HOMEOWNERSHIP PRESERVATION IN LIGHT OF RECENT CHANGES IN THE USE OF TARP FUNDS

Treasury is currently examining strategies for homeownership preservation, including maximizing loan modifications, in light of a refocus in its use of TARP funds. Treasury's initial focus in implementing TARP was to stabilize the financial markets and stimulate lending to businesses and consumers by purchasing troubled mortgage-related assets—securities and whole loans—from financial institutions. Treasury planned to use its leverage as a major purchaser of troubled mortgages to work with servicers and achieve more aggressive mortgage modification standards. However, Treasury subsequently concluded that purchasing troubled assets would take time to implement and would not be sufficient given the severity of the problem. Instead, Treasury determined that the most timely, effective way to improve credit market conditions was to strengthen bank balance sheets quickly through direct purchases of equity in banks.

The standard agreement between Treasury and the participating institutions in the Capital Purchase Program includes a number of provisions, some in the "recitals" section at the beginning of the agreement and other detailed terms in the body of the agreement. The recitals refer to the participating institutions' future actions in general terms—for example, "the Company agrees to work diligently, under existing programs to modify the terms of residential mortgages as appropriate to strengthen the health of the U.S. housing market." Treasury and the regulators

[13] U.S. Department of the Treasury, Comptroller of the Currency and Office of Thrift Supervision, *OCC and OTS Mortgage Metrics Report, Disclosure of National Bank and Federal Thrift Mortgage Loan Data*, January–June 2008.

[14] Freddie Mac, *Freddie Mac's Second Quarter 2008 Financial Results*, August 6, 2008.

have publicly stated that they expect these institutions to use the funds in a manner consistent with the goals of the program, which include both the expansion of the flow of credit and the modification of the terms of residential mortgages. But, to date it remains unclear how OFS and the regulators will monitor how participating institutions are using the capital injections to advance the purposes of the act. The standard agreement between Treasury and the participating institutions does not require that these institutions track or report how they use or plan to use their capital investments. In our first 60-day report to Congress on the TARP program, mandated by the Emergency Economic Stabilization Act, we recommended that Treasury, among other things, work with the bank regulators to establish a systematic means for reviewing and reporting on whether financial institutions' activities are consistent with the purposes of CPP.[15]

Without purchasing troubled mortgage assets as an avenue for preserving homeownership, Treasury is considering other ways to meet this objective. Treasury has established and appointed an interim chief for the Office of the Chief of Homeownership Preservation under OFS. According to Treasury officials, the office is currently staffed with Federal Government detailees and is in the process of hiring individuals with expertise in housing policy, community development, and economic research. Treasury has stated that it is working with other Federal agencies, including FDIC, HUD, and the Federal Housing Finance Agency to explore options to help homeowners under TARP. According to the Office of Homeownership Preservation interim chief, Treasury is considering a number of factors in its review of possible loan modification options, including the cost of the program, the extent to which the program minimizes recidivism among borrowers helped out of default, and the number of homeowners the program has helped or is projected to help remain in their homes. However, to date the Treasury has not completed its strategy for preserving homeownership.

Among the strategies for loan modification that Treasury is considering is a proposal by FDIC that is based on its experiences with loans held by a bank that was recently put in FDIC conservatorship. The former IndyMac Bank, F.S.B., was closed July 11, 2008, and FDIC was appointed the conservator for the new institution, IndyMac Federal Bank, F.S.B. As a result, FDIC inherited responsibility for servicing a pool of approximately 653,000 first-lien mortgage loans, including more than 60,000 mortgage loans that were more than 60 days past due, in bankruptcy, in foreclosure, and otherwise not currently paying. On August 20, 2008, the FDIC announced a program to systematically modify troubled residential loans for borrowers with mortgages owned or serviced by IndyMac Federal. According to FDIC, the program modifies eligible delinquent mortgages to achieve affordable and sustainable payments using interest rate reductions, extended amortization, and where necessary, deferring a portion of the principal. FDIC has stated that by modifying the loans to an affordable debt-to-income ratio (38 percent at the time) and using a menu of options to lower borrowers' payments for the life of their loan, the program improves the value of the troubled mortgages while achieving economies of scale for servicers and stability for borrowers. According to FDIC, as of November 21, 2008, IndyMac Federal has mailed more than 23,000 loan modification proposals to borrowers and over 5,000 borrowers have accepted the offers and are making payments on modified mortgages. FDIC states that monthly payments on these modified mortgages are, on average, 23 percent or approximately $380 lower than the borrower's previous monthly payment of principal and interest. According to FDIC, a Federal loss sharing guarantee on re-defaults of modified mortgages under TARP could prevent as many as 1.5 million avoidable foreclosures by the end of 2009. FDIC estimated that such a program, including a lower debt-to-income ratio of 31 percent and a sharing of losses in the event of a re-default, would cost about $24.4 billion on an estimated $444 billion of modified loans, based on an assumed re-default rate of 33 percent. We have not had an opportunity to independently analyze these estimates and assumptions.

Other similar programs under review, according to Treasury, include strategies to guarantee loan modifications by private lenders, such as the HOPE for Homeowners program. Under this new FHA program, lenders can have loans in their portfolio refinanced into FHA-insured loans with fixed interest rates. HERA had limited the new insured mortgages to no more than 90 percent of the property's current appraised value. However, on November 19, 2008, after action by the congressionally created Board of Directors of the HOPE for Homeowners program, HUD announced that the program had been revised to, among other things, increase the maximum

[15] GAO–09–161.

amount of the new insured mortgages in certain circumstances.[16] Specifically, the new insured mortgages cannot exceed 96.5 percent of the current appraised value for borrowers whose mortgage payments represent no more than 31 percent of their monthly gross income and monthly household debt payments no more than 43 percent of monthly gross income. Alternatively, the new mortgage may be set at 90 percent of the current appraised value for borrowers with monthly mortgage and household debt-to-income ratios as high as 38 and 50 percent, respectively. These loan-to-value ratio maximums mean that in many circumstances the amount of the restructured loan would be less than the original loan amount and, therefore, would require lenders to write down the existing mortgage amounts. According to FHA, lenders benefit by turning failing mortgages into performing loans. Borrowers must also share a portion of the equity resulting from the new mortgage and the value of future appreciation. This program first became available October 1, 2008. FHA has listed on the program's Web site over 200 lenders that, as of November 25, 2008, have indicated to FHA an interest in refinancing loans under the HOPE for Homeowners program. See the appendix to this statement for examples of Federal Government and private sector residential mortgage loan modification programs.

Treasury is also considering policy actions that might be taken under CPP to encourage participating institutions to modify mortgages at risk of default, according to an OFS official. While not technically part of CPP, Treasury announced on November 23, 2008, that it will invest an additional $20 billion in Citigroup from TARP in exchange for preferred stock with an 8 percent dividend to the Treasury. In addition, Treasury and FDIC will provide protection against unusually large losses on a pool of loans and securities on the books of Citigroup. The Federal Reserve will backstop residual risk in the asset pool through a non-recourse loan. The agreement requires Citigroup to absorb the first $29 billion in losses. Subsequent losses are shared between the Government (90 percent) and Citigroup (10 percent). As part of the agreement, Citigroup will be required to use FDIC loan modification procedures to manage guaranteed assets unless otherwise agreed.

Although any program for modifying loans faces a number of challenges, particularly when the loans or the cash flows related to them have been bundled into securities that are sold to investors, foreclosures not only affect those losing their homes but also their neighborhoods and have contributed to increased volatility in the financial markets. Some of the challenges that loan modification programs face include making transparent to investors the analysis supporting the value of modification over foreclosure, designing the program to limit the likelihood of re-default, and ensuring that the program does not encourage borrowers who otherwise would not default to fall behind on their mortgage payments. Additionally, there are a number of potential obstacles that may need to addressed in performing large-scale modification of loans supporting a mortgage-backed security. As noted previously, the pooling and servicing agreements may preclude the servicer from making any modifications of the underlying mortgages without approval by the investors. In addition, many homeowners may have second liens on their homes that may be controlled by a different loan servicer, potentially complicating loan modification efforts.

Treasury also points to challenges in financing any new proposal. The Secretary of the Treasury, for example, noted that it was important to distinguish between the type of assistance, which could involve direct spending, from the type of investments that are intended to promote financial stability, protect the taxpayer, and be recovered under the TARP legislation. However, he recently reaffirmed that maximizing loan modifications was a key part of working through the housing correction and maintaining the quality of communities across the Nation. However, Treasury has not specified how it intends to meet its commitment to loan modification. We will continue to monitor Treasury's efforts as part of our ongoing TARP oversight responsibilities.

Going forward, the Federal Government faces significant challenges in effectively deploying its resources and using its tools to bring greater stability to financial markets and preserving homeownership and protecting home values for millions of Americans.

Mr. Chairman, this concludes my statement. I would be pleased to respond to any questions that you or other members of the subcommittee may have at this time.

