# ROBO–SIGNING, CHAIN OF TITLE, LOSS MITIGATION, AND OTHER ISSUES IN MORTGAGE SERVICING

## HEARING

BEFORE THE

SUBCOMMITTEE ON
HOUSING AND COMMUNITY OPPORTUNITY

OF THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

NOVEMBER 18, 2010

Printed for the use of the Committee on Financial Services

**Serial No. 111–166**

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ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

# ROBO–SIGNING, CHAIN OF TITLE, LOSS MITIGATION, AND OTHER ISSUES IN MORTGAGE SERVICING

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**Thursday, November 18, 2010**

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON HOUSING AND
COMMUNITY OPPORTUNITY,
COMMITTEE ON FINANCIAL SERVICES,
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 10:05 a.m., in room 2128, Rayburn House Office Building, Hon. Maxine Waters [chairwoman of the subcommittee] presiding.

Members present: Representatives Waters, Lynch, Cleaver, Green, Ellison, Donnelly, Kilroy, Himes; Biggert, Miller of California, and Neugebauer.

Ex officio present: Representatives Frank and Bachus.

Also present: Representatives Watt, McCarthy of New York, Miller of North Carolina, and Speier.

Chairwoman WATERS. This hearing of the Subcommittee on Housing and Community Opportunity will come to order.

Good morning, ladies and gentlemen. I would like to thank our ranking member and other members of the Subcommittee on Housing and Community Opportunity for joining me today for this hearing entitled, "Robo-Signing, Chain of Title, Loss Mitigation, and Other Issues in Mortgage Servicing."

This hearing is about the failure of the mortgage service industry to uphold due process, to obey the law, and to live up to its oft-stated goal of preventing foreclosures. This hearing is about the aftermath of what happens when an industry is essentially broken. It is also about what happens when our regulators do nothing to pick up the pieces.

Since foreclosures started to spin out of control in 2007, I have been sounding the alarm about problems in the mortgage servicing industry. Working directly with homeowners, I have seen firsthand the problems they create for borrowers trying to obtain a loan modification, lost paperwork, incorrect information, incorrect fax numbers, and flat-out lies. Therefore, the recent allegations of foreclosure fraud and robo-signing don't surprise me at all. In fact, I believe that we are seeing foreclosure fraud and robo-signing for the same reasons that we are seeing problems with homeowners unable to receive loan modifications; it is because it is in the servicers' financial interest to foreclose. They want to foreclose as quickly as possible no matter the consequences.

The financial incentive that pushes servicers to foreclose is the very reason why the Treasury Department designed the Home Affordable Modification Program, that is the HAMP program, which was supposed to remove that incentive to foreclose by paying servicers to modify loans. However, it appears that HAMP is delaying foreclosures just long enough for the banks to improve their balance sheets. Of the 1.6 million homeowners who have been offered trial modifications through HAMP, only 36 percent have obtained permanent modifications. In the meantime, foreclosure rates are virtually unchanged since this time last year when HAMP was supposed to be in full swing.

I think it is safe to say that HAMP isn't meeting its goal of preventing foreclosures.

There is significant evidence to suggest that the speed-driven, corner-cutting operations endemic in the mortgage servicing industry have produced systemic and damaging consequences for the Nation's homeowners and for our housing and financial markets.

First, I am very concerned about reports that in the rush to securitize loans, many promissory notes may have never been properly transferred into their trust. Without properly transferred notes, servicers could lack standing to foreclosure and mortgage securities lose their favorable tax treatment. I agree with my colleagues on this committee, the Congressional Oversight Panel, and Senator Dodd that the Financial Stability Oversight Council created by the Dodd-Frank Act should access the extent to which this poses a systemic risk to the Nation's financial system.

Second, and more importantly, a broken servicing industry means that borrowers are likely denied due process. They got the runaround. They waited for loan modification requests to be processed only to be served with foreclosure notices. They faxed and refaxed paperwork which was repeatedly lost. They were told to skip payments in order to receive help only to be placed into foreclosure when they followed that advice.

Third, investors in mortgages are growing increasingly dissatisfied with services for not meeting their contractual obligations to negotiate profit-maximizing loan modifications. Some of them are suing originators for misrepresenting the original loan packages, and some are uneasy that servicers may never have standing to foreclose on thousands of homes in the first place. I am very anxious to hear from our witnesses about these issues. Frankly, I want to know, given the problems in the mortgage servicing industry—problems which have been apparent for years—what our government and industry witnesses intend to do to fix these problems and why any of them should keep their jobs.

I would now like to recognize our subcommittee's ranking member to make an opening statement. Mr. Neugebauer, you will be doing that today; is that correct?

Mr. NEUGEBAUER. Yes.

Chairwoman WATERS. Thank you.

Mr. NEUGEBAUER. I thank Chairwoman Waters for holding this important hearing.

While we cannot lose sight of the fact that losing a home is an emotional and gut-wrenching experience for any homeowner, it is our job as Members of Congress to remove that emotion and thoughtfully analyze the foreclosure process to determine the best way to move forward for the American people as a whole.

Currently, the average foreclosure process takes nearly 16 months. To state it simply, a homeowner can live in a house for 16 months without making a single mortgage payment. Furthermore, there are examples of homeowners who are actually making money by renting out their homes during the foreclosure process. I think we can all agree that is probably not appropriate.

On the other side of the question, I have yet to hear any victims who have been evicted while meeting all or most of their mortgage payment obligations. In fact, some of the banks that do business in my district have stated that they attempt to contact homeowners an average of 100 times before they make any foreclosure action.

There is no doubt that mortgage servicers should be accountable for sloppy paperwork in the foreclosure process. It is also inexcusable for any employees of a mortgage servicer to sign off on foreclosure affidavits without diligently reviewing each case filed. I am pleased with most of the remedial steps taken by the financial institutions to address paperwork problems in the foreclosure process in place to work with the Federal regulators to ensure that this progress is built upon.

With all that being said, I am concerned that the paperwork problems are being used as a tool to deliberately slow down the mortgage foreclosure process. Lawyers see an opportunity to extract fees by gaming the system to avoid foreclosures. While borrowers are in default, then the foreclosures, for all intents and purposes, are appropriate. State Attorneys General are threatening to prolong legal action as a way of intensifying pressure on lenders to modify mortgages as a part of a potential settlement. Because of these actions, foreclosure processes have slowed significantly. In the State of Florida alone, for example, listings of foreclosed homes have dropped 24 percent since late September.

I am also concerned about the ballooning foreclosure this backlog will prevent the market from clearing, which could lead to a further decline in housing prices. Delays are also costing some banks as much as a couple of hundred million dollars per month, according to some analysts. On top of that, mortgage servicers are facing mounting legal expenses that have increased servicing cost for lenders.

Over the long run, responsible borrowers will undoubtedly face hundreds of dollars in additional fees or slightly higher interest rates while delinquent borrowers enjoy, unfortunately, free housing. That is just not right. As I study this issue more closely, I am convinced that more than ever, we need to work together to improve all aspects of the mortgage financial system, and reduce the amount of opportunistic and frivolous lawsuits so that our businesses and capital markets can be more competitive globally. I look forward to working with my colleagues on both sides of the aisle to address these issues in the 112th Congress.

With that, thank you, Madam Chairwoman.

Chairwoman WATERS. Thank you very much.

Without objection, Representatives Brad Miller, Jackie Speier, and Carolyn McCarthy will be considered members of the subcommittee for the duration of this hearing.

I will now turn to the chairman of the Financial Services Committee, Mr. Barney Frank, for 2 minutes.

The CHAIRMAN. Thank you, Madam Chairwoman. And thank you for the diligence with which you have been pursuing this issue.

The first thing I want to say is that I hope going forward in a bipartisan way—because while there are issues that divide us, this shouldn't be one—we will be able to adopt legislation that will prevent this mess from occurring again.

It ought to be an important principle of the law that there should not be important decisions that need to be made in the private sector, and no one has the authority to make them. That is where we are, to some extent, in the mortgage area.

Unthinkingly, we all allowed a system to grow up—and all participants have some responsibility here because no one foresaw this—in which there are disputes among servicers, investors, and originators of the loan, and second lienholders—and sometimes those are the same party wearing different hats—and that has enormously complicated things. Yes, there have been some perverse financial incentives as well, but even where there is a will to move, we have a tangle that is very daunting.

So I would hope that we would, going forward, be able, in a bipartisan way, to pass laws that say—and I think the principle should be simple—for every residential mortgage—perhaps we go beyond that—there ought to be one party that is responsible for making the decision. People who want to invest in pools of mortgages ought to be told that they are doing that subject to the right of that individual in charge to make decisions so as long as no one's legitimate economic interests are totally disregarded, but we also have to note that there will be cases where inevitably there will be a conflict of interest as to what should be done, and that is the important thing to do going forward.

As to the paperwork, yes, I think those who have ignored the law are culpable. I would hope that every financial institution would be doing everything possible to straighten out that paperwork problem. I think we do have to distinguish between paperwork problems and substantive problems. And I don't want people to get false hopes that this is going to lead to a substantial number of foreclosures being permanently forgotten.

There are people out there who got loans that they shouldn't have gotten, and there is a lot of responsibility for why they got them. And I would note that the legislation that we got signed into law makes it very much less likely that will happen in the future because of the rules we have about these things. But we have to have a situation in which we move as quickly as possible and is distinguished between paperwork problems and those cases where there has been misjudgment and fraud and get this cleared up because it is bad for the economy, from all perspectives, to have this continue.

Chairwoman WATERS. Thank you very much.

Mr. Miller for 4 minutes.

Mr. MILLER OF CALIFORNIA. Thank you, Madam Chairwoman, and Mr. Ranking Member, for convening this hearing today.

Many of the problems we got into in recent years, as all of you know, were due to the lack of due process in the underwriting process. I have been involved in the real estate industry for almost 40 years, and normally, when you go through a process of underwriting, an individual takes a loan and processes it from inception to closure of the loan. That is not happening today in the foreclosure process, and that has to be addressed. Many of them out there are doing a good job at it, the burden that is placed on them is making it very difficult, but there are some that are short-cutting the process, and that is pretty much why we are here today.

It is apparent more must be done to reach all who are in need of assistance in the foreclosure process. Everyone needs to have a better hand on the process. I have heard from many back home in California, consumers are confused and don't know where to go for information; the information they receive is unbelievable. The confusion is not surprising given why we are here today. I have talked to my constituents who provide foreclosure assistance. The departments for servicing and loss mitigation are not prepared to handle the volume of the types of issues that are being raised by homeowners.

While I commend servicers for responding to the foreclosure crisis by hiring more staff, additional bodies don't really resolve the underlying process unless they are qualified to handle that process. For instance, I have been told by consumers that they have each received different information, instructions and advice basically from each individual they talk to on the phone; and every time they talk to somebody on the phone, the information is different.

I understand this is a daunting process. Mr. Neugebauer made a very good point that the delay in the normal process is going to have a huge impact on the recovery of the housing industry in the long run if we don't handle this in a professional and efficient way.

What we need to know is how can servicers, regulators, GSEs, and securitization markets do a better job of coordinating so that consumers are fully aware of all their options and that there isn't any mismanagement in the foreclosure process? A few years ago, the California Association of Mortgage Brokers testified on this very issue, and I am frustrated that after all these years talking about many of the things that we were worried about then have come to fruition today.

For instance, the Feds recently issued guidance pursuant to the language I amended in the Dodd-Frank replacing harmful and punitive HVCC laws on appraisals. I was pleased that the Feds issued a rule that would allow consumers a maximum amount of flexibility when working through an agent. Once again, consumers were able to shop for the most affordable loan without having to order appraisal after appraisal in the process.

However, FHFA has allowed both Fannie Mae and Freddie Mac to put conflicting guidance in place. Denying the consumers the right to flexibility in the appraisal process, the regulators are continuing to end the cycle of uncertainty in the marketplace. Housing recovery will be delayed if there continues to be a lack of continuity in the system and a lack of certainty in the process.

I thought we dealt with that issue because the issue of appraisals proved to be very defective in the process, and I don't know why Freddie and Fannie haven't accepted those same guidelines. Perhaps you can inform me privately later about it, but it seems like a process should be a process, and if it is acceptable, it should be applied on a broad basis.

There needs to be certainty on the part of servicers, investors, and homeowners, and regulators must do a better job in providing that. I do look forward to your testimony. Hopefully, everybody will be candid today, and we can try to resolve this issue in a fruitful way that will benefit homeowners and lenders both.

I yield back the balance of my time.

Chairwoman WATERS. Thank you very much.

Mr. Lynch for a minute and a half.

Mr. LYNCH. Thank you, Madam Chairwoman, for holding this hearing.

Unfortunately, the effects of the foreclosure crisis are still with us. As we have seen lately, the most recent hurdles to mortgage modification continue with this robo-signing and related title fraud. I believe the complications we now see in the modification process are a direct result of the complexity of our mortgage securitization practices. The opaque nature of the bundling and the marketing and the slicing and dicing of mortgage-based securities had made the process of mortgage modification and foreclosure extremely difficult. The most recent problems, so-called robo-signing, which is nothing more than civil law, in some cases criminal fraud, indemnification of title insurers in determining who has standard to foreclose are just echoes of the complicated process by which these mortgages originated.

I would like to hear from the servicers on the second panel, especially about the process by which they manage the parts of the loans that have failed and how certain tranches of the toxic assets since affected the remaining management of income on the loan for both the investors and the homeowners.

I appreciate the opportunity to look into these matters, Madam Chairwoman, and I thank you for the time. I yield back.

Chairwoman WATERS. Thank you very much.

Mr. Green for a minute and a half.

Mr. GREEN. Thank you, Madam Chairwoman.

I would like to do two things: I would like to, first, thank you and the staff. The staff has been absolutely excellent in preparing materials for this hearing, and I would like to thank you for your leadership. I do this for fear that I may not have another formal opportunity to do so in a setting such as this.

The second thing that I would like to do is mention that we have two significant phases of this process that create a great deal of consternation. We have the alpha of it, which is where the loans originate, and I think we have worked to try to clear this up, but we have persons who originated loans and would pass all of the liability onto others. And then at the omega part of the process, we have persons who are identified as servicers who don't suffer a lot of loss if delinquencies are not properly handled, or if the modifications don't take place as some think they should.

So with this in mind, I am curious as to how we will handle this omega part, the end of the process, such that the loans that are in delinquency can be appropriately handled such that there can be loan modifications, and the servicers, of course, are where this takes place.

So I am interested in hearing how we can make the necessary adjustments and how the Consumer Financial Protection Bureau is going to fit into this process. I thank you, and I yield back the balance of my time.

Chairwoman WATERS. Thank you very much.

The CHAIRMAN. Madam Chairwoman, I would ask unanimous consent to make a brief statement. I am not going to be able to stay, and there was one point that I rambled on more than I thought, and I understand my light was on.

Chairwoman WATERS. Without objection.

The CHAIRMAN. I would like to, if I could, leave a question that I hope will be addressed, and it is for the FHFA and others, and that is, one argument that was suggested to me is that one thing that could help with this substantively is for there to be a requirement of third-party notification of anyone who is about to be foreclosed, because we have read these stories about errors. I do not see any objection to a requirement—some States require it, but I would hope, too, that those agencies that are under Federal supervision, they could implement it.

And it does seem to me that third-party notification would go a long way—it is a lot easier to prevent something from happening that shouldn't happen than to try to undo it. So I would hope that people would comment on that, tell us what their practices are with regard to an independent, third-party notification and what, if any, objection there would be to making it a requirement. I thank you, and I thank the members for allowing me that.

Chairwoman WATERS. Mr. Chairman, I want to thank you.

I am pleased to welcome our distinguished first panel.

Our first witness will be Ms. Phyllis Caldwell, Chief, Homeownership Preservation Office, U.S. Department of the Treasury. Our second witness will be the Honorable Elizabeth A. Duke, Governor, Board of Governors of the Federal Reserve System. Our third witness will be the Honorable David Stevens, Assistant Secretary for Housing and Federal Housing Administration Commissioner, U.S. Department of Housing and Urban Development. Our fourth witness will be Mr. John Walsh, Acting Comptroller of the Currency, Office of the Comptroller of the Currency. And our fifth witness will be Mr. Edward DeMarco, Acting Director, Federal Housing Finance Agency.

I thank you for appearing before the subcommittee today. And without objection, your written statements will be made a part of the record. You will now be recognized for a 5-minute summary of your testimony. Let us get started first with Ms. Phyllis Caldwell.

## STATEMENT OF PHYLLIS CALDWELL, CHIEF, HOMEOWNERSHIP PRESERVATION OFFICE, U.S. DEPARTMENT OF THE TREASURY

Ms. CALDWELL. Thank you, Chairwoman Waters, Ranking Member Capito, and members of the subcommittee. Thank you for the opportunity to testify before you today on robo-signing and servicer performance in the Making Home Affordable Program.

The reports of robo-signing, faulty documentation, and other improper foreclosure practices by mortgage servicers are unacceptable. If servicers fail to comply with the law, they should be held accountable. The Administration is leading a coordinated interagency effort that includes many of the agencies represented on this panel to investigate misconduct, protect homeowners, and mitigate any long-term effects on the housing market.

The foreclosure problems underscore the continued critical importance of the Making Home Affordable Program launched by Treasury of which HAMP is a part. Preventing avoidable foreclosures through modifications and other alternatives to foreclosure continues to be a critical priority. Foreclosures dislocate families, disrupt the community, and destabilize local housing markets.

Over the last 20 months, the HAMP program has developed rules and procedures to ensure that responsible homeowners are offered meaningful modifications and other foreclosure alternatives. To remedy servicer shortcomings, we have urged servicers to rapidly increase staffing and improve customer service. We have helped develop guidelines and certifications on how and when borrowers must be evaluated for HAMP before starting a foreclosure. We have also continued our compliance efforts to ensure borrowers are fairly evaluated and that all servicer operations reflect Treasury guidance.

Making Home Affordable has strong compliance mechanisms in place to ensure that servicers follow our program's guidelines. Treasury has built numerous procedural safeguards in HAMP to avoid foreclosure sales. Specifically, program guidelines require participating mortgage servicers to: evaluate homeowners for HAMP modifications before referring those homeowners for foreclosure; suspend any foreclosure proceedings against homeowners who have applied for HAMP modifications while their applications are pending; evaluate whether homeowners who do not qualify for HAMP or who have fallen out of HAMP qualify for other loss mitigation programs or private modification programs; evaluate whether homeowners who cannot obtain alternative modifications may qualify for a short sale or deed-in-lieu of foreclosure; and finally, provide a written explanation to any borrower who is not eligible for a HAMP modification and to delay any foreclosure for at least 30 days afterwards to give the homeowner time to appeal.

Servicers may not proceed to foreclosure sale unless they have tried these alternatives. They must also first issue a written certification to their foreclosure attorney or trustee stating that "all available loss mitigation alternatives have been exhausted and a non-foreclosure option could not be reached." On October 6th, Treasury clearly reminded servicers of this existing rule, that they are prohibited from conducting foreclosure sales until these preforeclosure certifications are properly completed.

In addition, we have instructed our compliance team to review the 10 largest servicers' internal policies and procedures for complying with these guidelines. If we find incidents of noncompliance, Treasury will direct these servicers to take corrective action which may include suspending those foreclosure proceedings and reevaluating the affected homeowners for HAMP.

HAMP has achieved three critical goals; it has provided immediate relief to struggling homeowners; it has used taxpayer resources efficiently; and it has helped transform the way the mortgage servicing industry operates. To date, almost 1.4 million borrowers have started trial modifications, and over 520,000 homeowners have started permanent modifications. These homeowners have experienced a 36 percent median reduction in their mortgage payments, or more than $500 a month.

By establishing modifications and affordability standards, HAMP has dramatically changed the way servicers treat borrowers at risk of foreclosure. In the first quarter of 2009, nearly half of mortgage modifications increased monthly payments. By the second quarter of 2010, 90 percent of mortgage modifications lowered payments for the borrower.

In conclusion, we believe that foreclosure problems underscore the continued need for servicers to focus on evaluating borrowers for all loss mitigation options, starting with HAMP. They must continue to be the servicers' first priority.

We sincerely appreciate the efforts of both the members of this committee and our partners in the housing community in holding servicers accountable and improving the program's design and performance. I look forward to taking your questions.

[The prepared statement of Ms. Caldwell can be found on page 174 of the appendix.]

Chairwoman WATERS. Thank you.

Our next witness is the Honorable Elizabeth A. Duke.

**STATEMENT OF THE HONORABLE ELIZABETH A. DUKE, GOVERNOR, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM**

Ms. DUKE. Thank you.

Chairwoman Waters and members of the subcommittee, I am pleased to appear today to discuss issues related to mortgage loan servicing and the mishandling of documentation in foreclosure proceedings.

As you know, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the Federal Deposit Insurance Corporation, and the Federal Reserve are conducting an in-depth review of practices at the largest mortgage servicing operations. In our examinations, the agencies are reviewing firms' policies, procedures, and internal controls related to foreclosure practices and are sampling loan files to test the effectiveness of those policies, procedures and internal controls. We are prepared to take supervisory action where necessary and appropriate to hold institutions accountable for poor practices.

Losing a home is a tragic event for a family and the community in which they live. It is imperative that lenders and servicers provide borrowers every opportunity to modify their loans and retain their homes. If modification is not possible, borrowers must be assured of all the protections afforded by due process as required by law.

The issues raised as foreclosure improprieties came to light have cast a pall of uncertainty across the entire housing market. Any response must ensure that actions taken with respect to borrowers and their homes are valid and in accordance with the law. At the same time, those actions should remove uncertainty and restore smooth functioning to housing and financial markets. While it is difficult to determine the incremental impact of further procedural delays in foreclosures, delays and uncertainty resulting from flaws in the foreclosure process have the potential to delay recovery in housing markets and to undermine confidence in our financial and legal systems.

Consumers and consumer counselors have been quite vocal in their frustration over unreturned phone calls, lost documents, and changing decision criteria that have plagued the loan modification process. In light of such experiences, evidence of improper procedures in foreclosure cases causes consumers, at a minimum, to further mistrust the loan servicing process. At worst, it can result in the improper loss of a home or premature eviction from that home. For individual borrowers, uncertainty about the prospect or timing of foreclosure makes everyday decisions difficult. Borrowers who are uncertain about their ability to keep their homes have little incentive to invest in or maintain those homes, resulting in damage to neighborhoods and lowering the value of surrounding properties.

And with widespread stories of foreclosure improprieties, families in the process of buying a home or considering the purchase of a home have become concerned about the validity of their titles. Others who have purchased homes in foreclosure have had their closings delayed while documents are reviewed. Consumers have already fallen victim to foreclosure rescue scams as charlatans posing as mortgage counselors claim to be able to obtain mortgage modifications for a fee. In light of new stories of mortgage abuse, new incarnations of these scams are sure to proliferate.

Financial institutions face a number of risks if inadequate controls result in faulty foreclosure documents or failure to follow legal procedures. Recent events have shown that even the possibility of problems leads to costly delays and reviews. In cases where actual problems are found, regulators will require lenders and servicers to correct not only the faulty documents themselves, but the faulty systems that made them possible. Institutions with widespread problems may be subject to fines and fees in addition to the costs associated with correcting the errors.

The Federal Reserve believes the best way to assist struggling borrowers is with a mortgage modification that allows borrowers to retain their homes with an affordable mortgage payment. Foreclosures are costly to all parties, and more broadly to our economy. Prudent modifications that are consistent with safe and sound lending practices are generally in the long-term best interest of both financial institutions and borrowers.

In summary, the Federal Reserve has been actively working to mitigate the harm to consumers and markets caused by problems in mortgage loan origination, securitization, and loan foreclosures. We are participating in interagency examinations of the foreclosure processes in the financial institutions that control the majority of the Nation's mortgages. We are conducting examinations of lenders and servicers' loan modification efforts. These efforts reflect a continuation of actions undertaken by the Federal Reserve System since the start of the financial crisis. We remain committed to the goal of stabilized financial markets that promote economic recovery.

Thank you for holding this important hearing today, and I would be happy to answer any questions you may have.

[The prepared statement of Governor Duke can be found on page 199 of the appendix.]

Chairwoman WATERS. Thank you.

Next, the Honorable David Stevens.

**STATEMENT OF THE HONORABLE DAVID H. STEVENS, ASSISTANT SECRETARY FOR HOUSING/FHA COMMISSIONER, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**

Mr. STEVENS. Chairwoman Waters, and members of the subcommittee, thank you for the opportunity to testify before you today on behalf of HUD and the FHA regarding foreclosure processing concerns that have been raised about certain servicers.

Since taking office, helping families and the economy recover from the worst economic crisis in 80 years has been the top priority of this Administration. And with your help, we have taken a comprehensive approach to addressing the housing crisis that has helped more than 3.5 million families since April of 2009 receive restructured mortgages with more affordable monthly payments and only 3 times the number of foreclosures completed during the same period.

But the job is far from over. Recent reports of faulty documentation and fraudulent affidavits in the foreclosure process remind us that we continue to pay a very steep price for nearly a decade of abuses and bad behavior.

The notion that many of the very same institutions that helped caused this housing crisis may well be making it worse is not only frustrating; it is shameful. That is why HUD is working with Federal agencies and regulators joining me today to fully review the issues that recent foreclosure revelations have raised. I appreciate the opportunity to discuss how the Federal Housing Administration is responding to these challenges and holding servicers accountable.

As you know, FHA requires the servicers it approves to actively engage struggling homeowners to prevent avoidable foreclosures; we call it loss mitigation. We do this to ensure that help is being provided before homeowners get into trouble, not just after the fact, by which time it is much less likely that the families will be able to stay in their homes. FHA's loss mitigation program has helped more than half a million homeowners keep their homes in the last year alone, protecting families, but also the taxpayer by reducing the number of defaults in the FHA portfolio.

But at the time I took office, we found that significant reviews of servicer performance were not being done at the level of detail required. Last November, we implemented very specific monitoring around servicer performance. This new, more detailed reporting system enabled FHA to provide peer group comparisons of servicers in their utilization of loss mitigation options to allow us to identify which tools servicers are using, how frequently, and how consistently.

Initial findings showed significant variations in the performance of different servicers, triggering a much more in-depth review of servicer operations. These early returns suggest that some servicers are falling short in varying degrees of meeting HUD's expectations in assisting borrowers through the loss mitigation process. Fielding analyst reviews suggest that some servicers appear to lack knowledge of FHA's loss mitigation process while others may lack the correct technology necessary to expedite loss mitigation requests. And some seem to lack a sufficient number of experienced staff necessary to clear loan modification request backlogs.

FHA is ensuring these servicers address these issues through customized training and planning assistance, ongoing evaluation of servicers' progress in correcting deficiencies, improving compliance, and extensive consultation with servicers' senior management and assigned work groups.

While FHA was focused well before these recent revelations on the mortgage servicing process as a whole, we have expanded our lender review to look into specific compliance with the foreclosure process. In order to fully evaluate servicers compliance, FHA is conducting onsite servicer inspections. Specifically, FHA is reviewing how servicers track affidavits, security instruments, and promissory notes, and whether servicers verify the validity of these documents and have controls in place to identify failures in the process. Should it become clear that these early indications are, in fact, part of a much broader problem of unacceptable behavior on the part of servicers participating in FHA programs, these servicers will face the full strength of our enforcement authority. This is all taking place as FHA is implementing the most sweeping reforms to credit policy, risk management and consumer protections in the Agency's history, and that includes lender enforcement.

Since I became Commissioner, we have drawn approval for over 1,500 institutions and imposing over $4.25 million in civil money penalties and administrative payments to noncompliant lenders. We are sending a signal that if you don't operate ethically and transparently, we won't do business with you, and we will not hesitate to act.

We appreciate the full support of the committee for giving FHA the authority to increase its premiums and for supporting broader FHA reform legislation that will provide additional tools to hold lenders accountable.

Madam Chairwoman, we appreciate the lead you took on these efforts, and we urge Congress to follow your lead to enact these enforcement elements of that legislation as quickly as possible.

So as you can see, the FHA is providing tools and enforcement mechanisms essential to protecting families and restoring trust in America's mortgage markets. And as I noted at the outset, HUD protects consumers in additional ways through RESPA and the SAFE Act and other provisions, but government can't do the job alone. Throughout this controversy and this crisis, the banks have lost an enormous amount of trust from the American people. Whether it is reducing principal for underwater homeowners, adopting responsible underwriting practices that ensure fair access to credit or ensuring greater transparency and accountability in their own business practices, banks need to take steps to earn the trust back.

With that, I thank you for the opportunity to testify.

[The prepared statement of Commissioner Stevens can be found on page 328 of the appendix.]

Chairwoman WATERS. Thank you very much.

Next, Mr. Walsh.

**STATEMENT OF JOHN WALSH, ACTING COMPTROLLER OF THE CURRENCY, OFFICE OF THE COMPTROLLER OF THE CURRENCY**

Mr. WALSH. Thank you. Chairwoman Waters, Mr. Neugebauer, and members of the subcommittee, I appreciate the opportunity to discuss improprieties in the foreclosure process and the steps being taken by the Office of the Comptroller of the Currency to address them. The OCC supervises most of the Nation's large banks, including eight of the largest mortgage servicers, so this is a matter of great concern to us.

Let me say clearly, the shoddy practices that have come to light, including improperly executed documents and attestations, are absolutely unacceptable. They raise questions about the integrity of the foreclosure process and concerns about whether some homes may have been improperly taken from their owners. The OCC is moving aggressively to hold banks accountable and to fix the problem.

As problem loans surged in recent years, the OCC's primary focus was on efforts to prevent avoidable foreclosures by increasing the bank's volume and sustainability of loan modifications. The transparency and clarity provided by our Mortgage Metrics project helped in that effort by providing thorough, accurate data on the performance of mortgages and modifications. When we saw, for example, that an inordinate number of modifications initiated in 2008 were re-defaulting, we directed national bank servicers to take corrective action. Since then, we have seen a sharp increase in modifications that lowered monthly payments and fewer delinquencies subsequent to modification. While these efforts are helping some families avoid foreclosure, many are still struggling and face the prospect of losing their hone. We owe these homeowners our best efforts to assure that they receive every protection provided under law.

Foreclosures are governed by State law and the requirements vary considerably across jurisdictions. As a result, most nationwide servicers hire local firms familiar with those requirements, and both Fannie Mae and Freddie Mac require servicers to use law firms they pre-approve for a given locality. The OCC reviews a bank's foreclosure governance process to determine if it has appropriate policies, procedures, and internal controls to ensure the accuracy of information relied upon in the process in compliance with Federal and State laws. We expect banks to test these processes through periodic internal audits, and their ongoing quality control function.

Examiners generally do not directly test standard business processes or practices, such as the validity of signed contracts or the process used to notarize documents absent red flags that indicate systemic flaws in those business processes.

Unfortunately, neither internal quality control tests, internal audits, nor data from our consumer call center suggested foreclosure document processing was an area of systemic concern. When problems at Ally Bank, which is not supervised by the OCC, first came to light, we immediately directed the eight largest national bank servicers to review their operations and take necessary corrective action while we prepared to launch onsite examinations at each of the major servicers. Those exams are well underway and we have more than 100 national bank examiners assigned to that task.

In concert with other regulatory agencies, examiners are reviewing samples of individual borrower foreclosure files from judicial and non-judicial States that include both in process and completed foreclosures. They will determine whether foreclosed borrowers were appropriately considered for alternative home retention actions such as loan modification. In addition, examiners are looking for evidence that financial information in affidavits is accurate and complies with State laws and that the fees charged are correct. They will determine whether the servicer has possession and control over critical loan documents needed to support a legal foreclosure proceeding and are seeking evidence that affidavits and documents were independently and appropriately reviewed and that proper signatures were obtained.

Turning to those that provide service to the servicers, the OCC is heading an onsite interagency examination of the Mortgage Electronic Registration System, or MERS, in coordination with the Federal Reserve, the FDIC, and the Federal Housing Finance Agency, and we are participating in an examination led by the Federal Reserve of Lender Processing Services which provides third-party foreclosure services to banks.

Where we find errors or deficiencies, we are directing banks to take immediate corrective action, and we have an array of enforcement actions and penalties that we will not hesitate to impose if warranted. These can include civil money penalties, removals from banking, and criminal referrals. We expect to complete our examinations by mid to late December, and by the end of January, we hope to have our analysis of the exams completed to determine what additional supervisory actions may be needed, and enforcement as well.

Thank you again for the opportunity to appear today. I will be happy to answer questions.

[The prepared statement of Acting Comptroller Walsh can be found on page 336 of the appendix.]

Chairwoman WATERS. Thank you very much.

And finally, Mr. DeMarco.

**STATEMENT OF EDWARD J. DeMARCO, ACTING DIRECTOR, FEDERAL HOUSING FINANCE AGENCY**

Mr. DEMARCO. Thank you.

Good morning, Chairwoman Waters, Ranking Member Neugebauer, Ranking Member Bachus, and members of the subcommittee. Thank you for having me here today.

The recently identified deficiencies in the preparation and handling of legal documents to carry out foreclosures are unacceptable. Those deficiencies undoubtedly reflect strains on a system that is operating beyond capacity, but they also represent a breakdown in corporate internal controls and management oversight.

FHFA's goals in this matter are twofold: To ensure that foreclosure processing is done in accordance with the servicer contract and applicable laws; and to protect taxpayers from further losses on defaulted mortgages. Of course, before any foreclosure is completed, we expect servicers to exhaust all alternatives.

My prepared statement reviews the actions that FHFA has taken to date, as well as those underway. It also provides context for understanding the problems that have arisen, including consideration of the role of servicers and a description of the diverse range of foreclosure processing requirements.

As I reported to the full committee, the Enterprises—Fannie Mae and Freddie Mac—minimize losses on delinquent mortgages by offering distressed borrowers loan modifications, repayment plans, or forbearance. These loss mitigation tools reduce the Enterprise's losses on delinquent mortgages and help homeowners retain their homes. Servicers and Enterprise mortgages know that these tools are the first response to a homeowner who falls behind on their mortgage payment, yet for some delinquent borrowers, their mortgage payments are simply not affordable due to unemployment or other hardship, and a loan modification is not a workable solution. For these cases, the Enterprises offer foreclosure alternatives in the form of short sales and deeds-in-lieu of foreclosure. Despite these options for a graceful exit from the home, foreclosure remains the final and necessary option in many cases.

As we know, foreclosure process deficiencies have emerged in several major servicers. Recently, FHFA provided the Enterprises and their servicers a four-point policy framework for handling these deficiencies. The four points are simply stated: Verify that your foreclosure process is working properly; remediate any deficiencies identified in foreclosure processing; refer suspicions of fraudulent activity; and avoid delay in processing foreclosures in the absence of identified problems.