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[16] *See http://www.hud.gov/news/release.cfm?content=pr08-178.cfm.*

APPENDIX I.—EXAMPLES OF FEDERAL GOVERNMENT AND PRIVATE SECTOR RESIDENTIAL MORTGAGE LOAN MODIFICATION PROGRAMS

Institution	Program or effort	Selected program characteristics
Federal Government Sponsored Programs		
Federal Deposit Insurance Corporation (FDIC).	IndyMac Loan Modification Program	Eligible borrowers are those with loans owned or serviced by IndyMac Federal Bank. Affordable mortgage payment achieved for the seriously delinquent or in default borrower through interest rate reduction, amortization term extension, and/or principal forbearance. Payment must be no more than 38 percent of the borrower's monthly gross income. Losses to investor minimized through a net present value test that confirms that the modification will cost the investor less than foreclosure.
Federal Housing Administration (FHA)	Hope for Homeowners	Borrowers can refinance into an affordable loan insured by FHA. Eligible borrowers are those who, among other factors, as of March 2008, had total monthly mortgage payments due of more than 31 percent of their gross monthly income. New insured mortgages cannot exceed 96.5 percent of the current loan-to-value ratio (LTV) for borrowers whose mortgage payments do not exceed 31 percent of their monthly gross income and total household debt not to exceed 43 percent; alternatively, the program allows for a 90 percent LTV for borrowers with debt-to-income ratios as high as 38 (mortgage payment) and 50 percent (total household debt). Require lenders to write down the existing mortgage amounts to either of the two LTV options mentioned above.
Federal Housing Finance Agency (FHFA)	Streamlined Loan Modification Program [1]	Eligible borrowers are those who, among other factors, have missed three payments or more. Servicers can modify existing loans into a Freddie Mae or Fannie Mac loan, or a portfolio loan with a participating investor. An affordable mortgage payment, of no more than 38 percent of the borrower's monthly gross income, is achieved for the borrower through a mix of reducing the mortgage interest rate, extending the life of the loan or deferring payment on part of the principal.
Private Sector Programs		
Bank of America	National Homeownership Retention Program.	Eligible borrowers are those with subprime or pay option adjustable rate mortgages serviced by Countrywide and originated by Countrywide prior to December 31, 2007. Options for modification include refinance under the FHA HOPE for Homeowners program, interest rate reductions, and principal reduction for pay option adjustable rate mortgages. First-year payments mortgage payments will be targeted at 34 percent of the borrower's income, but may go as high as 42 percent. Annual principal and interest payments will increase at limited step-rate adjustments.

APPENDIX I.—EXAMPLES OF FEDERAL GOVERNMENT AND PRIVATE SECTOR RESIDENTIAL MORTGAGE LOAN MODIFICATION PROGRAMS—Continued

Institution	Program or effort	Selected program characteristics
JPMorgan Chase & Co.	General loan modification options	Affordable mortgage payment achieved for the borrower at risk of default through interest rate reduction and/or principal forbearance. Modification may also include modifying pay-option ARMs to 30-year, fixed-rate loans or interest-only payments for 10 years. Modification includes flexible eligibility criteria on origination dates, loan-to-value ratios, rate floors and step-up adjustment features.
	Blanket loan modification program	Eligible borrowers are those with short-term hybrid adjustable rate mortgage owned by Chase. Chase locks in the initial interest rate for the life of the loan on all short term adjustable rate mortgages with interest rates that will reset in the coming quarter.
	American Securitization Forum Fast Track	Eligible borrowers are those with non-prime short-term hybrid adjustable rate mortgages serviced by Chase. Under the program developed by the American Securitization Forum Chase freezes the current interest rate for 5 years.
Citi	Homeowner Assistance Program	Eligible borrowers are those not currently behind on Citi-held mortgages but that may require help to remain current. Citi will offer loan workout measures on mortgages in geographic areas of projected economic distress including falling home prices and rising unemployment rates to avoid foreclosures.
	Loan Modification Program	Affordable mortgage payment achieved for the delinquent borrower through interest rate reduction, amortization term extension, and/or principal balance. According to Citi, program is similar to the FDIC IndyMac Loan Modification Program.
HOPE NOW Alliance	Foreclosure prevention assistance programs.	HOPE NOW is an alliance between Department of Housing and Urban Development (HUD) certified counseling agents, servicers, investors and other mortgage market participants that provides free foreclosure prevention assistance. Forms of assistance include hotline services to provide information on foreclosure prevention, which according to HOPE NOW receives an average of more than 6,000 calls per day; and access to HUD approved housing counselors for debt management, credit, and overall foreclosure counseling. Coordinates a nationwide outreach campaign to at-risk borrowers and states that it has sent nearly 2 million outreach letters. Since March 2008, has hosted workshops in 27 cities involving homeowners, lenders, and HUD certified counselors.

[1] This program was created in consultation with Fannie Mae, Freddie Mac, HOPE NOW, and its 27 servicer partners, the Department of the Treasury, FHA, FHFA.

Senator DURBIN. Our next witness is Bruce Gottschall, the Executive Director of Neighborhood Housing Services of Chicago. He's an expert in the field of housing and community development, served in a number of housing-related committees and was put on Chicago's Affordable Housing Task Force, and the Federal Home Loan Bank's Advisory Council.

He graduated from Dartmouth with a master's in social service administration from the University of Chicago.

Welcome.

STATEMENT OF BRUCE GOTTSCHALL, EXECUTIVE DIRECTOR, NEIGHBORHOOD HOUSING SERVICES OF CHICAGO

Mr. GOTTSCHALL. Thank you, Mr. Chairman, and thank you very much for inviting me to speak today.

My name is Bruce Gottschall, I'm the Executive Director of Neighborhood Housing Services (NHS). We're a not-for-profit community development organization, and counseling and homeownership development organization in the city of Chicago.

In our experience, the Federal Government's efforts to address the foreclosure crisis through the Emergency Economic Stabilization Act have been in good faith, but the effects are not trickling down to homeowners fast enough and are not leading to significant reductions in foreclosures.

NHS has been working on addressing foreclosures in Chicago's neighborhoods since 2002 through the homeownership preservation initiative (HOPI). Our organization assisted over 2,000 individuals last year, and we are on track to see more than 3,000 this year.

NHS conducted a review of some of our clients' financial characteristics over the last year and developed a map or typology that helps us identify, sort, and assist clients more quickly. Eleven percent are distressed homeowners who can avoid foreclosure by simply working out a traditional repayment plan with their lender. Another 29 percent could avoid foreclosure if their lender would modify the interest rate of their mortgage down to 6 percent or a little lower. Thus, for approximately 40 percent of homeowners facing foreclosure, a possible solution already exists that could keep them in their home if the loan servicer and investor are willing and able to offer that solution.

For the remaining 60 percent, the principal balances are too high for the loan to be sustainable. In order to avoid foreclosure, some form of principal deferral or reduction, coupled with an interest rate modification, is necessary.

Of course, there are severe cases in which no argument can be made to justify foreclosure avoidance methods and in some cases, as with speculative investors, little effort should be made. To reach solutions, housing counselors serve as trusted third parties who can assist borrowers in assessing their situation.

While individuals in foreclosure will frequently avoid their lenders because they feel intimidated or afraid, they will talk openly and honestly with a counselor who can then bridge the communication gap between the borrower and the servicer.

While some of our HOPI lending and servicing partners have taken action to increase the capacity of their organizations to work

with housing counselors and offer loan modifications, the results across the industry are spotty at best.

Frequently servicers loss mitigation staff lack the authority, knowledge, training and expertise to make decisions about loss mitigation or loan modifications. Counselors' and borrowers' inability to access staff who can make the right decision means successful strategies to avoid foreclosure are not being used by servicers.

Efficiency is also a challenge. Despite advances in technology, loss mitigation departments still rely on faxing documents back and forth between borrowers and the servicer. These documents are frequently lost or misplaced. All of these inefficiencies mean that many homeowners who could avoid foreclosure are falling through the cracks.

In response to this problem, NHS—through Neighborworks America and NHS America, and a handful of servicers are now using a new online service called "Best Fit," which allows NHS and participating servicers to track clients and scan and upload documents into a universal database, to which only the servicer and counselor have access. This will create and streamline processes that need to be expanded to more servicers and counselors.

Many loan modifications that have been done in the past are unaffordable. A review of 60 loan modifications that were facilitated by NHS of Chicago counselors showed that fully one-third of loan modifications offered to borrowers in distress had housing ratios of over 50 percent—one-third over 50 percent housing ratio. Another one-third had housing ratios between 35 and 50 percent, which means they were on the verge of being unaffordable.

Considering this, reports in the press and by analyses that 50 percent of homeowners receiving loan modifications re-default is not a surprise, since two-thirds of the loan modifications were essentially unworkable from the outset, it is amazing that more don't fail, considering the poor nature of the modifications.

For these reasons, NHS supports efforts to compel mortgage holders to offer proactive, standardized loan modifications to large numbers of mortgagees in a systematic manner such as the method employed by the FDIC with the IndyMac portfolio you've heard about.

Along this line, NHS also supports the more recent proposal by FDIC, that would partially ensure affordable and sustainable loan modifications, which would create appropriate incentives for mortgage servicers and investors to take the necessary steps to stem foreclosures. Further, regulators should require that all servicers report on not only the number of loan modifications they offer, but also the affordability of these loan modifications.

Also, the issue of principal deferral or reduction is clearly necessary in many situations of foreclosure prevention and I encourage you to move this to being used in cases where it makes economic sense.

Finally, NHS would like to see regulators make clear to the recipients of the TARP funds their responsibility to use those funds to originate mortgages in low to moderate income communities. Frequently, we receive calls and questions from homeowners asking what the rescue funds mean for them. Unfortunately, it is unclear that homeowners and neighborhoods are experiencing any

real benefit from the $350 billion invested in our financial services industry.

As the subcommittee looks for suggestions on how to adapt the program, it would be our advice that new efforts focus on homeowners in foreclosure and the neighborhoods in which they live. The Greater Southwest Development Corporation and the neighborhood it serves is just one of many, many communities and neighborhoods that are embedded severely right now by the foreclosures.

Again, thank you for your invitation, and for focusing on this issue. I'd be happy to answer any questions.

Senator DURBIN. Thanks.

[The statement follows:]

PREPARED STATEMENT OF BRUCE GOTTSCHALL

Mr. Chairman, members of the Committee, thank you very much for inviting me to testify today. My name is Bruce Gottschall and I am the Executive Director of Neighborhood Housing Services of Chicago (NHS of Chicago). I appreciate the opportunity to share with you the experience NHS has had in helping families facing foreclosure in Chicago and how that experience can and should inform a Federal response to the foreclosure crisis. In our experience, the Federal Government's efforts to address the foreclosure crisis through the Emergency Economic Stabilization Act (EESA) have been in good faith, but the effects are not trickling down to home owners fast enough and are not leading to significant reductions in foreclosures. Until the Federal response focuses on homeowners, not just financial institutions, these efforts will be ineffective.

NHS has been working on addressing foreclosures in Chicago's neighborhoods since 2002 through the Home Ownership Preservation Initiative (HOPI). This partnership of lenders, servicers, regulators, non-profit counselors, and the City of Chicago led by NHS of Chicago has proved to be an effective venue for identifying and addressing issues related to foreclosure. Our work here in Chicago has become the national model for communities and local governments seeking to mitigate the impact of foreclosures on their own neighborhoods.

NHS uses its own experiences working with foreclosure clients to inform the HOPI effort. Our organization assisted over 2,000 individuals seeking advice about avoiding foreclosure last year and this year we are on track to see more than 3,000. There is no typical foreclosure client, which is why there is no silver bullet to solving the foreclosure crisis. Rather, there is a wide range of individuals experiencing foreclosures cutting across income levels, demography and loan type.

NHS conducted a review of our clients' financial characteristics over the last year and developed a map or typology that helps us identify, sort, and assist clients more quickly. It also helps us understand the nuances and complexities of the foreclosure crisis. Based upon our review of other foreclosure data from around the country, we are confident that this typology is a representative cross-section of the subprime mortgage market. This typology is attached to my written testimony.

In essence, this information shows us 11 percent of distressed homeowners are in a strong enough financial position that they can avoid foreclosure by simply working out a traditional repayment plan with their lender. Another 29 percent could avoid foreclosure if their lender would modify the interest rate of their mortgage down to 6 percent or lower. Thus, for approximately 40 percent of homeowners facing foreclosure, a possible solution already exists that could keep them in their home if the loan servicer and investor are willing and able to offer that solution.

For the remaining 60 percent, their principal balances are too high for the loan to be sustainable regardless of interest rate. In order to avoid foreclosure, some form of principal deferral or reduction coupled with an interest rate modification is necessary. Depending on the homeowner's income, the amount of principal deferral/reduction necessary ranges from a few thousand dollars up to half of the outstanding principal. In fairness, there are severe cases in which no argument can be made to justify foreclosure avoidance methods and in some cases, as with speculative investors, little effort should be made. However, in many cases, principal reduction makes sense for both the homeowner and investor.

For those clients who can be saved from a foreclosure, housing counselors, such as those at NHS, are important players when it comes to securing a loan modification, workout plan, or principal write-down. Housing counselors serve as trusted

third parties who can assist borrowers in assessing their situation, help them create a realistic budget, and collect the necessary documents for the servicer to make a decision. While individuals in foreclosure will frequently avoid their lenders because they feel intimidated or afraid, they will talk openly and honestly with a counselor who can then bridge the communication gap between the borrower and the servicer.

NHS has the largest staff of housing counselors working on foreclosure in the City of Chicago. Our experience working with servicers is a valuable example of what other counseling agencies and borrowers are also experiencing as they attempt to work with loan servicers. The shortfall of loss mitigation efforts we have seen highlights the need for increased action by regulators, either through the existing authority under EESA or other mechanisms to achieve the outcomes we all expect and desire.

Senior leadership of many lending and servicing organizations have expressed their commitment to helping owners avoid foreclosure. Unfortunately, this does not seem to be translating into increased workouts and loan modification offerings nearly fast enough to address the foreclosure crisis. While some of our HOPI lending and servicing partners have taken action to increase the capacity of their organizations to work with housing counselors and offer loan modifications to their clients, the results across the industry have been spotty at best.

In the best situations, servicers set up separate departments or staff contacts to work directly with housing counselors. In these cases, the counselors are able to expedite the modification process for the servicers by collecting completed documents from the client in person, eliminating much of the back and forth that otherwise occurs between the borrower and servicer. They can also assist the borrower in developing a realistic budget and push back when the servicer wants to owner to enter into an unsustainable modification. These efforts lead to a quicker more sustainable outcome and a foreclosure avoided.

In the worst situations, and these are still the majority, clients and counselors are bounced back and forth between the collections and loss mitigation departments. Their calls are frequently dropped in the process. When they call back, there are rarely any notes from the last conversation they had with the servicer so they have to start over again. Fore example, one of our counselors made 17 separate contacts with one servicer over 4 months in order to get that servicer to correct a mistake they had made which was forcing our client into foreclosure in error.

Most servicers continue to staff their loss mitigation departments with individuals who either lack the authority or the knowledge, training, and expertise to make decisions about loan modifications or principal write-downs. Many servicing staff come from a debt-collection background and do not receive adequate training on loss mitigation and the role of housing counselors and so are unable to leverage the resources and expertise of local counseling staff to help families avoid foreclosure. Counselors' inability to access the decision makers means some of the most creative and cutting edge strategies to avoid foreclosure are not being used by servicers.

For example, over a year ago, NHS of Chicago developed a grant program through which our non-profit lending arm, Neighborhood Lending Services, offered to refinance homeowners out of unsustainable, mortgages and into 30-year, prime rate fixed mortgages. This was intended for customers for whom either the outstanding principal was too much for the homeowner to afford even at the prime rate or for whom there was considerable negative equity. We offered grant money to the servicers on condition that they would match the grant with a commensurate principal write down in order to achieve an affordable new loan balance for the homeowner. Fewer than five servicers approved writes downs of even a few thousand dollars. Despite the fact that investors stood to lose tens of thousands of dollars more if they proceeded with a foreclosure, they would not agree to any principal reduction.

Efficiency is also a challenge. Despite advances in technology, loss mitigation departments still rely on faxing documents back and forth between borrowers and the servicer. These documents are frequently lost or misplaced and the process must be restarted over and over again. These small delays quickly add up to days, weeks, and even months during which additional fees accrue and the homeowner becomes discouraged and gives up. When homeowners and housing counselors call servicers, too often they remain on hold for long periods of time and are transferred numerous times before they speak to someone. Files are shuffled between departments without any apparent rhyme or reason and there is a disconnect and lack of communication between and even within these departments. All of these inefficiencies mean that many homeowners who could avoid foreclosure are falling through the cracks. This should be considered unacceptable during such a crisis and regulators should step in to demand better results.

In response to this problem, NHS and a handful of servicers are now using a new online service called "Best Fit," which allows NHS and participating servicers to track clients and scan and upload documents into a universal database, and to which only the servicer and counselor have access. This online platform shows great promise for reducing the unnecessary delays and waste that are keeping people from avoiding foreclosure. However, more servicers need to adopt this tool and train their staff in its use to maximize benefit.

Another challenge is that when servicers do loan modifications, the modifications are often unaffordable, which means they frequently fail down the road. A review of 60 loan modifications that were facilitated by NHS of Chicago counselors showed that fully one-third of loan modifications offered to borrowers in distress had housing ratios of over 50 percent. In these cases, the interest rate was typically frozen at its current level and the arrearage, costs, and fees were capitalized. Another 34 percent had housing ratios between 35 and 50 percent, which means they were on the verge of being unaffordable and had a significant likelihood of failure. It was only the final third of the loan modifications that had reasonable housing payment ratios giving the homeowners a real chance for long-term sustainability.

Our analysis is confirmed by recent reports that approximately 50 percent of homeowners receiving loan modifications re-default within a few months. Since two-thirds of loan modifications are essentially unworkable from the outset, it is no wonder that half of them fail. However, I urge you not to draw the same conclusion that some housing market observers have reached: namely, that loan modifications do not work and lenders ought to foreclose instead. Instead, consider the fact that good loan modifications that create a reasonable housing payment do work over the long term and can go to great lengths to stem the tide of foreclosures.

While we believe that the efforts outlined in the Emergency Economic Stabilization Act were developed with the best of intentions, these experiences show that the impact of the efforts thus far are not leading to increased efforts to avoid foreclosures by lenders and servicers and are also not translating into access to capital for individuals to purchase homes, a necessary next step for market recovery. We feel this is because the efforts thus far have focused on the impact of foreclosure to the market, not on helping individual homeowners avoid foreclosure.

Some of our counselors even report that during October and November servicers became less willing to offer loan modifications—a response they attribute to financial institutions waiting to see if their troubled assets would be purchased.

It had been our hope that if the Government purchased the troubled assets of struggling financial institutions that they could in turn offer standardized loan modifications and principal reductions in such a way that large numbers of foreclosure could be avoided in an efficient and effective way. In the absence of such a program it appears that lenders and servicers have not taken sufficient steps to reduce foreclosures on their own.

For these reasons, NHS supports efforts to compel mortgage holders to offer proactive, standardized loan modifications to large numbers of mortgagees in a systematic manner such as the method employed by the FDIC with the Indy Mac portfolio. We feel that all lenders and servicers should undertake similar efforts immediately in order to assist the maximum number of families avoid foreclosure. The FDIC has even provided template documents for other investors and servicers to use to replicate their mass loan modification program, which are available on their website.

Along this line, NHS also supports the more recent proposal by the FDIC to partially insure affordable and sustainable loan modifications made by servicers, which we feel would create appropriate incentives for mortgage servicers and investors to take the necessary steps to stem foreclosures. Further, regulators should require that all servicers report on not only the number of loan modifications they offer, but also the affordability of these loan modifications. As I have just outlined, loan modifications are a crucial component to addressing the foreclosure crisis, so additional information about the use and structure of loan modifications is essential.