Pursuant to that guidance, the Enterprises continue to gather information on the full nature and extent of servicer problems. Only a small number of servicers have reported back to the Enterprises as having some problem with their foreclosure processing that needs to be addressed. Still, these firms represent a sizable portion of the enterprises' combined books and business. The Enterprises are currently working directly with their servicers to ensure that all loans are handled properly, and corrections and refiling of paperwork are completed where necessary and appropriate. To be clear, FHFA does not regulate mortgage servicers, and the Enterprise's relationship with them is a contractual one.

As conservator of the Enterprises, FHFA expects all companies servicing Enterprise mortgages to fulfill their contractual responsibilities, which includes compliance with both the Enterprise's seller servicer guides and applicable law. Also, FHFA remains committed to ensuring borrowers are presented with foreclosure alternatives.

Still, it is important to remember that FHFA has a legal obligation as conservator to preserve and conserve the Enterprise's assets. This means minimizing losses on delinquent mortgages. Clearly, foreclosure alternatives, including loan modifications, can reduce losses relative to foreclosure, but when these alternatives do not work, timely and accurate foreclosure processing is critical for minimizing taxpayer losses.

To conclude, regulatory agencies, including FHFA, are carrying out important examination activities that will better inform this issue. Thus, identification of further actions or regulatory responses should await the results of these examinations and an evaluation of the information developed.

Thank you.

[The prepared statement of Acting Director DeMarco can be found on page 186 of the appendix.]

Chairwoman WATERS. Thank you very much for your testimony; it was tremendously informative. And I certainly have a few questions.

Let me start with Ms. Phyllis Caldwell, Chief, Homeownership Preservation Office, U.S. Department of the Treasury. I have a press release from November 30, 2009, from the Treasury Department. The press release says, "Servicers failing to meet performance obligations under the servicer participation agreement will be subject to consequences which could include monitory penalties and sanctions." That was November 30, 2009. Have you levied any penalties or sanctions?

Ms. CALDWELL. Madam Chairwoman, thank you for that question. We take the servicer performance under HAMP very seriously—

Chairwoman WATERS. I know you do, but have you levied any penalties or sanctions?

Ms. CALDWELL. We have. In terms of penalties to the servicers, we have required that servicers go back and re-solicit homeowners that they may not have solicited. We have required servicers to change their process and reevaluate homeowners for HAMP. In addition, we have required servicers to suspend foreclosures—

Chairwoman WATERS. Have you levied any penalties or sanctions?

Ms. CALDWELL. We have not levied monetary clawbacks—

Chairwoman WATERS. Any penalties or sanctions, have you levied any?

Ms. CALDWELL. We have levied many non-monetary penalties on the servicers.

Chairwoman WATERS. Have you levied any penalties or sanctions? I understand what you are saying; you have required them to do some things.

Ms. CALDWELL. Correct.

Chairwoman WATERS. You have asked them to change some of their procedures, etc., but my question is, have you levied any penalties or sanctions?

Ms. CALDWELL. We have not levied major monetary remedies which—

Chairwoman WATERS. So you have not levied any penalties or sanctions; is that your answer?

Ms. CALDWELL. That is not correct. We have given several penalties under the servicer performance agreement.

Chairwoman WATERS. Okay, fine, that is okay. Can you describe those penalties to us?

Ms. CALDWELL. As I described earlier, the remedies available under the servicer performance agreement are limited to directing servicers to do additional things, withholding compensation for those permanent modifications that have been made, or going back and clawing back incentives that have already been paid. To date, we have not gone back to take back incentives that have already been paid, but we have pursued many of the nonmonetary remedies, including further actions and evaluations and reevaluations.

Our focus in the first year of our compliance was making sure that servicers were implementing the program correctly and that homeowners had every opportunity to—

Chairwoman WATERS. I understand that. I was just interested, because of the press release that you released on November 30, 2009, where you said servicers failing to meet performance obligations under the servicer participation agreement will be subject to consequences which could include monetary penalties. There have been no monetary penalties from what I am hearing from you, and no sanctions, but you have done some work in instructing them that they have to change their practices and procedures.

With over 1 percent of the money obligated to HAMP spent, do you think servicers have met performance obligations?

Ms. CALDWELL. As we go in and review the compliance, what we have found is that less than 5 percent of the time, servicers have not met those requirements. When they do, we have instructed them that they may not decline a homeowner from HAMP and that they must go back and fix the process. Again, in the first year, our focus was making sure that homeowners had every opportunity to be considered for HAMP modification. Certainly, in the second year, we need to—

Chairwoman WATERS. Thank you very much.

Let me turn to Mr. Walsh, Acting Comptroller of the Currency, Office of the Comptroller of the Currency. Let me read you a paragraph from a recent Washington Post article from November 8th: "When two banks, JPMorgan Chase and Wells Fargo, declined to cooperate with the State banking investigation into their foreclosure practices, the State officials asked the bank's Federal regulator for help, according to a letter they sent, but the Office of the Comptroller of the Currency, which oversees national banks, denied the State's request saying the firm should answer only to inquiries from Federal officials.

"But even as it closed the door on State oversight, the OCC chose itself not to scrutinize the foreclosure operations of the largest national banks, foregoing any examination of their procedures and paperwork. Instead, the agency relied on the bank's in-house assessments."

Are you familiar with this?

Mr. WALSH. I read that story, yes. I don't agree with the facts.

Chairwoman WATERS. Besides reading the story, do you have knowledge of what took place?

Mr. WALSH. I do. Would you like me to recount?

Chairwoman WATERS. Yes. That is what I am asking you.

Mr. WALSH. Okay. At that period, the States had gone to one bank seeking information about subprime loans and their performance. We were in the process at that time of developing what is now our Mortgage Metrics report, which involved a more extensive body of information than what the States had asked the banks about developing.

We, in fact, began gathering that information and releasing a more detailed report of that information on a broader range of information on mortgages. In fact, the report has become sufficiently robust that in the Dodd-Frank Act, we were directed by Congress to make that information available State By State and on an aggregate basis, and we have been doing so.

Chairwoman WATERS. I am going to turn to our ranking member of the Financial Services Committee, Mr. Bachus, for questions.

Mr. BACHUS. Thank you. I appreciate the testimony of the regulators. And it does look as if you are doing a pretty thorough review of the internal policies of the institutions at this time.

I had this question: Members of Congress first learned about these robo-signings, which I assume were used by the mortgage companies to speed through the paperwork. But they are a violation of procedures, so they are serious. We were not aware of the news reports, and I think the news reports were based on a deposition that someone was giving in response to the deposition that they used robo-signing. Were you aware of these problems before the news report? I may ask the Federal Reserve, or just maybe from left to right. Were any of you aware of it before you read it in the newspaper?

Ms. DUKE. We were not aware of it significantly before we read it in the newspaper. Right about that time, because we supervise Ally, we had a meeting with Ally, so I am not sure whether it was the same day or the day before, but it was about the same time.

Mr. BACHUS. And I am glad you read the newspapers.

Mr. WALSH. Just to follow up on that, it is the case that we were not aware of the robo-signing issue until it came to light, and that was the trigger then for proceeding to the reviews.

Mr. BACHUS. But in a way, they would have been visible to you, or should have been, would they not? If they were visible to the bank's internal controls, the regulators were also in some of those banks looking. I wonder why they weren't visible.

Mr. STEVENS. I think that is an absolutely valid question. We were very concerned about servicers' compliance with the entire foreclosure process, and we identified this through some fairly indepth reporting back in November. We actually sent teams in this year to a number of the larger servicers to do loan level reviews of their entire foreclosure processes on the loss mitigation front. It didn't go up to the final check of who is signing the affidavit, but it did indicate to us there was some variability. We were not specific with the robo-signing particular piece, but as this has broadened out, it clearly is highlighting broader concerns that we had about how servicers are handling the foreclosure process in total.

And we have already completed several in-depth research reviews of several larger servicers, and we are working through the process as to what kind of action that will result in.

Mr. BACHUS. I think your main concern is the same concern we have, which is that borrowers who are current or who should not be foreclosed on, in other words, a wrongful foreclosure, someone who was paying their mortgage or had the ability, and procedural irregularities or the lack of documentation, as long as the documentation of the mortgage is not current, I can see why your main concern would be—and there have been, as I understand, very few reports, at least to date, of people who were current or almost current being foreclosed on; is that true?

Mr. DEMARCO. I believe it is for the Enterprise loans, Congressman. I am not aware of people who are current being foreclosed upon.

Mr. BACHUS. Okay. I would say this; I think going forward, we need to all look at this. I think one thing I hope you are concerned about, which we are, is that maybe the lack of documentation or these procedural irregularities—I will call them those, as long as they don't indicate more—and I think, Mr. Walsh, or Comptroller, you mentioned whether they affect more significant problems within the mortgage financing. Are you concerned that these disclosures may indicate that there may be potential for a larger problem?

Mr. WALSH. Any time you identify a problem of this kind, it makes you concerned about the integrity of the process within the particular bank. Obviously, there are institutions that were not complying with applicable requirements of State law, so of course, that is the purpose of going in and doing this sort of hard scrub of the process. We are not aware of a reason to believe that there is some systematic or systemic reason to doubt the functioning of the system, but certainly, there were some systematic failures within the individual servicers.

Mr. BACHUS. Okay. Thank you.

Let me just close by saying, I think we all agree and I think the banks agree, obviously borrowers agree, regulators and the Congress that the decision to foreclose on a homeowner is very serious, it not only affects them, it affects their families, and their neighbors. I think all our interests going forward is to make sure that the foreclosure process is handled properly, and that concern won't end today. I look forward to working with all of you, with the institutions and in the next Congress as we monitor this process and work through it.

Thank you.

Chairwoman WATERS. Thank you very much.

Mr. Lynch.

Mr. LYNCH. Thank you, Madam Chairwoman.

I am going to follow up on your questions from earlier. I want to thank all the witnesses for their willingness to help the committee with its work.

The Treasury has existing contracts with a large number of mortgage servicers representing a majority of outstanding mortgages in our country through the Making Homes Affordable Program. Each of these contracts imposes various duties that the chairwoman has pointed out on the financial institutions that are parties to the agreements, and those including requirements that they perform certain servicing duties in compliance with applicable State and Federal law. And it also says, as the Chair has noted, "failure to adhere to the agreement could result in the termination of the contract and withholding of payments, reductions of payments, or recoupment of payments already made."

Now, however, I have a GAO report here that says that, "Treasury has yet to fine any servicer for noncompliance or even establish any specific penalties or consequences for noncompliance." I am troubled by that. And I know you say that you are reevaluating and doing things like that, but Ms. Caldwell, do you have evidence that you are actually—GAO says you are not penalizing, you are not—let me see what their word is—"Treasury has yet to fine any servicer for noncompliance or even establish any specific penalties or consequences for noncompliance." Do you have evidence to refute that? Can you share that with the committee?

Ms. CALDWELL. Certainly. Treasury takes the compliance under the Making Homes Affordable and HAMP programs very seriously—

Mr. LYNCH. Okay. I only have limited time. I understand, you said that previously. And I respect that, I just need some evidence of that.

Ms. CALDWELL. I will speak about a few of the main things. In January—

Mr. LYNCH. No, no, no, no, no. I don't have that much time. Off the record, can you just supply the committee with the evidence that you actually are enforcing this and are providing penalties, because I have another thing I want to ask you about.

Ms. CALDWELL. Yes, absolutely. In January of 2010, we told servicers that they may not decline any homeowner from HAMP until they have—

Mr. LYNCH. No, no, no. That is not a penalty though. That is not a penalty. You are readjusting things. I will reclaim my time.

We do have a report here, back in, let's see, back in September, Ambac Insurance sued Bank of America. Ambac had conducted a review of 6,533 loans that it reviewed across 12 securitizations sponsored by Countrywide—this was before Bank of America took over. They said that 97 percent of those 6,533 loans did not conform to underwriting guidelines. And here is my question: Treasury is paying these servicers—that you are not penalizing, you are also paying them enhanced payments in connection with modifications and other services.

We are finding that there are gaps, gaps in the chain of title, gaps in a lot of documents that are fraudulent. So what I am asking you is, are you concerned that you are paying servicers who don't actually own the properties that they are modifying or foreclosing on; that there is no clear chain of title for the properties, and you are paying—Treasury is paying the servicers.

Ms. CALDWELL. Our contract—Treasury's contract with the servicers only pays when a loan is modified permanently. And certainly we are very concerned about the issues regarding chain of title in the mortgages in the foreclosure process. However, none of those issues to date have been a part of the servicers' contract with the homeowner to collect payments. And our focus has been on making sure that the homeowner has an opportunity to modify that payment agreement with the servicer so that they may stay in the home and avoid foreclosure.

Mr. LYNCH. You said something that was news to me. A servicer only gets paid from Treasury if the modification is made permanent?

Ms. CALDWELL. Correct.

Mr. LYNCH. So they don't get any of their work unless the modification—

Ms. CALDWELL. Unless the modification is permanent, and then they only get partial payment. The HAMP program has a pay for success design, the servicers are paid over 3 years, each year that the modification remains current, and investors retain all of the risk of eventual redefault.

Mr. LYNCH. Okay. Thank.

Chairwoman WATERS. Thank you very much. Mr. Neugebauer.

Mr. NEUGEBAUER. Thank you, Madam Chairwoman. Just an observation before I start my questioning here. I have sat here for a number of years now and when we have had our regulators come before this group during what has become called the "financial crisis," the overriding theme is, we didn't know that was going on. We didn't know that people were making these kind of loans. We didn't know this, we didn't know that. To me it gets a little frustrating that the people that we have put in charge are supposed to know what is going on in the financial markets, regulating the financial markets, continuing to be their testimony is we didn't know. But when we bring you in, then the testimony is, but we are on it now.

I think the American people have a greater expectation that you know it before it happens rather than reacting to it after it happens. And I would hope going forward that we can begin to—we passed a historic financial regulation in this Congress. And a lot of us felt that what we didn't need was more regulation; we needed regulators who were doing their jobs. And I think coming forward, I think one of the things that we are going to have to ascertain is, do we have the competency level in our regulatory structure, and do we have a regulatory structure that can function as regulators and not necessarily burden these financial institutions with more regulation.

Mr. DeMarco, recently I think the Florida Attorney General, Mr. McCollum, launched an investigation into the allegations of unfair and deceptive actions by a Florida law firm that has been handling foreclosure cases. And I think that particular firm is one of the Fannie Mae-retained attorney network approved attorneys.

A couple of questions come to mind. How much money has Fannie Mae paid this entity? And if it turns out that the Attorney General can bring action on this, I am looking out after the taxpayers here because as you know, they are on the hook for whatever happens to Freddie and Fannie. And so I am kind of wondering what kind of financial implication that is going to have on the Enterprises.

Mr. DEMARCO. Thank you, Congressman. Yes, in fact not just Fannie Mae but Freddie Mac also had mortgages for which servicers were utilizing this same law firm. I can't tell you, sitting here today—I can try to get that information for you in terms of how much this firm has been paid in the past. The ultimate additional cost resulting from the failures of this law firm are to be determined.

The one thing I could add in a positive way on this is that we have been—both FHFA and the two Enterprises have been working in close cooperation with the State Attorney General in Florida on this matter. And we have a very good, cooperative relationship with regard to the documents and with regard to the ongoing investigation.

Mr. NEUGEBAUER. One of the concerns is, I have read where some of these attorneys general are trying to reach settlement agreements where part of that settlement agreement is a write-down of principal. The question I have is, if a law firm has done something that is inappropriate or didn't follow the law, and part of the settlement agreement is for a write-down in the principal, who is going to pick up that tab?

Mr. DEMARCO. All I know about that is a few things I have seen in the newspaper, Congressman. The connection does seem a bit tenuous to me. I think in terms of our work here, that law firm is in a contractual relationship with the Enterprises, and the remedies that we would seek would be those that are available through the contract, if there is something there to be recovered. But I can't speak to what the collection of State Attorneys General are considering right now, and I have not discussed any such thing with them at this point.

Mr. NEUGEBAUER. On the same note of lawsuits, I understand—I believe there was a securities fraud case that was brought against Fannie Mae, Frank Raines, Timothy Howard, and Leanne Spencer about the Ohio Public Employees Retirement System in 2004, and to my knowledge that case has not been resolved; is that correct?

Mr. DEMARCO. That is correct.

Mr. NEUGEBAUER. And do you know how much—are we still paying the legal fees for Mr. Raines and Mr. Howard and Ms. Spencer?

Mr. DEMARCO. Fannie Mae is advancing legal fees to them. Fannie Mae is advancing legal fees to them under an existing indemnification agreement.

Mr. NEUGEBAUER. Would you repeat that?

Mr. DEMARCO. Yes. Fannie Mae is advancing legal fees to those three individuals.

Mr. NEUGEBAUER. Could you get me the amounts of money that have been spent defending those folks, because obviously that is another tab that the taxpayers are now picking up, and I don't know if they are going to be excited about picking up the tab of legal defense for those individuals. Can you furnish it to us?

Mr. DEMARCO. I certainly can, Congressman. I will be glad to follow up with you with the context of that, because I share a concern about what the implications of this are for the taxpayers. But I would just like to assure you as a general matter, this is something that has been carefully weighed at the agency, and I will get back to you with that information.

Mr. NEUGEBAUER. Thank you.

Chairwoman WATERS. Mr. Cleaver?

Mr. CLEAVER. Thank you, Madam Chairwoman.

Mr. Walsh, in response to I think the ranking member or Mr. Bachus earlier, you said that there was no systematic operation, so you don't think there was any intent to do wrong.

Mr. WALSH. No, I didn't mean to imply that. I was—

Mr. CLEAVER. I am not suggesting that you were. I just want some clarification.

Mr. WALSH. Right. The distinction I was drawing there was that there were clearly some systematic failures within servicers to observe requirements of law that were necessary to the effective completion of a foreclosure. I was simply pointing out that we were not aware to this point of any broader systemic issue associated with the kind of nonperformance of these documents and processes, although that is an issue that many have suggested should perhaps be looked at more.

Mr. CLEAVER. So the RICO method of dealing with this issue would be inappropriate, going too far? The racketeering?

Mr. WALSH. That will depend on what the enforcement agencies, including our own enforcement people and the State AGs, determine in their investigation. I couldn't presume to comment.

Mr. CLEAVER. So do any of you believe that this issue or this crisis has metastasized to the point where there is a need for a deeper look, that there was intentionality to defraud? We have been using a lot of words. Foreclosure fraud is probably a better term. Do any of you think that goes deeper than what we are discussing?

Ms. DUKE. I don't think we have any information on that, but I can assure you that we regularly refer cases to the Justice Department when we find those in our examinations. So if we found that, we would make those referrals.

Mr. CLEAVER. Since we are communicating, do you support the creation of a compensation fund similar to what was done in the Gulf Coast after the oil spill that would make people whole?

Ms. DUKE. I have heard some reports that is one of the things that the 50 State AGs are looking at. And I think it would be very positive if there was a mechanism to deal with these problems as they came forward, and also to come to some resolution so that the mortgage functioning and the housing markets can continue. So yes, I would.

Mr. CLEAVER. One final question. You had mentioned earlier that there is the possibility of at least 4 million additional foreclosures that are seriously moving toward foreclosure between now and 2012. Do you believe that what we are trying to find information about today, the foreclosure fraud, will have any bearing at all on making the 4 million homeowners an inextricable part of the mess that we are hoping to clear up?

Ms. DUKE. I think the issues related to documentation would probably impact the timing of those foreclosures more than the number of the foreclosures. And you know, these are the estimates that we are making based on the number of loans today that are past due for nonperforming, as well as those that are in some process of foreclosure.

Mr. CLEAVER. Thank you, Madam Chairwoman.

Chairwoman WATERS. Thank you very much. Mr. Miller.

Mr. MILLER OF CALIFORNIA. Thank you, Madam Chairwoman.

I enjoyed hearing from each of you, and I wish we had a lot more time because I know there is a lot more that could be discussed. It sounds like you are trying to deal with the continuity of process where the system overall works as it should. You are trying to make sure the misinformation is dealt with, that foreclosure avoidance occurs when it can.

I guess one problem I am having is if fraud has been committed on the part of lenders and as it applies to foreclosures, they should be held independently responsible for each and every one of them without a doubt. But the concept of just arbitrarily assessing everybody who ever made a loan to pay into a pool to fund something in the future is unreasonable based on those who are trying to do the right thing. And the concept that there hasn't been some cost or punitive action towards everybody, whether it be a homeowner who took out a bad loan, they pay tremendously. The individuals who made loans, lenders, have paid tremendously. Investors have made huge investments and they have paid tremendously through loss of assets. Many who bought mortgage-backed securities at groups like Countrywide tried to format to look like a GSE mortgage-backed security, which it wasn't, those investors lost tremendous amounts of money.

So there has been hardship on everybody throughout this, if you want to call it a depression in the housing industry, whatever you want to call it. This debacle that occurred, everybody has paid a price. But if people are being unreasonably foreclosed upon, those individuals who have made those actions should be held accountable for those actions. And the part of Freddie and Fannie who hired attorneys who did something improperly, hopefully their errors and omissions insurance requirements are so great and the damage assessed against them are going to be enough that others in the future would want to avoid that.

But we have to say things have gone wrong in the past. We are dealing, trying to deal with them now. But how do we look to the future?

Mr. Stevens, you and Mr. Walsh made some very good comments. How much impact do you think your efforts are having on the system today as applies to rectifying some of these problems that have occurred?

Mr. STEVENS. Thank you for the question. We have seen a significant change in servicer behavior since we began our reviews. And as these work through the process of our formal procedures through the Mortgagee Review Board, I believe we will see even greater response. To date, we have already fined $4¼ million dollars in penalties, we suspended—

Mr. MILLER OF CALIFORNIA. For those responsible for misdeeds?

Mr. STEVENS. That is correct; specific cases, those institutions.

Mr. MILLER OF CALIFORNIA. I support that.

Mr. STEVENS. And we have eliminated 1,500 other institutions and it has without question elevated the awareness of all institutions in this country about the need to adhere to processes, just as clearly as has taken place right now through what has happened with the recent state of news around robo-signing and the various other issues.

Mr. MILLER OF CALIFORNIA. You think your actions that are taking place are effective and they are working?

Mr. STEVENS. I think we need a trust-but-verify approach, or at this point not even necessarily complete trust. I think we are doing what we think is appropriate. We are sending teams into the servicers right now, and we are expanding our reviews. We are going to look at the remaining stages of the foreclosure process beyond what we looked at at the last set of set of reviews. And if they are not compliant, we will take our authority, which we have some significant ability to assess penalties legally, and we will take that authority.

Mr. MILLER OF CALIFORNIA. You have to verify that your actions and implementations have taken place and there will be a consequence for that.

Mr. STEVENS. That is correct.

Mr. MILLER OF CALIFORNIA. Mr. Walsh, do you agree with that?

Mr. WALSH. Certainly when we took action a couple of years ago with the servicers to identify problems in their modification programs, they greatly improved the quality and effectiveness of the modifications. The examinations that we are now undertaking on an interagency basis are going to just grind right down to the most granular detail.

Mr. MILLER OF CALIFORNIA. Good.

Mr. WALSH. We need to understand what has been going on in the process, and to make sure the processes are remedied so that they operate in a fair and legal manner. And to the extent that there are systematic problems, there will be both remediation and there may be penalties.

Mr. MILLER OF CALIFORNIA. I applaud you on that.

Mr. DeMarco, I have a question for you. We had a debacle on HVCC and appraisals in the past year we proved that that did not work, and we put new guidelines in place, and FHFA basically is liable with Freddie and Fannie to put out conflicting guidance that applies to appraisal processes in the future. And I am bothered by that because they are the largest holder of the trust deeds. Why are they not complying with the same performance we have placed upon banks?

Mr. DEMARCO. Congressman, I am going to find out exactly what this discrepancy is that you are concerned with. Fannie and Freddie have maintained the positive elements of the HVCC. Now that that has gone away, principally focused on appraiser independence. The Federal Reserve has just recently—

Mr. MILLER OF CALIFORNIA. But they have not done that, that is my problem. I am out of time, but will you check into that and get back, because from what I am hearing that has not occurred.

Mr. DEMARCO. Okay, I certainly will.

Mr. MILLER OF CALIFORNIA. Thank you, sir.

Chairwoman WATERS. Thank you. Mr. Green.

Mr. GREEN. Thank you, Madam Chairwoman. Dr. King reminded us that for every complicated problem, there is a simple solution that is usually wrong. And what I would like to do is first examine how complicated this problem is and try to get beyond the superficial solutions if at all possible.

At one time, we had a mortgage circumstance wherein we had a borrower, a lender, and a lien or a mortgage. Currently that has metamorphosed into a lender, the borrower, the lien, the mortgage. But also we now have a sponsor who turns the mortgage into a bond and then sells it to a depositor. We have a depositor that sells the mortgage to a trust. And then the trust hires a servicer. This doesn't include the MERS and other entities that have become a part of this process. With all of these various entities in the process, the question becomes: Are there impediments to sustainable mortgage modifications with reference to this current crisis?

And I would just like to mention a couple of issues that have been called to my attention. Many of my issues have been satisfied.

I have had an opportunity to meet with some of the witnesses and have some of my issues addressed, but these I would like to just call to your attention this morning. The first has to do with servicers holding junior liens. Does a servicer holding a junior lien present an impediment to our having sustainable mortgage modifications?

I will just start with, first, Ms. Caldwell. Can you give me some intelligence on this, please?

Ms. CALDWELL. Thank you for raising second liens. The second liens, regardless of who they are held by, increase the homeowner's debt on the property and can sometimes prevent a sustainable modification. And so getting the second liens addressed, particularly on those loans where the mortgage is for more than the home is worth, it is a very, very important part of the modification process.

We tried to address that with the second lien program in HAMP, but we certainly need more focus on second liens to sustain modifications.

Mr. GREEN. Ms. Duke, if you would please?

Ms. DUKE. I would echo that the existence of the second liens themselves, further complicates the process. I don't think I would say anything different.

Mr. STEVENS. I agree that the more investors involved in the ultimate ownership of the obligations against a particular home complicates the process further, because it is another set of decisions that has to be concurred with when you are trying to do a modification.

Mr. GREEN. Mr. Walsh?

Mr. WALSH. Certainly as described, the additional debt burden would be an issue. But in terms of the second liens themselves, as a supervisory matter we certainly insist that the banks address the overall debt burden modification status of the first lien and to take that into account in reserving for and addressing the risks of the second lien. So we try to make sure that it is not an impediment in that way.

Mr. GREEN. Mr. DeMarco?

Mr. DEMARCO. Congressman, what I would say is that overseeing, again, towards a first mortgage, a second means a substantial problem for us and have been an impediment in some of the modification activity. And I would go further to suggest that as this committee considers housing finance reform in the coming year, that since it is, as I understand, going to take a comprehensive look at things, I would hope that we would reconsider some of the practices that have been put in place with regard to second liens.

Mr. GREEN. Now, quickly, because time is running out and I have received intelligence indicating that we have had about 21, that is "2-1," second lien modifications completed. But tell me this with reference to the second liens. What percentage are we dealing with with reference to the products that servicers have to negotiate, what percentage would be second liens?

Ms. CALDWELL. I can—in the HAMP portfolio, about 50 percent of the loans have second liens. In terms of our second lien program, which is voluntary, we have 17 servicers signed up to participate. And in this program they, the servicers, agree to modify the second loan, the second lien, when they get knowledge that the first was modified.

Mr. GREEN. Thank you, Madam Chairwoman.

Chairwoman WATERS. Thank you very much. There is a vote pending on the Floor, so this committee will be in recess so that members may go vote and return in about 15 minutes. I think I am going to forego the vote and I am going to stay. I will be here when you return. This will give me an opportunity to figure out a couple of things that have not been made clear while we were in session. So, please, you may take your vote.

The panel will stay. We have not finished the questioning of this panel, so this panel will be here when you return.

Thank you very much. While our members are voting, I would like to raise some questions that take a little bit more time to answer, that you may be able to help me with. How many of you who are here today representing your agencies have ever walked through a loan modification process? Do you know what happens when the average citizen calls into their bank where they thought their loan was being held at least, where they think they are paying their mortgage to? How many of you know what happens from the time that homeowner calls the bank? How many have walked through that process?

Ms. CALDWELL. Madam Chairwoman, I will start and say just in terms of my role at Treasury, almost a year ago we had a campaign where we sent Treasury staff on site to the servicer shops to listen to the calls that came in and to try to address issues and clarify guidance where possible.

But I would also add, more importantly on a personal note, prior to joining Treasury I had to work with a family member to renegotiate a very inappropriate mortgage product, subprime product that had been sold to her and to many of the senior citizens on her block, just devastating the neighborhood. And I also had to walk another family through a short sale, and both of those were very difficult and were part of why I made the decision to join Treasury and try to address this.

Chairwoman WATERS. I appreciate that.

How many people know what happens when you first call the bank and you say, I am Ms. Jones, I have a problem, I lost my job, or I don't have as much income. I would like to talk with someone about a loan modification because I don't think I am going to be able to make my payments. Maybe I can make my payments for 1 month, 2 months, but I am not going to be able to make them after 2 or 3 months. How many of you know what happens at that point?

Mr. DEMARCO. Madam Chairwoman, you have actually posed a couple of different scenarios there, and so what happens depends upon exactly what the scenario is. The borrower calls and says, I have just lost my job, I am still current on my mortgage. I have lost my job, I am going to have a disruption in income. Then there is one script that is used, because that is a particular situation.

In the situation where a borrower has missed several payments—

Chairwoman WATERS. No, I didn't go to where a borrower had missed several payments yet.

Mr. DEMARCO. That is fine, I just want to understand.

Chairwoman WATERS. What I am saying is, Ms. Jones is calling. She is saying, "I have a problem, I may not be able to or won't be able to make my payments after next month in the same amount that I have been paying. Can you help me? I need to talk with you about a loan modification." What happens then?

Mr. DEMARCO. The servicer should have a script with a set of questions to ask to understand the particular circumstances of the borrower.

Chairwoman WATERS. Who is the person talking to at that point?

Mr. DEMARCO. They may be talking to the mortgage servicer.

Chairwoman WATERS. A what?

Mr. DEMARCO. The servicer of their mortgage.

Chairwoman WATERS. No, the person does not get to the servicer of the mortgage on that first call. Are most of you aware that there is a loss mitigation department that may screen that call prior to it getting to a servicer, if they ever get to a servicer? Are you aware of that?

Mr. DEMARCO. Servicers have loss mitigation departments, yes. The banks have loss mitigation departments.

Chairwoman WATERS. Banks—when you call the bank with this problem you go to the loss mitigation department first; is that correct?

Mr. DEMARCO. What different servicer companies call their different departments, Madam Chairwoman, rather than get into that, I think that the servicers should be well equipped to direct the call to the right place—from a borrower.

Chairwoman WATERS. Are you aware that it is almost impossible for a homeowner to get to the servicer; that the systems now have screeners, this first contact person, and they have a cookie-cutter sheet, and they ask a number of questions. And if they determine that the ratio of debt to earnings does not comply with what they have on the sheet, that they can never get to discuss that modification? They never get to the servicers necessarily? Are you aware of these systems?

Mr. DEMARCO. I am aware that servicers have instructions from their various investors in terms of the series of questions to ask, the information to gather, and the assessments to make regarding those loans. And no, not everyone that calls that has a problem with their loan is going to be eligible for a particular modification program. There are many variables at play here. What is the mortgage? Who is the investor in the mortgage? Is this particular circumstance of the borrower eligible for a HAMP or not? These are the screening questions that are asked when an individual calls.

Chairwoman WATERS. When the individual calls and they are talking to this person who is not a service—who can not really negotiate a modification, this person simply can go down the questions that are prearranged to determine whether or not they are meeting the investor's requirement, for example. So if Ms. Jones would like to talk about a reduction in interest rates or asked a question about reduction in principal, that person is not able to discuss that with them. Are you aware of that?

Mr. DEMARCO. How each individual servicer handles that process, I wouldn't want to speak to there being a single answer to that question.

Chairwoman WATERS. If you knew and understood what takes place when Ms. Jones first calls and Ms. Jones cannot discuss a reduction in interest rate or principal outside of the cookie cutter arrangement that the first person that they encounter uses, what would you advise Ms. Jones to do?

Mr. DEMARCO. I believe most of the major servicers encourage borrowers and make available to borrowers home counselors in their local area who can assist the troubled homeowner in evaluating their entire situation and also to assist them in working with their mortgage servicer with regard to options that might be available to assist them with that mortgage and to help facilitate the gathering of appropriate and needed information for the mortgage servicer to do an appropriate and full assessment of the alternative—

Chairwoman WATERS. How many of you know that if Ms. Jones would like to talk about a modification and ask questions about a reduction in interest rates or write-down in principal, how many of you know that Ms. Jones is being referred to someplace else, some counselor somewhere for help? How many of you know that is taking place?

Mr. STEVENS. Madam Chairwoman?

Chairwoman WATERS. Yes.

Mr. STEVENS. Two things. One, you are highlighting a part of the reason why we went through the servicer reviews we just started, we just completed with the top five. You are specifically addressing the disconnects that are occurring and cause such delays for solving the problem. And I believe it is an issue, we believe at FHA it is. And just to highlight it, in many cases, actually the first call goes into a collections department to determine if they can get payments made, and then it might go from there to a loss mitigation area after that.

And while it varies by servicer in terms of how to implement solutions, that is precisely why we did a servicer-by-servicer loan-level review, on site in their operations, to go through the process. We literally just completed that and we are taking action on those servicers that are not meeting the expectations, because to your point it is the frustration that we get daily e-mails and phone calls from families who are desperate.

We have a call center at FHA that is overwhelmed with calls from families in crisis. And it is why we sent in teams to look at that. And we do have monetary penalties provided to us by Congress that can be ultimately treble damages for not complying with the process to provide a solution to a family early on in the early stages of delinquency. So we did not know it until we sent our teams in.

We are now recognizing the gaps. And we have to be much more vigilant and aggressive with the servicers that make it hardest on families in crisis to connect the results, a solution for them when they can have it provided to them without having to go through all those calls.

Chairwoman WATERS. How many of you know what banks have their loss mitigations offshore? And that when American taxpayers are calling their banks to get some help on a loan modification, if they are first encountering the loss mitigation department, how many of you know that they may be talking to somebody in India?

Mr. STEVENS. Just a quick—we do know it exists for some servicers. FHA has a provision that does not allow any customer service to be handled offshore, contracted out.