Also, the issue of principal deferral or reduction is clearly the cutting edge of foreclosure prevention and I encourage you to do all you can to help move it from being only a theoretical option to one that's used judiciously in cases where it makes economic sense. As positive examples of what has already been done, the leadership shown by the FDIC in its handling of the IndyMac portfolio, along with the recent announcements by Fannie Mae and Freddie Mac, have made significant progress towards making principal deferral or reduction the industry standard in cases where it maximizes net present value. However, more must be done. Servicers need guidance on how and when to engage in principal deferral or reduction.

Finally, NHS would like to see regulators make clear to the recipients of the TARP funds their responsibility to use those funds to originate mortgages in LMI

communities. NHS has seen an increase in clients needing to use our purchase loans because they cannot get traditional financing through banks. This remained the case during the last 2 months when lenders should have been expanding their willingness to lend the capital they received through the EESA.

We have received numerous calls from homeowners in trouble asking what the rescue plan means for them. Unfortunately, thus far, it is unclear that homeowners and neighborhoods are experiencing any real benefit from the $350 billion invested in our financial services industry.

As the committee looks for suggestions on how to adapt the program, it would be our advice that new efforts focus on homeowners in foreclosure and the neighborhoods in which they live.

Senator DURBIN. The next witness, Marguerite Sheehan is Senior Vice President of JPMorgan Chase, Housing Policy Executive for Chase Home Lending. Ms. Sheehan has been with the firm for over 25 years, starting with the predecessor company, manufacturers Hanover.

A member of the New York State Bar, she has her B.A., master's and J.D. from Catholic University.

Ms. Sheehan, please proceed.

STATEMENT OF MARGUERITE E. SHEEHAN, SENIOR VICE PRESIDENT AND HOME LENDING SENIOR EXECUTIVE, JPMORGAN CHASE

Ms. SHEEHAN. Senator Durbin, members of the Senate subcommittee, we appreciate the opportunity to appear before you today on this most important topic of troubled homeowners. We recognize that no one benefits in foreclosure.

My name is Molly Sheehan and I work for the Home Lending Division of JPMorgan Chase as a senior housing policy advisor.

Chase is one of the largest residential mortgage servicers in the United States, serving over 10.5 million customers over the platforms of Chase, and more recently, WaMu and EMC, with mortgage and home equity loans of approximately $1.5 trillion in every State of the country.

We are proud to be part of one of this country's preeminent financial institutions with a heritage of over 200 years.

Chase services about $335 billion in mortgages and home equity loans it originates and owns. It also services or subservices more than $1.166 trillion in first-lien mortgage loans owned by investors; that's about 78 percent of our total services.

As you know, we announced several weeks ago, several significant enhancements to our foreclosure prevention and loan modification efforts. We would like to share them with you.

While Chase has helped many families already, we feel it is our responsibility to provide additional help to homeowners during these challenging times. We will work with families who want to save their homes but are struggling to make their payments. We announced on October 31 that we are undertaking multiple new initiatives designed to keep more families in their homes. We are in the process of implementing these changes, and expect to be ready to launch the program within the next 60 days.

While implementing these enhancements, we have stopped any additional portfolio loans from entering the foreclosure process. This will give potentially eligible homeowners in owner-occupied properties with mortgages owned by Chase, WaMu or EMC an opportunity to take advantage of these new enhancements, and we will continue to work diligently with our investors to get their ap-

proval to bring enhancements to loans we service on behalf of others so our efforts can have the broadest possible impact.

The enhanced program is expected to help an additional 400,000 families—with $70 billion in loans—in the next 2 years. Since early 2007, Chase, WaMu and EMC have helped about 250,000 families avoid foreclosure, primarily by modifying their loans or monthly payments.

Specifically, we will systematically review the entire mortgage portfolio to determine proactively which homeowners are most likely to require help, and try to provide it before they are unable to make payments; proactively reach out to homeowners to offer pre-qualified modifications such as interest-rate reductions and/or principal forbearance. The pre-qualified offers will streamline the modification process and help homeowners understand that Chase is offering a specific option to make their monthly payment more affordable.

We will establish 24 new regional counseling centers to provide face-to-face help in areas with high delinquency rates, building on the success of 1- and 2-day HOPE NOW outreach days. We will partner with our community counselors to reach more borrowers through these centers.

We will add 300 more loan counselors—bringing the total to more than 2,500—so that delinquent homeowners can work with the same counselor throughout the process, improving follow-through and success rates. Chase will create a separate and independent review process within Chase to examine each mortgage before it is sent into the foreclosure process, and to validate that the homeowner was offered appropriate modifications. We will staff the new function with approximately 150 people.

We will expand the range of financing alternatives to modify pay-option ARMs which face really specific challenges. These are loans that we inherited when we acquired the mortgage portfolios of WaMu, and the EMC unit of Bear Stearns. We will offer them a payment at a 30-year, fixed-rate loan, with the appropriate interest rate reductions, principal deferral, and/or interest-only payments for 10 years. All the alternatives will eliminate negative amortization.

We will offer a substantial discount on, or donate, 500 homes to community groups or through nonprofit or Government programs designed to stabilize communities. And that would be specifically addressed to the vacant property that we find in neighborhoods throughout our communities. And we will use more flexible eligibility criteria on origination dates, loan-to-value ratios, and rate floors.

These enhancements reflect Chase's commitment to continue to seek additional ways to help homeowners. We have already established a dedicated 800 number for customers who want to call us and discuss loan modification options. This number is available on the Chase website, along with other useful information about our programs.

And in addition to what we are doing with our own programs, we are participating with FHFA and the GSEs to implement their streamline modification program and we are in the process of working on the Hope for Homeowners FHA Program.

Thank you very much for your attention, I'd be happy to take any questions.

Senator DURBIN. Thanks very much, Ms. Sheehan.

[The statement follows:]

PREPARED STATEMENT OF MARGUERITE E. CHASE

Chairman Durbin and members of the Subcommittee on Financial Services and General Government, we appreciate the opportunity to appear before you today on this most important topic of helping homeowners. We recognize that no one benefits in a foreclosure.

My name is Molly Sheehan and I work for the Home Lending Division of JPMorgan Chase as a senior housing policy advisor. Chase is one of the largest residential mortgage servicers in the United States, serving over 10.5 million customers on the platforms of Chase, WaMu, and EMC, with mortgage and home equity loans of approximately $1.5 trillion in every State of the country. We are proud to be part of one of this country's pre-eminent financial institutions with a heritage of over 200 years.

Chase services about $335 billion in mortgages and home-equity loans it owns; that's $181 billion (12 percent of total serviced) in first-lien mortgage loans and about $154 billion in home equity (10 percent of total serviced). It also services or sub-services more than $1.166 trillion (78 percent of total serviced) in first-lien mortgage loans owned by investors. In the combined $1.5 trillion portfolio, there is $144 billion (10 percent) of non prime: $23 billion owned by Chase and $121 billion owned by investors. Pay option ARMs are 9 percent of the total serviced portfolio, with $50 billion owned by Chase and $74 billion owned by investors. Chase inherited pay option ARMs when we acquired WaMu's mortgage portfolio in late September and EMC's portfolio earlier this year as part of the Bear Stearns acquisition.

As you know, we recently announced several significant enhancements and we would like to share those with you.

EXPANDED FORECLOSURE PREVENTION INITIATIVES

While Chase has helped many families already, we feel it is our responsibility to provide additional help to homeowners during these challenging times. We will work with families who want to save their homes but are struggling to make their payments.

That's why we announced on October 31 that we are undertaking multiple new initiatives designed to keep more families in their homes.

We will open regional counseling centers, hire additional loan counselors, introduce new financing alternatives, proactively reach out to borrowers to offer prequalified modifications, and commence a new process to independently review each loan before moving it into the foreclosure process. We expect to implement these changes within the next 60 days.

While implementing these enhancements, we have stopped any additional portfolio loans from entering the foreclosure process. This will give potentially eligible homeowners an opportunity to take advantage of these enhancements, and applies to owner-occupied properties with mortgages owned by Chase, WaMu, or EMC, or with investor approval. Chase has worked diligently and will continue to work diligently with investors to apply these enhancements to loans we service on behalf of others so our efforts can have the broadest possible impact. We also will advise homeowners in the foreclosure process to continue to work with their assigned counselors who will have access to our expanded range of modification alternatives.

The enhanced program is expected to help an additional 400,000 families—with $70 billion in loans—in the next 2 years. Since early 2007, Chase, WaMu, and EMC have helped about 250,000 families avoid foreclosure, primarily by modifying their loans or payments. The enhanced programs apply only to owner-occupied properties.

We inherited pay-option ARMs when we acquired WaMu's mortgage portfolio in late September and EMC's portfolio earlier this year as part of the Bear Stearns acquisition. After reviewing the alternatives that were being offered to customers, we decided to add more modification choices. All the offers will eliminate negative amortization and are expected to be more affordable for borrowers in the long term.

As a result of these enhancements for Chase, WaMu, and EMC customers, Chase will:

—Systematically review its entire mortgage portfolio to determine proactively which homeowners are most likely to require help—and try to provide it before they are unable to make payments.

—Proactively reach out to homeowners to offer pre-qualified modifications such as interest-rate reductions and/or principal forbearance. The pre-qualified offers will streamline the modification process and help homeowners understand that Chase is offering a specific option to make their monthly payment more affordable.
—Establish 24 new regional counseling centers to provide face-to-face help in areas with high delinquency rates, building on the success of 1- and 2-day Hope Now reach-out days. We will partner with our community counselors to reach more borrowers.
—Add 300 more loan counselors—bringing the total to more than 2,500—so that delinquent homeowners can work with the same counselor throughout the process, improving follow-through and success rates. Chase will add more counselors as needed.
—Create a separate and independent review process within Chase to examine each mortgage before it is sent into the foreclosure process—and to validate that the homeowner was offered appropriate modifications. Chase will staff the new function with approximately 150 people.
—Not add any more Chase-owned loans into the foreclosure process while enhancements are being implemented.
—Disclose and explain in plain and simple terms the refinancing or modification alternatives for each kind of loan. Chase also will use in-language communications, including local publications, to more effectively reach homeowners.
—Expand the range of financing alternatives offered to modify pay-option ARMs to an affordable monthly payment, including 30-year fixed-rate loans, interest rate reductions, principal deferral, and interest-only payments for 10 years. All the alternatives eliminate negative amortization.
—Offer a substantial discount on or donate 500 homes to community groups or through non-profit or Government programs designed to stabilize communities.
—Use more flexible eligibility criteria on origination dates, loan-to-value ratios, rate floors and step-up features.

The enhancements reflect Chase's commitment to continue to seek additional ways to help homeowners.

EXPANDED OFFERS FOR ARM CUSTOMERS

Chase offers two programs for unsolicited rate modifications for short-term hybrid ARMS (2, 3). These programs are specifically designed to avoid delinquency and reward current borrowers who have demonstrated a willingness and ability to pay but may be subject to future payment shock.

—In late 2007, we began a blanket loan modification program for Chase-owned loans. It works very simply for homeowners: We unilaterally lock in the initial interest rate for the life of the loan on all short-term ARMs that are due to reset in the coming quarter. This saves homeowners hundreds of dollars a month. We also have done similar blanket modification programs for investors at their request. Fewer than 10 percent of these modified loans end up in re-default. We are currently reviewing the EMC and WaMu portfolios to see if this program should be expanded.
—In early 2008, we kicked off the American Securitization Forum (ASF) Fast Track loan modification program for non-prime, short-term hybrid ARMs serviced by us. ASF developed a systematic, highly streamlined process that quickly freezes the loan's current interest rate for 5 years, protecting the borrower from rate and payment increases. WaMu and EMC also use the ASF Fast Track procedures.

Chase also provides loan modifications for customers who can not sustain their current payment due to affordability. As a general rule, an analysis is completed to determine an affordable payment level for the customer that will result in a reasonable housing ratio (principal, interest, taxes, and insurance and condo or association fees as a percentage of income) while producing a more positive result for the investor than foreclosure. Income is subject to verification. WaMu and EMC presently use a net present value (NPV) and affordability model to determine the optimal modification for the borrower and investor. Chase is reviewing that model to determine which approach yields the most consistent and efficient process across all the portfolios.

Chase has had a proactive outreach program for resetting ARM customers since the first quarter of 2007, with no restriction based on origination date. The outreach is done for all ARM customers with contacts occurring 120 days and 60 days before reset. Under WaMu's Program for option ARMs, starting in January 2008, customer contact begins for all option ARM customers up to 180 days before reset to explore

workout and refinance options. EMC has a similar program of outreach that they started in the fourth quarter of 2007, beginning outreach up to 270 days before reset.

Also, as we announced, we will proactively reach out to homeowners to offer pre-qualified modifications such as interest-rate reductions and/or principal forbearance. The pre-qualified offers will streamline the modification process and help homeowners understand that Chase is offering a specific option to make their monthly payment more affordable.

NEW OFFERS FOR OPTION ARM CUSTOMERS

Chase did not originate or purchase option ARMs but has acquired portfolios of Option ARMs as a result of its acquisition of EMC and WaMu loans.

WaMu began a proactive program for its owned Option ARM portfolio in January of 2008. Nine months later, WaMu kicked off a more aggressive campaign with more refined targeting and offers for borrowers due to recast in the next 180 days. The offer—and the frequency of follow-up mailings—depends on whether the consumer is coming up on a scheduled recast or a forced recast. Under the WaMu and EMC programs, the first offer is a refinance into an Agency or FHA loan, including FHASecure. Borrowers can also be referred directly to loss mitigation counselors at their request.

Under the expanded initiatives we recently announced, our second offer for Pay Option ARMs will be a modification to a 30-year fixed-rate fully amortizing loan with elimination of the negative amortization feature. In addition, terms may be extended to as long as 40 years to increase affordability. The interest rate can be reduced as low as 3 percent to achieve affordability. If a below-market rate is required, the loan rate will begin to step up to a market rate after 3 years with any adjustments capped at 1 percent every year to eliminate payment shock. If needed, principal can be deferred down to as low as 90–95 percent of the current loan-to-value.

The third offer is a 10-year/interest only ARM at a discounted rate with a floor of 3 percent and no modification fees. Negative amortization is eliminated. Principal deferral will also be used to as low as a 90–95 percent current loan-to-value ratio if required. If a below-market rate is required, the loan rate will begin to step up to a market rate after 3 years with adjustments capped at 1 percent every year to eliminate payment shock. This program is designed for home owners who want to stay in their home, so it is limited to owner occupants.

Once operational at Chase, the FHA Hope for Homeowners Program will provide an additional option for these borrowers. We were pleased that HUD announced several modifications to the H4H Program because we believe those changes should expand the number of borrowers we will be able to reach and reduce the operational complexity of offering the product.

For these loan modification programs, we will determine affordability based on a housing ratio (principal, interest, taxes, insurance, and condo or association fees) that generally does not exceed a range of 31 percent to 40 percent, based on income. Borrowers with housing ratios between 40 percent and a hard cap of 50 percent may be eligible if they demonstrate documented compensating factors, which can include the amount by which the monthly payment has been reduced and payment history during the trial modification period. These ratios are being used today by Chase in its current modification programs and their reasonableness has been validated by the relatively low level of recidivism. An NPV analysis will be used to evaluate refinance and modification offers including, in both cases, potential principal deferral. There is no interest charged on the principal forbearance, but a required payment upon sale or refinance allows the owner of the loan to share in any potential future appreciation.

Once borrowers provide preliminary income information, they begin making a reduced payment. But the final modification will be subject to the borrower making up to three consecutive payments at the modified amount as well as receipt and validation of income information and confirmation of current collateral value. No modification fees will be charged and delinquency fees will be waived.

As announced, we anticipate being able to implement the program over the next 2 months and we will not commence foreclosure proceedings for potentially eligible borrowers for loans owned by Chase and seek investor consent, where required, for serviced loans. Our Project Team has been formed and is working on each of the announced initiatives and we are making significant progress toward our goal of implementing all of them across our portfolio by January 31. As part of that process, we have formed a team to focus on our investors and are developing our outreach strategy to bring these enhancements to loans we service on behalf of investors. Our

efforts then can have the broadest possible impact. Once we are able to tangibly demonstrate the methodology and the process, we believe our investors will become comfortable as we roll the program out more broadly and provide any consent that may be needed in particular cases.

We also believe that with the efforts of many servicers, the sharing of best practices and the leadership of the FDIC and the GSEs, the industry is starting to converge on a new industry standard for loan modifications. To the extent the investor community joins in accepting this emerging standard that will provide greater certainty to the servicing industry.

We applaud the announcement by FHFA, Fannie Mae, and Freddie Mac of their Streamlined Modification Program (SMP). This Program will bring needed simplicity and consistency to loans being modified in the GSEs' portfolios and securities. While the SMP only applies to loans that are delinquent for more than 90 days, it is still an important step forward. We encourage the FHFA and the Agencies to consider expanding the SMP to also address the needs of homeowners that are current but where default is reasonably foreseeable, based on the borrower's financial profile and the terms of their loan.

The SMP is being implemented by servicers that are part of the HOPE NOW Alliance for Agency loans they service. HOPE NOW servicers and the GSEs have been working closely with a target date of mid-December to develop the procedures and protocols that servicers will need to implement the SMP. This new initiative will supplement the loan modification efforts of all HOPE NOW servicers who have prevented almost 2.7 million foreclosures since the Alliance began reporting in July 2007. The GSEs have announced a freeze on new foreclosure sales during this implementation period. Director Lockhart of the FHFA is calling on the private investor community to adopt the SMP model—a development that would further enhance the effectiveness of the SMP and further reduce foreclosures.

We are pleased to provide this information to you and we will be happy to meet with you and respond to additional questions you may have or ideas you would like to share. In turn, as we continue to improve or programs and efficiency, we would be happy to keep you advised. We especially appreciate your leadership and that of subcommittee members in keeping a focus on this important issue of keeping families in their homes.

Senator DURBIN. Attorney General Madigan, tell me what, before you get into some legal elements here, tell me what you think the impact is of this reign of foreclosure—even if it stays the same, let alone increases—on a neighborhood like what would be in this manner.

STATEMENT OF LISA MADIGAN, ATTORNEY GENERAL, STATE OF ILLINOIS

Ms. MADIGAN. Mr. Chairman, let me just state that it's not just this neighborhood in Chicago. There are many neighborhoods where the maps would look exactly the same. The situation, certainly on the west side, as well as the south side, not just the southwest side where we're seeing an unmatchable rate of foreclosures.

And so first, you have to recognize that you have the impacts on the family that was looking to own, currently. Not only will they be out of their housing, but they will also have their credit destroyed, making it virtually impossible for them to get into another house, most likely. Then they will be forced to find rental property, which can be a challenge in many parts of the city right now.

In addition, you have to take into consideration the impact that this has on the property values of the surrounding homes. So, reports that I have seen indicate almost 1 percent, in terms of the decrease in property values experienced by surrounding homes when there is a home that is foreclosed on. So, you are reducing the amount that people see, you know, in worth in terms of that home.

And because of that, as you recognized, we have a resulting decrease in the tax base, so we don't have the resources necessary to provide police protection, fire protection, education, infrastructure, we cannot do that.

So, it is absolutely devastating, both on a personal level to the family, on the neighbors' level, as well as, you know, all of the services we have come to expect in the city of Chicago, and in our communities. So, it's very—it's difficult, in some ways, to fully appreciate that all of us, regardless if we are able or unable to afford our mortgage payment, are going to be panicking during the last year, as people have come to realize that's the case.