Chairwoman WATERS. Treasury?

Ms. CALDWELL. Treasury operates in partnership with the Home Preservation Foundation, the 1–888–995 HOPE hotline that is 100 percent onshore.

Chairwoman WATERS. No, that is not my question. My question is how many of you know that banks have loss mitigation departments offshore? And this Ms. Jones that I am describing, her first contact to discuss whether or not she is eligible for a loan modification may be talking with someone in India, Taiwan, or someplace.

Ms. CALDWELL. I know that it exists within the servicing industry. I can confirm whether or not it is a requirement in the HAMP program or not.

Chairwoman WATERS. I beg your pardon?

Ms. CALDWELL. My understanding is the same as Mr. Stevens, that within some of the servicing industry, calls are handled offshore. I do know that in the Making Home Affordable hotline, it is onshore. I don't know about the other servicers.

Chairwoman WATERS. But don't forget Ms. Jones doesn't know anything about anything. She is calling the bank where she sends her payments and she is talking with someone whom she thinks can help her with a loan modification. And it turns out that she is talking with the call center offshore, with someone with the cookie-cutter sheet that asks her some questions and basically tells her she is not eligible for the loan modification. How many of you understand that?

Ms. CALDWELL. I think there is—I think we do understand that and it is very, very frustrating. And the issue—

Chairwoman WATERS. If you understand it, why can't you do something about it?

Ms. CALDWELL. One of the things that we continue to do—first of all, it is endemic of the still lack of capacity to respond to the magnitude of this crisis. But we have held—recognizing the importance of person-to-person contact, we in conjunction with HUD and some of the others have held outreach events in over 50 cities where homeowners and servicers are on site, they are meeting in person, and they have the opportunity to talk about the modification one on one.

What continues to be very disturbing is that when we survey, we still find many of the homeowners who stand in line, who come to these events and meet with their servicer, the first time they are making a connection with their servicer is at that event. And so it is a daily reminder to us that there continues to be some disconnect in the call and contact environment.

Chairwoman WATERS. Big disconnects.

Let me ask another question of you. When the contact person for the bank, who is not a servicer, who is answering Ms. Jones on this first call, looks at the debt and they look at the income and they look at—they are looking at whether or not this person qualifies for a loan modification. Basically Ms. Jones now has a property that is underwater. It is not worth what she purchased it for, what she thought they had purchased, it is not the same thing. And so Ms. Jones really will never qualify for a loan modification based on a difference in income, less income.

And she wants to talk about what can she do with the income that she has, that does not meet the criteria that the loss mitigation person is describing. But she has income, and she wants to stay in her house, so what should she do?

Ms. CALDWELL. I will go ahead and start. Certainly within the HAMP program, the servicer would have to see if Ms. Jones or the person is eligible for a HAMP modification and in many—and the median homeowner who gets a modification has had their payment reduced by a third. In those cases where there is not enough income, the servicer has to look for other home retention opportunities—

Chairwoman WATERS. This person Ms. Jones is talking to in the loss mitigation department, are they going to say, oh, Ms. Jones let me refer to you the HAMP program. Let me help you go through a program by the Federal Government that may give you an opportunity to pay what you can, I guess, for the first 3 months or so, and let's see if you can qualify for a loan modification. Is that what this person is supposed to do?

Ms. CALDWELL. If the servicer is participating in HAMP, they are required—

Chairwoman WATERS. Don't forget, Ms. Jones hasn't gotten to a servicer yet, the screen now that is set up to keep Ms. Jones from getting to a servicer so the servicer doesn't have to be bothered with someone who does not meet the underwriting criteria as they know it.

OCC, you have all of the major servicers, you have the majors, you have the "too-big-to-fail," you have all of them. Do you know and understand what I am talking about?

Mr. WALSH. I certainly understand the situation that you are describing and I have not myself walked through that process, but we have examiners in the large banks who review the servicing process. And, somewhat akin to the FHA project, we did a horizontal review of mortgage modifications processes, I guess in 2008, 2009, to look at the practices across the firms where there were deficiencies. As a result, we issued a letter to the CEOs of the banks indicating deficiencies in the process and calling for improvements.

Certainly there has been a systemic effort to get the institutions to bring on more staff and to train them and otherwise make more service available to the people who are calling. But the process, bank to bank, may vary. There may be an intake process and there will be a loss mitigation process that will be part of the overall servicing process.

Chairwoman WATERS. Of course. Let me point you to page 13 of your testimony where you say, examiners generally do not directly test standard business process or practices, such as the validity of signed contracts or the processes used to notarize documents or the actual physical presence of notes, with document of custodians, unless there is evidence of a material weakness or breakdown in governance and internal controls.

I have a New York Times article from January 2008, detailing how Countrywide was fabricating documents, and how the Chapter 13 bankruptcy trustee in western Pennsylvania was concerned about it. There are many, many articles like this, and Members of Congress have been talking about the failures of mortgage servicers for years. Was all of this evidence not enough to qualify as a material weakness or breakdown?

Mr. WALSH. We very specifically went in and examined the modification process and demanded improvements. That is not the kind of routine matter that I was referring to on page 13. The re-underwriting of a loan is a substantial issue for a bank; it involves people with skill and understanding of the process. It is part of the safety and soundness of a bank. That is not the kind of technical matter that was referred to in that statement.

Chairwoman WATERS. What Members of Congress are trying to figure out is why regulators are not able to pick up on, identify these weaknesses and these big problems? What takes so long, and why is it you don't know how these systems really operate as regulators? That is the big question among Members on both sides of the aisle.

Mr. WALSH. We—

Chairwoman WATERS. Do you believe that Ms. Jones should be able to get to a servicer who can really negotiate a loan modification, or should she be stuck with a clerk who basically follows this cookie-cutter sheet and tells her you don't qualify, or unless you have X amount of dollars, I can't help you? Do you think that really should happen that way?

Mr. WALSH. It would be hard to say, without understanding the circumstance of the individual. But if someone is having difficulty getting the relief that they think they should have, as was mentioned. I think it is quite important to rely upon counseling which is an important part of helping people navigate the system. It is also the case at the OCC that if someone feels the process is unfair or is not working, they can file a complaint with our customer assistance group. And it is true that mortgage complaints have become the number one—

Chairwoman WATERS. They can file a complaint with whom?

Mr. WALSH. Our customer assistance group.

Chairwoman WATERS. What is that?

Mr. WALSH. It is a unit that is based in Houston, Texas, that has an 800 number and a Web site to assist people with—

Chairwoman WATERS. How would Ms. Jones know about that?

Mr. WALSH. We are on the Internet. We periodically do public service announcements about what we do. We have an 800 number.

Chairwoman WATERS. So you think the average citizen really knows that?

Mr. WALSH. The effort to create a nationwide point of contact, the 1–800 number, was actually part of legislation that was reported out of this committee, I believe in the last Congress, to sort of expand upon this thought. And I think it is kind of central to what the consumer bureau was about, to have a single place where—

Chairwoman WATERS. Do any of you require the loss mitigation department or the bank or anybody to walk through with Ms. Jones what she should do following the contact with them? They can't go any further, that is all they can do. And now, Ms. Jones, I am going to give you a telephone number, I am going to point you in a direction, I am going to tell you how you can get in touch with your servicer. Do any of you require that?

Mr. STEVENS. We do require it. It is mandatory to be an approved FHA insurer that contact be made no later than 120 days, that loss mitigation programs provided by FHA are offered, and we track them in detailed reporting that we have created over the last year, by institution, by month, how many have gone through the program of their delinquent borrowers, and what the total outcome is. And there have been gaps as I said earlier. And gaps do exist today, so that is why we are using our authority in our reviews. And should we not get to resolution, we will assess the penalties that are within our legal rights and, again, granted by Congress recently, that can be fairly damaging.

Chairwoman WATERS. I asked—

Mr. DEMARCO. Chairwoman Waters, if I could—

Chairwoman WATERS. I asked earlier about whether or not fines had been levied from the Treasury Department. Let me turn to you, the OCC. Since we started experiencing the fallout from the subprime boom, has the OCC taken any enforcement actions against servicers?

Mr. WALSH. We have certainly issued supervisory requirements on them, matters requiring attention and other things—

Chairwoman WATERS. Have you levied any fines?

Mr. WALSH. I do not believe that we have.

Chairwoman WATERS. Have you issued any cease-and-desist orders?

Mr. WALSH. I don't believe that there have been any public actions against them.

Chairwoman WATERS. Have you threatened to revoke any charters?

Mr. WALSH. No.

Chairwoman WATERS. Do you think the servicers really believe that you mean business if they don't have to fear any consequences?

Mr. WALSH. I think the consequences are quite clear and present to them, in that we can compel action and the threat of more serious penalties.

Chairwoman WATERS. But you haven't done that, you haven't done any of that. Why should they take you seriously?

Mr. WALSH. The supervisory process does not mainly happen in the public spotlight. It happens in the dealings directly with the institution through the process of examination, matters requiring attention and other things. Only when a particular problem is identified that rises to the appropriate level do we get into the area—

Chairwoman WATERS. Let's talk about examiners. If you have examiners onsite, can you explain how you don't know about all the problems that have recently come to light? What do the examiners do?

Mr. WALSH. As I mentioned, our attention was focused on the modification process. It would be quite unusual for us to be in the room or present at the point where an affidavit is being signed or a notarization is taking place. We do rely on the systems and controls of the financial institution, its own internal audit, and any red flags that arise, like through our consumer complaint function. Unfortunately, those systems and controls did not raise an alarm about this process.

Chairwoman WATERS. I know that as top leaders in your agencies, you are not doing day-to-day work. You don't necessarily know details. But I think it is important for somebody to understand how it really works. And I don't get the impression in talking with most of you here today that you really do understand what the homeowner is confronted with when they are seeking help and loan modification and wishing to talk with someone who can make decisions.

I think that if that was well understood, that you have the power by which to help make systems work so that homeowners can really get some assistance. This problem is so big, so many families are devastated because they got into the subprime loans, these exotic products, without knowing or understanding thoroughly what they were all about. And some people would like to say they are just irresponsible homeowners. But I have said to anybody who would listen, you don't have this many Americans all irresponsible; something happened in the system.

We all know what it is. We all know that these exotic products, no documentation loans, these ARMs, these interest only, all of these products came on to the market and simply placed homeowners in the position of trying to follow the American dream and get that home, because they are now told that I can get you in a house, and they are following the lead of those who are initiating the loans. And we have this problem that has been going on for a long time and it is not getting any better.

What can you tell us today that you can do to straighten this out? What can you tell us? What is your answer?

Mr. DEMARCO. Madam Chairwoman, I think that all of us have made it quite clear that we have a lot of active targeted work going on, examination work with regard to the specific matters that have recently arisen, and that it is prudential for us to complete that examination work so that we are operating with facts, so we know the scope and magnitude of particular issues, either generally, or particular firms. And at that point we will be in a better place to make informed judgments about appropriate responses.

But in the meantime, I think there has been a tremendous amount of work done by all the agencies represented here to stand up, develop, and enhance multiple programs to allow troubled homeowners to retain their homes. And I think that these particular matters about the foreclosure processing, we are gathering this information and we will certainly have the improvements in place once we have a firm grasp where the problems are, and what they specifically are, and I am sure the servicers will as well.

Chairwoman WATERS. I would like to thank you for basically—I am going to call on Mr. Miller. I would like to thank you for basically just reiterating what you have said over and over again, and what Mr. Neugebauer warned you about: coming here saying we are working on it.

Yes, we are moving on it. And you can't show us that in this length of time you have done anything to bring about penalties or to levy fines or to show us that you are serious about assisting the homeowners.

Mr. Miller, please.

Mr. MILLER OF NORTH CAROLINA. Thank you, Madam Chairwoman. I asked Secretary Geithner in September if the stress test done early last year had taken into account potential liability by the servicers of the residential mortgage-backed securities, essentially the biggest banks, for put-backs. And at that time, we were hearing more about underwriting, whether the underwriting of the mortgages really met, really satisfied the representations and warranties of the pooling and servicing agreements or PSAs.

Since then, we have heard more about the documentation and whether the documentation maintained by the servicers in the files is sufficient under those representations and warranties as well. Secretary Geithner said he wasn't sure. Since then, I have heard from a variety of sources that they have been not including from employees of the Fed.

Ms. Duke, earlier this week, I think just yesterday in fact, the Board of Governors announced a new round of stress tests, but it seemed to be geared towards capital requirements under Basel III and to take into account macroeconomic forces. There was not one word about potential liability.

And also, earlier this week, the Congressional Oversight Panel issued a report that said that the Treasury's assurances that there is no evidence that there was any systemic risk arising out of the documentation issues was premature and called for tests that would look specifically at potential liability for put-backs.

Ms. Duke, will the new stress test examine potential liability for put-backs either for underwriting failures or for failures of proper documentation?

Ms. DUKE. Yes. We are requiring 19 institutions to provide capital plans and included in that would be estimates of losses under stress scenarios, both scenarios that they developed and scenarios that we have developed. And included in that would be estimates of liability out there for put-back risk. We have actually done some estimates on it.

Mr. MILLER OF NORTH CAROLINA. I hope you are not taking their word for it.

Ms. DUKE. No. We are asking for their estimates and comparing them to our estimates, but we are doing our own independent estimates.

Mr. MILLER OF NORTH CAROLINA. Are you examining the collateral loan files or representative samples that are selected at random and not by the servicers, to see if those files have all the documents required under the PSAs?

Ms. DUKE. In the exams we are doing right now, we are pulling specific loan files both for loans that are in foreclosure, have been foreclosed, and for loans that have not been foreclosed, and requesting that they produce the documentation for those loans that have not been foreclosed.

Mr. MILLER OF NORTH CAROLINA. And those are all at random. Are you comparing the documents that exist in the files, that are in the files with the requirements of the PSAs?

Ms. DUKE. I don't know whether that specific step is taken, but can I check on that and get back to you?

Mr. MILLER OF NORTH CAROLINA. That would be great.

I also understand the PSAs are very specific that the failure to have that documentation does give rise to a requirement to repurchase, a put-back right. Could you confirm that as well, because one—I have heard or read in the press, as most of us have, that the potential liability is enormous. The banks say on one hand, this is all overblown, it is no big deal, these are technical issues, this is all just little paperwork stuff cross Ts, dotting Is, it will be easily contained.

And then we hear, no, this is very serious and probably threatens their solvency and presents systemic risk issues. It very much reminds me the one-up to the financial crisis of 2 years ago and how important or how significant the subprime mortgages were.

Mr. DeMarco, you sent 63 subpoenas, I think it was in July, to the private label securitizers for the private label mortgage-backed securities that the agencies purchased. Did that go to documentation issues or did that go only to underwriting issues?

Mr. DEMARCO. The subpoenas were focused principally on underwriting issues, and so we have issued that to gather the data on these particular loans so that they can be reviewed and evaluated.

Mr. MILLER OF NORTH CAROLINA. Mr. Green asked a question earlier about servicers holding second mortgages, and he talked generally about the problems second liens created. But I think the gist of Mr. Green's question was really about whether it is a conflict of interest for servicers of firsts held by others being serviced and also holding seconds on the same property. What possible justification would there be for having that alignment of interest, of having a server who has a fiduciary duty to the beneficial owners of the first mortgages also holding or being affiliates of companies that hold second liens on the same properties? Is there any justification for it? It appears to be a conflict of interest. Is there any countervailing advantage in doing it that way?

Mr. Walsh, you seem to be—

Mr. WALSH. The question you are asking or the suggestion is that, by virtue of the fact that they are holding the second, that they would potentially not modify a first or—

Mr. MILLER OF NORTH CAROLINA. Or just delay, extend and pretend.

Mr. WALSH. As we supervise the loans, to the extent that a company has a portfolio of first mortgages and second mortgages, we look at the condition of the loans and the loss experienced with the firsts and seconds. In the small number of cases where, for example, there is a modified first and a performing second, we would require the holder of the second to mark down or to reserve against that second, even though there are payments being received by virtue of the fact that there is an impairment of the underlying.

Chairwoman WATERS. Thank you.

Ms. Kilroy?

Ms. KILROY. Thank you, Chairwoman Waters. I appreciate the fact that you called this important hearing.

I also want to thank the panelists for coming today to help our committee sort out these difficult issues.

Like many of my colleagues, I was deeply disturbed by recent revelations of, at best, shoddy paperwork by mortgage servicers working for the Wall Street banks that own an overwhelming percentage of our residential mortgage market. Some of the panelists have described this as a weakness in the foreclosure process and also submit that it is a weakness or a deliberate noncompliance with various State laws regarding the recording of titles and liens that has definitely affected not only the residential mortgage market but also perhaps affected State and local governments and their efforts to send the appropriate party the bill for property taxes and to collect the same. And contrary to what some on Wall Street and even the Administration have suggested, these problems, these robo-signings are not superficial or harmless. They could, in the worst-case scenario, put a cloud on the title to millions of properties across the country and send more shock waves into the residential mortgage-backed securities market.

It is important that Congress does what it can to ensure that this does not happen and to make sure that the rules of law and due process are given the respect that they are entitled to in our country of laws, a country based on respect for due process and the rule of law. That is why I think it is more than just weakness in the foreclosure process. There is something very fundamentally American at stake here.

But I don't want to focus entirely on the dangers that the industry brought on itself with the slicing and dicing of mortgages but on the homeowners. Homeowners are entitled to our attention as well. The mortgage industry has complained in recent years that the legal requirement of physically recording each change of ownership in a piece of property needlessly impedes its ability to innovate or modernize the real estate market. That is not so. These laws exist to protect each participant in the real estate market—the mortgage holders, the servicers, the originators, the homebuyer, potential homebuyers, homeowners, and other lienholders, including State and local government.

In many cases, homeowners who are unable to keep up with their payments will have inevitably faced foreclosure regardless of the faulty paperwork. I certainly recognize that. But servicers have been too quick to proclaim that each and every foreclosure they pursued that suffered from robo-signing and shoddy paperwork is legitimate. I believe we must verify that no one unlawfully lost their homes because a corporate or government bureaucrat cut a few corners or that homeowners in the process of modification found themselves suddenly in foreclosure. Any solution to this problem must ensure that homeowners who are improperly foreclosed on are compensated for their loss. These homeowners are entitled the full measure of due process and equal protection of the law. So I am very concerned, in terms of these various revamping, various programs, of what the impacts are on these.

Mr. DeMarco, you indicated that it is the same law firm that is involved in these issues, one law firm?

Mr. DEMARCO. I indicated, in response to an earlier question, that there is a particular law firm in the State of Florida which was on the approved attorney network of Fannie Mae and thus was processing foreclosures of Fannie Mae loans. I observed that it was both Fannie Mae and Freddie Mac loans that were being worked through that particular law firm. That is not the only law firm in the State of Florida that is working on foreclosures of Fannie Mae and Freddie Mac loans.

Ms. KILROY. Thank you. I certainly did not hear that earlier testimony along the same lines, so I appreciate that clarification.

In terms of respecting the rule of law, homeowners now are not able to protect their properties in the bankruptcy court. They can't ask the bankruptcy court to align their various debts or their payments and protect that home. Of course, they could if they had a yacht or a boat or a vacation home, but they are not able to ask the court to address their debts and address that first mortgage.

Do any of the panelists believe that a bankruptcy court would be in a good position to take a look at all of these issues, help put pressure on the servicers of mortgagers and others to engage in a modification but also that the court would protect the rule of law and the appropriate mortgage—

Chairwoman WATERS. Let's let them answer that question.

Ms. KILROY. Nobody has an opinion on that?

Thank you, Madam Chairwoman.

Nobody chose to respond, which I think is interesting that nobody has an opinion one way or another on that.

Mr. DEMARCO. I am sorry. I will venture into this.

I think that there is reason to rethink some of this, but I would suggest that if there was a change in longstanding practice about mortgages being outside of the bankruptcy process, it would have to be considered in a way in which the fact that this is a secured lien would need to be greatly respected, and that would include if the bankruptcy court actually had access to the mortgage that there would be guidance here to reflect the priority of lien and how that would be managed by a bankruptcy judge. And that is not to say that this should or shouldn't be done, but I would simply say that if a change to longstanding practice were made I would hope that it would be made with clear legislative direction about the priority of a secured lien and also, within multiple liens on a residence, the relative priority of position.

Chairwoman WATERS. Mrs. Biggert.

Mrs. BIGGERT. Thank you, Madam Chairwoman.

I was going to wait for the next panel, but since this issue just came up I wanted to ask something about it. And that is, for quite a while I have been asking and questioning the FHFA about the list of approved law firms that—some are now labeled as foreclosure mills, and the chosen few firms that Fannie Mae and Freddie Mac have picked to process foreclosures. And, to this date, I haven't really gotten the answers to why there are so few law firms. This obviously continues to be a problem. So I introduced a bill last February to require the FHFA Inspector General to report to Congress on this matter, including the eligibility criteria used for such approval or retention.

And then, in October or November, the Wall Street Journal reported about the Florida law firm that had 1,000 employees processing more than 70,000 foreclosures last year, and that firm allegedly—whether they forged notarized documents and the employees signed files without reviewing them. So is there anything more that you can tell me, Mr. DeMarco?

Mr. DEMARCO. I can tell you that both companies have been expanding their network of law firms. In particular, in the State of Florida, it had been capping the share of business going to any one firm, so there is progress in that way.

I believe we have gotten back to you, but if we have not gotten back to you with all the answers to your questions, Congresswoman, I will make sure that we do and provide some follow-up information for you with regard to the change that has been taking place over the course of this year regarding both the oversight of law firms and the expansion of the approved networks of each company.

Mrs. BIGGERT. Do you think that we should have the Inspector General report to Congress on this matter?

Mr. DEMARCO. That would be your call, not mine. But I would be happy to cooperate with my new Inspector General on any inquiry that he has or that you all would like him to have.

Mrs. BIGGERT. Thank you. I yield back.

Chairwoman WATERS. Is that a request that you are making, Congresswoman?

Mrs. BIGGERT. Yes.

Chairwoman WATERS. Without objection, that request is duly recorded, and we would expect a response.

Do you have a timeframe by which you would like to hear from them?

Mrs. BIGGERT. Two weeks.

Chairwoman WATERS. Two weeks. Is that understood?

Mr. DEMARCO. I will get back to Congresswoman Biggert in 2 weeks. Thank you.

Chairwoman WATERS. Thank you.

I would like to thank the panel for being with us today.

The Chair notes that some members may have additional questions for this panel which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

This panel is now dismissed, and I would now like to call upon our second panel. Thank you very much.

Our first witness will be Ms. Rebecca Mairone, default servicing executive, Bank of America. Our second witness will be Mr. Thomas Marano, CEO of Mortgage Operations, Ally Financial Incorporated. Our third witness will be Ms. Stephanie Mudick, executive vice president, Office of Consumer Practices, JPMorgan Chase. Our fourth witness will be Mr. Alan Jones, manager of operations, Wells Fargo Home Mortgage Servicing. Our fifth witness will be Mr. Harold Lewis, managing director, Citi Mortgage. Our sixth witness will be Mr. R.K. Arnold, president and CEO, Mortgage Electronic Registration Systems, Inc., commonly known as MERS.

Without objection, your written statements will be made a part of the record.

I think that when you were asked to come, you were notified that we may want to swear you in, so, before you begin your oral testimony, I would like each of you, if you would, to rise, raise your right hands, and answer the following by saying, "I do."

[Witnesses sworn.]

Chairwoman WATERS. Thank you. Would you please be seated?

You will now be recognized for a 5-minute summary of your testimony.

We will start with you, Ms. Mairone.

**STATEMENT OF REBECCA MAIRONE, DEFAULT SERVICING EXECUTIVE, BANK OF AMERICA HOME LOANS**

Ms. MAIRONE. Thank you, Chairwoman Waters, and members of the subcommittee. Thank you for the opportunity to testify today.

The economic downturn and sustained high unemployment, coupled with the collapse of the housing market, have led to challenges much more profound and complex than anyone anticipated. For a borrower, the prospect of falling behind on a mortgage payment due to loss of income would be a wrenching personal situation in any times, but these are not normal times.

Every day we talk to tens of thousands of customers who are facing hardship and looking for our help. Importantly, more than 86 percent of our customers are current on their mortgage payments today. Unfortunately, others are not. At a foreclosure sale, one in three properties are vacant, and there are far too many abandoned properties, driving down home values in neighborhoods across our country.

Helping customers remain in their homes, wherever possible, is a top priority for Bank of America, as evidenced by nearly 725,000 modifications completed. We have reached a crossroads between modification efforts now and the reality of foreclosure. Despite our best efforts and numerous programs, for some customers, foreclosure will be unavoidable. That has driven an increase in the concerns that both we and you have, and we are hearing from our distressed customers.

It is our responsibility to be fair and to treat customers with respect as they transition to alternative housing. We, and those who work with us in connection with foreclosure proceedings, have an obligation to do our best to protect the integrity of those proceedings. When and where that has not happened, we accept responsibility for that, and we deeply regret that.

When industry concerns arose with the foreclosure affidavit process, we were the only servicer who stopped foreclosure sales nationwide to review all of our procedures. We know concerns aren't just those that are technical, and we are taking this matter extremely seriously. We have confirmed that the basis for our foreclosure decisions has been accurate, but we did not find a perfect process. We are already moving forward with needed improvements, but engagement of others is also required.

As a servicer, we must follow the guidelines established by our investors relating to modification and other foreclosure alternatives. Where we can act to improve the process alone, we will and we have. We will continue to innovate on behalf of our customers.

Here are just a few of the things we are doing based on feedback from you and our customers as well as other stakeholders.

First, we will improve the communication with our customers. A frequent source of customer frustration is when they feel they do not speak to the same person twice or more than twice. We are and have redesigned our loan modification process to offer a single point of contact for every eligible customer who desires modification. More than 140,000 customers have already been assigned to a case owner to whom they can always turn.

To reach more customers, we have held more than 500 housing fairs throughout the United States, partnering with nonprofits and Members of Congress. We have found that the opportunity for customers to meet face to face is important and can enhance both response from our customers as well as a successful modification outcome. In particular, we value the leaders and members of this committee who have provided their communities to organize outreach efforts and look forward to working with members in the future.

Second, we will provide greater clarity to customers going through the process. Another source of frustration for our customers is the parallel foreclosure and modification process that is required by many investors. We want to partner with you and other stakeholders, including the AGs, in looking for ways to change this so-called dual track process and mitigate the very real concerns that we have heard about that practice.

Third, we are making improvements to the foreclosure process. We determined during our ongoing review that our process for preparing affidavits of indebtedness in judicial foreclosure States did not conform to the best practices in some cases. We have introduced a new affidavit form and additional quality controls. We are also implementing new procedures for selecting and monitoring outside foreclosure counsel. We are carefully restarting the affidavit process with these and other new controls in place.

Our commitment at Bank of America is to ensure that no property is taken to foreclosure sale until the customers are given a fair opportunity to be evaluated for a modification or, if that cannot be done, a short sale or a deed in lieu of foreclosure happens. Foreclosure is the option of last resort.

Thank you.

[The prepared statement of Ms. Mairone can be found on page 300 of the appendix.]

Chairwoman WATERS. Thank you very much.

Let us go to our next witness who is seated there, Mr. Thomas Marano.

## STATEMENT OF THOMAS MARANO, CEO OF MORTGAGE OPERATIONS, ALLY FINANCIAL INC.

Mr. MARANO. Thank you.

Chairwoman Waters, Ranking Member Biggert, and members of the subcommittee, I thank you for the opportunity to appear before you today. My name is Tom Marano, and I am the CEO of Ally Financial's Mortgage Operations.

Ally's mortgage business is conducted through GMAC Mortgage. As you have heard, there were certain unacceptable flaws in our execution and notarization of certain affidavits in the judicial foreclosure process. The errors we have found should not have happened, and we have undertaken a significant and expansive remediation effort.

Initially, our remediation efforts focused on those affidavits. We then decided to go further. We have a dedicated team, independent of the foreclosure department, that is taking a second look at each loan to ensure that a homeownership preservation option was offered. In addition, we have retained national counsel to oversee the remediation efforts and to review our policies and procedures related to foreclosure in all 50 States. We also brought in PricewaterhouseCoopers to evaluate those policies and procedures across-the-board. We have increased staffing and provided additional training.

At this point in our review, we have not discovered a single instance where the foreclosure sale was unjustified. By that, I mean our ongoing review has shown that by the time a case has gone to foreclosure, a borrower is in default, and we have reached out to offer a homeownership solution.

I have long been an outspoken advocate of loan modifications. I believe foreclosure is a last resort and is not economically advantageous for anyone. It is devastating for consumers and provides no additional benefit for servicers, investors, or communities over a workout solution.

I brought my perspective on homeownership preservation to GMAC Mortgage when I came to the organization in 2008. At that time, GMAC Mortgage was a company in severe distress. Today, we have turned the corner and continue to focus our efforts to help consumers find an affordable and sustainable alternative to default.

While some of the home preservation programs were in place before I arrived, I have worked to increase these efforts. I have always believed that we have a much better chance of helping consumers stay in their homes when we reach a consumer at the early stages of default, seek complete financial information early in the foreclosure process, and work on solutions at the early stage.

We can do better, and I have tried to instill a sense of urgency in our company to find workout solutions where possible. Since 2008, we have achieved 565,000 workout solutions, which is more than 3 times the number of actual foreclosure sales. Many of these families would have otherwise lost their home. Even if a homeowner does not qualify for a loan modification, there are many alternatives to foreclosure, such as forbearance and repayment plans. With your help, principal forgiveness may become a more widely available solution.

Rest assured, I know this process is devastating for homeowners. The paperwork required is cumbersome and the strain of meeting monthly obligations can be difficult for a family who has experienced financial hardship.

The most important objective for loans we service is to work with consumers and our investors to achieve a solution that reduces the risk of default and foreclosure. I am committed to finding innovative ways to help streamline the process and to assist even more borrowers. I regret the errors that have occurred, and we have been working hard to fix them across-the-board.

I also believe that we must work hard to avoid foreclosures, particularly during the early stages of default. Of course, there are still going to be times when foreclosure is unavoidable. My 25 years of experience in the mortgage industry has led me to believe that we must work harder to find solutions for homeowners who want to remain in their homes or sell their property. We reach out to homeowners several dozen times throughout the lengthy foreclosure process to find a workout option if one is available. I strive to ensure that no American loses their home without an opportunity to obtain a loan modification or an alternative to foreclosure.

Thank you.

[The prepared statement of Mr. Marano can be found on page 307 of the appendix.]

Chairwoman WATERS. Thank you very much.

Next, we will have Ms. Stephanie Mudick, executive vice president, Office of Consumer Practices, JPMorgan Chase.

**STATEMENT OF STEPHANIE MUDICK, HEAD, OFFICE OF CONSUMER PRACTICES, JPMORGAN CHASE**

Ms. MUDICK. Thank you.

Madam Chairwoman, Congresswoman Biggert, and members of the subcommittee, thank you for inviting me to appear before you today. My name is Stephanie Mudick, and I am the head of the Office of Consumer Practices at JPMorgan Case.

JPMorgan Chase is committed to ensuring that all borrowers are treated fairly and with respect, that all appropriate measures short of foreclosure are considered, and that if foreclosure is necessary, the process complies with all applicable laws and regulations. We take these issues seriously. As I discuss in detail in my written testimony, we regret the errors in our affidavit processes, and we are actively correcting those issues.

At the outset, I would like to emphasize that Chase strongly prefers to work with borrowers to reach a solution that permits them to keep their homes. Foreclosures cause significant hardships to borrowers and to their communities. Foreclosures also inevitably result in severe losses for lenders and investors. Therefore, we always consider whether there are viable alternatives to foreclosure.

Chase adopted its own modification program starting in 2007, and in 2009 was an early adopter of the government's HAMP program. Our efforts to date have yielded significant results. Since January of 2009, Chase has offered almost 1 million modifications to struggling borrowers and has completed over 250,000 permanent modifications.

Sustainable modifications are not always possible. There are some borrowers who simply cannot afford to stay in their homes, notwithstanding the modification programs and other foreclosure prevention alternatives. There are other borrowers who are not seeking modifications.

While we make repeated efforts to modify delinquent loans, sometimes we must proceed to foreclosure. A property does not go to foreclosure if a modification is in process. But if the foreclosure has begun and a borrower later begins the modification process, our investors, including the GSEs, have instructed us to allow the two processes to run at the same time. However, we will not allow a foreclosure sale if a modification is in progress.

I understand the folks at the committee today have reached a decision to temporarily suspend foreclosures in a number of States. It is important to note that the issues that have arisen in connection with foreclosure proceedings do not relate to whether those foreclosures were warranted. We have not found issues that would have led to foreclosures on borrowers who are current. In addition, we have substantial safeguards to ensure that foreclosures are both a last resort and occur only in appropriate cases. To be clear, we service millions of loans and sometimes we make mistakes, but when we find them, we fix them.

Our recent temporary suspension of some foreclosure operations arose out of concerns about affidavits prepared by local foreclosure counsel, signed by Chase employees, and filed in certain mortgage foreclosure proceedings. Specifically, employees in our foreclosure operations area may have signed affidavits on the basis of file reviews and verifications performed by other Chase personnel, not by the affiants themselves. But the facts set forth in the affidavits with respect to the borrowers' default and the amount of indebtedness, the core facts justifying foreclosure, were verified prior to the execution of the affidavits.

Let me repeat. We take these issues very seriously. Our process was not what it should have been, and it did not live up to our standards. While foreclosures have been halted, we have thoroughly reviewed our procedures and undertaken a complete review of our document execution policies. We have also enhanced training for all personnel involved.

In addition to strengthening our procedures for future foreclosure filings, we are also working to remedy any issues with affidavits on file in pending matters. We are working diligently to complete our review and strengthen our procedures. We are committed to addressing these issues as thoroughly and as quickly as possible.

I would be happy to answer any questions you may have.

[The prepared statement of Ms. Mudick can be found on page 316 of the appendix.]

Chairwoman WATERS. Thank you very much.

Mr. Alan Jones.

## STATEMENT OF ALAN JONES, MANAGER OF OPERATIONS, WELLS FARGO HOME MORTGAGE SERVICING

Mr. JONES. Thank you, Chairwoman Waters, Congresswoman Biggert, and members of the subcommittee. I am Alan Jones, and I manage operations for Wells Fargo Home Mortgage Servicing. I appreciate the time to discuss our efforts related to the housing crisis and keeping American families in their homes.