[The statement follows:]

PREPARED STATEMENT OF LISA MADIGAN

THE ILLINOIS ATTORNEY GENERAL'S PROTECTION OF CONSUMERS FROM PREDATORY MORTGAGE LENDING PRACTICES

Introduction and Background

Senator Durbin and members of the subcommittee, thank you for inviting me to testify at today's hearing on the implementation of the Troubled Asset Relief Program (TARP), which is the centerpiece of the recently enacted Emergency Economic Stabilization Act (EESA). As the chief consumer advocate for a State that has been especially hard hit by the nationwide foreclosure crisis, I am pleased to share my thoughts on how the Department of Treasury can best use its authority under EESA to ensure that millions of distressed homeowners receive the sustainable loan modifications they need to remain in their homes.

Since taking office as Illinois Attorney General nearly 6 years ago, I have made a priority of protecting homeowners from predatory and irresponsible mortgage lenders. In my role as prosecutor, I have brought enforcement actions against some of the largest mortgage lenders in the Nation for engaging in the kinds of reckless lending practices that attracted headlines only after the collapse of the housing market threatened to bring the global economy to its knees. In my role as policymaker, I have drafted and lobbied successfully for the passage of State legislation to curb the excesses of a mortgage industry that, during the housing bubble, had grown all too willing to abandon time-honored prudent lending standards in pursuit of fast and easy profits.

Despite all these efforts, there is only so much that one State official can do to address a foreclosure crisis of global proportions. This is especially true in view of the ongoing and lamentable movement in Washington to limit the authority of the States to regulate mortgage lending within their own borders. Additionally, the last 2 years have seen a massive shift in mortgage lending to nationally chartered financial institutions. With more than 90,000 foreclosure filings expected in Illinois this year, this clearly is the moment for the Federal Government to exercise the full extent of its power to regulate the conduct of the mortgage industry. If we are to stem the rising tide of foreclosures, the Federal Government must use TARP resources and other legislative initiatives to incentivize the mortgage industry to implement comprehensive loan modification programs that will keep hardworking families in their homes and preserve surrounding communities—not only in Illinois but throughout the Nation.

My testimony today is divided into two main parts. First, I will review my office's investigation of Countrywide Home Loans and my subsequent lawsuit against that company. This review will include a summary of the landmark loan modification program at the center of our recent settlement agreement with Countrywide's new owner, Bank of America. The terms of the Countrywide settlement provide an excellent template for the kind of wide-scale loan modification programs that are necessary to address the foreclosure crisis at its root cause: namely, the mortgage industry's insistence on originating millions of home loans to borrowers who could not afford them in the first place.

In the second part of my testimony, I will identify some of the key impediments standing in the way of implementing systematic loan modifications and offer policy and legislative recommendations for overcoming those obstacles.

The Illinois Attorney General's Prosecution of Predatory Mortgage Lending: Ameriquest and Countrywide

As I indicated earlier, I am not a newcomer to the idea that the mortgage industry is in serious need of tighter Government control. One of my early major enforcement actions as Illinois Attorney General was to join with several other State attorneys general in an investigation of the lending practices of Ameriquest, the Nation's largest subprime mortgage lender at the time. That investigation, which was launched more than 5 years ago, revealed that Ameriquest was engaged in many of the abusive business practices that, in the last year or so, have come to characterize the mortgage industry as a whole. Those predatory practices included: inflating appraisals of homes, inflating borrowers' income, and using deceptive means to put homeowners into loans they could not afford. For example, Ameriquest would switch homeowners from fixed loans to loans with adjustable rates at the last moment, when many borrowers felt it was too late to back out. In an especially pernicious practice, Ameriquest would switch borrowers to a loan with a higher rate at closing, promising to re-finance borrowers before the loan became unaffordable, even as they were locking the borrowers into the loans with exorbitant prepayment penalties.

As a result of our investigation, Ameriquest settled with 49 States and the District of Columbia, in an agreement worth $325 million. Just as importantly, the settlement's relief package contained four essential components that went to the heart of the industry's unfair and misleading lending practices: (1) early disclosure of essential terms of the loan and the additional requirement that, if the terms changed, they would be re-disclosed prior to closing; (2) scripts to be used during the sale of the loan setting out what borrowers would be told about the essential terms of their loan; (3) provisions ensuring that Ameriquest would deal at arms-length with appraisers; and (4) restrictions on placing prepayment penalties on hybrid ARMs, so that borrowers would not be trapped in loans when their interest rates reset upward.

Having learned to recognize the signs of abusive mortgage lending from our investigation of Ameriquest and other mortgage lenders, we knew by the fall of 2007 that Countrywide merited a closer look. In September 2007, we launched an investigation into the lending practices of the largest mortgage lender in the Nation. The story that our investigation revealed is an allegory; it is in many ways the story of the rise and collapse of our Nation's mortgage industry. Here, in abridged form, is what went wrong at Countrywide.

In pursuit of market share, Countrywide engaged in a wide range of unfair and deceptive practices, including the loosening of underwriting standards, structuring unfair loan products with risky features, engaging in misleading marketing and sales techniques, and incentivizing employees and brokers to sell more and more loans with risky features.

Countrywide's business practices resulted in unaffordable mortgage loans and increased delinquencies and foreclosures for Illinois homeowners, and, as we now know, for homeowners nationwide.

Countrywide's explosive growth was paralleled by the demand on the secondary market for loans with non-traditional risky features. Through the securitization process, Countrywide shifted the risk of the failure of these non-traditional loans to investors. Moreover, securitization allowed Countrywide to gain much needed capital to fuel the origination process and reach its goal of capturing more and more market share. As the risky Countrywide loans began to fail, the company was contractually obligated to repurchase or replace the failing loans in the investor pools. This created further pressure to increase the volume of loan origination. It was a vicious cycle.

To facilitate the increase in loan origination volume, Countrywide relaxed its underwriting standards and sold unaffordable, and unnecessarily expensive, home loans. Reduced documentation underwriting guidelines were heavily used to qualify many borrowers for unaffordable loans. Countrywide mass-marketed so-called "affordability" loan products, such as hybrid adjustable rate mortgages and interest-only loan products that only required qualifying borrowers at less than the fully indexed/fully amortized rate. Countrywide pushed products containing layers of unduly risky features, such as pay option ARMs and mortgage loans for 100 percent of the value of borrowers' homes. Unfair and deceptive advertising, marketing and sales practices were utilized to push mortgages, while hiding the real costs and risks to borrowers. These practices included enticing borrowers with low teaser rates, low monthly payments, and "no closing cost" loans that failed to make clear disclosures of the products' risks.

For a while, these business practices paid off for Countrywide. By the first quarter of 2007, Countrywide had become the largest originator of subprime loans, with a

total subprime loan volume of roughly $7.8 billion. By 2008, the company was well-established as America's largest mortgage lender. In just the first quarter of 2008, the company originated $73 billion nationally in mortgage loans. Countrywide is also the Nation's largest loan servicer. The company administers $1.5 trillion in loans made by both it and other institutions. Countrywide's servicing operation generated $1.4 billion in revenue in the first quarter of 2008. Our focus on Countrywide's large servicing operation was key to achieving my lawsuit's primary goal of keeping as many families as possible in their homes: a mass loan modification program is impossible without the cooperation of the servicing industry.

Countrywide Settlement

On October 6, 2008, I announced a nationwide settlement with Countrywide. The settlement established the first mandatory loan modification program in the country, and I hope it serves as a model for others lenders and for the Federal Government.

The settlement covers approximately 400,000 borrowers nationwide and provides $8.7 billion in loan modifications to homeowners.

As we here today already know, the most immediate need at this moment is to help homeowners to stay in their homes and stabilize our communities. The features of the Countrywide settlement loan modification program should be a part of any national home retention program. Those features are as follows:

—A uniform and routinized approach to modifying loans to sustainable payment levels. This should include establishing clear guidelines for servicing staff to follow in offering loan modifications on a standardized basis.

—Proactively reviewing loans with certain features for automatic loan modification eligibility. Eligible borrowers will receive notification of the modification, with the option of contacting Countrywide if more assistance is needed.

—A streamlined documentation process that minimizes the amount of time and financial data necessary to effect the loan modification. There is not time for in-depth analyses of the homeowner's finances. A review of current income should be sufficient for many borrowers to enter into a sustainable loan modification.

—Options for crafting a loan modification that offers the borrower affordable payments in the present and also eases the borrower into a sustainable market rate loan for the future. In the Countrywide settlement, this goal is achieved with a number of options, including:

  —A reduction of the interest rate to as low as 3.5 percent for 5 years, at which time the loan will be converted to a fixed interest rate set at the greater of the Fannie Mae rate or the introductory interest rate on the loan. If that rate is still unaffordable, the reduced interest rate can be extended for another 2 years;

  —A reduction of the interest rate to as low as 2.5 percent with annual step rate increases, subject to a lifetime cap on the interest rate on the loan; and

  —A 10-year interest-only modification, with an interest rate reduction to as low as 3.5 percent for these modifications and yearly step rate increases, subject to a lifetime cap on the interest rate on the loan.

—Principal reductions to 95 percent LTV for pay option ARM loans in which the borrower has no equity in the home. Principal reductions of at least this amount—for any type of loan—should be used as a tool to assist any homeowner in trouble if the reduction contributes to a sustainable loan modification. Homeowners have less financial incentive to stay, even with more affordable payments, if they have no or little equity in their home. Reasonable and sustainable debt-to-income guidelines, to lessen the possibility of defaulting on the loan modification.

—A hold on foreclosures while loans are being reviewed for eligibility, to ensure that homes are not lost during implementation of the Countrywide settlement.

—Loan modification availability to homeowners in default as well as for those for whom default is reasonably foreseeable. We believe this is permitted by most pooling and servicing agreements.

—Waiving certain fees as part of the loan modification.

—A reporting requirement to provide us with data on the results of Countrywide's loan modification program.

Impediments to Implementing Wide-Scale Loan Modification Programs

After the announcement of the Countrywide/Bank of America settlement, I worked with a group of my colleagues from around the country and called upon all servicers to initiate loan modification programs similar to the one negotiated with Countrywide. As a result of that outreach, we have been engaged in a series of dis-

cussions with the servicers. However, we continue to identify obstacles that limit the number of loan modifications being carried out:

—*Investor concerns.*—Servicers have continued to voice concern about potential investor lawsuits based on an alleged violation of the Pooling and Servicing Agreements. In fact, a group of investors sued Countrywide earlier this week.

—*Second liens.*—Additional liens can serve as an impediment in the loan modification process. Many of the homes purchased in 2006 with subprime mortgages have second mortgages and open home equity lines of credit secured by their home.

—*Servicer staffing.*—Many lenders and servicers have announced plans for expanded loss mitigation programs and increased staffing. However, many homeowners continue to complain to my Office that when they contact their lender, they are unable to reach a live person or someone with loan modification decision-making authority.

—*Servicer incentives.*—The loan modification process is a labor-intensive process that increases servicers' costs, and yet servicers are not often compensated for loan modifications by lenders. In contrast, servicers are reimbursed for foreclosure costs at the end of the process.

Recommendations

Seriously delinquent loans are at a record high for both subprime and prime. In October 2008, Credit Suisse reported that only 3.5 percent of delinquent subprime loans received modifications in August 2008. Similarly, my colleagues and I, through our State Foreclosure Working Group, have confirmed that the current progress in stopping foreclosures is disappointing. The data in our report indicates that nearly 8 out of 10 seriously delinquent homeowners are not on track for any loss mitigation outcome. What further actions can be taken? We need to incentivize servicers quickly to enter into more sustainable loan modifications and require that they make their process more transparent so that we can evaluate it. Below are my suggestions:

—*Guarantee Home Mortgages in Exchange for Loan Modifications*.—TARP money should be utilized to provide Federal loan guarantees to servicers to incentivize more loan modifications. These Federal loan guarantees should be provided when the lender can demonstrate the modification is affordable and sustainable. The guarantee on restructured loans will provide a new incentive for servicers to act on behalf of investors in modifying a loan. The FDIC has proposed such a plan. Payments to Servicers for Restructuring Loans. Servicers receive compensation for the cost of foreclosing on a home, but are often paid little or nothing for the cost of doing a loan modification. This tips the balance unfairly in favor of foreclosing on a loan, as opposed to modifying the loan. Loan servicers should receive payments to perform loan modifications on a per transaction basis, similar to what the FDIC has proposed.

—*Transparency and Uniformity in the Loan Modification vs. Foreclosure Calculation*.—Require transparency and uniformity from lenders in the analyses they use to determine whether a loan modification or foreclosure is the more cost-effective choice. Servicers must engage in this calculation—a net present value analysis—in order to justify a loan modification to their investors. I support the improvements of the net present value analysis proposed by the FDIC.

—*Waiver of Fees*.—For all loan modifications, lenders should waive late fees and other fees resulting from the homeowner's default. These fees—many of which are "junk" fees—unnecessarily prevent otherwise workable solutions for homeowners facing foreclosure.

—*Explore Safe Harbor for Servicers*.—Congress should explore a safe harbor exemption from investor lawsuits for servicers who implement systematic loan modification programs that substantially conform to the program proposed by the FDIC. Servicers continue to tell us they are concerned about being sued by investors for implementing loan modification programs. Countrywide, for example, was sued in early December for implementing our settlement program. Moreover, any such legislation should also amend EESA to establish that, in all situations, servicers owe their duty to investors as a whole and not to any particular class of investors who may be harmed by a modification.

—*Homeowner Tax Relief*.—The Mortgage Debt Forgiveness Relief Act of 2007 should be amended to ensure that any debt forgiven in a modification is not taxable to the homeowner, not just in instances when the loan was for the purchase or improvement of the home. A tax penalty runs counter to a loan modification's purpose of helping families regain their financial footing.

—*Loan Modifications and Bankruptcy Proceedings*.—Senator Durbin has championed legislation to authorize judicial loan modifications for homeowners in

bankruptcy. I strongly support his efforts. It is paradoxical that all homeowner debts may be modified in bankruptcy, except for their most important debt—the mortgage on their home. This inequity in the bankruptcy code must be remedied.

Conclusion

Thank you for the opportunity to testify before the subcommittee today. I am grateful that you chose to conduct this field hearing in Chicago, a city in which every neighborhood is suffering the devastating effects of the foreclosure crisis. As I have described, it is my belief that strong, comprehensive loan modification programs are the most effective means for stemming the rising tide of foreclosures. I call on Congress to immediately use its powers to incentivize such programs.

Senator DURBIN. Our friends from SWOP came down the other day, they told the story, someone in one of the neighborhoods saw, or had seen, a boarded-up home and decided to take it over. Put their own locks on the door in a vacant, basically, a dorm house. This is a haven for criminal activity, so it could go from bad to even much worse.

Mr. Gottschall, you've been involved in this a long time, I'm sure you've seen a lot of foreclosures and had some neighborhoods. What is your impression, if this continues, unabated?

Mr. GOTTSCHALL. Well, as you suggest, I've been working on this since 2002, the increasing foreclosure issue, but what we and many other community organizations look to restore that confidence, get the best people in the neighborhoods, so we're seeing that improvement lost over these last few years. And increasingly, you've got a foreclosure now and over the next months or years, the property then will stay there a long time, be vacant for awhile, as you see on the map—three, four or five buildings on the block that are vacant.

It impacts dramatically when people say, "Why would you want to do that? Restore confidence and keep those neighborhoods strong. Or you've got some neighborhoods where they're in on the multiple listing service because of the vacant properties, you've got numerous buildings under $20,000 listed for sale, $120,000 or $130,000, it impacts dramatically people's perception and impacts the value of people's properties, impacts your capacity, then, to refinance and get money back into those neighborhoods.

So, it has a huge, huge impact. Foreclosure is one of these, but then how to deal with the vacant property going forward and work to—work on blocks, one of the people to see it as not a problem. Now in the better neighborhoods it's a much more general problem with the State and everybody fix, you know, making improvements and figure out how to deal with that vacant property is the way that and we are working to have that negative impact be not as great as it could be if you didn't do those types of things.

Senator DURBIN. Ms. Sheehan, I want to now take this from a neighborhood perspective to the bank's perspective.

It's become cliché, people say, "Oh foreclosure's not good for any person, family is going to lose a home, there's going to be a lengthy legal proceeding," some say up to 13 months before a foreclosure finally reaches its conclusion, and it's expensive. It's an expensive process in terms of legal fees and for the bank involved in it, as well as the fees for our system, our legal system, and in the meantime, there sits the house, with nobody in it.

And the bankers who don't like to make—cutting grass and pulling weeds and the like—are responsible for the property which could be deteriorating during this period of vacancy.

Out on the west side of town, here, there's a wonderful row of houses that people had spent a lot of money on. And there was one, smack dab in the middle, that was boarded up, it was going to foreclosure. You could just—you didn't have to hunt, you could look right down the yards and tell which one had been abandoned, because it was just full of trash and litter, and detracted from the entire neighborhood, all of the investments of the neighbors.

So, tell me what bankers were spending, you know, in foreclosure, to possibly be a winner from Chase's point of view?

Ms. SHEEHAN. I would say no. And generally speaking, everything you described is true. When we look at the, sort of negative impacts, the expense of foreclosure, the impact on the neighborhood, generally speaking, you know, there are very, very few situations where affecting a reasonable loan modification would not be the best solution, all around.

From the investor perspective, from the servicer perspective, and from the perspective of the homeowners, and I think that one of the things we really need to emphasize to our homeowners is the ability that they have to reach out, even directly, to the servicer, or through their trusted counselors to get help early and stop that foreclosure, frankly, from even being initiated.

And one of the elements of the program that we're working out right now, that we spoke about, and that we have been doing for the last 6 months, and I think was mentioned by Attorney General Madigan earlier, not just looking at delinquent loans, but looking at loans that are coming for reset or recast, where you're in a position to reasonably predict that that homeowner is going to have payment shock, that they are not going to be able to afford that loan.

Senator DURBIN. I have heard repeatedly, and you tell me whether this is close, that it costs about $50,000 to go through a foreclosure. Is that—do you have any figures like that?

Ms. SHEEHAN. That's the conventional wisdom, I will tell you, in some neighborhoods, given the severities with properties, it's probably more than that.

Senator DURBIN. So, let me go back to Mr. Gottschall's testimony. If I—and he can correct me if I didn't quite get this right. But I heard him say about 40 percent of those that were talking about it, are souls that can be saved. These are homeowners which, if there's a modification, for example, of the mortgage interest rate, below 6 percent, I made the call yesterday, the current rate is below 6 percent for most mortgages being offered this week.

Then he said there's another 60 percent where you have to get into principal modification, they're going to have to lower—these people are underwater. They have a principal balance than is far greater than the current fair market value of the home.

So, if the bank is sitting there in a position where there comes a looming foreclosure, and a $50,000 outlay for the foreclosure process, where they end up with this property at the end of 13 months, it seems there would be an economic incentive for the bank to sit down with the homeowners, even talking about reduction in prin-

cipal. At the end of the day, the bank is not likely to even get fair market value for a home that's been abandoned for a period of time.

So, you explained what Chase is going to do, but why don't we see more banks coming forward, saying, "Foreclosure is a bad outcome for us, too. We're going to put some money on the table to see if that family can be saved, and stay in the home."