As a company, Wells Fargo has followed three fundamental tenets: First, we view foreclosure as a measure of last resort—in unfortunate cases where a customer simply cannot afford their property even with a modification, we actively look at other remedies, such as short sales, to prevent foreclosure and protect the surrounding community; second, we hold ourselves accountable for the quality of our foreclosure data and work to ensure that our borrowers are protected from wrongful foreclosures; and third, we understand the necessity of having procedures that ensure our documents comply with the laws and regulations that govern our industry.

As the economy has continued to present challenges, our goal has been to keep customers in their home. Since January 2009, we have provided nearly 2.5 million customers with home payment relief through refinances and modifications, including more than $3.5 billion of principal reductions. More than 92 percent of our servicing portfolio has remained current on their home payments, and fewer than 2 percent of our owner-occupied servicing portfolio has gone to foreclosures now, statistics that have remained the best among our peers over time.

With the goal of exhausting all options before moving a property to foreclosure sale, we have invested heavily in hiring and training 10,600 home preservation staff, for a current total of 16,000 people, and we expect all of them to follow our policies and procedures 100 percent of the time.

Here are some key aspects of our approach:

First, we create an electronic system of record for each mortgage customer that includes data such as the customer's name, address, number of payments, and notes about home retention efforts. We attempt to contact our customers on average more than 125 times by phone and letter during the period of first delinquency to foreclosure sale. Investors often require that we initiate foreclosure proceedings at a certain point in the loan delinquency, but we continue to work with these customers on foreclosure prevention options.

When customers continue to work with us, we prevent foreclosures for 7 of every 10 customers who are 60 days or more past due. Unfortunately, some customers are in homes they just cannot afford, even with substantially reduced payments. In September, customers who completed foreclosure were, on average, 16 months payments delinquent and could not sustain their mortgage contracts.

When there is no reasonable alternative, we believe it is best for people to transition to affordable housing, and we repair and/or sell 25 percent of properties already vacant to alleviate further burden on a community.

Wells Fargo has a rigorous system designed to ensure quality in the data used to make foreclosure decisions. As mentioned before, it includes an electronic system of record as well as controls to lessen the chances of error. As just one example, we pull a daily sample of the data we send electronically to external foreclosure attorneys and do a manual check for accuracy.

We continually work on improvements to reduce the likelihood of errors and address all errors when found. For example, we identified instances where we did not adhere to a final step relating to the execution of foreclosure affidavits, including a final review of the affidavit as well as some aspects of the notarization process. While we do not believe these issues resulted in foreclosures that should not have otherwise occurred, we voluntarily opted to provide additional assurance by executing supplemental foreclosure affidavits in the judicial States. We retain and rely on the guidance provided by outside foreclosure attorneys who are licensed by each State to ensure that we comply with State law and regulation.

In conclusion, Wells Fargo will continue to help homeowners to stay in their homes, including better explaining the home retention process. For example, earlier this year, we introduced a one-to-one model to enable at-risk customers to work with one person from beginning to end on their options. Additionally, we have met face to face with 15,000 customers at 15 large-scale home preservation events and 25,000 customers at our 27 home preservation centers across the country.

Thank you, and I look forward to your questions.

[The prepared statement of Mr. Jones can be found on page 252 of the appendix.]

Chairwoman WATERS. Thank you very much.

Mr. Harold Lewis.

**STATEMENT OF HAROLD LEWIS, MANAGING DIRECTOR, CITI MORTGAGE**

Mr. LEWIS. Thank you, Chairwoman Waters, Congresswoman Biggert, and subcommittee members. I am Harold Lewis, head of Citi's Homeowners Assistance Program. I am pleased to speak with you today about Citi's efforts to assist our distressed homeowners.

At Citi, we are working tirelessly to help families stay in their homes. Since 2007, we have helped more than 1 million distressed borrowers in their efforts to avoid potential foreclosure, but we know there is more to be done. We have redoubled our efforts toward helping customers who are facing financial challenges. We have a well-trained and dedicated staff of approximately 5,000 employees who work with at-risk borrowers to help them find solutions to avoid foreclosure. In addition, we have partnered with a number of community groups across the country to further these efforts, including NACA, the National Council of La Raza, and NeighborWorks.

We believe we have been a leader in HAMP. We actively identify eligible borrowers, conduct extensive outreach to make contact, and then guide them through the process of applying for trial modifications and obtaining permanent modifications. We make housing counselors available to borrowers, provide detailed instructions for completing required documents, and follow up with applicants by phone, e-mail, text messages, and in-home visits. By the end of September, 44 percent of our eligible borrowers had obtained a permanent modification under HAMP.

Further, Citi's re-default rate is well below that of our peers. Borrowers who do not qualify for HAMP modification may be eligible for one of Citi's proprietary programs to address their specific challenges. For example, we have an Unemployment Assist program that provides temporary lowered payments to borrowers who have lost their jobs. Further, we offer a supplemental modification program for eligible borrowers who have completed a 3-month trial period. For those borrowers who simply cannot sustain homeownership, we have in place short sale and deed of lieu of foreclosure programs which provide alternatives to foreclosures and allow families to relocate with dignity.

All of us at Citi recognize the hardship that can be suffered by a family losing its home. Indeed, foreclosures are a terrible outcome for both families and communities. As such, foreclosure is always the last resort for us. In the event that a foreclosure cannot be avoided, we do everything possible to make sure that the process for our customers is as smooth as possible.

Now, regarding your specific concerns about the foreclosure process, we undertook a thorough review of our process beginning in the fall of 2009. Subsequently, we implemented a series of steps to strengthen existing practices and add additional resources to ensure foreclosures were being processed correctly.

We centralized our foreclosure operations into one unit, added staff, and enhanced training for greater efficiency and control. We limited the volume of documents that staff is permitted to process at any given time and now require our employees to be recertified on proper procedures every year. For their part, managers remain accountable for regularly reviewing files to ensure that employees comply with the procedures.

As an additional quality control measure, we have been reviewing affidavits that were executed and pending judicial foreclosures initiated prior to the full implementation of our improved practices. We expect to re-file a number of our affidavits. Should defects be found, no foreclosure will be completed until a new affidavit is filed. This exercise will help us to ensure that these affidavits are accurate and properly executed.

The changes we have made this year give us confidence that there are no systemic issues in our existing foreclosure processes.

While we have made important progress in helping keep Americans in their homes, there is more work to be done. As CEO of Citi, Vikram Pandit, has said, we owe a debt of gratitude to the American taxpayer for providing Citi with TARP funds. We believe it is our responsibility to help American families in financial distress. In particular, Citi remains committed to helping our customers with homeownership challenges they face.

Thank you.

[The prepared statement of Mr. Lewis can be found on page 292 of the appendix.]

Chairwoman WATERS. Thank you very much.

Mr. Arnold.

**STATEMENT OF R.K. ARNOLD, PRESIDENT AND CEO, MORTGAGE ELECTRONIC REGISTRATION SYSTEMS, INC. (MERS)**

Mr. ARNOLD. Chairwoman Waters, Congresswoman Biggert, and members of the subcommittee, my name is R.K. Arnold, and I am president and CEO of MERS. Thank you for this opportunity to appear today.

MERS is a member-based organization made up of 3,000 mortgage lenders. It maintains a nationwide database that tracks changes in servicing rights and ownership interests in mortgage loans.

Today, MERS is keeping track of more than 31 million active loans. That is about 50 percent of all the loans in the United States.

The MERS database is important to the mortgage industry because it is the only centralized registry in the industry that uniquely identifies each mortgage loan.

The MERS database is important to individual borrowers because it provides a free and accessible resource where borrowers can locate their servicers and, in many cases, learn who their note owner is.

The MERS database is important to communities because housing code enforcement officers use it to identify who is responsible for maintaining vacant properties.

The MERS database aids law enforcement in the detection of fraud by tracking liens taken out utilizing the same borrower name, Social Security number, and property.

MERS also performs another key function. It serves as the mortgagee of record or the holder of the mortgage liens on behalf of its members as a common agent. MERS is designated as the mortgagee in the mortgage document, and this designation is approved by the borrower at the closing by signing the mortgage, and then the mortgage is recorded in the appropriate local land records.

Serving as the mortgagee enables MERS to receive and maintain updated information as loan servicers and loan holders change over time because we are the central clearinghouse for receipt of mail pertaining to the mortgage.

One thing that is always clear in a mortgage document is that if the borrower defaults on his or her obligation, the lender can foreclose. If MERS holds the mortgage lien, foreclosures can occur in two ways: either the mortgage lien is reassigned in the land records to the lender holding the note, which is the vast majority of cases, and a lender initiates the action on its own; or MERS initiates the action as the mortgagee of record in the land records. Either way, the note and mortgage come together at foreclosure.

To do this, MERS relies on specially designated employees of its members called certifying officers to handle the foreclosure. To be a MERS certifying officer, one must be an officer of the member institution who is familiar with the functions to be performed and who has passed an examination administered by MERS. Generally, these are the same individuals who would handle the foreclosure if the lender was involved without MERS. The loan file remains with the servicer as it did before MERS.

MERS is not a repository for mortgage documents or promissory notes. MERS derives its revenues entirely from fees charged to its members. It makes no money from foreclosures. And MERS does not decide when to foreclose. Foreclosure must be authorized by the note owner, and it must be done in accordance with our strict rules and procedures which we regularly enforce and refine. For example, it is a key rule that the note must be presented in foreclosure, which some States do not require; and we prohibit the use of loss note affidavits and foreclosures done by MERS once we saw they were being used as an excuse not to produce the note.

Earlier this year, when we became aware of the acceleration in foreclosures, we asked for assurances; and when we did not receive assurances that our rules would be followed, we suspended relationships with some companies. When we discovered that so-called robo-signers might be officers of MERS, we suspended their authority until they could be retrained and retested.

Madam Chairwoman, all of us at MERS keenly understand that while owning your own home is a dream, the American dream, losing that home is a nightmare. As professionals, we are dedicated and deeply dismayed by the current foreclosure crisis. We believe that MERS can be a national tool to better access information about mortgages and provide transparency for consumers.

Most of all, it doesn't just benefit financial institutions, the broader economy, and the government; MERS benefits real people, real homeowners.

Thank you for holding these hearings and inviting MERS to participate.

[The prepared statement of Mr. Arnold can be found on page 91 of the appendix.]

Chairwoman WATERS. Thank you all very much.

I would like to ask a few questions, and I yield myself 5 minutes to do that.

I have here a stack of depositions. In these depositions, your employees—I think except for MERS; I don't think we have MERS—admit to things, including robo-signing, false notarizations, not being trained in how to prepare affidavits, not having manuals to follow on how to complete foreclosure paperwork. The list goes on and on. Each of these depositions are dated well before you initiated your moratorium, started your comprehensive reviews, or issued press releases about the changes you have made to your systems.

My question is, these depositions were taken months ago. What has taken so long to institute changes?

Could I just start with Bank of America? Why did it take so long?

Ms. MAIRONE. Sure. Thank you, Madam Chairwoman.

For the last 2 years, our focus has clearly been on dealing with the extreme volume and capacity requirements and staffing requirements. As we have worked through these issues, our primary focus has been around data and controls as well as serving the customers and the modification as well as foreclosure prevention space.

We were, as a management team, not aware of the inconsistencies around the affidavit process until very recently. Unfortunately, we did have associates who were relying on upstream processes and data controls and ended up signing high volumes of affidavits inappropriately. They did not adhere to the procedures and policies, and we are changing that process significantly as a result and taking this very seriously.

We have also, at the same time, made the decision to halt and pause foreclosures across the Nation in order to ensure that we could do a fairly dramatic review in all State cases, both judicial and non-judicial, to ensure that we are in compliance.

Chairwoman WATERS. Thank you very much.

I am not going to be able to get to each of you to ask you why it has taken so long, but let the record show that it is a real concern that it has taken so long when we have so many of these problems that exist.

I want to put something up on the screen, if I could get some help from the staff. I want to put a price sheet from Lender Processing Services Subsidiary.

This price sheet advertises services like creating collateral files, among other document creation services. We do not know when this price sheet was drafted or for how long it was used, but the very fact that it exists is very alarming.

I did want everyone to address this in their testimony, but I didn't really get that feedback that I thought was necessary to address it. Would you consider document creation in a foreclosure case to be fraud?

Let me just go down really quickly and ask each one of you, starting with Bank of America, just yes or no. Do you consider document creation in a foreclosure case to be fraud?

Ms. MAIRONE. A new document creation to find files, I don't believe that would be fraud.

Chairwoman WATERS. Yes, right down the line.

Mr. MARANO. You raise a good point. Again, we do not use DOCX.

Chairwoman WATERS. Okay. Next.

Ms. MUDICK. Chase does not use DOCX. We have some companies that we have acquired in the last 2 years, Washington Mutual and Bear Stearns, who did, but even for those companies, we stopped using DOCX a year ago.

Chairwoman WATERS. So do you do document creation now? Are you doing that with the companies that you have alluded to?

Ms. MUDICK. No, we do not.

Chairwoman WATERS. Would you consider it fraud?

Ms. MUDICK. I think that the question about when documents are replaced is very specific to the case involved.

Chairwoman WATERS. Okay. Mr. Jones.

Mr. JONES. We also do not use DOCX for those things that are listed on there, on the board. We used them for lien releases for mailing documents, and that was it, and that stopped in January.

Chairwoman WATERS. Do you use any services to do document creation?

Mr. JONES. I think you have to ask, as the previous witness said, exactly what you mean by document creation. We don't fabricate documents for foreclosure.

Chairwoman WATERS. Let me just put it this way: Is creating an entire collateral file fraud? Would you consider that fraud?

I will just move to Mr. Lewis. What about you?

Mr. LEWIS. We do not use DOCX.

Chairwoman WATERS. Do you use anybody to do document creation?

Mr. LEWIS. As the other members have said, it depends on what you mean by doc creation.

Chairwoman WATERS. Let me ask this: Is creating an entire collateral file fraud?

Mr. LEWIS. An entire collateral file that doesn't exist or a reproduction from a database?

Chairwoman WATERS. Let me go to MERS.

You see what the concern is, and we are basically out of time. So let me just go to Mrs. Biggert.

Mrs. BIGGERT. Thank you, Madam Chairwoman.

I have one quick question for Mr. Lewis. You mention in your testimony that you work with Neighborhood Assistance Corporation of America, NACA.

Mr. LEWIS. Yes, ma'am.

Mrs. BIGGERT. We have had some strange things happen in DuPage County. Things have been coming to my office where we received papers faxed to me, and it would be somebody's mortgage papers, their Social Security, a lot of personal information from them, and it has on it to call NACA. Has this happened—these are formal papers for mortgages or for foreclosures.

Mr. LEWIS. I am not aware of what you are speaking of, ma'am, but I would be happy to follow up and get some more information.

Mrs. BIGGERT. If you could, since you work with them. But it is information, and then the clients have signed off the privacy, but this is something that is going around. And it is as if we are supposed to be helping them with their mortgages.

Mr. LEWIS. Just to make sure I am clear, the question that I am following up on is why NACA would send private information to your office?

Mrs. BIGGERT. That is correct.

Mr. LEWIS. I will follow up with that.

Mrs. BIGGERT. Thank you.

Just a yes or no question: How many of you use Fannie and Freddie?

Ms. MAIRONE. At Bank of America, we do, yes.

Mr. MARANO. At GMAC Mortgage, we do as well.

Ms. MUDICK. The same is true for Chase.

Mr. JONES. At Wells Fargo, we service loans for Fannie Mae and Freddie Mac.

Mr. LEWIS. Yes, we sell off to Fannie and Freddie and service groups.

Mrs. BIGGERT. Maybe I should have asked, who doesn't?

Mr. ARNOLD. Fannie and Freddie are very large users of MERS.

Mrs. BIGGERT. And you probably heard my question of Mr. DeMarco asking for more information. Can any of you describe the problems that you have had working with the—and what I am concerned about is the very limited number of Fannie and Freddie approved law firms that process for foreclosures.

Mr. MARANO. I can take that.

We raised the issues with these law firms with both Fannie and Freddie from the very beginning when the issues came to my attention. The issues are really twofold. One issue is simply a lack of capacity. There are a limited number of firms on their list. One of the GSEs in particular has not added a substantial number of firms in more than 2 years, the other GSE has added firms, and now they are both actively adding firms.

The second issue appears to be one surrounding the behavior of their firms. And I would say initially, while there was oversight present, I don't think that they were fully aware of all the activities. And once we assisted them in understanding what our concerns were, they both reacted very quickly.

Mrs. BIGGERT. Anyone else? Nobody has any problems?

Mr. Jones?

Mr. JONES. We have experienced the same as the previous witness.

Mrs. BIGGERT. In a Wall Street Journal article about the issue, I am going to quote here that, "While Fannie conducts regular audits of its approved attorneys, it said that the mortgage servicers that select the firms are ultimately responsible for ensuring that foreclosures are done properly. Fannie also said it was preparing to add more attorneys in Florida." Would you think that is true, that it is the mortgage servicers who are really responsible for the approved attorneys?

Ms. Mairone?

Ms. MAIRONE. At Bank of America, we are requested to use both Fannie and Freddie specific outside counsel. We do so at their direction. We clearly are responsible ultimately for quality of foreclosure, but we are directed specifically to those firms.

Mrs. BIGGERT. Mr. Marano?

Mr. MARANO. Mrs. Biggert, we take responsibility for our actions. However, I would also say that we are using counsel. They are referred to as directed counsel. And we are in a constant battle of managing the timeline of our investors, including Fannie Mae and Freddie Mac, and the needs of our consumers. We do everything we can to facilitate what we can do for the consumers, but it should not be lost on this committee that our investors put enormous pressure on us to follow timelines and processes, and we often push back very hard so that we can meet the consumer's need.

Mrs. BIGGERT. Ms. Mairone, it also talks about your bank as having suspended thousands of foreclosures. Was that due to the limited attorneys or was that a different problem?

Ms. MAIRONE. We have suspended about 102,000 or more foreclosures in judicial States primarily due to the affidavit issue that came up and process improvements, but, at the same time, we are looking at end to end, including foreclosure counsel quality and controls.

Mrs. BIGGERT. Thank you. I yield back.

Chairwoman WATERS. Thank you.

Ms. Kilroy.

Ms. KILROY. Thank you, Madam Chairwoman. And thank you to the witnesses for appearing here this morning. One of the testimonies talked about the hard reality of homeowners who can't afford the mortgages that they engaged in, and that maybe implicitly in that statement is a comment that it really doesn't matter whether the rule of law and due process were filed in moving to foreclose against these homeowners.

I think there is also a hard reality that a lot of investors bought toxic paper, paper that may have been rated by a rating agency as triple A or a viable investment, sometimes not depending on different tranches that were bought. But these investors also are playing a role in the decision of whether to foreclose or not to foreclose. And there are various people who may have conflicting interests. And I think there's also a hard reality here that the Wall Street banks—Lehman's, Goldman Sachs, and others that were encouraging this securitization of mortgages—also played a role in getting this to the place where we are today here; and that perhaps some interests here, like MERS, facilitated all of this to happen, making it easy to get around State requirements for actually filing mortgages and other liens.

My concern really is where should the public interest lie in all of this; whether it should be the community which is seeing mortgages and home values decline; people who maybe have bought a house in these communities and are making their payments, but nevertheless because of what's going on with their neighbors in their neighborhood is finding that their investments now are underwater.

Should we protect the homeowners or should we be looking to be concerned with the investors who have invested in these mortgages and now find those investments not paying off?

One of my concerns is this process of talking to the homeowners about home modifications and engaging the homeowners in making those payments, but at the same time engaging in a dual track in which foreclosure proceedings are already begun against that very same homeowner.

I'm curious about the response from Chase, and Citi, and Bank of America as to whether or not you are engaging in this track, and what you see as the value or who is hurt, who gains, who loses in this dual-track process.

Ms. Mairone, do you want to start?

Ms. MAIRONE. Sure. And you have raised a number of very valid concerns that we share as well. Specifically, to the dual-track piece, our concerns are very specific and include the customer experience along the way. From a customer's perspective, as they move into the foreclose process and then at the same time are reviewed for a modification, that can be extremely confusing. We have worked hard, including putting single point of contact in, and extra communications and to help the customers understand, but nonetheless it continues to be a problem.

At Bank of America specifically, we are re-reviewing the process where we own those loans themselves, to reconsider how we are handling that dual track, to make that potentially a significantly better experience for the customers. Outside of those loans that we own ourselves, which are nearly 80 percent of our portfolio, we are directed by investor requirements to do so. So we do that dual track.

Ms. KILROY. So your role as a servicer with these mortgages is one that goes one direction with the customer, but you have a different obligation to the investors that requires you to move faster on a foreclosure, despite the modification process.

Ms. MAIRONE. That's correct.

Ms. KILROY. Mr. Marano?

Mr. MARANO. As you did raise several good points, what I would like to make sure is clear is that my firm and I believe that foreclosure is a very poor choice in this entire equation. The problem we have as an industry is that the mortgage market is one where you have servicers who service for their own portfolio and also for others. You have a long legacy of rules and securitization processes that were not designed for the current environment.

We actually only own less than 5 percent of the loans that we service. So what we try to do is make sure that we serve the consumer and encourage the investors to do what's right for them, which is to prevent foreclosures.

In particular in the past year, I have attempted to notify investors that the existing private label servicing contracts need to be changed to give us even greater flexibility. We have received virtually no support from that.

Ms. KILROY. Do you think—

Mr. MARANO. What I would hope is that through your efforts and through the efforts of the chairwoman that we can begin a process of rewriting these rules and moving this industry forward. It has been 3 years of this. We need to change the process.

Ms. KILROY. Thank you.

Chairwoman WATERS. Mr. Miller.

Mr. MILLER OF NORTH CAROLINA. Thank you. I'm afraid I missed your testimony earlier, I had to step out, but I understand that the witnesses for servicers earlier this week in the Senate Banking Committee testified that a major reason there were not modifications that reduced principal was the objections of investors, the holders of the residential mortgage-backed securities.

I have heard no such thing from investors. They would like nothing more than to reduce principal on mortgages if that meant that you could avoid foreclosure. It would be far better for them if that was the case. And they further say that they believe the reason the servicers are not doing it is because the servicers have interests that are different from theirs: their interest in avoiding liability, their interest pertaining to second liens. There are different interests in the failure to foreclose—a failure, rather, to modify when it is in their interest to modify is a violation of the fiduciary duty of the servicers to the holders of the residential mortgage-backed securities.

If you contend that investors' objections, that the objection of an investor is a reason for not modifying and reducing principal, can you identify for me and for the committee the investors who have objected? And provide us with documents with the letters that state their objections, with memoranda that state their objections, with e-mails or whatever documentation they have provided you, that they do object and what their objections are. Can you do that for us, Ms. Mairone?

Ms. MAIRONE. Sure. On the modification side overall, what I would say is—

Mr. MILLER OF NORTH CAROLINA. No, I just want you to—would you give us the names, identify those investors who have objected?

Ms. MAIRONE. We can definitely get you the names of investors who do not allow modifications and there are very, very few of those. I think from a principal reduction perspective, that's where it has gotten a little more difficult in those discussions. At Bank of America overall, we do have very specific principal reductions, but do not have it more broadly outside of the HAMP program as well as the hardest hit.

Mr. MILLER OF NORTH CAROLINA. If you could give us those investors and the reason for their objection. As to the rest of you, can you provide that information?

Ms. MAIRONE. Yes.

Mr. MILLER OF NORTH CAROLINA. Okay, I have a lot of nodded heads there that you would get that to us.

Second, there were questions before the last panel, which I'm sure you heard about, whether there was a conflict of interest for servicers of first held by others, owned by others, beneficial owners or somebody else also to own on their own or to be an affiliate of a firm that owned seconds on the same property.

We have also heard about conflicts of interest for servicers or trustees or others involved in servicing securitized mortgages to be affiliated with firms that securitize the mortgages in the first place. They have control of information that's important for litigation that the investors want access to. There should be a fiduciary duty to those investors. They say that they are not getting that information because the servicers or the trustees are protecting affiliates.

Without addressing whether there is a conflict of interest or whether it really results in a breach of fiduciary duties, what possible advantage is there for a servicer being affiliated with a securitizer? Is there—if there's any reason at all not to have them be affiliated, if there is any possible conflict of interest, what is the countervailing consideration that should allow it? Does anyone have a reason? What's the advantage?

Mr. Jones, the name of your firm is Wells Fargo Home Mortgage Servicing. I assume you're an affiliated corporation of Wells; is that correct?

Mr. JONES. That's correct.

Mr. MILLER OF NORTH CAROLINA. Could you not perform all of your functions as well if you were completely independent and not an affiliate of Wells? What's the advantage of being affiliated with Wells?

Mr. JONES. Thank you for your question. Wells Fargo is a full financial services firm. And we offer our banking customers loans, right?

Mr. MILLER OF NORTH CAROLINA. Right.

Mr. JONES. And to do—and the securitization process is important for us to be able to make that happen. We don't own all the loans that we service. Therefore, those customers who come to us, come to us in a bank branch, who have other relationships, want a home loan, we are able to take care of that home loan need and service that loan and work with the bank to make that occur. So it is a customer convenience item for us.

Mr. MILLER OF NORTH CAROLINA. Customer convenience.

Mr. JONES. A customer convenience, absolutely, because our customers who have mortgages with us have many other products as well as banking, etc.

Mr. MILLER OF NORTH CAROLINA. My time has expired.

Chairwoman WATERS. Thank you very much. The Chair notes that some members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

Before dismissing this panel, I would like to say that this hearing is but the tip of the iceberg. We did not get a chance for all of our members to raise their questions they would like to raise.

This business of document production is a serious question. There are other serious questions about MERS and what authority it operates under and whether or not it should be regulated, but I think that we will consult with the chair of our committee and others, so that we can continue to hold hearings so that we can understand better what we can do to help our citizens who are faced with the tremendous problems that they have with foreclosures and other interactions with the bank's financial institutions, the servicers in particular.

Thank you very much. This panel is now dismissed, and I would like to welcome our distinguished third panel.

I am pleased to welcome our distinguished third panel and thank you for being here and thank you for your patience. Our first witness will be Mr. Adam Levitin, associate professor of law, Georgetown University Law Center. Our second witness will be Mr. Anthony B. Sanders, professor of finance, and distinguished professor of real estate finance, school of management, George Mason University. Our third witness will be Ms. Julia Gordon, senior policy counsel, Center for Responsible Lending. Our fourth witness will be will be Ms. Linda Fisher, professor of law, Seaton Hall School of Law. And our final witness will be Ms. Ann Anastasi, president, American Land Title Association.

Let me just alert you that we're nearing the time when we will be called to the Floor and we may have to leave the panel for a short period of time, but let's get started and see how far we can get. We'll start with Mr. Adam Levitin.

## STATEMENT OF ADAM J. LEVITIN, ASSOCIATE PROFESSOR OF LAW, GEORGETOWN UNIVERSITY LAW CENTER

Mr. LEVITIN. Good afternoon, Chairwoman Waters, and members of the subcommittee. My name is Adam Levitin, and I am an associate professor of law at Georgetown University where I teach courses in bankruptcy, commercial law, contracts, and structured finance. I also served as special counsel to the Congressional Oversight Panel, but I'm testifying today solely in my capacity as an academic.

In my prepared statement, I wish to make three points:

First, it's crucial that the committee understand that mortgage servicer incentives are badly misaligned with those of both investors and homeowners.

Second, there are real harms from procedural fraud that should not be ignored. It is not a case of no harm, no foul.

And third, there is a very serious chain of title issue in mortgage securitization that could pose an immense systemic risk to the financial system.

Mortgage servicers' incentives are not aligned with that of investors and homeowners. There are numerous conflicts of interest, but perhaps the most fundamental is that investors want to maximize the value of a loan, whereas servicers merely want to maximize the amount of their fee income. And that fee income does not correlate with the ultimate performance of the loan. So unlike investors, mortgage servicers are indifferent to the ultimate loss on the loan.

Servicers can often make more money in foreclosure than by doing a loan modification. This gives servicers an incentive to foreclose regardless of whether the modification would be value-enhancing for investors. Moreover, servicers' fees and reimbursements are paid off the top from any foreclosure sale proceeds. This gives servicers a strong incentive to lard on junk fees and to in-source foreclosure costs to their affiliates at exorbitant markups. Countrywide, I would note, recently settled with the FTC over precisely such issues.

Servicers are primarily in the transaction processing business. That's a business that's all about automation and economies of scale. There generally would be a stretch to expect servicers to perform lots of successful loan modifications, which require discretion and manpower. But when one considers the misaligned incentives, it is no surprise that loan modifications that depend on servicers have failed miserably.

My second point is that the argument that foreclosure irregularities cause no harm because borrowers are deadbeats is fallacious. First, in many cases the only evidence that the borrower is in default is the false affidavit, so we don't actually know if the borrower is in default. The fact that the servicer initiates a foreclosure action cannot create such a presumption.

Second, there are borrowers in foreclosure who are not in fact in default. And there are others who are in default only because of servicer malfeasance such as misapplication of payments or because of overpriced force placed insurance. We simply don't know how many cases involve real defaults, how many involve servicer-induced defaults, and how many don't involve a default at all.

Third, there are very clear economic harms. The mortgage bargaining involves a bundle of rights, including procedures in the event of default. We know those procedural rights have value because mortgages cost more in States with judicial foreclosures than States with non-judicial foreclosures. In essence, borrowers are paying more to get legal process in judicial foreclosure States. Robo-signing cheats those borrowers of that value, and rampant fraud ultimately undermines confidence in markets generally.

In truth, economic harm is just irrelevant to the issue. Violation of procedure rules is a harm to society that is never excused by the substantive merits of a case. Even if we all know that a defendant is guilty of a heinous crime, that can never excuse perjury or lynching.

Earlier this week, the American Securitization Forum put out a white paper on how residential mortgages are transferred in the securitization process. The paper aims to soothe concerns about chain-of-title issues. The analysis in the ASF white paper is good as far as it goes. It argues that as a generic matter there are two alternate ways mortgage notes could have been transferred to securitization trusts under the Uniform Commercial Code. Unfortunately, the ASF white paper neglects to address that these generic processes are not what actually control in securitization transactions, which leads to four observations:

First, parties are allowed to contract around the Uniform Commercial Code.

Second, residential mortgage-backed securities are issued by trusts, and the transacting authority of those trusts is limited by their trust documents.

Third, the trust documents set forth a more restrictive legal standard than the generic one addressed by ASF.

And fourth, under New York law, which governs most RMBS trusts, failure to comply with the trust documents voids the transaction, meaning the transfer into the securitization trust never occurred.

The trust documents usually require a complete chain of endorsements that document every transfer of the mortgage note before a final endorsement in blank. Unfortunately, it appears that there is widespread noncompliance with the requirements for transfers set forth in the trust documents. The full chain of endorsements is often lacking on notes, and sometimes there are no signatures whatsoever.

I emphasize that these signatures are no more technicalities than that of the borrower on the note. And they are in fact an important part of making the trust assets bankruptcy remote.

Just this Tuesday, in a case captioned Kempf and Countrywide Home Loans Incorporated, a Federal judge in the United States Bankruptcy Court for the District of New Jersey disallowed a securitization trust mortgage claim because the note in question lacked an endorsement and was never delivered to the trustee.

If I may conclude, I would suggest that I want to be clear, I am not saying that there is a systemic problem, I'm saying that there very well could be one, and Congress would do well to be ahead of the ball on the systemic risk rather than behind it. Thank you.

[The prepared statement of Professor Levitin can be found on page 262 of the appendix. ]

Chairwoman WATERS. Thank you.

Our next witness is Mr. Anthony B. Sanders.

**STATEMENT OF ANTHONY B. SANDERS, PROFESSOR OF FINANCE, AND DISTINGUISHED PROFESSOR OF REAL ESTATE FINANCE, SCHOOL OF MANAGEMENT, GEORGE MASON UNIVERSITY**

Mr. SANDERS. Chairwoman Waters, and members of the subcommittee, thank you for the opportunity to testify before you today. The U.S. mortgage market grew at a phenomenal pace from 1998 to 2009 with the GSEs, Fannie and Freddie, and the Federal Home Loan Banks alone accounting for $5 trillion in debt to fund mortgage growth.

As we sit here today, there are over 42 million mortgages outstanding in the United States. Of the 42 million mortgages, approximately 60 percent were securitized or assigned to another party. Loan assignments have occurred in the United States since before the Great Depression, yet only now have Congress and the Administration taken notice of the loan assignments.

What is particularly interesting is the myriad of Federal housing agencies, pseudo agencies, and financial system regulators that have been in existence since the Great Depression. The Federal Government has ignored the fundamental problem of loan assignment regarding location of title or other potential document problems pertaining to foreclosure.

What is the economic harm to borrowers of alleged document defects pertaining to foreclosure? The answer is none. First, the loans are in default. Second, the average length of time for foreclosure and liquidation is over 17 months. If each borrower was living in the dwelling and not paying interest, say $1,000 a month, that translates to $17,000 in lost earnings to the lenders/investors.

Suppose that 3 million are in the foreclosure process. That translates to a potential loss of $51 billion to lenders/ investors over and above the loss incurred by lenders/investors.

Insofar as the foreclosure process takes 17 months, lenders/investors are not receiving any payment for interest and principal and are incurring transaction costs. In the meantime, borrowers are not making payments on the house in which they are still living, effectively receiving over a year of housing rent free.

In the case of loan default, the lender has the right to take the asset and sell it in order to recoup the amount owed if possible. Document defects pertain to foreclosure if material can slow down the foreclosure process. Therefore, lenders/investors have the economic incentive to clear up any material document defects pertaining to foreclosure as soon as possible.

Any proposed solution such as a moratorium on foreclosures with the Federal-State levels represents the dangers of the stability of the housing market. Government intervention in the housing market, such as HAMP and tax credits, have failed to slow and have merely delayed defaults.

The housing market needs to heal and it can only do so if defaulted loans can be brought to the market through foreclosure. Preventing foreclosures extends losses to lenders/investors, and allows nonpaying households to continue staying in the dwelling.

If material document defects were pervasive in the economy, why weren't our regulatory agencies on top of the problem seeking solutions? It is notable that the leading thrifts that securitized loans were Countrywide, Indy Mac, and WaMu, all supervised by the Office of Thrift Supervision, OTS, which is the regulatory body of the thrift industry.

As defaults and foreclosures mounted, OTS should have been painfully aware that the problem of foreclosure could arise if title and accurate supporting loan documentations could not be produced. It should be determined if the OTS was aware of the problem and considered it to be trivial. Or if there was a problem, why did they choose to do nothing about it, or were they just unaware of the problem?

Of course the same question should be asked of the FDIC, the regulated State charter banks, the OCC that regulates nationally chartered banks, and the Federal Reserve that regulates State charter member banks. And then there are the State and bank thrift regulators.