Ms. SHEEHAN. Well, I think, in fact, many, many of the large servicers have already implemented programs and are doing things that they need to do to maintain the court rule. I believe, Mr. Krimminger indicated earlier that in the last couple of years, at least—and a lot of it has to do with the particular loan product—a rate reduction was largely what was needed in order to make that payment affordable.

So, there's a lot that has been done, either through the ASF, investor loans, certainly Chase on its own loan had blanket modified frozen in the initial rates that were demonstrably affordable for them.

I think we're coming into a new era, I think we're going to have new challenges as pay-option adjustable rate mortgages (ARMs) come up to recast over the next couple of years, and certainly we agree that you need to do more in terms of principal forbearance.

We work very hard with the GSEs and with FHA to make sure that the new programs being rolled out this month for the agency-owned loans, which are—in our case—investor loans, not Chase-owned loans—will have a feature of principal forbearance, in addition to term extension and rate reduction.

Senator DURBIN. I'd like to see for the record that after SWOP visited me this week, reached out to Chase, I believe a meeting's going to take place this week to talk about this neighborhood. And for the record, if these statistics are accurate, in this neighborhood that you see with this map, here, there's some 217 properties in foreclosure initiated by U.S. Bank, which is headquartered in Minneapolis, 161 by Deutsch Bank, 151 by Bank of America, and 124 from Chase, but that includes WaMu as well, and others in other categories.

But, the explanation for the red dots here are what banks have filed foreclosure petitions against the homeowners. If I could go back to the Attorney General, for a moment, so what we're going to do with Countrywide is kind of the answer to the problem, to come up with a settlement that mandated certain action on the part of this lending institution so that these people had a chance to stay in their homes.

So, what did you learn, I mean, what have you learned, so far? Are there things that you would change in that settlement agreement that might have been even more productive, in terms of renegotiating?

Ms. MADIGAN. Mr. Chairman, we think that the settlement we reached with Countrywide is a very good one. As I explained, it should save about 400,000 people's homes across the country, there are probably 20,000 more people here, in the State of Illinois, who have received help from that settlement.

We will continue to watch how the settlement goes. As I mentioned, the loans that will automatically be reviewed were the ones

that had the most toxic interest, so it's the higher ARMs, those that have a low introductory rate and then will readjust, as well as the pay-option ARMs that have a real problem with negative amortization.

So, what we think is that—we'll give it to you to watch, because maybe there are more loan products that will need to be addressed in the same way that the higher ARMs and the pay-option ARMs have been addressed. But again, we have used this as a model to go to Chase, to go to Citi, and to go to the other large lenders and servicers, and say, "This is what you should be adopting," for exactly the reason you just mentioned—it should be more affordable, and it should be a better business practice to keep people in their homes, than having them end up in foreclosure.

But, we have not seen a whole-hearted embrace of this program across the country by servicers; in fact, I am one of about a dozen State Attorneys General who have been working together in a foreclosure working group, I've been fishing through reports, I think I made a packet on the most recent report available to the subcommittee, and in that you will see that 8 out of 10 seriously delinquent homeowners, aren't on track for any sort of loss mitigation.

So, part of the problem, and we tried to address this, is before you go there today is to make sure that people are aware—don't be embarrassed, don't be scared, reach out and call the lenders. They can contact the lender, let them know that you are either having problems, or you foresee that you will have problems making your mortgage payments, so they will start, hopefully, to work on some form of modification.

In addition—and we really applaud the work of Mr. Gottschall and the organizations throughout our State, he said, reach out to HUD-certified housing counselors, we can actually put people in contact with HUD-certified housing counselor, as Mr. Gottschall correctly stated, people are more comfortable, oftentimes, talking to them, then they are talking to the lenders, talking to banks.

We actually put in place a home foreclosure referral line, essentially, and we have gotten 5,000 calls since March, most of those coming after our settlement with Countrywide.

And so, people do recognize that help is out there, most people are not on track to receive any help, however.

Senator DURBIN. Mr. Scire, there's been a lot of talk, and Mr. Kashkari testified—they have the authority through the Emergency Economic Stabilization Act to move into mortgage foreclosure area, if the Treasury Department makes that choice, and they're considering several options.

Mr. Krimminger talked about the FDIC option, I think Treasury has other things under consideration that they mentioned to you. Do you have your own opinion as to what would be the most effective way to really start turning the tide?

I think GAO has told us that this is the highest mortgage default rate in 29 years; I think they might have reported that through the Mortgage Bankers Association. Do you have a personal opinion about the best plan that we could use now to try to turn the tide on this?

Mr. SCIRE. Well, our work is based on looking at TARP, and within that program, it's unclear what strategy the Department is

taking to meet the purpose of the act in terms of preserving homeownership and protecting home values, as we've been talking about here.

So, what we expect to see is for Treasury to make clear what that strategy will be. They've put together an Office of Home Ownership Preservation, and it is looking at a number of options, and expects to put together positions on what options it recommends within the next few weeks, I understand.

So, we believe that Treasury needs to complete that effort, and to lay out what their strategy will be in terms of preserving homeownership.

Senator DURBIN. Mr. Gottschall, you referred earlier, the percentages using for Chicago, 1 percent traditional work-out, 29 percent reduced rate reduction, 6 percent or lower, and 60 percent principal reduction. Do you think these are indicative of foreclosures nationwide, or just reflective of our situation here in Chicago?

Mr. GOTTSCHALL. These are borrowers who have come to us and already are asking for assistance, so it's not a complete random sample and so forth. But it's talking with other people and reading accounts over I think that that probably is not far from what exists in States like Illinois, California, and Florida. It would be hard for me to say exactly whether that fix is probably more or principle, but their servicing is actually in investor-home situations. And when you're listing what can and can't be done, I think it makes a huge difference if it's a investor portfolio, or a portfolio that is a home, basically flexibility of working on making an examination, on the other one when you hear the language it's always kind of confident about what they can or can't do it.

And I think that's where the whole issue of requirement, incentive, you know, some way that the modification becomes more standard and something that the servicer is protected as long as they're doing it right, is extremely important, and I think that relates to the idea that you need principal reduction, and it's kind of a standard way to do it, but you figure out how to do it, and then it becomes something that's acceptable, and the investors can't come back on the service and say, "Hey, wait a minute," like, you know, now we're being sued by investors, because they think—some investor thinks they might get hurt by this when in reality everybody in the bank business has been raped.

Senator DURBIN. Ms. Sheehan, I have two last questions for you to conclude this hearing. The first of which is, in the previous hearing, in Washington, a couple of weeks ago, when Cook County Sheriff Tom Dart came in and talked about the difficulties he faced on getting an eviction order on renters who clearly have been paying their monthly rent, and the landlord has been holding their mortgage and they were about to have all of their earthly belongings out on the sidewalk, which were stolen during the course of the day while they were at work, that's another story, but certainly part of the human side of this.

We also came up with testimony at that hearing from a professor, a law professor, who said that there is a financial incentive for mortgage bankers to favor foreclosure over renegotiation, because they are paid on a cost-plus basis for foreclosure, and a flat-

fee for renegotiation. Are you familiar with any perverse economic incentives to move toward foreclosure rather than negotiation in the current process? In the current system?

Ms. SHEEHAN. I do not believe that to be the case, certainly that is not the case—I can't speak for every organization, but that is not the case for us, and in fact I think there is recognition that some historic agreements have not provided sufficient incentives to servicers, and certainly the GSEs have stepped up to the plate, they have been helping servicers and encouraging servicers to modify loans, their new streamline modification program does, actually now, even further increase the payment to the servicer to do the modification.

And so that should be—I think that should be significant. Back to the point that Mr. Gottschall made about the composition of our servicing portfolio. When you look at that, 78 percent that's investor, I'm going to guesstimate that about half of that is actually agency. We are a big prime, as opposed to—percentage, as opposed to subprime.

Senator DURBIN. Last question, you mentioned that Chase is going to open 24 centers—is that nationwide? Or in the State of Illinois, or city of Chicago?

Ms. SHEEHAN. Okay, so what we are doing right now, by the way, that is nationwide, so the number of 24 regional centers, we're going to work in all of our markets, you know, particularly with the acquisition of WaMu, we now have Oregon, Florida, because as you know they are very distressed markets, and we are already in Arizona, another very distressed market.

So, we are looking at the top MSAs throughout the country, the top 24, where we see not only existing delinquency and foreclosure, but the potential for future coming down the road this is, emerging markets, and around that we're going to site the regional counseling centers.

Our objective is to be completed with our analysis by the end of December, and I think we're well on track for that, certainly Illinois is right up there as one of the States that has markets that need to be address through our counseling centers.

Senator DURBIN. Thank you. Thanks to all of you for participating in this hearing. I've learned a lot of further insight into progressive action to keep more Americans in their homes during this challenging financial crisis.

I will just tell you, that I think that this map is the canary in the bird cage. I think we ought to take a look at this, and if this is the current status of mortgage foreclosures in one Zip Code in the city of Chicago, with more to follow, we'd better take heed and do something, and quickly, to start stemming these tides of foreclosures. And that result, as the Attorney General and Mr. Gottschall and others have testified, could be a dramatic negative impact on this great city and many others across the United States. And not to mention the human suffering associated with families who are evicted from their homes, and then have to find a place to live in a very, very tough economy.

So, we've been forewarned. I hope with the new administration coming on-board we can respond quickly with even more creative approaches.

The hearing record will remain open for 1 week until Thursday, December 11 at noon, for subcommittee members to submit statements or questions.

CONCLUSION OF HEARING

The subcommittee meeting is recessed, I thank everyone for participating.

[Whereupon, at 11:26 a.m., Thursday, December 4, the hearing was concluded, and the subcommittee was recessed, to reconvene subject to the call of the Chair.]

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