With so much regulatory power were the FDIC, the OCC, and the Fed not investigating the potential foreclosure documents and taking corrective action if it was material? For those solutions I have, all relevant loan documents should be immediately scanned and a digital file created. This file which would be called "securitization packet" would travel with the loan when it is sold. The digitized file could be kept either at the Federal Reserve or private market enterprise with regulatory oversight. The regulatory bodies, whether it's the Federal Reserve, the FDIC or the OCC should develop requirements for the assignment of loans requiring notification of when an entity has purchased a loan or new service is applicable.

That is, the regulatory bodies can either set the standards or work with the industry on setting such standards that would alleviate problems in the future regarding this loan documentation issue. Thank you very much.

[The prepared statement of Professor Sanders can be found on page 323 of the appendix.]

Chairwoman WATERS. Thank you.

Ms. Gordon.

**STATEMENT OF JULIA GORDON, SENIOR POLICY COUNSEL, CENTER FOR RESPONSIBLE LENDING**

Ms. GORDON. Good morning, Chairwoman Waters, and members of the subcommittee. Thank you for inviting me today. And I also want to thank the chairwoman for your tireless attention to these problems in mortgage servicing. If folks had been listening to you all along, maybe we wouldn't keep having this similar hearing over and over.

As we sit here, 2 million families are in the middle of losing their homes. More than 3 million more are on the verge of default. Over the next several years, the toxic combination of unsustainable loans, high unemployment, and underwater mortgages could mean a stunning total of more than 13 million foreclosures. African-American and Latino families are much more likely than Whites to lose their home. And we estimate that communities of color will lose over $360 billion in wealth.

The fate of foreclosed homeowners impacts all of us. Foreclosures bring down home values across-the-board and devastate communities and municipal budgets. Continued weakness in the housing sector hangs like an albatross around the neck of our economic recovery. Things did not need to be this bad. If government had acted quickly and forcefully, we could have significantly limited the fallout. But instead, some policymakers believed servicers' early assurances that they would handle the crisis on their own. When that turned out to be wrong, we provided legislative tools such as the Investor Safe Harbor, we added financial incentives through HAMP and related programs. We cajoled and begged and threatened. None of those strategies has worked. It's quite clear that servicers will not do what needs to be done, unless someone makes them do it. It may be that they can't do it at all under the current structure.

Everyone agrees that homeowners not in default should not lose their home. There is also little disagreement that sustainable loan modifications can keep families in their homes and provide greater returns to investors. Similarly, there is consensus that for vacant homes and situations where the homeowner cannot possibly remain, it is best to move a new family into that home.

With all of this consensus, why are we here today? It's because the servicing system is running an outmoded model, crippled by cross-cutting incentives and overwhelming volume, and it can no longer reliably sort out which foreclosure should happen and which should not. How to get this done right is the crucial question.

Under the exiting dual-track system, borrowers get foreclosed on even when they are in the middle of being reviewed for other solutions. Once in foreclosure, we now know that servicers have been cutting corners and inventing paperwork, sometimes because they simply don't have the recordkeeping ability to do otherwise.

The principal government response to the foreclosure crisis, HAMP, has proved very disappointing. In the face of nearly 8 million foreclosure starts, the HAMP program has produced fewer than half a million permanent modifications. More than 60 percent of borrowers in trouble, though, have had no evaluation of their situation at all, because the fact is the HAMP program has not had what it needed to succeed.

A key part of the original Administration foreclosure prevention plan was to involve the bankruptcy courts who serve as our Nation's comprehensive resolution authority when debt goes bad. Failed subprime originators got bankruptcy protection. So did Lehman Brothers. Bankruptcy courts can modify mortgages on vacation homes, farms, and commercial properties.

If servicers knew that homeowners had bankruptcy court as a backstop, that might have spurred the necessary workouts to happen. But although this Chamber saw that need for reform early, industry pressure derailed the effort. Those bankruptcy laws should still be changed.

In the meantime, let's broaden and enforce a commonsense practice, requiring servicers to review all loans for alternatives to foreclosure, either loan modifications when that makes financial sense, or short sales and deeds in lieu. Most important, let's get that review done before foreclosure proceedings are even started.

To make such a system work in practice, homeowners need a chance to stop their foreclosure if they haven't been properly reviewed. In many cases, homeowners will need access to legal help to do so. Congress should appropriate the $35 million authorized in the Dodd-Frank Act for foreclosure prevention legal assistance. While this is a very small amount compared to what will be spent on the corporate lawyers for the other side, it will make a real meaningful difference for people who can't afford an attorney. In addition, banking regulators should enforce existing roles and establish any additional duties and standards necessary to prevent predatory servicing practices.

I look forward to working with you to make our mortgage servicing system work, both for families and for those who invest in our economy. Thank you for your time and I look forward to your questions.

[The prepared statement of Ms. Gordon can be found on page 219 of the appendix.]

Chairwoman WATERS. Thank you very much.

As I mentioned earlier, we have votes, and we only have a few minutes left. It's very important that our members get up there. Unemployment benefits expansion is on the Floor.

If you would be so kind as to remain, we would like very much to continue to hear from you and to raise some questions. I would appreciate it very much. The committee is in recess.

[recess]

Chairwoman WATERS. We will now resume the hearing.

**STATEMENT OF LINDA FISHER, PROFESSOR OF LAW, SETON HALL UNIVERSITY SCHOOL OF LAW**

Ms. FISHER. I am a law professor at Seton Hall Law School in New Jersey. Part of my duties include teaching a civil litigation clinic in which third year law students and I represent low- and moderate-income borrowers in urban north New Jersey, particularly the Newark area, in cases involving foreclosure defense, predatory lending, and mortgage fraud. I am here largely in that capacity today.

My testimony will focus primarily on one point, and that is a refutation of the argument that we have heard raised many times in recent weeks, including earlier today by one of the members, that it doesn't really matter if servicers committed what are called technical violations of law because the borrowers are in default anyway; so why not just foreclose so they won't get a free house out of the deal.

This argument relies on a number of erroneous assumptions.

First, that virtually all of these people or no more than a negligible number are actually in default. Many are not. We don't know the exact numbers because the system is extremely opaque, as Professor Levitin pointed out a little earlier. There are many, many anecdotes out there. Just a recent media search would raise a lot of those.

And, furthermore, we can reasonably infer from our knowledge of the level of error in the system generally that many more errors must have been made than have come to light of late. Errors include, of course, listing arrears that don't exist in part because payments are not credited in time or inflated fees have been tacked onto amounts due.

As an example of that, a colleague of mine in New Jersey told me just a couple of days ago that recently she has seen many broker price opinions (BPOs) that is, quick appraisals that are done on houses in foreclosure, periodically charged at $800 per BPO when $200 until recently was the going rate.

Second, even if there are defaults, it is far from the end of the story. The law is clear that a default alone does not a foreclosure make. For example, I have recently had a couple of cases where the wrong entity filed a foreclosure alleging it held the note in a trust when it was not a trustee and that did not prove to be the case.

Of course, nobody can deny it is not right that a nonowner of a mortgage can collect on an obligation. Without legal representation, however, I am afraid many of the mistakes are never discovered.

Which leads to a further point, and that is that very, very few borrowers in foreclosure are able to obtain counsel. Until quite recently, well over 95 percent of all New Jersey foreclosures were defaults because counsel was not involved. The numbers have gone down into the 80-plus percent more recently. A lot of this is because legal services offices are overwhelmed, and most people in foreclosure just cannot afford the legal representation that would be necessary to find those valid claims and defenses that do exist.

Another set of examples illustrating what might appear on its face as a default is not necessarily so, involve origination fraud, which can render the obligation itself on the loan void or voidable. Origination fraud was very, very frequent during the peak subprime years of 2004 to 2007. We are still seeing a lot of foreclosures resulting from this because of ARMs resetting.

A few examples from my practice: A mortgage broker loan officer fills in a mortgage application based on mostly fictional information regarding income, assets, and employment without consulting the borrower, resulting in a higher loan amount than they can afford. The application is bolstered by an inflated appraisal, which happened almost across-the-board in the cases I have seen. The borrower doesn't discover this until closing when they may also discover that the actual purchase price of the property is higher than what had been quoted to them. They are told at this point they have to go through with the closing or be liable for the entire amount, which is of course not the case legally. So, pressured, they continue. And they are also told, you can refinance in a couple of years anyway because housing prices always go up.

In conjunction with these practices, I also litigated many claims in the Newark area over the last few years involving a large predatory property flipping and loan operation in which unscrupulous mortgage brokers worked with a developer, a local developer, who would buy distressed houses and do a few shoddy repairs and then flip them at much higher prices to unsuspecting buyers.

In many of these instances, even when the repairs were not done, the flipper would promise the buyers that he would make the mortgage payments on the property until everything was complete and the second and third units in these properties could be rented out. He did not do that. Almost inevitably, these people fell into foreclosure, yet almost all of them had good claims and defenses based on origination fraud.

In appropriate cases, securitizers can be held liable for this as well if they are not holders in due course.

While we did settle virtually all of those claims, it just provides another set of examples of the sorts of things that can go wrong here, and ultimately even if a default occurs, provide valid defenses to foreclosure. These are not technical violations, obviously.

So default is only the beginning of the story. And of course we have heard much today, and in the Senate Banking Committee the other day, about outright fraud in servicing processes. The most prominent examples, of course, include forged signatures and the like over and above legal violations involved when a robo-signing occurs. As a result, I believe we are not going to make any progress here unless serious mortgage modifications are required, including principal write-down in appropriate cases.

I think also independent auditors and monitors should be appointed to review the foreclosure practices and sample loan files of servicers, rather than having them do it themselves. I did hear some testimony that that is starting to be done.

And then, finally, just as an example, a final example of why the modifications are necessary. Last night, a cab driver, when I was coming to my hotel here in D.C., told me he had been trying to get a mortgage modification all year now since his wife lost her job of 14 years late last year. He doesn't want a principal reduction. He wants an interest rate reduction. He can pay. He is making money as a cab driver. But he asked me then, as he is handing a suitcase off to me and I am proceeding to go into the hotel, "Why did we bail out the banks with our tax money when they won't even give us a break, homeowners don't get a break? All I want is an interest rate reduction. Why can't I get that?" Why indeed?

Thank you.

[The prepared statement of Professor Fisher can be found on page 213 of the appendix.]

Chairwoman WATERS. Thank you very much.

We are going to now move to Ms. Anastasi. Thank you for your patience.

**STATEMENT OF ANNE ANASTASI, PRESIDENT, AMERICAN LAND TITLE ASSOCIATION**

Ms. ANASTASI. Thank you. Madam Chairwoman and members of the subcommittee, thank you for your patience today.

I am Anne Anastasi, president of Genesis Abstract, in Hatboro, Pennsylvania. For the past 33 years, I have worked in the land title industry, and I am the current president of the American Land Title Association.

Integrity in real estate transactions is of the utmost importance to the land title industry. I appreciate that you have asked ALTA to testify today regarding the American system of land ownership so that we may better understand the effects of foreclosure irregularities and deficient documentation on housing markets and property rights.

For centuries, our public recording structure has provided transparency, efficiency, and security that is unimaginable in countries where governmental approval is required for the transfer of ownership from one owner to the next. Our system of land transfer provides individuals with a strong protection of their property rights within a relatively short settlement transaction time, saving borrowers and sellers money. This system, combined with the confidence that consumers and lenders have in the work of the land title and settlement service professionals, allows the United States to have the strongest real property transfer system in the world.

The accuracy of the public records is extraordinarily important for this confidence to exist. Land title and settlement service professionals maintain accuracy in our public record by curing defects to the benefit of sellers and buyers and lenders and the public. Our research has found that curing public record defects alone was necessary in over 35 percent of all transactions. This is one of the most valuable services the land title industry offers and is an inherent part of the underwriting process.

As we hear about document irregularities and question the validity and credibility of foreclosures, it is important to make the distinction that the reported problems are about how safeguards that are already built in the legal system were treated. To appreciate whether errors in the foreclosure documentation extend to the public records and what can be discovered in the preparation of a title insurance policy, one must understand what documents are included in the public record and what documents are not.

When consumers purchase a home and finance their purchase with a mortgage loan, three major documents are executed. In our country, real property is conveyed by a private contract most commonly called a deed which conveys ownership from one party to another. This document is publicly recorded. These records are administered by public officials, and they give notice that the property ownership is transferred.

The second document is the mortgage. In some of your States, it is called a Deed of Trust. This document is also recorded in the public records in order to secure the priority of the lender's lien and to give notice to the world that there is a debt on the property.

The third document is the promissory note. It is the personal promise to pay the loan back. And within the promissory note, the principal interest rate repayment schedule and other terms of the loan are noted. The note is not put on the public record for a variety of reasons, most importantly to protect the purchaser's right to privacy.

Whether a property has gone through a judicial or a non-judicial foreclosure, land title agents examine the recorded documents before a title policy is issued. With many of the issues in question today they are not discoverable by simply reviewing the recorded documents.

It is important to note, however, that homeowners and lenders who obtain title insurance are protected under their policy if a claim arises. In addition, title insurers are responsible for the cost of defense for those policyholders if a claim arises.

Let me conclude by saying that while risks appear to be in the foreclosure process, they do not appear to extend to the public records and should not generate a systemic risk to the title industry. However, the title industry, if a policy is purchased, will be responsible to defend the homeowner's property rights at the cost being borne by the title insurers. It is one of the most important parts, most important components of owning a title insurance policy.

In addition, we should not lose sight of the fact that our property transfer system is successful because the work of the land title industry provides the trust and confidence to allow people to buy and sell homes. What is important to note is that homeowners have to understand that buying a lender's title insurance policy at the time they finance does not protect them. They have to understand that in order to have the protection of the industry, and in order to have an insurance company defending their right, they need to have their own owner's title insurance policy.

We are eager to serve as resources and so thankful to be here today. Thank you, Madam Chairwoman.

[The prepared statement of Ms. Anastasi can be found on page 76 of the appendix.]

Chairwoman WATERS. Thank you very, very much.

And, again, I would like to thank you all for your patience and your understanding and your willingness to come here to try and help us figure out what this is all about and what we do, what can we do.

I would like to take 5 minutes and ask a few questions.

I want to ask you to comment on this document production. As I understand it, a lot of the servicers outsource to firms that recreate or reproduce documents. Do you know anything about this and what this means in terms of fraudulent materials being produced in order to have documents that you can then foreclose with because they are not in the system anywhere? What do we know?

Does anybody know anything about this? If so, just speak up. Have you had any experience with this fraudulent documentation production? Do you know anything about it?

Ms. FISHER. I can answer some aspects of that question.

It is not susceptible of an easy answer. I am sure you won't be too surprised to hear that. But in my own practice I frequently litigate against securitized trusts that are attempting to foreclose on my clients. Of course, in order to prove that they have a right to foreclose, they need both, in most cases, to show that they possessed the original note at the time that they filed the foreclosure—otherwise, they lack standing—as well that the mortgage was properly assigned per our State's property law and that other State law, including foreclosure law, was complied with.

I have had a very difficult time getting the documentation in many cases. Sometimes when I do get it, say when I do see the original note, its chain of custody is entirely unclear, even apart from the question whether the PSA was complied with, thus allowing the REMIC requirements to have been met and bankruptcy remoteness to be met.

And apart from the question whether New York trust law was violated, we don't even know whether the original note was possessed at the time of foreclosure. In many cases, it is my understanding that the original notes are kept in a warehouse operated by the originator. The servicer may have access to those. In many cases, the servicer is affiliated with the originator, but that is not necessarily enough to confer standing on a later trust that alleges that it acquired the note and whose documents related to the PSA may indicate that it acquired the note at the time of closing so that it can foreclose.

These problems are enormously time consuming to address in discovery in cases. Part of the reason foreclosures are being held up is because of these. I have had a number of cases where discovery has gone on for at least 2 years, notwithstanding what seemed to be good-faith efforts by all to comply. The level of complexity, the number of agents involved, a servicer's inability to track where things are, where they were, when they were there, so complicates the process that it has almost broken down.

Chairwoman WATERS. Yes?

Mr. LEVITIN. I just want to add a few points to that.

There are, I think, two distinct issues. One is whether documents are lost and, therefore, need to be—there is just a question whether documents are lost. And then secondly is the problem of creation of documents.

The question of whether documents are lost, we have seen an awful lot of so-called lost note affidavits being filed, saying that the purported owner of the note had the note and somehow lost it, "the dog ate my homework" kind of thing. It turns out in a lot of cases the note isn't actually lost, even though the servicer will file an affidavit saying so. It is often that the servicer just doesn't want to bother getting the note. Because the note is not usually in the servicer's custody. Usually, it is in a warehouse in, as Professor Fisher was saying, like Iron Mountain warehouse somewhere outside of Denver. And the servicer doesn't want to have to pay $30 to get the note, and the servicer also doesn't trust his attorneys with the note.

There is very often substitution of counsel in foreclosure cases, and what servicers are very concerned about is if they give the precious original note to counsel and there is substitution of counsel, that note is going to get lost in the transfer and then they are going to have a bigger problem. So rather than trying to solve this problem the correct way, which would be maybe appearing themselves even, in some cases, it seems that either servicers or their counsel have taken some shortcuts and had actual notes counterfeited.

There are a pair of companies that have come to light in this regard. One is a company called DOC–EX, that is "D–O–C-E–X." Now, DOC–EX, it is my understanding that it had some sort of affiliation with a company called LPS. LPS is one of the major sort of service providers to mortgage servicers. They provide everything from the standard software platform used for mortgage servicing to all kinds of document services. LPS apparently shut down DOC–EX as soon as its activities came to light. But you can see floating around on the Internet, and I can't vouch for its voracity, but you can see a DOC–EX pricing sheet. And that pricing sheet has lines for creation of note, creation of mortgage. And $12.95 will buy you a counterfeit—

Chairwoman WATERS. We have it up on the screen today, yes.

Mr. LEVITIN. You can actually see in the official—in the county land records in—let's see which county it is—Nassau County in Florida, you can see an assignment that includes the words "assigned to." Then it says, bogus assignee for interventing assignments whose address is, and then there is a chain of Xs. It seems that someone filed this assignment and didn't bother removing the placeholder language of fill in above the bogus name.

Additionally, there was—just this last week I saw a new story that emerged—there seems to be another DOC–EX-like company based in the Atlanta area which was actually using a counterfeit notary seal made out in the name of the former Fulton County recorder of deeds.

So here is the problem. There is definitely some misbehavior going on in the servicing industry. We don't know the extent of it. And that is kind of what is scary, that we don't know if these are one-off cases or this is endemic.

Chairwoman WATERS. Thank you very much.

Ms. Kilroy.

Ms. KILROY. Thank you very much, Madam Chairwoman. I appreciate the testimony. I thank all of you for joining us this afternoon.

Again, I just see this as a continuing playing out of the greed that Wall Street drove with the securitization, with the rating agencies stamping triple A on stuff that turned out to be junk, a lot of greed driving the system and a lot of mortgages that probably never should have been written, and now we have this big mess.

My State of Ohio is one of the hardest hit States in the country. And it is affecting our local governments, our tax revenues. It is affecting the safety of our communities. It is affecting the values of my constituents whose home might be their single biggest investment and seeing that even though they are paying their mortgage lowered in price because of problems that their neighbors might be having of problems with this whole issue of servicing of mortgages and modifications.

I have engaged in some conversations and letter writing with Treasury regarding the need for legal services, and I so agree with that, Ms. Fisher, that we need to do something to help fund legal aid. And it is a shame that Treasury will not allow the hardest hit funds in all our States to apply some of that money for legal services.

Representative Kaptur has a bill that would address that issue. I hope she introduces it in the next Congress, and I hope that it passes.

And I am also just stunned that, Professor Sanders, that you would be so disregarding of due process and the rule of law. This crisis was brought about when regulators frequently looked the other way. The laws might have been there, but they weren't enforced, that they didn't put real meaning into the laws and regulations that Congress had passed and regulators had enacted. We can't continue to just look the other way and shrug our shoulders.

Yet think about if it had been the government that was doing this and robo-signing stuff and taking property away from individuals, there would be people who would be screaming about that about denial of property rights and not protecting that bedrock principle in our government, that you can't take private property without due process.

But we do have this big mess here right now, and sometimes I think that even though maybe it doesn't affect directly because the borrower might actually be in foreclosure, it might affect an investor who might have lost their investment as well because of these affidavits and these robo-signings and the lack of title and making up documents. So it is not just a borrower in default that might be hurt by this.

And some of the investors, particularly those who hold the most toxic paper, might be holding up loan modifications because they want to get paid and that modification wouldn't hit their lower tranche. And they might actually not have a property interest in that mortgage, but they just don't know who owns it, we don't know where all this paper is. So it really disturbs me, all of this.

I greatly appreciate the suggestions from Ms. Gordon and wholeheartedly wish we would have passed the cramdown that would have allowed the bankruptcy courts to be able to put that pressure on our banking industry to modify mortgages, but, if they didn't, to allow the bankruptcy courts to marshal the assets and to take a look at ownership and to hopefully get a plan so that borrower could protect that home and be able to make payments and stay in that home and do it within the rule of law.

I think we need to fix—I urge Congress to fix the abuses in the securitization industry, the conflict of interest in the servicing industry, and to look for where is the public interest in all of this. The public interest in our communities, our local government, our taxpayers, the people who borrowed money, the people who invested, our banking industry, all of that. I think it is a huge task that we undertake.

Again, I thank you so much for the suggestions that you made. I certainly would like to understand from the panelists if there is one thing that Congress could do in the next Congress what would you suggest that be.

Mr. SANDERS. Let me address this.

First of all, I agree with Mr. Levitin that—I am not saying—being dismissive—that rule of law is not appropriate. I just want to see what it is first. I want to see how many of these loans went into foreclosure by accident. And if that is true, that is terrible. If people were current on their loans and went into foreclosure, that is not a good thing. I absolutely agree. What I was trying to say is, to agree with Chairwoman Waters, is that the government knew about a lot of these problems coming up, although—

Ms. KILROY. But I want to take a look at going forward.

Mr. SANDERS. But I am saying that—

Ms. KILROY. What should Congress undertake going forward to address this?

Mr. SANDERS. I would say a modernization of the lending industry. We are still operating with a lending industry that looks like the Bailey family's S&L in the movie, "It's a Wonderful Life."

Ms. KILROY. I agree with that. If the banking industry and all these servicers had actually done that and advocated for modernization, again, maybe there would have been a fix here within the rule of law. But, instead, corners were cut and law wasn't followed. To allow people to say that they, under penalty of perjury, believe this to be true and just shrug our shoulders at it, I am really bothered by that. But one suggestion, Mr. Levitin?

Mr. LEVITIN. Take the servicers out of the modification business. The servicers are just hopelessly compromised.

Ms. KILROY. Who would do it?

Mr. LEVITIN. I think you have three possibilities. One is bankruptcy courts, and that does not necessarily have to be through Chapter 13.

Ms. KILROY. Right.

Mr. LEVITIN. You could have a streamlined mortgage only resolution process. That would be another way to deal with bankruptcy courts.

The second possibility would be through a government agency, something similar to what we had during the Depression, the Homeowners Loan Corporation, except you don't necessarily have to take the loans to do that.

And the third possibility would be conceivably finding some unconflicted third parties that could—basically outsourcing it, not to the existing servicers. I am not sure who that would be, but in theory that would be a way to pursue it.

Ms. KILROY. Thank you.

Ms. Gordon?

Ms. GORDON. What Congress can do is, short of giving the job to someone else, make the servicers do their job. And which form that takes—the bankruptcy reform is ideal, because it solves every problem out there. It solves the second lien problem. It solves the consumer back end debt problem. It solves the need to have a third party in there overseeing the whole thing. It solves any investor tranche-warfare-type issues. It solves all of that. So it is ideal.

There may be ways to do it other than the way we tried. Whether it is something other than Chapter 13 or there are a bunch of other new ideas floating around there. But, aside from that, we can still require that servicers conduct loss mitigation prior to instituting foreclosure.

Ms. KILROY. If we can let the other two quickly answer, because I think I am out of time here.

Ms. FISHER. I can answer very quickly. I agree with all of Ms. Gordon's suggestion and Mr. Levitin's as well; and, of course, we do need to modernize the banking industry, as Mr. Sanders suggested.

Chairwoman WATERS. Thank you very much.

We are going to go to Mr. Miller now.

Mr. MILLER OF NORTH CAROLINA. Thank you, Madam Chairwoman.

Mr. Levitin just used the term "unconflicted third party." There has been a lot of discussion earlier about whether servicers in fact do have a conflict in servicing mortgages for whom the beneficial lenders are someone else. There seemed to be a lot of conflicts or potential conflicts in all the various roles involved in securitization. At the very least, the interests of the various parties are not identical. Even if it is not always possible to tell exactly how the conflict would play out, the servicer versus the beneficial owners, the investors, who hold the mortgage-backed securities, the trustees, the securitizers or sponsors, whatever the current terminology is. There seems to be a great many potential conflicts there.

What is the advantage? Why should a servicer be an affiliate of a larger financial institution? Why should a trustee be an affiliate of a larger—if they are going to be the ones who control the information that the investors, the people to whom they owe a fiduciary duty, must depend upon information about whether they have a put-back claim against the securitizer, the lender, what sense does it make for them to be an affiliate of the company that may be the defendant in that lawsuit? What advantage?

You heard Wells' representative earlier say that they like to be a full service company, but do you see any advantages in having the same firms play all those roles?

Mr. Levitin?

Mr. LEVITIN. Sure. There are several reasons, and I don't want to represent that these are necessarily all of them. This is just what comes to mind.

The first is that servicing is a countercyclical business to loan origination, that when loan originations are down that means refinancings are down which increases the value of servicing rights. So that is a very good reason to combine servicing with an origination practice.

Secondly, it doesn't necessarily mean you have to service third-party loans. The second thing is to service—keeping servicing secure when you securitize loans, but to keep a pretty good revenue stream while moving the credit risk onto someone else's books.

Another reason is that mortgage servicing rights are very useful to banks as a way to smooth out earnings. Servicing rights are very difficult to value, and, therefore, they are quite easy to manipulate. So if a bank wants to increase earnings in one quarter, it can basically increase the multiples that it uses to calculate its servicing rights or vice versa.

And, finally, there is an aspect of keeping a customer relationship. That the bank may want to have further dealings, often refinancing the homeowner. That was one thing we saw during the housing bubble, was we make you a loan and we are going to try and refinance you 3 months later and get fees on that. And keeping that relationship I think is one reason that servicing is often retained.

Mr. MILLER OF NORTH CAROLINA. Not all those reasons sound like wholesome reasons that we should encourage.

Mr. LEVITIN. They are not, especially mortgage servicing right valuation. If you look at bank failures, quite often there are vastly overvalued mortgage servicing rights on those banks' books.

Mr. MILLER OF NORTH CAROLINA. Ms. Gordon, do you see any— what advantages do you see in allowing servicers to be affiliated with companies doing other things than securitization, most notably the securitizers themselves?

Ms. GORDON. I agree with Professor Levitin about the reasons, and I do think that customer relationship is important. It is also— in some instances in this environment we are seeing a usefulness in that certain investors may be unwilling to come down on the company for its servicing when it is depending on them for originations.

What is missing in all of this is that in this business relationship, unlike many other relationships, such as the origination relationship, calling the homeowner the customer is a little bit misleading. The homeowner does not have the ability to switch servicers if they don't like their servicer. So that is kind of a fundamental problem with using any kind of market analysis here. The customers are just captive. And, again, because this is the home loan which they have no rights in bankruptcy court and there are very little other particular powers, they are disadvantaged vis-a-vis all of the other stakeholders.

Mr. MILLER OF NORTH CAROLINA. Professor Levitin, I notice you are also counsel to the Congressional Oversight Panel. It is striking how much we are groping in the dark for information about this, just as we were for the couple of years before the financial crisis, about how big a deal subprime mortgages and foreclosures really were going to be. The industry was telling us it was nothing to worry about, it was a mild hiccup. And now we are still trying to figure out 2 years later just how big a deal this is. How big a deal are the documentation issues and requirements in the pooling servicing agreements, the PSAs, and the put-back liability that may result from not having the documents required by the PSAs. And it again appears that the information is controlled by a party that has some motive to conceal information if it points to insolvency or significant solvency issues for themselves or for an affiliate.

Is it a problem with systemic risk or identifying systemic risk that the trustees and the servicers are affiliates of the securitizers of the biggest banks?

Mr. LEVITIN. It certainly is. And there is a "Groundhog Day" aspect of this hearing that we are facing the same issues we have been facing for the last 4 years in dealing with foreclosures. And it seems like servicers come up and say, look at all the modifications we have made, even though I think they often double count, the same loan might get multiple modifications. But here we are. Every year we have another set of hearings, and we can add another 2 million foreclosure sales to the count.

I think there is a real problem, information problem, as you identify, that the information that we need to evaluate modification programs, to evaluate chain of title issues and so forth is all in the hands of the servicers who are not going to reveal any of it voluntarily. There is virtually no oversight of servicers.

When you hear that there is a trustee, that is not like a trustee for a child's college fund. These are corporate trustees who have very, very narrow contractual duties and no others. They are not general fiduciaries, and they are paid almost nothing, and they have no incentive to look for trouble, not least because they often have very close business relationships with the servicers.

So we have a situation where we are not going to get the information unless Federal regulators go after it, and there is the problem. And here I very much agree with Professor Sanders. Federal regulators don't want to get this information. They don't want to see if there is a problem because they are too scared that if there is a problem they are going to have to do something about it. And that is rather disturbing. But, basically, this is, let's stick our head in the sand and hope there isn't a problem. Because the prime directive coming out of Treasury is protect the banks. Don't let anything happen that will prevent the banks from kind of recognizing their losses over retained earnings over the next decade. And, unfortunately, I am not sure that is a strategy that is really good for the U.S. economy as a whole.

Mr. MILLER OF NORTH CAROLINA. One of the lessons of the financial crisis is that it is better to recognize problems sooner than later. Thank you.

Chairwoman WATERS. I would like to thank the members who came back and stayed with the committee. I know that a lot of our members are rushing out to get to those airplanes and to get out of here, but I really appreciate your interest in the time that you have put in.

I would really like to thank the panel. You have been here for a long time. You have been very patient. You have been very helpful to us. We recognize that a lot more has to be done, but we want to thank you for looking at what we are attempting to do with loss mitigation work and demanding our legislating, attempting to legislate the work of the servicers.

One of the things that we are finding out that has happened in this industry is, whether you are talking about servicers or MERS, all of these ancillary type businesses popped up with no regulation, and we don't know a lot about them and how they operate, and we keep finding out more and more and more. So not only do I appreciate the attention you have given us already, we are going to call on you to help us as we try and figure this out and make it right for our homeowners.

So thank you all again so very much.

The Chair notes that some members may have additional questions for this panel which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

Before we adjourn, the written statements of the following organization will be made a part of the record of this meeting: The Council of State Bank Supervisors.

This hearing is now adjourned. Thank you all very much.

[Whereupon, at 3:05 p.m., the hearing was adjourned.]

# A P P E N D I X

November 18, 2010

AMERICAN
LAND TITLE
ASSOCIATION

TM

# TESTIMONY OF ANNE ANASTASI ON BEHALF OF THE AMERICAN LAND TITLE ASSOCIATION

## "Robo-Signing, Chain of Title, Loss Mitigation, and Other Issues in Mortgage Servicing."

Thursday, November 18, 2010
10:00 a.m.

HOUSE FINANCIAL SERVICES SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

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My name is Anne Anastasi and I am the President of Genesis Abstract, LLC in Hatboro, Pennsylvania. I have been in the land title insurance industry for 33 years, and I hold Pennsylvania's Certified Land Title Professional designation, which is the highest designation available in the title industry.

I am the current President of the American Land Title Association. ALTA, founded in 1907, is the national trade association and voice of the real estate settlement services, abstract and title insurance industry. ALTA's over 3,800 member companies operate in every county in the country, where we search, review and insure land titles to protect buyers and mortgage lenders who invest in real estate. ALTA members serve as independent, third-party facilitators of real estate transactions. We do not represent the borrower, lender, seller or any other party in a transaction. ALTA members include title insurance companies, title agents, independent abstracters, title searchers and attorneys, ranging from small, one-county operations, to large, national title insurers.

On behalf of ALTA, I appreciate the opportunity to appear before you today and to discuss how improper foreclosure practices by our nation's lenders affect the process of transferring real property in the United States.

**The United States Real Property Transfer System**

Internationally respected economist Hernando de Soto said, "Westerners take [their land ownership system] so completely for granted that they have lost all awareness of its existence." I agree with Mr. de Soto, and to help change that observation, I am going to discuss our system of land ownership so that we may better understand the effects of foreclosure irregularities and deficient documents on housing markets, mortgage finance and property rights.

Mr. de Soto's research finds that systemic poverty in poor countries results from the absence of a formal property rights structure. De Soto argues that economic success in America relies on a clear system of property rights which was developed to meet land owners' needs over the course of American history. This legal system is the basis for economic activity, entrepreneurship and the creation of wealth and capital. De Soto holds,

> You are able to hold, transfer, assess and certify the value of such assets only through documents that have been legally authenticated by a global system of rules, procedures and standards. Ensuring that the relationship between those documents and each of the independent assets they represent is never debased requires a formidable system of legal property

rights. That system produces the trust that allows credit and capital to flow and markets to work[1].

The United States' property transfer system, governed by local public records, provides our economy with the legal underpinning to make homeownership possible. The land title industry fosters the trust necessary in these records so that equity in real property can be exchanged for mortgage credit. This trust, which is taken for granted in our country, is fundamental to our economy and extraordinary to the rest of the world.

For centuries, this public recording structure has provided transparency, efficiency, and security that is unimaginable in countries where numerous steps and government approval is required before real property can be conveyed from one owner to the next. Our system of land transfer has a relatively short settlement transaction time and provides individuals strong protection of their property rights, saving borrowers and sellers money. It is our system and the confidence that consumers and creditors can have in the work of land title and settlement service professionals, which allows the United States to have the strongest real property transfer system in the world.

**What is Title?**

The "ownership" of real estate involves the interest in a bundle of rights relating to the use of, and disposition of real property. This concept is called title, and these rights can be transferred individually or together. Prior owners may have created interests in a property or suffered liens against a property that will affect the interests acquired by a new purchaser. Potential buyers need to know which rights have been removed from or added to the bundle as this will affect the use of the land, and as a result, its value.

Some rights can be removed from the title bundle voluntarily. That is, the owner may agree to sell, give away, or otherwise forfeit a right. Rights that can be voluntarily removed from a bundle include:

1) Rights to natural resources, such as water or timber on the property;
2) Subsurface rights to other natural resources, including mineral and oil rights; and,
3) Air rights, such as the right to construct a building above a certain height.

In addition, rights that can be voluntarily granted and added to the bundle include:

1) Easements to utility companies;

[1] De Soto, Hernando. "TOXIC Paper: The Obama administration must tackle a problem that has bedeviled the emerging markets for years." Newsweek Mar 2, 2009.

2) Joint use agreements, such as common driveways and party walls;
3) Life estates, in which one party other than the owner retains the right to use and occupy a property for the rest of his or her life;
4) Reversionary rights, where title passes back to a previous owner if property ceases to be used for purposes other than those for which it was deeded;
5) Restrictive covenants, in which private parties agree to limit uses of a property – for instance, property restricted to residential use only; and,
6) The rights of consensual lien holders, those who obtain rights through other voluntary agreements, deeds of trust or mortgage for instance.

Other rights may be legally removed regardless of a property owner's wishes as ordered by local, state or the federal governmental authorities and courts. Typical involuntary removal of rights might include:

1. Continued ownership if taxes go unpaid;
2. Bankruptcy court order, forcing the owner to sell land rights to pay off debts;
3. Money judgments, awarded by the courts in civil suits that could result in a foreclosure;
4. Eminent domain, giving the government the right to take land by condemnation for official use or for use by the public;
5. Divorce, allowing courts to divide marital property between the owners or for payment of child support;
6. Mechanics liens, imposed in cases where construction or other types of work have been performed on the property and the contractor hasn't been paid;
7. Zoning laws, imposed by government to prohibit all but a single use of the property;
8. Health and environmental regulations, subdivision, or condominium regulations and flood control requirements may be imposed, forcing the owner to give up certain property rights; and,
9. Improvements from an adjacent property may encroach or intrude on real estate.

In time, a parcel of land may have a number of important rights missing from the bundle which could cause a potential buyer to reconsider the value of the property or their purchase.

**How Does our System Evidence Which Rights are Included in Title?**

Public records document the history of title and reveal the rights that have been removed or added. In our country, real property is conveyed by a private contract – most commonly called a deed. This document is recorded in the county land records to give notice to the public that the property's ownership rights have been transferred. Generally, under state law, courts will not enforce or protect individuals' property rights unless those rights have been recorded in the land records.

As we hear about document irregularities and question the validity and credibility of foreclosures, it is important to make the distinction that the reported problems are in areas of due process. To appreciate whether errors in foreclosure documentation extend to public records and what can be discovered in the preparation of a title insurance policy, one must understand what documents are included in the public record and what documents are not included in the public record.

When a consumer purchases a home and finances their purchase with a mortgage loan, there are three main documents that are executed to transfer title. The first document is a deed, which conveys ownership from one party to another and is recorded on the public record. The deed is a private contract, separate from the purchase contract, and it must contain certain legally-required provisions including: a legal description of the property, a statement describing the rights being sold, and the purchase price. The deed must be signed by the sellers and acknowledged by a notary public. Public recording of the deed allows consumers to protect their property rights, including the right to possess the property against challenge from a subsequent or prior unrecorded claimant to the property.

The second document is the mortgage, also called a deed of trust, which is also recorded into the public record. A mortgage is a lien on the property that notifies the public that there is a mortgage loan outstanding that gives the lender the right to sell the property in order to satisfy payment of a debt. Liens and lien priority are hallmarks of our property rights system. Lien priority is the legal structure that determines which creditor has the right to be paid in which order if a property must be sold to satisfy payment of a debt. This structure assures creditors of their rights when property is used as collateral for payment of a debt. Creditors lending money to finance the purchase of real property require that they will have the first right (lien priority) to foreclose upon the property in the event of default. To do this, the borrower is required to execute a mortgage (or deed of trust), which grants the creditor the right to foreclose upon and sell the property if the borrower defaults on their mortgage obligation. This mortgage is recorded in order to secure the priority of the lender's lien.

The third document is a promissory note, which identifies the principal, interest rate, repayment schedule and other terms of the loan. The note is not publicly recorded for a number of reasons – most importantly to protect the purchaser's right to privacy.

**The Need for Land Title Services**

Before a transaction can be completed, buyers, sellers and mortgage creditors depend on the land title industry to research the public record in order to determine which rights have been removed from the title bundle. In any real estate transaction, the buyer needs to be certain that they will ultimately be acquiring ownership of the property subject only to those liens and encumbrances that they know to exist and are willing to accept.

The seller signs the deed, which will likely contain a general or special warranty deed, in which the seller provides certain warranties of title to the buyer. Thus, the seller is contractually liable to the buyer if those title warranties are not accurate. Therefore, the seller has an interest in ensuring that the title transferred to the buyer will not be subject to any potential claims that could trigger liability under those warranties.

The mortgage lender is willing to provide financing for the transaction on the condition that the buyer, in fact, will own the property and that the mortgage lender will obtain a valid and enforceable first mortgage lien that is not subject to any other lien or claim that could adversely affect that mortgage interest. While various approaches have been used in the history of the United States to provide these assurances, since the late $19^{th}$ century, the gold standard by which buyers, sellers, and lenders obtain these assurances is by purchasing a title insurance policy. To understand the reasons why this has come to be the standard, one must first understand title insurance, its value and how it satisfies important market demands.

The need for land title services has become especially acute as real estate transactions became more complex in the last half of the $20^{th}$ century. In a market where land transfer is so complicated, buyers need to know exactly what interests are included in the bundle of rights that convey with the property.

The process to determine title begins when agents or abstractors search the public records for documents showing who owns the land and which rights have been removed from the bundle. By doing this, agents and abstractors build the chain of title or the specific rights the buyer is or is not receiving with the property according to the public records. The agent or abstractor uses these records to compile a title abstract, which is a condensed version of the records they have searched. The abstract lists the history of title as it appears in the public record, but does not offer an opinion or draw any conclusion as to how the rights, or lack thereof, affect title to the land. This is the "title search," and the information collected is "title evidence." The length of this process can take as little as a few hours to as many as a few weeks, depending upon the complexity of the title, the accessibility of the land records and available technology.

Having collected the title evidence, individuals experienced in real estate law and title insurance principles examine the title evidence to determine whether the seller has, and can convey, his or her title to the buyer. This evidence discloses the liens and other issues that must be resolved or cured, and discloses exceptions that may have to be included in the policy. It is at this "title examination" stage that the title agent performs one of the most valuable services, which is an inherent part of the title insurance underwriting function: curing defects that may exist on the public record.

The accuracy of public records is extraordinarily important for trust to exist. Land title and settlement service professionals maintain accuracy in our public records by curing defects that are found to the benefit of sellers, buyers, lenders and the public. ALTA's research has found that curing defects in the public record was necessary in over 35% of all transactions. Curative actions include obtaining releases or pay-offs of discovered liens such as mortgage liens, child and spousal support liens, judgment liens, tax liens, homeowner's association debts, mechanic liens as well as liens from previous owners that remain on the public record. Curative measures may also include correcting typographical recording and indexing errors in the public record, correcting misspelled names or incorrect legal descriptions.

After the thorough search and examination, a commitment to insure is then sent to the prospective policyholder. The commitment sets forth the conditions that must be met in order for a title insurance policy to be issued, such as additional documents that need to be produced. These documents may include a deed or a new mortgage in favor of the buyer's lender. The commitment reveals the items that need to be resolved before the policy can be issued, and among others, this might include the payoff of mortgages, judgments, liens, federal and local taxes, municipal bills, and child support debts. Also included in the title commitment are the exceptions to the policy coverage that were found during the title search and examination process. These exceptions include rights that the seller cannot convey, such as the right of utility companies to maintain their lines over the land being conveyed.

If an exception poses a problem for the prospective policyholder, an attempt may be taken by the parties, with the assistance of the title agent, to eliminate those exceptions. If an exception cannot be removed, the title underwriter may be willing to insure over it, either because the title underwriter concludes that the risk of loss or financial damage is small, or because an indemnity or warranty can be obtained from the seller. If an exception cannot be removed and the buyer chooses to proceed with the purchase, the buyer may seek to modify the terms of their purchase contract with the seller or, in an extreme case, decline to proceed with the transaction. Because the title industry has been so effective over time in detecting and clearing titles errors and preserving the integrity of the public records, it is exceedingly rare that a seller's title is so defective as to be uninsurable or unmarketable, and while troubled titles may take a great deal of time and resources to cure, most issues are curable. This track record provides exceptional liquidity to U.S. real estate markets.

The last step in the process involves the closing of the transaction and services conducted after the closing. At the closing or settlement, the relevant deeds, mortgage instruments, and other documents are executed and funds are exchanged through escrow. After the closing, the new deed and mortgage lien are recorded, and then the title insurance policy is issued to the lender and the new owner, if an owner's policy is purchased. Between the time the new deed and mortgage are signed and the time that the new deed and mortgage lien are entered into the index of the public records, a gap may occur. The length of this gap period depends on the efficiency of local jurisdiction's recording office, and if another document is recorded "in the gap," a title agent will simply not have the ability to discover the document. For example, in Fairfax County, Virginia, the gap is almost non-existent. However, at one point in my home state of Pennsylvania, the gap in one locality was over 11 months in length. This is particularly troubling to the title insurance industry because the gap in the time between the closing of the transaction and the recording of documents represents an opportunity for fraudulent activity. The fraud risk arises because a dishonest party could convey the same interest in the property a number of times to different people during this gap period, similar to selling the same widget on eBay to multiple bidders. Title insurance provides coverage against this risk. We protect borrowers, sellers and lenders during this vulnerable period of time in order to ensure that the transaction can go through quickly, safely and efficiently.

An owner's policy insures the purchaser against financial loss or damage that may arise from defects in the title as it is insured, including the assertion of liens and claims against the property that are not otherwise excepted from policy coverage. The policy includes protection against title defects that may be found in public records but were not discovered during the search of those records and against those non-record defects that even the most comprehensive search of the records would not reveal. These risks include, among others:

- fraud or forgery in the execution of documents in the chain of title (in deeds, mortgages, mortgage satisfaction pieces, etc);

- mistakes in interpretation of wills, divorce decrees, bankruptcy court directives and other legal documents;
- the execution of documents by minors or incompetent persons who could not legally convey property interests;
- the existence of undisclosed heirs who did not consent to a prior transfer;
- deeds executed under an expired power of attorney or on behalf of someone who has died; and,
- errors.

The title policy is issued for a one-time fee, paid at the closing, and there are no renewal premiums. The protection of an owner's title insurance policy continues so long as the policyholder or his or her heirs own the insured property, and can protect the policyholder even after they sell the property if the buyer later asserts claims under a warranty deed with regard to matters covered by the policy.

A loan policy insures the lender: 1) that it will have a valid, enforceable lien on the property in accordance with the mortgage interest created by the loan, 2) that the person borrowing the money has title to the property being mortgaged, and 3) that no other claimant, other than those specifically noted in the policy has a prior, superior claim. The policy is in force so long as there is a balance due on the loan and is assignable to a purchaser of the loan in the secondary mortgage market.

Under both policies, the title insurer is obligated to pay for the costs of defending the title as insured against any covered claim. In virtually all areas of the country, if an owner's policy is issued in the transaction, the cost of a loan policy that is "simultaneously issued" with the owner's policy involves a relatively small additional charge to the cost of the owner's policy.

The single most important aspect of the title insurance industry that cannot be overlooked is that we are the independent third party to the transaction whose only interest is to the integrity of the transaction and the protection of our customers. We are the people who handle the funds that come from the borrower and the lender and disburse it to the appropriate parties in the transaction. Our job is to close the transaction equitably, honestly and in accordance with the agreed-upon instructions, and to get the funds into the appropriate hands.

**How a Foreclosure Affects the Title Process**

The presence of a foreclosure in the chain of title does not alter the title industry's duty to provide title assurance to parties involved in the transaction. However, the ability of the industry to provide that assurance becomes more challenging when the credibility of the foreclosure process is damaged by process and documentation deficiencies. Allegations of affidavit issues, robo-signing, notary irregularities, or incorrectly endorsed or assigned promissory notes are serious, but stakeholders can work together to resolve any uncertainty and restore credibility to the system equitably. After all, everyone has a stake in the outcome.

Regardless of any deficiency in the foreclosure process, fundamental to our understanding of how foreclosure affects title, we must remember that foreclosure in a judicial foreclosure process results from a court issuing a binding order allowing the foreclosure sale to proceed. A court order by a judge has the force of law. The judgment can only be vacated or corrected if one of the parties to the proceeding makes an appeal or other motion. It is not appropriate for, nor does the land title industry have the power to challenge these judgments or act as a check and balance on the court system.

A foreclosure appears in the title search and evidencing process in three ways. First, when the mortgage creditor institutes a foreclosure suit, they file a *lis pendens* in the public records. This gives the public notice that a foreclosure action is pending against the property. Second, the court docket in the foreclosure action, including the final judgment of foreclosure is available for examination. Third, after the foreclosure sale either the sheriff will issue a sheriff's deed to transfer property to the successful bidder at the foreclosure sale or the court clerk will issue a certificate of title. Whichever form of document the evidence of the foreclosure sale takes, the document is entered into the public record. The three documents discussed above give notice to the world that a foreclosure action was instituted, that a sale was ordered by the court and that the sale occurred. What these documents do not show is any problem with the evidence used to secure that foreclosure order.

As we hear about document irregularities and question the validity and credibility of foreclosures, we need to remember that these are due process issues. They are fundamentally about the fairness of the process, but also its outcome. The question raised by recent media reports is whether the foreclosing party properly evidenced their standing to obtain a foreclosure judgment by a court. Standing is an important due process protection, akin to proving one's identity, as it ensures that the party asking a court to take away another party's legal rights actually has the legal authority to assert a valid claim. Intrinsic problems with the underlying foreclosure documents, whether they are affidavit issues, robo-signing or notary irregularities, are not themselves a title defect; however when these issues are not identified during court proceedings, they allow the credibility of a court order to be called into question, and by extension, they become a title defect. Because these problems are part of the court process, they are properly the responsibility of the judicial system to resolve.

The title industry has no way to discover foreclosure irregularities that are not included in court proceedings or documented in the public record. As such, unlike the curative work to correct errors in the public record that occurs before a title insurance policy is issued, the title insurer or agent cannot cure foreclosure defects. Unlike property and casualty insurance lines, title insurance protects against risks that exist at the time the policy is issued. The underwriting of title insurance operates almost entirely on the basis of identifying, evaluating, and addressing title problems before a policy is issued. It is theoretically possible, through a thorough search and examination of the title, to identify all the record defects (but, of course, not the off-record defects) that may exist and then to address them and either eliminate them, insure over them, or exclude them from coverage. Defects in the foreclosure process, while underpinning the documents that are on the record, are in fact similar to other off-record title defects in that they cannot be discerned until someone appears before a court and challenges title after the policy is issued. Therefore it is impossible to eliminate the defect. Each title insurer must decide whether to exclude foreclosure problems from coverage or insure over them.

Differing risk tolerances in the industry will determine how each insurer chooses to handle transactions involving foreclosure. ALTA believes that an increased risk of losses for title insurers' due to litigation or other costs is minimal because: 1) servicers are undertaking appropriate remedial work at the direction of federal and state regulators; 2) to our knowledge, no foreclosure irregularities have resulted in a claim under a title policy; and 3) there are legal protections for purchasers of REO properties that which I will discuss in detail. Although it is possible that insurer costs could increase through additional litigation costs associated with defending a homeowner's title under their owner's policy, we believe that title insurers will be able to obtain recourse from parties responsible for any deficiency. For these reasons and the strong reserving policies of our prudential regulators and our members, state insurance departments have not required title insurers to take additional steps, and discussion of additional capital reserving is premature.

**Legal Protections for Purchasers of REO Properties**

There are three main protections for consumers who purchase a previously foreclosed property, also called a Real Estate-Owned (REO) property: 1) an owner's title insurance policy, 2) bona fide purchaser for value status, and 3) equitable rights should a court rescind the foreclosure that in all likelihood would result in the homeowner keeping their home and the person who was foreclosed upon being compensated by their lender for their loss.

Under an owner's title insurance policy, a consumer will be protected from challenges against title by a previously foreclosed upon owner of the property. This protection is two-fold. First, the policy covers cost of defense. Thus under the terms of the policy, even if a title challenge is meritless, the title company will step in and assume the cost of litigation, protecting the consumer's right to title until the matter is resolved.

Second, if a title challenge is successful, the policy will cover a claim and make the insured whole up to the insured amount (typically the purchase price). As a note, a consumer can purchase an owner's policy at any time after closing. If a consumer makes substantial improvements to the property which increase its value (as is frequent when a purchasing an REO), they can purchase an updated owner's policy to protect themselves for the new appraised value.

Bona fide purchaser protection, which is codified in state statutes and common law, allows a consumer to take good title despite competing claims if they record their conveyance first and there is no notice of the claims. The triggers for this protection are recordation and notice. Once a consumer purchases the property, their deed is recorded by the settlement agent, meeting the recordation requirement. Under the notice requirement, a consumer must have actual or constructive notice of a specific claim. Actual notice is met when the purchaser knows that the foreclosed upon owner is planning to sue to re-obtain title. Constructive notice is met when notice of a challenge is filed in the public or court records. Media speculation or newspaper articles about a foreclosure deficiency are not sufficient to defeat bona fide purchaser protections.

Should a court decide that the circumstances of a particular case require the foreclosed upon borrower to re-obtain title the property, the traditional court remedy is rescission of the entire foreclosure. When rescinding the foreclosure, the court seeks to place all the affected parties in the same position they were in before the foreclosure occurred. Thus, in theory, the foreclosed upon owner would receive title, the mortgage creditor would have their mortgage reinstated and the innocent consumer who purchased the REO property, would be refunded all the monies that they put into the property. While the innocent homeowner would be harmed by losing title to the property and having to move out of the home, they will not suffer financially, either because the title policy or the court will make them whole. We do not believe that a court would take these steps as it is likely that the previously foreclosed upon borrower, if his or her title is reinstated, will not be able to meet the obligations of the mortgage and would simply face a second foreclosure proceeding shortly thereafter. Rather, the purchaser would keep their home and the person who was foreclosed upon would be compensated by their lender for their loss.

**Electronic Recordkeeping**

Title information found in the title search of the public record and subsequent examination is discovered not by simply finding a document, but also through the tedious study and review of the relevant documents. Each of these documents requires close scrutiny by a trained professional. The signatures, notarizations, and legal descriptions must be reviewed. Often, a right included within the bundle of rights discussed above, is buried in the middle of a paragraph in a document.

Technology can help people to retrieve a document more quickly, but trained professionals must still read and examine each document that is retrieved. Even where documents are found electronically, which are available in 406 of the roughly 3,600 local record-keeping jurisdictions in the country, these documents must still be read, word-by-word to understand the rights that they convey and any limits to these rights.

In addition to electronic public records, the Mortgage Electronic Recording System (MERS) is a valuable tool for our system of property rights that brings efficiency and surety to public records. MERS was created in the 1990's as a response to the time and the cost required to record mortgage assignments in local jurisdictions. As I discussed earlier, the gap between when a document is executed and presented for recordation and when it actually appears in the public record, is the time when mortgage fraud occurs, and this increases the costs and risks for all stakeholders. MERS was created to help reduce the burden on the system and bridge the gap by giving stakeholders the surety to know who owns the mortgage lien.

Title professionals interact with MERS in two ways. First, when conducting the settlement, a title agent receives the mortgage from the lender listing MERS as the nominee for the mortgagee. After the closing, the agent records that mortgage into the public record, thus protecting the mortgagee's rights. A mortgage listing MERS as the mortgagee includes the MERS Mortgage Identification Number on the front page giving the public notice that they can conduct further investigation through the MERS system to identify the mortgagee.

Second, the title agent encounters MERS when they conduct a title search for a sale or refinance transaction. When an agent discovers a MERS mortgage in the chain of title, they know that they need to contact MERS, either through the MERS website or through its toll-free phone number. Using the MERS Mortgage Identification Number, the title agent determines the contact information for the servicer, and then can order the payoff information.

Reports suggest that MERS creates a defect in the securitization process. A potential defect in the securitization process does not create a title claim as a lender's policy is effective as of the policy date. It protects the lender's interest against actions that occurred prior to and including the policy date. Any problems with the securitization occur after the policy date and thus are outside the scope of coverage of a lender's policy.

**ALTA's Response to Recent Controversy**

Soon after initial media reports were published about foreclosure deficiencies, ALTA reached out to industry stakeholders, including Fannie Mae, Freddie Mac and their regulator, the Federal Housing Finance Agency (FHFA) in an effort to restore certainty and confidence in the REO market. On October 1, FHFA announced that Fannie Mae and Freddie Mac were "working with their respective servicers to identify foreclosure process deficiencies and that where deficiencies are identified, would work together with FHFA to develop a consistent approach to address the problems." On that same date, ALTA indicated that it would be "asking lenders to acknowledge that all appropriate procedures have been followed by the lending community before foreclosed properties are resold on the market."

Staff held individual discussions with ALTA members to discuss whether any additional steps should be taken by servicers to ensure that title insurance policies would continue to be issued to buyers of REO properties and their lenders. On October 13, FHFA directed Fannie and Freddie to "implement a four-point policy framework, including guidance for consistent remediation of identified foreclosure process deficiencies. This framework envisions an orderly and expeditious resolution of foreclosure process issues that will provide greater certainty to homeowners, lenders, investors, and communities alike." This direction required servicers to, "take actions as may be required to ensure that title insurance is available to the purchaser for the subject property in light of the facts surrounding the foreclosure actions." On that same date, ALTA indicated that, "Title insurers are looking to lenders to provide appropriate indemnities," and that "we will continue to work with federal and state regulators, Fannie Mae, Freddie Mac and lenders to bring certainty to the marketplace."

ALTA drafted a model indemnity agreement with Fannie and Freddie that acknowledged the insurer's obligation to defend its policyholders in the event of a court challenge to the property's title, and required the servicer to reimburse the title insurer for any costs of defending the title of the purchaser of an REO property. Since that time, because of the remedial work that servicers have undertaken at the direction of federal and state regulators, that to our knowledge no claim under a title policy has yet occurred due to foreclosure irregularities and the legal protections discussed above, parties on all sides have walked away from the concept of special indemnity agreements.

**Conclusion**

ALTA appreciates the opportunity to discuss public records, the land title industry and the effect of the foreclosure crisis on real estate transactions. Bringing stability back to the market for REO properties is essential not just for the title and settlement services industry, but for the nation's economy as a whole. Our country will not see strong economic recovery until we also have a robust housing recovery, and delays in selling REO properties will only add to the already fragile housing market.

Actions like the ones taken by FHFA in its October 13 guidance, servicers in reviewing their foreclosure processes and the courts in scrutinizing servicer practices, are essential for bringing stability back to the market. Transparency protects the integrity of real estate transactions. ALTA is eager to serve as a resource to the Subcommittee and other stakeholders, and I am happy to answer any questions. Thank you.

MERS®
Process loans, not paperwork.™

**REMARKS AND TESTIMONY OF**

**R.K. ARNOLD**

**PRESIDENT AND CEO OF MERSCORP, INC.**

**BEFORE THE**
**SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY**
**HOUSE FINANCIAL SERVICES COMMITTEE**

**NOVEMBER 18, 2010**

1818 Library Street, Suite 300 • Reston, VA 20190 • 800-646-MERS (6377) • www.mersinc.org

# Remarks of R.K. Arnold
# President and CEO of MERSCORP, Inc.
# Before the
# Subcommittee on Housing and Community Opportunity
# House Financial Services Committee

## November 18, 2010

Chairman Waters, Ranking Member Capito and members of the Subcommittee, my name is R.K. Arnold. I am President and CEO of MERSCORP, Inc. Thank you for this opportunity to appear today.

MERS is a member-based organization made up of about 3,000 mortgage lenders. It maintains a nationwide database that tracks changes in servicing rights and ownership interests in mortgage loans. Today MERS is keeping track of 31 million active loans.

The MERS database is important to the mortgage industry because it is the only centralized registry in the industry that uniquely identifies each mortgage loan.

The MERS database is important to individual borrowers because it provides a free and accessible resource where borrowers can locate their servicers, and in many cases, learn who their note-owner is as they change over time.

The MERS database is important to communities because housing code enforcement officers use it to identify who is responsible for maintaining vacant properties.

The MERS database aids law enforcement in the detection of mortgage fraud by tracking liens taken out utilizing the same borrower name, social security number, or property.

MERS also performs another key function: It serves as the mortgagee of record, or the holder of mortgage liens, on behalf of its members as a common agent. MERS is designated as the mortgagee in the mortgage document, and this designation is approved by the borrower at loan closing and then recorded in the appropriate local land records. Serving as the mortgagee enables MERS to receive and maintain updated information as loan servicers and noteholders change over time because we are the central clearinghouse for receipt of mail as mortgagee.

One thing that is always clear in a mortgage document is that if the borrower defaults on his obligation, the lender can foreclose. If MERS holds the mortgage lien, foreclosures can occur in two ways: Either the MERS mortgage interest is reassigned in the land records to the lender holding the note and the lender initiates the action on its own, or MERS initiates the action as the mortgagee of record in the land records.

To do this, MERS relies on specially designated employees of its members, called certifying officers, to handle the foreclosure. To be a MERS certifying officer, one must be an officer of the member institution who is familiar with the functions to be performed, and who has passed an examination administered by MERS. Generally, these are the same individuals who would handle the foreclosure if the lender was involved without MERS. The loan file remains with the servicer as it did before MERS. MERS is not a repository for mortgage documents or promissory notes.

MERS derives its revenues entirely from fees charged to its members—it makes no money from foreclosures. And MERS does not decide when to foreclose. Foreclosure must be authorized by the note-owner (or noteholder), and it must be done in accordance with our strict rules and procedures, which we regularly enforce and refine.

For example, it is a key MERS rule that the note must be presented in a foreclosure, which some states do not require. And we prohibited the use of lost note affidavits in foreclosures done by MERS once we learned they were being used as an excuse to not produce the note.

Earlier this year, when we became aware of acceleration in foreclosure document processing, we grew concerned that some certifying officers might have been pressured to perform their responsibilities in a manner inconsistent with our rules. When we did not get the assurances we thought were appropriate to keep this from happening, we suspended our relationships with those companies.

When we discovered that some so-called "robo-signers" were MERS certifying officers, we suspended their authority until they could be retrained and retested. We are asking our members to provide us with specific plans outlining how they intend to prevent such actions in the future.

Mr. Chairman, all of us at MERS keenly understand that while owning your own home is a dream, losing that home is a nightmare. As professionals who have dedicated ourselves to helping people realize their dream, we are deeply dismayed by the current foreclosure crisis. We take our role as a mortgagee very seriously and we see our database as a key to moving toward better access to information and transparency for consumers.

I am hopeful that as people understand more about MERS and the role we play, they will see that MERS adds great value to our nation's system of housing finance in ways that benefit not just financial institutions, the broader economy and the government, but—most of all—real people.

Thank you for holding these hearings and inviting MERS to participate.

Your invitation letter contained a number of specific questions that you wished to have addressed. For ease of reference, I have appended them to this short statement.

**Testimony of R.K. Arnold**
**President and CEO of MERSCORP, Inc.**
**Before the**
**Subcommittee on Housing and Community Opportunity**
**House Financial Services Committee**

**November 18, 2010**

Chairman Waters, Ranking Member Capito and members of the Subcommittee, my name is R.K. Arnold. I am President and CEO of MERSCORP, Inc. and its subsidiary, Mortgage Electronic Registration Systems, Inc. I appreciate the opportunity to appear before the Committee today to explain what MERS is and isn't, its critical role in our nation's housing finance system, and how MERS has been affected by the current foreclosure crisis.

I have written testimony and an oral statement that has already been delivered to the committee that I would request be made part of the record.

**BACKGROUND**

MERS is owned by the mortgage industry[1] and operated as a membership organization. Almost all mortgage lenders (about 3,000) are members of MERS, though not all members register all the loans they originate on the MERS® System.[2] MERS derives its revenue solely

[1] MERSCORP, Inc. is structured as a privately held stock company. Its principal owners are the Mortgage Bankers Association, Fannie Mae, Freddie Mac, Bank of America, Chase, HSBC, CitiMortgage, GMAC, American Land Title Association, and Wells Fargo. MERS is headquartered in Reston VA.

[2] Members tend to register only loans they plan to sell. Wells Fargo and JP Morgan Chase are the principal members in this regard. They service most of the loans they originate themselves, so registering their retail business on the MERS® System is of less practical value to them. However, when these institutions purchase loans from others, known as their correspondent business, they do require that those loans be registered on the MERS® System.

from its members.[3] MERS charges no fees and makes no money from mortgages, from the securitization or transfer of mortgages, or from foreclosures done in its name.

MERS serves two important functions. First, it maintains a database or registry of mortgage loans, keeping track of changes in servicing rights and beneficial ownership interests over the life of the loan. Second, it can be designated by its members to serve as the mortgagee, or the holder of the mortgage lien, in the public land records. This designation is what enables MERS to maintain its accurate database.

**MERS AND YOUR MORTGAGE**

The mortgage loan process can be confusing and complex to consumers. There is a lot of paperwork generated and many documents to be signed. However, two pieces of paper stand out from the rest as the most important pieces needed so that the consumer can get a mortgage loan. They are: (1) the promissory note, which is a promise by the borrower to repay the loan amount to the lender or noteholder; and (2) the mortgage (also referred to as the "deed of trust" in some states), which establishes a lien against the property as collateral for the loan and allows the lender (or noteholder) to foreclose on the property if the borrower does not repay the loan according to the terms of the promissory note. The person who borrows the money is called the "mortgagor" and the holder of the mortgage is called the "mortgagee." Once the borrower signs both pieces of paper, the borrower receives the money

[3] MERS makes its money through an annual membership fee (ranging from $264 to $7,500) based on organizational size, and through loan registration and servicing transfer fees. MERS charges a one-time $6.95 fee to register a loan and have Mortgage Electronic Registration Systems, Inc. serve as the common agent (mortgagee) in the land records. For loans where Mortgage Electronic Registration Systems, Inc. will not act as the mortgagee, there is only a small one-time registration fee ($0.97). This is known as an iRegistration. Transactional fees (ranging from $1.00 to $7.95) are charged to update the database when servicing rights on the loan are sold from one member to another.

to buy the house. To obtain a mortgage loan, the borrower must agree that the mortgagee has the right to foreclose in the event of a default.

Another important party in the life of a mortgage loan is the loan servicer. The servicer is a company named (by the note-owner) to be the interface between the note-owner and the borrower to collect payments and remit them to the note-owner. It may become the noteholder for purposes of enforcing the terms of the note on behalf of the note-owner.[4]

MERS acts as the designated "common agent" for the MERS member institutions in the land records, which means that MERS holds the mortgage lien on behalf of its members and acts on their behalf as mortgagee. To accomplish this, at the time of the closing, the borrower and lender appoint MERS to be the mortgagee. The designation of MERS is prominently displayed on the mortgage document and is affirmatively approved by the borrower at closing.[5] After the borrower executes the mortgage document, it is recorded in the public land records with Mortgage Electronic Registration Systems, Inc. noted in the index prepared by the recorder (or clerk) as the mortgagee. Mortgage loan information is then registered on the MERS database.

These two key pieces of paper in a mortgage transaction follow very different paths after they are signed. The mortgage (or deed of trust) is recorded in the county land records where an imaged copy is stored.[6] The original mortgage document, with recording data added by the county recorder, is returned to the servicer and goes into the servicer's master loan file.

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4 The originating lender may be the servicer in some cases.

5 A copy of a sample mortgage document can be found in Attachment One. A short summary of MERS prepared by the Mortgage Bankers Association can be found in Attachment Two.

6 This action tells the world that there is a lien against the property. This is done to protect the lender's interest. The recording of the mortgage puts future purchasers on notice of any outstanding claims against the property.

The note is sent to a custodian (usually a regulated depository institution) and is typically bought and sold (and thus trades hands) in the normal course of financial activity.[7] The servicer undertakes the obligations to service the loan, but servicing rights also may move from one servicing business to another because servicing rights are contract rights, which are bought and sold independent of any sale of the promissory note. MERS does not receive or maintain either the mortgage or the promissory note.

Every time a note or servicer changes hands, a notation of that change is made (electronically) on the MERS® System by the members involved in the sale. In this way, changes in servicing rights and beneficial ownership interest in the promissory note are tracked over the life of the loan.[8]

A fundamental legal principle is that the mortgage follows the note, which means that as the note changes hands, the mortgage remains connected to it legally even though it is not physically attached. In other words, the promissory note is enforceable against the property because of the mortgage, but the mortgage instrument itself is not independently enforceable as a debt. This principle is not changed when MERS is the mortgagee because of the agency relationship between MERS and the lender. An agency relationship arises where one party is specifically authorized to act on behalf of another in dealings with third persons, and the legal definition of a "nominee" is a "party who holds bare legal title for the benefit of others." Here,

[7] The promissory note is not (and never has been) recorded or stored with the county land records office. The note is a negotiable instrument that can be bought and sold by endorsement and delivery from the seller to the note purchaser. This activity is governed in all fifty states by the Uniform Commercial Code (UCC) Article 3.

[8] The MERS® System is the database; MERSCORP, Inc is the operating company that owns the database; and Mortgage Electronic Registration Systems, Inc ("MERS") a subsidiary of MERSCORP, Inc., which serves as mortgagee in the land records for loans registered on the MERS® System. For discussion purposes, "MERS" may be used in this testimony to refer to all three entities unless specifically stated otherwise.

the language of the mortgage appoints MERS as nominee, or agent, for the lender and its successors and assigns for the purposes set forth therein. The mortgage also grants MERS broad rights, again as nominee for the lender and the lender's successors and assigns, "to exercise any or all" of the interests granted by the borrower under the mortgage, "including but not limited to, the right to foreclose and sell the property; and to take any action required of the lender." Thus, the language of the recorded mortgage authorizes MERS to act on behalf of the lender in serving as the legal titleholder under the mortgage and exercising any of the rights granted to the lender there under.

MERS members affirm this agency relationship with MERS in their membership agreements, which provide that MERS "shall serve as mortgagee of record" with respect to each mortgage loan that the MERS member registers on the MERS® System and provide that "MERS shall at all times comply with the instructions of the holder of mortgage loan promissory notes."

**THE MECHANICS OF MERS**

MERS tracks mortgage loans through an 18-digit identification number called the Mortgage Identification Number (MIN). With one notable exception, the MIN is to a specific home loan what the VIN (Vehicle Identification Number) is to an individual automobile. Like the VIN, the MIN can be assigned at the earliest stage of the product's creation and stays with it for its entire life. However, unlike cars which all get a VIN, not all loans get MINs and are registered on the MERS® System. This is because some loan originators do not use MERS when they do not intend to sell the servicing rights. About half of all loans active in the United States are registered on the MERS® System.

As the mortgagee of record, MERS receives all notices including legal pleadings on actions pertaining to the property such as foreclosure notices and complaints, tax sales and eminent domain actions, among the many other types of mail. MERS forwards those documents electronically to the relevant servicer who will then take the appropriate action to respond on behalf of the note-owner and MERS.

MERS plays an important role for borrowers as the permanent link between borrowers and their servicers. If servicers change or if they declare bankruptcy, the borrower always has a knowledgeable point of contact in MERS. A toll free number, the unique Mortgage Identification Number (MIN) and mailing address are prominently included on the first page of the mortgage document. MERS also maintains a website, which serves as another resource for borrowers. MERS is also a means by which the borrower can easily identify the note-owner.[9]

MERS is not part of the decision-making process as to which mortgage loans the lenders make to borrowers, nor is MERS part of how mortgage loans get securitized. It is the note-owner who decides whether a note should be sold, or transferred to a trust, or ultimately securitized with a pool of other loans.[10] Loans were securitized long before MERS became

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[9] The design of the MERS® System always anticipated and required that borrowers would be able to access the system to determine the servicer of their loans. Providing such information to MERS is a requirement of membership and loan registration. When Congress acted last year to require that borrowers be told when their note is sold and the identity of the new note-owner, MERS established, within a matter of weeks, a new service called Investor ID. Of the 3,000 members of MERS, 97% agreed to disclose the identity of the note-owner through the MERS® System. Fannie Mae opted to be disclosed. Freddie Mac chose not to be disclosed.

[10] The issue of whether transfers of residential mortgage loans made in connection with securitizations are sufficient to transfer title and foreclosure rights is the subject of a "View Point" article entitled "Title Transfer Law 101" by Karen Gelernt that appeared in the October 19, 2010 edition of the *American Banker*. A copy can be found in Attachment Three.

operational, and in fact, there are loans in securities today that do not name Mortgage Electronic Registration Systems, Inc. as the mortgagee. What MERS does is eliminate the expense of repeated assignments, resulting in lower cost for lenders when they sell the loans (represented by the promissory note) to investors. When the note is sold, MERS continues to act as the mortgagee for the new noteholder because the mortgage interest follows the note when it changes hands.

**OTHER FACTS ABOUT MERS**

The number of loans registered on the MERS® System is substantial. Since its establishment in 1997, about 66 million loans have been registered and tracked on the MERS® System. About half of those loans (about 31 million) are active mortgage loans.

Measured by direct employment, MERS is a relatively small organization. About 50 people work for MERSCORP, Inc. in our Reston, Va. office. Hewlett-Packard is the MERS technology partner and runs the database with an additional 150 people.

In significant ways, MERS is analogous to the Depository Trust and Clearing Corporation (DTCC) that electronically records the assignment of stock and bond certificates, thus eliminating the need to create a new certificate each time a security is bought or sold. The benefit of MERS is similar to that of the DTCC: It reduces the errors associated with paper processes and increases system efficiency.[11] Also like the DTCC, MERS is adjacent to the systems that create the data it tracks; it is integrated with, but independent of, its member

[11] A 1993, 36-page white paper entitled "Whole Loan Book Entry Concept for the Mortgage Finance Industry" addresses the concepts underlying MERS and the problems it was designed to address. It is available upon request.

organizations. The two primary differences between the organizations are that the DTCC holds title to the financial instrument and that it clears trades between its participants (including the exchange of funds between the counter-parties).

**MERS CERTIFYING OFFICERS**

Mortgage Electronic Registration Systems, Inc. takes the majority of its actions as the mortgagee through the use of officers commonly referred to as "certifying officers." From inception, the concept of certifying officers has always been fundamental to the operations of MERS. In the white paper calling for the creation of MERS (referenced in footnote 11), it was recognized that members would need to have a form of authority to act on behalf of MERS when MERS is the mortgagee on their behalf. That authority took the form of electing persons (designated by the member) as officers with limited authority to take certain actions. The offices to which each of these individuals are officially appointed are vice president and assistant secretary. The authority granted to these officers is limited to: (1) executing lien releases, (2) executing mortgage assignments, (3) initiating foreclosures, (4) executing proofs of claims and other bankruptcy related documents (e.g., motions for relief of the automatic stay), (5) executing modification and subordination agreements needed for refinancing activities, (6) endorsing over mortgage payment checks made payable to MERS (in error) by borrowers, and (7) taking such other actions and executing documents necessary to fulfill the member's servicing duties.

It is important to note that the certifying officers are the same officers whom the lenders and servicers use to carry out these functions even when MERS is not the mortgagee.

MERS has specific controls over who can be identified by its members as a certifying officer. To be a MERS certifying officer, one must be a company officer of the member institution, have basic knowledge of MERS, and pass a certifying examination administered by MERS.

Under the corporate law in Delaware (where MERS is incorporated), there is no requirement that an officer of a corporation also be an employee of that corporation. A corporation is allowed to appoint individuals to be officers without having to employ those individuals or even pay them. This concept is not limited to MERS. Corporations cannot operate without officers; they can and often do operate without employees. It is not uncommon for large organizations to have all its employees employed by an operating company and for those employees to be elected as officers of affiliated companies that are created for other purposes (all corporations are required by law to have officers to act for it). Even for loans where MERS is not the mortgagee, employees of the servicer are generally delegated the power to take actions (e.g., initiate foreclosures) and execute documents (e.g., lien releases and assignments) on behalf of the owner of the loan (and the servicer, in turn, may further delegate such authority to a third-party vendor).

**MERS AND FORECLOSURE**

When Mortgage Electronic Registration Systems, Inc. is the mortgagee of record, and the borrower is in default on the mortgage, and the note-owner decides to foreclose, foreclosure can be undertaken in one of two ways: Either in the name of MERS, or in the name of the noteholder (which is usually the servicer).

If the noteholder chooses to foreclose in its own name, under the MERS rules, it must be named as mortgagee in the land records. MERS, through the MERS member's designated certifying officer, will execute an assignment to the foreclosing company and the assignment will be recorded in the land records. At this point, MERS no longer holds any legal interest in the mortgage, and it plays no further role in the foreclosure process. Most loans are assigned out of MERS in this way and not foreclosed in the name of MERS.

If the note-owner chooses to have Mortgage Electronic Registration Systems, Inc. foreclose, then the note-owner endorses the note in blank (if it has not already done so), making it bearer paper, and grants possession of the note to a MERS certifying officer. This makes MERS the noteholder. Since MERS is already the mortgagee in the land records, MERS is now able to legally begin the foreclosure process on behalf of the note-owner. The foreclosure is managed entirely by the member institution's MERS certifying officer. This person typically works in the default department within the MERS member institution so they are familiar with the various state foreclosure requirements. The member manages the relationship with the law firm that is handling the foreclosure. The member retains the law firm on behalf of MERS and the member provides the necessary documents and information to the law firm. The member obtains these documents and information from the servicing files and system, which are maintained by the member.

As noted earlier, the MERS certifying officers are the same employee officers who handle foreclosure functions for the MERS member institutions. Whether a foreclosure is initiated in the name of MERS and handled by the certifying officers, or by the lender in its own name, the same people would be doing the work. Likewise, the loan file remains with the servicer as it did before MERS existed. MERS is not a repository for mortgage documents or promissory notes.

It is important to note that Mortgage Electronic Registration Systems, Inc. only initiates foreclosure when it has been instructed to do so by the servicer (acting on behalf of the note-owner) or directly by the note-owner. MERS has strict rules and procedures governing foreclosure, most notably a requirement that the certifying officer be in possession of the mortgage note when foreclosing in the name of MERS. In addition, pursuant to a 2006 MERS membership rule, no foreclosures in the name of MERS are allowed in the State of Florida. In the event a MERS member contracts out foreclosure operations to a vendor or a law firm, a separate contract is entered into by MERS, the MERS member and the contracted firm for the purpose of establishing our understanding of the obligations of the parties and for the purposes of designating certifying officers. The specific, authorized functions of MERS certifying officers are enumerated in a corporate resolution by which MERS makes the appointment.

Because there is a choice whether a foreclosure is done in the name of the servicer, note-owner or MERS, one might wonder if there is an advantage in choosing one way or the other. The advantage to institutions by foreclosing in the name of MERS is that they do not need to record an assignment from MERS to themselves, saving them time and money. The advantage that some lenders see in not foreclosing in the name of MERS is that the MERS rules are strict and require that the note be produced. If the lender does not want to do this, the MERS member cannot commence a foreclosure action in the name of MERS, but must assign the mortgage out of MERS. This is a major reason why most loans are not foreclosed in the name of MERS.

In 2005, when it became apparent to us that foreclosures undertaken in Florida were relying excessively on lost note affidavits, MERS adopted a rule forbidding the use of lost note affidavits when foreclosures were done in the name of MERS in Florida. That rule was extended nationally in 2006 and is still in effect today. MERS believes that borrowers are entitled to know that the company foreclosing has all of the necessary paperwork and rights to do so. Showing up with the original note provides the borrower and the court with proof that the foreclosing company is the proper party to foreclose.

**COMMON QUESTIONS ABOUT MERS STRUCTURE AND ROLE IN MORTGAGE MARKETS**

When servicing rights or promissory notes are sold for loans where MERS is not the mortgagee, the usual practice is for the seller to execute and record an instrument assigning the mortgage lien to the purchaser (commonly referred to as an "assignment"). Assignments are not required by law to be recorded in the land records. The primary reason assignments are recorded (in cases where MERS is not the mortgagee), stems from the appointment of servicers to administer the loan on behalf of the mortgage loan owner. In which case, the servicer will be assigned the mortgage lien (thus becoming the mortgagee) in order to receive the service of process related to that mortgage loan. When Mortgage Electronic Registration Systems, Inc. is the mortgagee (i.e., holds the legal title to the mortgage lien), there is no need for an assignment between its members because MERS is the common agent for them. It is not the case that the assignments are now being done electronically through the MERS® System instead of being recorded in the land records. The need for an assignment is eliminated because title to the mortgage lien has been grounded in MERS. Moreover, transfers of mortgage notes and servicing rights are not recordable transactions (and have never been reflected in the land records) because they are not a conveyance of an interest in real property that is entitled to be recorded; only the transfer of the lien is a conveyance. A promissory note is sold by endorsing the note, and delivering it to the purchasers. Servicing rights are non-recordable contracts rights. Mortgage Electronic Registration Systems, Inc. remains the mortgagee regardless of the number of these non-recordable transfers that may occur during the life of the loan. Upon such sales, the seller and purchaser update the MERS® System of the transfer with an "electronic handshake." If the purchaser does not confirm the transaction, it is flagged by the MERS® System for follow-up. MERS also audits its members for the accuracy of the information they provide to the MERS® System.

The only reason servicers needed to appear in the county land records before MERS was so they could receive legal notices pertaining to the property. That role is now played by MERS as their common agent. MERS runs a massive mailroom and help desk operation to handle millions of legal notices for its members, which makes it far more efficient and certain that mail will go to the correct place. Today, if a servicer "boxes up" in the middle of the night and disappears, the homeowner can have confidence that legal notices will be delivered to the correct successor company without delay.

The chain of title starts and stops with Mortgage Electronic Registration Systems, Inc. as the mortgagee. MERS, as the agent for the note-owner, can hold legal title for the note-owner in the land records.[12] The basic concept of a recording statute is that a person or company

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[12] The essential elements of the legal principles underlying MERS can be found in "MERS Under Attack: Perspective on Recent Decisions from Kansas and Minnesota," an article by Barkley and Barbara Clark in the February 2010 edition of *Clark's Secured*

claiming an interest in land protects its interest by recording that interest at the county recorder of deeds office. The recorded document provides constructive notice to the world of the claim. In many states, there is no requirement that a conveyance of real estate must be recorded in the land records. The concept of nominees appearing in the land records on behalf of the true owner has long been recognized. It has never been the case that the true owners of interests in real estate could be determined using the land records.

The use of MERS is in compliance with the statutory intent of the state recording acts. When MERS is the mortgagee, the mortgage is recorded at the county land records, thereby putting the public on notice that there is a lien on the property. As the 1993 white paper describing MERS makes clear, at certain time periods, the flow of assignments were overwhelming the county recorder system, resulting in long backlogs, and in some cases, taking the county recorder over a year to record an assignment. Now that assignments are eliminated because a common agent like MERS is holding the mortgage lien, the land records can operate more efficiently. Multiple assignments can lead to errors and uncertainty in the chain of title because assignments were often missing, incomplete, inaccurate, or misfiled. In situations where the recorded assignment identified the wrong property, the lender had not perfected its lien on the right property but had clouded the title for some unrelated third party.

The MERS® System also complements the county land records by providing additional information that was never intended to be recorded at the county level, namely the information about the mortgage loan servicer, and now, with the addition of MERS® InvestorID, the name of the investor.

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*Transactions Monthly*. A copy of this article can be found in Attachment Four.

Some have raised questions about the reduction of recording fees that has accompanied the elimination of the need to record assignments, and there have been suggestions that these fees are somehow owed or outstanding. Fees are paid for a service performed, and if a document is eliminated because it is no longer legally necessary, no fee is due and owing because there is nothing to record. Another way to look at it is that, because MERS greatly reduces the workload of county recorders, the lower operating expenses of the county recorder's office offsets the loss in fee income. Moreover, it would be the borrower, and not the lender, who ultimately pays the costs of recording assignments, either directly or indirectly.[13]

The use of MERS is based on sound legal principles. Its legal validity has been upheld as it was in the Cervantes, Jackson and In re Tucker cases, to just name a few. While there is much support by courts for the MERS role as a common agent, there have been cases where there have been evidentiary issues, which have resulted in outcomes that do not always let MERS, or its members, foreclose without going back and proving up the right to take action. States have laws that govern foreclosures[14] and when the process is not followed, it can, and should result in a court not allowing it to go forward. In some of these cases, judges wanting more evidence or information about MERS have made comments about MERS. In light of the recent foreclosure crisis, it is probable that MERS will continue to be challenged. But we are confident

[13] On loans originated by correspondent lenders or brokers (where MERS is not the mortgagee), the costs of preparing assignments and the associated filing fees are listed on the HUD-1 and paid directly by the borrower.

[14] Individual states handle real estate foreclosures differently. In some states the foreclosure process is judicial, and in some states it is non-judicial. Under both systems, time frames and terms vary widely from state to state. A brief, general, description of both processes prepared by the Mortgage Bankers Association can be found in Attachment Five.

that when courts are provided with all of the facts, MERS will continue to prevail.[15] A MERS case law outline (current through October 20, 2010) is available upon request.[16]

**MERS CONTINUES TO IMPROVE ITS PROCESSES**

In 2009, when it came to our attention that some employees designated by member institutions to serve as MERS certifying officers were not entrusted by their own institutions with signing authority, MERS enhanced its procedures to require that each MERS certifying officer be a company officer of the member institution. In addition, MERS has developed a primer containing information to be reviewed by each prospective MERS certifying officer. To test this knowledge, MERS instituted an online examination to make sure prospective certifying officers had a basic knowledge of MERS and of their roles and responsibilities as MERS certifying officers. MERS requires that these certifications be renewed annually, and we also instituted a recertification process for current certifying officers who had been designated prior

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[15] Some important recent cases upholding the rights of MERS include:

- **IN RE Mortgage Electronic Registration Systems (MERS) Litigation**, a multi-district litigation case in federal court in Arizona where the court issued a favorable opinion, stating that "The MERS System is not fraudulent, and MERS has not committed any fraud."
- **In re Tucker** (9/20/2010), where a Missouri bankruptcy judge found that the language of the deed of trust clearly authorizes MERS to act on behalf of the lender in serving as the legal title holder.
- **Mortgage Electronic Registration Systems, Inc. v. Bellistri**, 2010 WL 2720802 (E.D. Mo. 2010), where the court held that Bellistri's failure to provide notice to MERS violated MERS' constitutional due process rights.
- **Taylor v. Deutsche Bank Nat'l Trust Co.**, So. 3d, 2010 WL 3056612 (Fla. 5th DCA 2010), where the court held the MERS mortgage to be valid under Florida law, and held that MERS may assign its rights in the mortgage to the foreclosing company who holds the note. The Florida court also held that where MERS is described as the "mortgagee under the Security Instrument" the document grants to MERS legal status under the UCC, which MERS can assign to the foreclosing bank.
- **Deutsche Bank Natl. Trust Co. v. Traxler**, 2010-Ohio-3940, where the Ohio Court of Appeals recognizes MERS' authority to assign a mortgage when designated as both a nominee and mortgagee.
- **King v. American Mortgage Network, et al.**, United States District Court, District of Utah, Northern Division (Case No. 1:09-CV-125 TS), where the court, interpreting the language of the deed of trust, held that MERS had the authority to initiate foreclosure proceedings, appoint a trustee, and to foreclose and sell the property.

[16] A review of the use of MERS in all fifty states was done by Covington and Burling in 1996 and 1997 as part of the due diligence associated with the creation of MERS. It is available upon request.

to establishment of the online examination. MERS will continue to enforce these policies and refine its testing and certification program in recognition of the responsibility involved in initiating a foreclosure on someone's home.

When we saw actions were being undertaken to accelerate foreclosure document processing, we became concerned that certifying officers might be pressured to perform their responsibilities in a manner inconsistent with the MERS rules. When we did not receive the assurances we thought appropriate that this would not happen, we suspended relationships with some prominent players involved in the foreclosure process.

When we discovered that some "robo-signers" were MERS certifying officers, we contacted those certifying officers and suspended their authority. They will not be recertified until they retrain and submit to reexamination, and the members who employed them provide MERS with a plan on what will be changed within their companies to prevent this from happening again.

The MERS management team is committed to the highest standards; we believe that MERS adds great value to our nation's system of housing finance in a way that benefits financial institutions, borrowers and the government. There are many benefits derived from the MERS database:

- The MERS database is available to borrowers to locate their servicers, and in many cases, to identify note-owners.
- For local communities, MERS has become a much-needed link between code enforcement officers and the servicing community to help combat the blight that vacant

properties bring to neighborhoods. Over 600 government institutions (cities, municipalities and states) utilize the MERS® System for free to look up the property preservation contacts for loans registered on the system. This helps save the code enforcement officers much needed time in searching for the company directly responsible for the upkeep of that vacant property.

- For law enforcement agencies, MERS aids in combating mortgage fraud through the detection of undisclosed multiple liens taken out by fraudsters for the same social security number or property.

Also, with MERS, lien releases occur quickly at the time of payoff for borrowers because there can be no break in the chain of title with MERS. And finally, foreclosures in the name of MERS are not allowed without the note.

**IDEAS FOR THE FUTURE**

The MERS database, coupled with the Mortgage Identification Number, is a powerful tool that can be harnessed by the Congress and the industry to improve the mortgage finance system. There are a number of ideas that are worth considering so that when we emerge from this current crisis we have a housing finance system that meets our needs.

1. All residential home loans should be uniquely identified and tracked on a national database, which should include:
    a. Who is the borrower?
    b. What/Where is the property?

   c. Who is the owner of the loan's promissory note (the originator/investor)?
   d. Who is the servicer of the loan (the mortgage company)?

2. The cost of registration for the loan should be included with the other origination fees and disclosed on the HUD -1 at closing.
3. The national database should also track who has physical custody of the original promissory note (the mortgages are always available in the county land records).
4. The database should reflect both current and historical information regarding the home loan.
5. The national unique identifier should be a full life-of-loan identifier, from origination through final satisfaction (payoff) and lien release.
6. All federal data systems that deal with home loans should be required to integrate the unique national identification number, so that information regarding loans can be linked across multiple data sources, e.g., the FHA should be able to look at HUD data, and FDIC should be able to look at SEC information, always knowing that they are comparing apples to apples. State and local government agencies should also be encouraged to adopt the number.

Mr. Chairman, all of us at MERS keenly understand that while owning your own home is a dream, losing that home is a nightmare. As professionals who have dedicated ourselves to helping people realize their dream, we are deeply dismayed by the current foreclosure crisis. We take our role as a mortgagee very seriously and we see our database as a key to moving toward better access to information and transparency for consumers.

I am hopeful that as people understand more about MERS and the role we play, they will see that MERS adds great value to our nation's system of housing finance in ways that benefit not just financial institutions, the broader economy and the government, but—most of all—real people.

Thank you for holding these hearings and inviting MERS to participate.

**ATTACHMENTS:**

1) Sample mortgage document
2) MBA Fact Sheet on MERS
3) "Title Transfer Law 101," by Karen Gelernt, *American Banker*, October 19, 2010
4) "MERS Under Attack: Perspective on Recent Decisions from Kansas and Minnesota," by Barkley and Barbara Clark, *Clark's Secured Transactions Monthly*, February 2010
5) "Judicial Versus Non-Judicial Foreclosure," Mortgage Bankers Association, October 2010

**ATTACHMENT 1:**

**SAMPLE MORTGAGE DOCUMENT**

**This is an Example of a Mortgage which names MERS as the Original Mortgagee (MOM Document).**

**Prepared by or under the supervision of:**

*[Name of Natural Person]*

*[Street Address]*

*[City, State Zip Code]*

**The MERS 18-digit MIN must be visible on the Security Instrument. Place the MIN to the right of the form title, but not within the top recording margin or on the right margin.**

*[Space Above This Line For Recording Data]*

# MORTGAGE MIN: 1000XXX-XXXXXXXXXX-X

**DEFINITIONS**

Words used in multiple sections of this document are defined below and other words are defined in Sections 3, 11, 13, 18, 20 and 21. Certain rules regarding the usage of words used in this document are also provided in Section 16.

**(A)** **"Security Instrument"** means this document, which is dated , together with all Riders to this document.

**(B)** **"Borrower"** is

**MERS as the Original Mortgagee language. See page 3 of this document to note further reference to MERS as Mortgagee.**

. Borrower is the mortgagor under this Security Instrument.

**(C)** **"MERS"** is Mortgage Electronic Registration Systems, Inc. MERS is a separate corporation that is acting solely as a nominee for Lender and Lender's successors and assigns. **MERS is the mortgagee under this Security Instrument.** MERS is organized and existing under the laws of Delaware, and has an address and telephone number of P.O. Box 2026, Flint, MI 48501-2026, tel. (888) 679-MERS.

**(D)** **"Lender"** is .

Lender is a organized and existing under the laws of . Lender's address is

**(E)** **"Note"** means the promissory note signed by Borrower and dated . The Note states that Borrower owes Lender

Dollars (U.S. $ )

plus interest. Borrower has promised to pay this debt in regular Periodic Payments and to pay the debt in full not later than .

Initials: ______ ______ ______

**This is an Example of a Mortgage which names MERS as the Original Mortgagee (MOM Document).**

**(F)** **"Property"** means the property that is described below under the heading "Transfer of Rights in the Property."

**(G)** **"Loan"** means the debt evidenced by the Note, plus interest, any prepayment charges and late charges due under the Note, and all sums due under this Security Instrument, plus interest.

**(H)** **"Riders"** means all Riders to this Security Instrument that are executed by Borrower. The following Riders are to be executed by Borrower *[check box as applicable]*:

☐ Adjustable Rate Rider
☐ Condominium Rider
☐ Second Home Rider
☐ Balloon Rider
☐ Planned Unit Development Rider
☐ Biweekly Payment Rider
☐ 1-4 Family Rider
☐ Revocable Trust Rider
☐ Other(s) *[specify]*

**(I)** **"Applicable Law"** means all controlling applicable federal, state and local statutes, regulations, ordinances and administrative rules and orders (that have the effect of law) as well as all applicable final, non-appealable judicial opinions.

**(J)** **"Community Association Dues, Fees, and Assessments"** means all dues, fees, assessments and other charges that are imposed on Borrower or the Property by a condominium association, homeowners association or similar organization.

**(K)** **"Electronic Funds Transfer"** means any transfer of funds, other than a transaction originated by check, draft, or similar paper instrument, which is initiated through an electronic terminal, telephonic instrument, computer, or magnetic tape so as to order, instruct, or authorize a financial institution to debit or credit an account. Such term includes, but is not limited to, point-of-sale transfers, automated teller machine transactions, transfers initiated by telephone, wire transfers, and automated clearinghouse transfers.

**(L)** **"Escrow Items"** means those items that are described in Section 3.

**(M)** **"Miscellaneous Proceeds"** means any compensation, settlement, award of damages, or proceeds paid by any third party (other than insurance proceeds paid under the coverages described in Section 5) for: (i) damage to, or destruction of, the Property; (ii) condemnation or other taking of all or any part of the Property; (iii) conveyance in lieu of condemnation; or (iv) misrepresentations of, or omissions as to, the value and/or condition of the Property.

**(N)** **"Mortgage Insurance"** means insurance protecting Lender against the nonpayment of, or default on, the Loan.

**(O)** **"Periodic Payment"** means the regularly scheduled amount due for (i) principal and interest under the Note, plus (ii) any amounts under Section 3 of this Security Instrument.

**(P)** **"RESPA"** means the Real Estate Settlement Procedures Act (12 U.S.C. §2601 et seq.) and its implementing regulation, Regulation X (24 C.F.R. Part 3500), as they might be amended from time to time, or any additional or successor legislation or regulation that governs the same subject matter. As used in this Security

Initials: ____ ____ ____ ____

**This is an Example of a Mortgage which names MERS as the Original Mortgagee (MOM Document).**

Instrument, "RESPA" refers to all requirements and restrictions that are imposed in regard to a "federally related mortgage loan" even if the Loan does not qualify as a "federally related mortgage loan" under RESPA.

**(Q)** **"Successor in Interest of Borrower"** means any party that has taken title to the Property, whether or not that party has assumed Borrower's obligations under the Note and/or this Security Instrument.

**TRANSFER OF RIGHTS IN THE PROPERTY**

This Security Instrument secures to Lender: (i) the repayment of the Loan, and all renewals, extensions and modifications of the Note; and (ii) the performance of Borrower's covenants and agreements under this Security Instrument and the Note. For this purpose, Borrower does hereby mortgage, grant and convey to **MERS (solely as nominee for Lender and Lender's successors and assigns) and to the successors and assigns of MERS, the following described property located in the**

*[Type of Recording Jurisdiction]*

of :

*[Name of Recording Jurisdiction]*

**MERS noted as lender's nominee in the transfer/due on sale clause.**

which currently has the address of

*[Street]*

, Florida ("Property Address"):

*[City]* *[Zip Code]*

TOGETHER WITH all the improvements now or hereafter erected on the property, and all easements, appurtenances, and fixtures now or hereafter a part of the property. All replacements and additions shall also be covered by this Security Instrument. All of the foregoing is referred to in this Security Instrument as the "Property." Borrower understands and agrees that MERS holds only legal title to the interests granted by Borrower in this Security Instrument, but, if necessary to comply with law or custom, MERS (as nominee for Lender and Lender's successors and assigns) has the right: to exercise any or all of those interests, including, but not limited to, the right to foreclose and sell the Property; and to take any action required of Lender including, but not limited to, releasing and canceling this Security Instrument.

BORROWER COVENANTS that Borrower is lawfully seised of the estate hereby conveyed and has the right to mortgage, grant and convey the Property and that the Property is unencumbered, except for encumbrances of record. Borrower warrants and will defend generally the title to the Property against all claims and demands, subject to any encumbrances of record.

Initials: ______

**This is an Example of a Mortgage which names MERS as the Original Mortgagee (MOM Document).**

THIS SECURITY INSTRUMENT combines uniform covenants for national use and non-uniform covenants with limited variations by jurisdiction to constitute a uniform security instrument covering real property.

UNIFORM COVENANTS. Borrower and Lender covenant and agree as follows:

**1. Payment of Principal, Interest, Escrow Items, Prepayment Charges, and Late Charges.** Borrower shall pay when due the principal of, and interest on, the debt evidenced by the Note and any prepayment charges and late charges due under the Note. Borrower shall also pay funds for Escrow Items pursuant to Section 3. Payments due under the Note and this Security Instrument shall be made in U.S. currency. However, if any check or other instrument received by Lender as payment under the Note or this Security Instrument is returned to Lender unpaid, Lender may require that any or all subsequent payments due under the Note and this Security Instrument be made in one or more of the following forms, as selected by Lender: (a) cash; (b) money order; (c) certified check, bank check, treasurer's check or cashier's check, provided any such check is drawn upon an institution whose deposits are insured by a federal agency, instrumentality, or entity; or (d) Electronic Funds Transfer.

Payments are deemed received by Lender when received at the location designated in the Note or at such other location as may be designated by Lender in accordance with the notice provisions in Section 15. Lender may return any payment or partial payment if the payment or partial payments are insufficient to bring the Loan current. Lender may accept any payment or partial payment insufficient to bring the Loan current, without waiver of any rights hereunder or prejudice to its rights to refuse such payment or partial payments in the future, but Lender is not obligated to apply such payments at the time such payments are accepted. If each Periodic Payment is applied as of its scheduled due date, then Lender need not pay interest on unapplied funds. Lender may hold such unapplied funds until Borrower makes payment to bring the Loan current. If Borrower does not do so within a reasonable period of time, Lender shall either apply such funds or return them to Borrower. If not applied earlier, such funds will be applied to the outstanding principal balance under the Note immediately prior to foreclosure. No offset or claim which Borrower might have now or in the future against Lender shall relieve Borrower from making payments due under the Note and this Security Instrument or performing the covenants and agreements secured by this Security Instrument.

**2. Application of Payments or Proceeds.** Except as otherwise described in this Section 2, all payments accepted and applied by Lender shall be applied in the following order of priority: (a) interest due under the Note; (b) principal due under the Note; (c) amounts due under Section 3. Such payments shall be applied to each Periodic Payment in the order in which it became due. Any remaining amounts shall be applied first to late charges, second to any other amounts due under this Security Instrument, and then to reduce the principal balance of the Note.

If Lender receives a payment from Borrower for a delinquent Periodic Payment which includes a sufficient amount to pay any late charge due, the payment may be applied to the delinquent payment and the late charge. If more than one Periodic Payment is outstanding, Lender may apply any payment received from Borrower to the repayment of the Periodic Payments if, and to the extent that, each payment can be paid in full. To the extent that any excess exists after the payment is applied to the full payment of one or more Periodic Payments, such excess may be applied to any late charges due. Voluntary prepayments shall be applied first to any prepayment charges and then as described in the Note.

Any application of payments, insurance proceeds, or Miscellaneous Proceeds to principal due under the Note shall not extend or postpone the due date, or change the amount, of the Periodic Payments.

**3. Funds for Escrow Items.** Borrower shall pay to Lender on the day Periodic Payments are due under the Note, until the Note is paid in full, a sum (the "Funds") to provide for payment of amounts due for: (a) taxes and assessments and other items which can attain priority over this Security Instrument as a lien or encumbrance on the Property; (b) leasehold payments or ground rents on the Property, if any; (c) premiums for any and all insurance required by Lender under Section 5; and (d) Mortgage Insurance premiums, if any, or any sums payable by

Initials: ______ ______ ______ ______

**This is an Example of a Mortgage which names MERS as the Original Mortgagee (MOM Document).**

Borrower to Lender in lieu of the payment of Mortgage Insurance premiums in accordance with the provisions of Section 10. These items are called "Escrow Items." At origination or at any time during the term of the Loan, Lender may require that Community Association Dues, Fees, and Assessments, if any, be escrowed by Borrower, and such dues, fees and assessments shall be an Escrow Item. Borrower shall promptly furnish to Lender all notices of amounts to be paid under this Section. Borrower shall pay Lender the Funds for Escrow Items unless Lender waives Borrower's obligation to pay the Funds for any or all Escrow Items. Lender may waive Borrower's obligation to pay to Lender Funds for any or all Escrow Items at any time. Any such waiver may only be in writing. In the event of such waiver, Borrower shall pay directly, when and where payable, the amounts due for any Escrow Items for which payment of Funds has been waived by Lender and, if Lender requires, shall furnish to Lender receipts evidencing such payment within such time period as Lender may require. Borrower's obligation to make such payments and to provide receipts shall for all purposes be deemed to be a covenant and agreement contained in this Security Instrument, as the phrase "covenant and agreement" is used in Section 9. If Borrower is obligated to pay Escrow Items directly, pursuant to a waiver, and Borrower fails to pay the amount due for an Escrow Item, Lender may exercise its rights under Section 9 and pay such amount and Borrower shall then be obligated under Section 9 to repay to Lender any such amount. Lender may revoke the waiver as to any or all Escrow Items at any time by a notice given in accordance with Section 15 and, upon such revocation, Borrower shall pay to Lender all Funds, and in such amounts, that are then required under this Section 3.

Lender may, at any time, collect and hold Funds in an amount (a) sufficient to permit Lender to apply the Funds at the time specified under RESPA, and (b) not to exceed the maximum amount a lender can require under RESPA. Lender shall estimate the amount of Funds due on the basis of current data and reasonable estimates of expenditures of future Escrow Items or otherwise in accordance with Applicable Law.

The Funds shall be held in an institution whose deposits are insured by a federal agency, instrumentality, or entity (including Lender, if Lender is an institution whose deposits are so insured) or in any Federal Home Loan Bank. Lender shall apply the Funds to pay the Escrow Items no later than the time specified under RESPA. Lender shall not charge Borrower for holding and applying the Funds, annually analyzing the escrow account, or verifying the Escrow Items, unless Lender pays Borrower interest on the Funds and Applicable Law permits Lender to make such a charge. Unless an agreement is made in writing or Applicable Law requires interest to be paid on the Funds, Lender shall not be required to pay Borrower any interest or earnings on the Funds. Borrower and Lender can agree in writing, however, that interest shall be paid on the Funds. Lender shall give to Borrower, without charge, an annual accounting of the Funds as required by RESPA.

If there is a surplus of Funds held in escrow, as defined under RESPA, Lender shall account to Borrower for the excess funds in accordance with RESPA. If there is a shortage of Funds held in escrow, as defined under RESPA, Lender shall notify Borrower as required by RESPA, and Borrower shall pay to Lender the amount necessary to make up the shortage in accordance with RESPA, but in no more than 12 monthly payments. If there is a deficiency of Funds held in escrow, as defined under RESPA, Lender shall notify Borrower as required by RESPA, and Borrower shall pay to Lender the amount necessary to make up the deficiency in accordance with RESPA, but in no more than 12 monthly payments.

Upon payment in full of all sums secured by this Security Instrument, Lender shall promptly refund to Borrower any Funds held by Lender.

**4. Charges; Liens.** Borrower shall pay all taxes, assessments, charges, fines, and impositions attributable to the Property which can attain priority over this Security Instrument, leasehold payments or ground rents on the Property, if any, and Community Association Dues, Fees, and Assessments, if any. To the extent that these items are Escrow Items, Borrower shall pay them in the manner provided in Section 3.

Borrower shall promptly discharge any lien which has priority over this Security Instrument unless Borrower: (a) agrees in writing to the payment of the obligation secured by the lien in a manner acceptable to Lender, but only so long as Borrower is performing such agreement; (b) contests the lien in good faith by, or

Initials: _____ _____ _____ _____

**This is an Example of a Mortgage which names MERS as the Original Mortgagee (MOM Document).**

defends against enforcement of the lien in, legal proceedings which in Lender's opinion operate to prevent the enforcement of the lien while those proceedings are pending, but only until such proceedings are concluded; or (c) secures from the holder of the lien an agreement satisfactory to Lender subordinating the lien to this Security Instrument. If Lender determines that any part of the Property is subject to a lien which can attain priority over this Security Instrument, Lender may give Borrower a notice identifying the lien. Within 10 days of the date on which that notice is given, Borrower shall satisfy the lien or take one or more of the actions set forth above in this Section 4.

Lender may require Borrower to pay a one-time charge for a real estate tax verification and/or reporting service used by Lender in connection with this Loan.

5. **Property Insurance.** Borrower shall keep the improvements now existing or hereafter erected on the Property insured against loss by fire, hazards included within the term "extended coverage," and any other hazards including, but not limited to, earthquakes and floods, for which Lender requires insurance. This insurance shall be maintained in the amounts (including deductible levels) and for the periods that Lender requires. What Lender requires pursuant to the preceding sentences can change during the term of the Loan. The insurance carrier providing the insurance shall be chosen by Borrower subject to Lender's right to disapprove Borrower's choice, which right shall not be exercised unreasonably. Lender may require Borrower to pay, in connection with this Loan, either: (a) a one-time charge for flood zone determination, certification and tracking services; or (b) a one-time charge for flood zone determination and certification services and subsequent charges each time remappings or similar changes occur which reasonably might affect such determination or certification. Borrower shall also be responsible for the payment of any fees imposed by the Federal Emergency Management Agency in connection with the review of any flood zone determination resulting from an objection by Borrower.

If Borrower fails to maintain any of the coverages described above, Lender may obtain insurance coverage, at Lender's option and Borrower's expense. Lender is under no obligation to purchase any particular type or amount of coverage. Therefore, such coverage shall cover Lender, but might or might not protect Borrower, Borrower's equity in the Property, or the contents of the Property, against any risk, hazard or liability and might provide greater or lesser coverage than was previously in effect. Borrower acknowledges that the cost of the insurance coverage so obtained might significantly exceed the cost of insurance that Borrower could have obtained. Any amounts disbursed by Lender under this Section 5 shall become additional debt of Borrower secured by this Security Instrument. These amounts shall bear interest at the Note rate from the date of disbursement and shall be payable, with such interest, upon notice from Lender to Borrower requesting payment.

All insurance policies required by Lender and renewals of such policies shall be subject to Lender's right to disapprove such policies, shall include a standard mortgage clause, and shall name Lender as mortgagee and/or as an additional loss payee. Lender shall have the right to hold the policies and renewal certificates. If Lender requires, Borrower shall promptly give to Lender all receipts of paid premiums and renewal notices. If Borrower obtains any form of insurance coverage, not otherwise required by Lender, for damage to, or destruction of, the Property, such policy shall include a standard mortgage clause and shall name Lender as mortgagee and/or as an additional loss payee.

In the event of loss, Borrower shall give prompt notice to the insurance carrier and Lender. Lender may make proof of loss if not made promptly by Borrower. Unless Lender and Borrower otherwise agree in writing, any insurance proceeds, whether or not the underlying insurance was required by Lender, shall be applied to restoration or repair of the Property, if the restoration or repair is economically feasible and Lender's security is not lessened. During such repair and restoration period, Lender shall have the right to hold such insurance proceeds until Lender has had an opportunity to inspect such Property to ensure the work has been completed to Lender's satisfaction, provided that such inspection shall be undertaken promptly. Lender may disburse proceeds for the repairs and restoration in a single payment or in a series of progress payments as the work is completed. Unless an agreement is made in writing or Applicable Law requires interest to be paid on such insurance proceeds, Lender shall not be

Initials: ____ ____ ____ ____

**This is an Example of a Mortgage which names MERS as the Original Mortgagee (MOM Document).**

required to pay Borrower any interest or earnings on such proceeds. Fees for public adjusters, or other third parties, retained by Borrower shall not be paid out of the insurance proceeds and shall be the sole obligation of Borrower. If the restoration or repair is not economically feasible or Lender's security would be lessened, the insurance proceeds shall be applied to the sums secured by this Security Instrument, whether or not then due, with the excess, if any, paid to Borrower. Such insurance proceeds shall be applied in the order provided for in Section 2.

If Borrower abandons the Property, Lender may file, negotiate and settle any available insurance claim and related matters. If Borrower does not respond within 30 days to a notice from Lender that the insurance carrier has offered to settle a claim, then Lender may negotiate and settle the claim. The 30-day period will begin when the notice is given. In either event, or if Lender acquires the Property under Section 22 or otherwise, Borrower hereby assigns to Lender (a) Borrower's rights to any insurance proceeds in an amount not to exceed the amounts unpaid under the Note or this Security Instrument, and (b) any other of Borrower's rights (other than the right to any refund of unearned premiums paid by Borrower) under all insurance policies covering the Property, insofar as such rights are applicable to the coverage of the Property. Lender may use the insurance proceeds either to repair or restore the Property or to pay amounts unpaid under the Note or this Security Instrument, whether or not then due.

**6. Occupancy.** Borrower shall occupy, establish, and use the Property as Borrower's principal residence within 60 days after the execution of this Security Instrument and shall continue to occupy the Property as Borrower's principal residence for at least one year after the date of occupancy, unless Lender otherwise agrees in writing, which consent shall not be unreasonably withheld, or unless extenuating circumstances exist which are beyond Borrower's control.

**7. Preservation, Maintenance and Protection of the Property; Inspections.** Borrower shall not destroy, damage or impair the Property, allow the Property to deteriorate or commit waste on the Property. Whether or not Borrower is residing in the Property, Borrower shall maintain the Property in order to prevent the Property from deteriorating or decreasing in value due to its condition. Unless it is determined pursuant to Section 5 that repair or restoration is not economically feasible, Borrower shall promptly repair the Property if damaged to avoid further deterioration or damage. If insurance or condemnation proceeds are paid in connection with damage to, or the taking of, the Property, Borrower shall be responsible for repairing or restoring the Property only if Lender has released proceeds for such purposes. Lender may disburse proceeds for the repairs and restoration in a single payment or in a series of progress payments as the work is completed. If the insurance or condemnation proceeds are not sufficient to repair or restore the Property, Borrower is not relieved of Borrower's obligation for the completion of such repair or restoration.

Lender or its agent may make reasonable entries upon and inspections of the Property. If it has reasonable cause, Lender may inspect the interior of the improvements on the Property. Lender shall give Borrower notice at the time of or prior to such an interior inspection specifying such reasonable cause.

**8. Borrower's Loan Application.** Borrower shall be in default if, during the Loan application process, Borrower or any persons or entities acting at the direction of Borrower or with Borrower's knowledge or consent gave materially false, misleading, or inaccurate information or statements to Lender (or failed to provide Lender with material information) in connection with the Loan. Material representations include, but are not limited to, representations concerning Borrower's occupancy of the Property as Borrower's principal residence.

**9. Protection of Lender's Interest in the Property and Rights Under this Security Instrument.** If (a) Borrower fails to perform the covenants and agreements contained in this Security Instrument, (b) there is a legal proceeding that might significantly affect Lender's interest in the Property and/or rights under this Security Instrument (such as a proceeding in bankruptcy, probate, for condemnation or forfeiture, for enforcement of a lien which may attain priority over this Security Instrument or to enforce laws or regulations), or (c) Borrower has abandoned the Property, then Lender may do and pay for whatever is reasonable or appropriate to protect Lender's interest in the Property and rights under this Security Instrument, including protecting and/or assessing the value of the Property, and securing and/or repairing the Property. Lender's actions can include, but are not limited to:

Initials: _____ _____ _____ _____

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(a) paying any sums secured by a lien which has priority over this Security Instrument; (b) appearing in court; and (c) paying reasonable attorneys' fees to protect its interest in the Property and/or rights under this Security Instrument, including its secured position in a bankruptcy proceeding. Securing the Property includes, but is not limited to, entering the Property to make repairs, change locks, replace or board up doors and windows, drain water from pipes, eliminate building or other code violations or dangerous conditions, and have utilities turned on or off. Although Lender may take action under this Section 9, Lender does not have to do so and is not under any duty or obligation to do so. It is agreed that Lender incurs no liability for not taking any or all actions authorized under this Section 9.

Any amounts disbursed by Lender under this Section 9 shall become additional debt of Borrower secured by this Security Instrument. These amounts shall bear interest at the Note rate from the date of disbursement and shall be payable, with such interest, upon notice from Lender to Borrower requesting payment.

If this Security Instrument is on a leasehold, Borrower shall comply with all the provisions of the lease. If Borrower acquires fee title to the Property, the leasehold and the fee title shall not merge unless Lender agrees to the merger in writing.

**10. Mortgage Insurance.** If Lender required Mortgage Insurance as a condition of making the Loan, Borrower shall pay the premiums required to maintain the Mortgage Insurance in effect. If, for any reason, the Mortgage Insurance coverage required by Lender ceases to be available from the mortgage insurer that previously provided such insurance and Borrower was required to make separately designated payments toward the premiums for Mortgage Insurance, Borrower shall pay the premiums required to obtain coverage substantially equivalent to the Mortgage Insurance previously in effect, at a cost substantially equivalent to the cost to Borrower of the Mortgage Insurance previously in effect, from an alternate mortgage insurer selected by Lender. If substantially equivalent Mortgage Insurance coverage is not available, Borrower shall continue to pay to Lender the amount of the separately designated payments that were due when the insurance coverage ceased to be in effect. Lender will accept, use and retain these payments as a non-refundable loss reserve in lieu of Mortgage Insurance. Such loss reserve shall be non-refundable, notwithstanding the fact that the Loan is ultimately paid in full, and Lender shall not be required to pay Borrower any interest or earnings on such loss reserve. Lender can no longer require loss reserve payments if Mortgage Insurance coverage (in the amount and for the period that Lender requires) provided by an insurer selected by Lender again becomes available, is obtained, and Lender requires separately designated payments toward the premiums for Mortgage Insurance. If Lender required Mortgage Insurance as a condition of making the Loan and Borrower was required to make separately designated payments toward the premiums for Mortgage Insurance, Borrower shall pay the premiums required to maintain Mortgage Insurance in effect, or to provide a non-refundable loss reserve, until Lender's requirement for Mortgage Insurance ends in accordance with any written agreement between Borrower and Lender providing for such termination or until termination is required by Applicable Law. Nothing in this Section 10 affects Borrower's obligation to pay interest at the rate provided in the Note.

Mortgage Insurance reimburses Lender (or any entity that purchases the Note) for certain losses it may incur if Borrower does not repay the Loan as agreed. Borrower is not a party to the Mortgage Insurance.

Mortgage insurers evaluate their total risk on all such insurance in force from time to time, and may enter into agreements with other parties that share or modify their risk, or reduce losses. These agreements are on terms and conditions that are satisfactory to the mortgage insurer and the other party (or parties) to these agreements. These agreements may require the mortgage insurer to make payments using any source of funds that the mortgage insurer may have available (which may include funds obtained from Mortgage Insurance premiums).

As a result of these agreements, Lender, any purchaser of the Note, another insurer, any reinsurer, any other entity, or any affiliate of any of the foregoing, may receive (directly or indirectly) amounts that derive from (or might be characterized as) a portion of Borrower's payments for Mortgage Insurance, in exchange for sharing or modifying the mortgage insurer's risk, or reducing losses. If such agreement provides that an affiliate of Lender

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takes a share of the insurer's risk in exchange for a share of the premiums paid to the insurer, the arrangement is often termed "captive reinsurance." Further:

**(a) Any such agreements will not affect the amounts that Borrower has agreed to pay for Mortgage Insurance, or any other terms of the Loan. Such agreements will not increase the amount Borrower will owe for Mortgage Insurance, and they will not entitle Borrower to any refund.**

**(b) Any such agreements will not affect the rights Borrower has – if any – with respect to the Mortgage Insurance under the Homeowners Protection Act of 1998 or any other law. These rights may include the right to receive certain disclosures, to request and obtain cancellation of the Mortgage Insurance, to have the Mortgage Insurance terminated automatically, and/or to receive a refund of any Mortgage Insurance premiums that were unearned at the time of such cancellation or termination.**

**11. Assignment of Miscellaneous Proceeds; Forfeiture.** All Miscellaneous Proceeds are hereby assigned to and shall be paid to Lender.

If the Property is damaged, such Miscellaneous Proceeds shall be applied to restoration or repair of the Property, if the restoration or repair is economically feasible and Lender's security is not lessened. During such repair and restoration period, Lender shall have the right to hold such Miscellaneous Proceeds until Lender has had an opportunity to inspect such Property to ensure the work has been completed to Lender's satisfaction, provided that such inspection shall be undertaken promptly. Lender may pay for the repairs and restoration in a single disbursement or in a series of progress payments as the work is completed. Unless an agreement is made in writing or Applicable Law requires interest to be paid on such Miscellaneous Proceeds, Lender shall not be required to pay Borrower any interest or earnings on such Miscellaneous Proceeds. If the restoration or repair is not economically feasible or Lender's security would be lessened, the Miscellaneous Proceeds shall be applied to the sums secured by this Security Instrument, whether or not then due, with the excess, if any, paid to Borrower. Such Miscellaneous Proceeds shall be applied in the order provided for in Section 2.

In the event of a total taking, destruction, or loss in value of the Property, the Miscellaneous Proceeds shall be applied to the sums secured by this Security Instrument, whether or not then due, with the excess, if any, paid to Borrower.

In the event of a partial taking, destruction, or loss in value of the Property in which the fair market value of the Property immediately before the partial taking, destruction, or loss in value is equal to or greater than the amount of the sums secured by this Security Instrument immediately before the partial taking, destruction, or loss in value, unless Borrower and Lender otherwise agree in writing, the sums secured by this Security Instrument shall be reduced by the amount of the Miscellaneous Proceeds multiplied by the following fraction: (a) the total amount of the sums secured immediately before the partial taking, destruction, or loss in value divided by (b) the fair market value of the Property immediately before the partial taking, destruction, or loss in value. Any balance shall be paid to Borrower.

In the event of a partial taking, destruction, or loss in value of the Property in which the fair market value of the Property immediately before the partial taking, destruction, or loss in value is less than the amount of the sums secured immediately before the partial taking, destruction, or loss in value, unless Borrower and Lender otherwise agree in writing, the Miscellaneous Proceeds shall be applied to the sums secured by this Security Instrument whether or not the sums are then due.

If the Property is abandoned by Borrower, or if, after notice by Lender to Borrower that the Opposing Party (as defined in the next sentence) offers to make an award to settle a claim for damages, Borrower fails to respond to Lender within 30 days after the date the notice is given, Lender is authorized to collect and apply the Miscellaneous Proceeds either to restoration or repair of the Property or to the sums secured by this Security Instrument, whether or not then due. "Opposing Party" means the third party that owes Borrower Miscellaneous Proceeds or the party against whom Borrower has a right of action in regard to Miscellaneous Proceeds.

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Borrower shall be in default if any action or proceeding, whether civil or criminal, is begun that, in Lender's judgment, could result in forfeiture of the Property or other material impairment of Lender's interest in the Property or rights under this Security Instrument. Borrower can cure such a default and, if acceleration has occurred, reinstate as provided in Section 19, by causing the action or proceeding to be dismissed with a ruling that, in Lender's judgment, precludes forfeiture of the Property or other material impairment of Lender's interest in the Property or rights under this Security Instrument. The proceeds of any award or claim for damages that are attributable to the impairment of Lender's interest in the Property are hereby assigned and shall be paid to Lender.

All Miscellaneous Proceeds that are not applied to restoration or repair of the Property shall be applied in the order provided for in Section 2.

**12. Borrower Not Released; Forbearance By Lender Not a Waiver.** Extension of the time for payment or modification of amortization of the sums secured by this Security Instrument granted by Lender to Borrower or any Successor in Interest of Borrower shall not operate to release the liability of Borrower or any Successors in Interest of Borrower. Lender shall not be required to commence proceedings against any Successor in Interest of Borrower or to refuse to extend time for payment or otherwise modify amortization of the sums secured by this Security Instrument by reason of any demand made by the original Borrower or any Successors in Interest of Borrower. Any forbearance by Lender in exercising any right or remedy including, without limitation, Lender's acceptance of payments from third persons, entities or Successors in Interest of Borrower or in amounts less than the amount then due, shall not be a waiver of or preclude the exercise of any right or remedy.

**13. Joint and Several Liability; Co-signers; Successors and Assigns Bound.** Borrower covenants and agrees that Borrower's obligations and liability shall be joint and several. However, any Borrower who co-signs this Security Instrument but does not execute the Note (a "co-signer"): (a) is co-signing this Security Instrument only to mortgage, grant and convey the co-signer's interest in the Property under the terms of this Security Instrument; (b) is not personally obligated to pay the sums secured by this Security Instrument; and (c) agrees that Lender and any other Borrower can agree to extend, modify, forbear or make any accommodations with regard to the terms of this Security Instrument or the Note without the co-signer's consent.

Subject to the provisions of Section 18, any Successor in Interest of Borrower who assumes Borrower's obligations under this Security Instrument in writing, and is approved by Lender, shall obtain all of Borrower's rights and benefits under this Security Instrument. Borrower shall not be released from Borrower's obligations and liability under this Security Instrument unless Lender agrees to such release in writing. The covenants and agreements of this Security Instrument shall bind (except as provided in Section 20) and benefit the successors and assigns of Lender.

**14. Loan Charges.** Lender may charge Borrower fees for services performed in connection with Borrower's default, for the purpose of protecting Lender's interest in the Property and rights under this Security Instrument, including, but not limited to, attorneys' fees, property inspection and valuation fees. In regard to any other fees, the absence of express authority in this Security Instrument to charge a specific fee to Borrower shall not be construed as a prohibition on the charging of such fee. Lender may not charge fees that are expressly prohibited by this Security Instrument or by Applicable Law.

If the Loan is subject to a law which sets maximum loan charges, and that law is finally interpreted so that the interest or other loan charges collected or to be collected in connection with the Loan exceed the permitted limits, then: (a) any such loan charge shall be reduced by the amount necessary to reduce the charge to the permitted limit; and (b) any sums already collected from Borrower which exceeded permitted limits will be refunded to Borrower. Lender may choose to make this refund by reducing the principal owed under the Note or by making a direct payment to Borrower. If a refund reduces principal, the reduction will be treated as a partial prepayment without any prepayment charge (whether or not a prepayment charge is provided for under the Note). Borrower's acceptance of any such refund made by direct payment to Borrower will constitute a waiver of any right of action Borrower might have arising out of such overcharge.

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**15. Notices.** All notices given by Borrower or Lender in connection with this Security Instrument must be in writing. Any notice to Borrower in connection with this Security Instrument shall be deemed to have been given to Borrower when mailed by first class mail or when actually delivered to Borrower's notice address if sent by other means. Notice to any one Borrower shall constitute notice to all Borrowers unless Applicable Law expressly requires otherwise. The notice address shall be the Property Address unless Borrower has designated a substitute notice address by notice to Lender. Borrower shall promptly notify Lender of Borrower's change of address. If Lender specifies a procedure for reporting Borrower's change of address, then Borrower shall only report a change of address through that specified procedure. There may be only one designated notice address under this Security Instrument at any one time. Any notice to Lender shall be given hy delivering it or by mailing it by first class mail to Lender's address stated herein unless Lender has designated another address by notice to Borrower. Any notice in connection with this Security Instrument shall not be deemed to have been given to Lender until actually received by Lender. If any notice required by this Security Instrument is also required under Applicable Law, the Applicable Law requirement will satisfy the corresponding requirement under this Security Instrument.

**16. Governing Law; Severability; Rules of Construction.** This Security Instrument shall be governed by federal law and the law of the jurisdiction in which the Property is located. All rights and obligations contained in this Security Instrument are subject to any requirements and limitations of Applicable Law. Applicable Law might explicitly or implicitly allow the parties to agree by contract or it might be silent, but such silence shall not be construed as a prohibition against agreement by contract. In the event that any provision or clause of this Security Instrument or the Note conflicts with Applicable Law, such conflict shall not affect other provisions of this Security Instrument or the Note which can be given effect without the conflicting provision.

As used in this Security Instrument: (a) words of the masculine gender shall mean and include corresponding neuter words or words of the feminine gender; (b) words in the singular shall mean and include the plural and vice versa; and (c) the word "may" gives sole discretion without any obligation to take any action.

**17. Borrower's Copy.** Borrower shall be given one copy of the Note and of this Security Instrument.

**18. Transfer of the Property or a Beneficial Interest in Borrower.** As used in this Section 18, "Interest in the Property" means any legal or beneficial interest in the Property, including, but not limited to, those beneficial interests transferred in a bond for deed, contract for deed, installment sales contract or escrow agreement, the intent of which is the transfer of title by Borrower at a future date to a purchaser.

If all or any part of the Property or any Interest in the Property is sold or transferred (or if Borrower is not a natural person and a beneficial interest in Borrower is sold or transferred) without Lender's prior written consent, Lender may require immediate payment in full of all sums secured by this Security Instrument. However, this option shall not be exercised by Lender if such exercise is prohibited by Applicable Law.

If Lender exercises this option, Lender shall give Borrower notice of acceleration. The notice shall provide a period of not less than 30 days from the date the notice is given in accordance with Section 15 within which Borrower must pay all sums secured by this Security Instrument. If Borrower fails to pay these sums prior to tbe expiration of this period, Lender may invoke any remedies permitted by this Security Instrument without further notice or demand on Borrower.

**19. Borrower's Right to Reinstate After Acceleration.** If Borrower meets certain conditions, Borrower shall have the right to have enforcement of this Security Instrument discontinued at any time prior to the earliest of: (a) five days before sale of the Property pursuant to any power of sale contained in this Security Instrument; (b) such other period as Applicable Law might specify for the termination of Borrower's right to reinstate; or (c) entry of a judgment enforcing this Security Instrument. Those conditions are that Borrower: (a) pays Lender all sums which then would be due under this Security Instrument and the Note as if no acceleration had occurred; (b) cures any default of any other covenants or agreements; (c) pays all expenses incurred in enforcing this Security Instrument, including, but not limited to, reasonable attorneys' fees, property inspection and valuation fees, and other fees incurred for the purpose of protecting Lender's interest in the Property and rights under this Security Instrument; and

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(d) takes such action as Lender may reasonably require to assure that Lender's interest in the Property and rights under this Security Instrument, and Borrower's obligation to pay the sums secured by this Security Instrument, shall continue unchanged. Lender may require that Borrower pay such reinstatement sums and expenses in one or more of the following forms, as selected by Lender: (a) cash; (b) money order; (c) certified check, bank check, treasurer's check or cashier's check, provided any such check is drawn upon an institution whose deposits are insured by a federal agency, instrumentality or entity; or (d) Electronic Funds Transfer. Upon reinstatement by Borrower, this Security Instrument and obligations secured hereby shall remain fully effective as if no acceleration had occurred. However, this right to reinstate shall not apply in the case of acceleration under Section 18.

**20. Sale of Note; Change of Loan Servicer; Notice of Grievance.** The Note or a partial interest in the Note (together with this Security Instrument) can be sold one or more times without prior notice to Borrower. A sale might result in a change in the entity (known as the "Loan Servicer") that collects Periodic Payments due under the Note and this Security Instrument and performs other mortgage loan servicing obligations under the Note, this Security Instrument, and Applicable Law. There also might be one or more changes of the Loan Servicer unrelated to a sale of the Note. If there is a change of the Loan Servicer, Borrower will be given written notice of the change which will state the name and address of the new Loan Servicer, the address to which payments should be made and any other information RESPA requires in connection with a notice of transfer of servicing. If the Note is sold and thereafter the Loan is serviced by a Loan Servicer other than the purchaser of the Note, the mortgage loan servicing obligations to Borrower will remain with the Loan Servicer or be transferred to a successor Loan Servicer and are not assumed by the Note purchaser unless otherwise provided by the Note purchaser.

Neither Borrower nor Lender may commence, join, or be joined to any judicial action (as either an individual litigant or the member of a class) that arises from the other party's actions pursuant to this Security Instrument or that alleges that the other party has breached any provision of, or any duty owed by reason of, this Security Instrument, until such Borrower or Lender has notified the other party (with such notice given in compliance with the requirements of Section 15) of such alleged breach and afforded the other party hereto a reasonable period after the giving of such notice to take corrective action. If Applicable Law provides a time period which must elapse before certain action can be taken, that time period will be deemed to be reasonable for purposes of this paragraph. The notice of acceleration and opportunity to cure given to Borrower pursuant to Section 22 and the notice of acceleration given to Borrower pursuant to Section 18 shall be deemed to satisfy the notice and opportunity to take corrective action provisions of this Section 20.

**21. Hazardous Substances.** As used in this Section 21: (a) "Hazardous Substances" are those substances defined as toxic or hazardous substances, pollutants, or wastes by Environmental Law and the following substances: gasoline, kerosene, other flammable or toxic petroleum products, toxic pesticides and herbicides, volatile solvents, materials containing asbestos or formaldehyde, and radioactive materials; (b) "Environmental Law" means federal laws and laws of the jurisdiction where the Property is located that relate to health, safety or environmental protection; (c) "Environmental Cleanup" includes any response action, remedial action, or removal action, as defined in Environmental Law; and (d) an "Environmental Condition" means a condition that can cause, contribute to, or otherwise trigger an Environmental Cleanup.

Borrower shall not cause or permit the presence, use, disposal, storage, or release of any Hazardous Substances, or threaten to release any Hazardous Substances, on or in the Property. Borrower shall not do, nor allow anyone else to do, anything affecting the Property (a) that is in violation of any Environmental Law, (b) which creates an Environmental Condition, or (c) which, due to the presence, use, or release of a Hazardous Substance, creates a condition that adversely affects the value of the Property. The preceding two sentences shall not apply to the presence, use, or storage on the Property of small quantities of Hazardous Substances that are generally recognized to be appropriate to normal residential uses and to maintenance of the Property (including, but not limited to, hazardous substances in consumer products).

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Borrower shall promptly give Lender written notice of (a) any investigation, claim, demand, lawsuit or other action by any governmental or regulatory agency or private party involving the Property and any Hazardous Substance or Environmental Law of which Borrower has actual knowledge, (b) any Environmental Condition, including but not limited to, any spilling, leaking, discharge, release or threat of release of any Hazardous Substance, and (c) any condition caused by the presence, use or release of a Hazardous Substance which adversely affects the value of the Property. If Borrower learns, or is notified by any governmental or regulatory authority, or any private party, that any removal or other remediation of any Hazardous Substance affecting the Property is necessary, Borrower shall promptly take all necessary remedial actions in accordance with Environmental Law. Nothing herein shall create any obligation on Lender for an Environmental Cleanup.

NON-UNIFORM COVENANTS. Borrower and Lender further covenant and agree as follows:

**22. Acceleration; Remedies. Lender shall give notice to Borrower prior to acceleration following Borrower's breach of any covenant or agreement in this Security Instrument (but not prior to acceleration under Section 18 unless Applicable Law provides otherwise). The notice shall specify: (a) the default; (b) the action required to cure the default; (c) a date, not less than 30 days from the date the notice is given to Borrower, by which the default must be cured; and (d) that failure to cure the default on or before the date specified in the notice may result in acceleration of the sums secured by this Security Instrument, foreclosure by judicial proceeding and sale of the Property. The notice shall further inform Borrower of the right to reinstate after acceleration and the right to assert in the foreclosure proceeding the non-existence of a default or any other defense of Borrower to acceleration and foreclosure. If the default is not cured on or before the date specified in the notice, Lender at its option may require immediate payment in full of all sums secured by this Security Instrument without further demand and may foreclose this Security Instrument by judicial proceeding. Lender shall be entitled to collect all expenses incurred in pursuing the remedies provided in this Section 22, including, but not limited to, reasonable attorneys' fees and costs of title evidence.**

**23. Release.** Upon payment of all sums secured by this Security Instrument, Lender shall release this Security Instrument. Borrower shall pay any recordation costs. Lender may charge Borrower a fee for releasing this Security Instrument, but only if the fee is paid to a third party for services rendered and the charging of the fee is permitted under Applicable Law.

**24. Attorneys' Fees.** As used in this Security Instrument and the Note, attorneys' fees shall include those awarded by an appellate court and any attorneys' fees incurred in a bankruptcy proceeding.

**25. Jury Trial Waiver.** The Borrower hereby waives any right to a trial by jury in any action, proceeding, claim, or counterclaim, whether in contract or tort, at law or in equity, arising out of or in any way related to this Security Instrument or the Note.

BY SIGNING BELOW, Borrower accepts and agrees to the terms and covenants contained in this Security Instrument and in any Rider executed by Borrower and recorded with it.

Signed, sealed and delivered in the presence of:

______________________________ ______________________________ (Seal)
-Borrower
*[Printed Name]*

Printed Name:______________________ Mailing Address:
*[Please Complete]*

______________________________ ______________________________ (Seal)
-Borrower

Initials: ____ ____ ____ ____

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*[Printed Name]*

Printed Name:____________________________
*[Please Complete]*

Mailing Address:

________________________________________ (Seal)
-Borrower
*[Printed Name]*

Mailing Address:

________________________________________ (Seal)
-Borrower
*[Printed Name]*

Mailing Address:

*[Acknowledgment on Following Page]*

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State of §
§
County of §

The foregoing instrument was acknowledged before me this *[date]* by

*[name of person acknowledging]*, who is personally known to me or who has produced *[type of identification]* as identification.

Signature of Person Taking Acknowledgment

Name Typed, Printed or Stamped

Title or Rank

Serial Number, if any

**After recording please return to:**

*[Company Name]*

*[Name of Natural Person]*

*[Street Address]*

*[City, State Zip Code]*

**ATTACHMENT 2:**

**MBA FACT SHEET ON MERS**

MORTGAGE BANKERS ASSOCIATION®
Investing in communities

# MBA Fact Sheet
# The Role of Electronic Mortgage Registrations

## The Need for Electronic Registration

Recent events in the mortgage loan servicing industry have prompted questions about how mortgages are recorded and their ownership tracked. These questions are important for a number of reasons. In today's mortgage finance system, a loan is often sold one or more times after origination and then securitized as part of a pool of similar mortgages. Additionally, the overwhelming majority of mortgage loans are paid off through refinancing or sale of a property long before their terms (such as 15, 30 or 40 years) expire. These facts make tracking the servicer and ownership of every mortgage challenging and, at the same time, absolutely critical to the efficient operation of the mortgage market.

To understand the purpose of a registry of mortgage rights, it is important to understand the nature of mortgage loans. Mortgage loans are complex financial products that come with piles of paperwork (actual and electronic) at every step of the process – from borrower application to the ultimate marketing of a security backed by that loan. Two instruments are fundamental to virtually every mortgage loan today and rise above the rest in terms of legal importance – the promissory note and the security instrument, which is generally a mortgage or deed of trust. The security instrument establishes the note holder's right to the property, securing repayment of the borrower's promissory note upon the borrower's default.

The legal principle governing the right to receive payment under a mortgage note is that "possession" of the note determines ownership and the security instrument follows the note. The security instrument is recorded in the local (usually county) land records office to provide "public notice" of the mortgage lien.

The American process for allowing a borrower to possess real estate while paying the debt, and requiring the lender to record a notice of lien so that subsequent creditors and other interested parties can be aware of the lender's security interest in the real property, has been in place since the early 17th century. For hundreds of years, it worked pretty much the same way in counties across the country.

In more recent history, it also has been common practice to divide up the rights in a mortgage into "legal" rights and "equitable" or "beneficial" rights. Going back to the launch of FHA-insured mortgages in the 1930's, when a loan was made, the mortgage originator was identified in the public records as "mortgagee of record" on behalf of a life insurance company that would purchase the mortgage obligation. All rights to receive payment were sold to the insurance company which would become the equitable owner of the promissory note. To the world, the mortgage originator/servicer would be the mortgagee of record, but the entity would hold only "bare legal title" in order to service the mortgage on behalf of its investor. "Servicing" includes collecting mortgage payments, remitting them to investors, and handling mortgage delinquencies and defaults on behalf of an investor. As the secondary mortgage market evolved, this model was adopted by Fannie Mae and Freddie Mac, Ginnie Mae, and private label securitizers.

Under this model, every time servicing obligations changed hands as the mortgage moved through the mortgage business chain, the new servicer was generally required by the investor to record the assignment of its bare legal title in the local land records office. The records also had to be updated and liens released, as they do still today, any time a mortgage was paid off through a refinance or sale of the property.

By the early 1990s, with homeownership continuing to grow and interest rates falling to new lows, it was apparent that the mortgage recordation system that had been in use for nearly 400 years could not keep up with the modern volume of residential real property finance transactions. In fact, the 1993 mortgage refinance boom, still one of the largest in American history, was hampered by a severe backlog of paperwork (which included the assignments between servicers) at land records offices in many areas of the country, often delaying lien releases and related home purchase and mortgage refinance transactions to the detriment of consumers trying to benefit from falling interest rates and compromising the chain of record title. Borrowers, lenders and government officials all became frustrated by this situation which was exacerbated by the growing volume of investor-required mortgage assignments.

The mortgage recordation backlog of the early 1990s was somewhat analogous to Wall Street's "paperwork crisis" of the late 1960s, where clerks were buried in so many paper stock certificates that they could not process them fast enough. To solve this crisis, Wall Street turned to technology and a system of book-entry accounting to track stock ownership. Mortgage companies, banks, investors and government officials saw the positive results of this evolution in the stock market and began to discuss how to apply a similar concept to tracking mortgage ownership rights, servicing rights and warehouse loans (short-term security interests in mortgage obligations prior to their sale into the secondary mortgage market). Out of these discussions was born an industry utility that came to be called MERS, or Mortgage Electronic Registration Systems, Inc.

## MERS Today

Today, MERS is an integral part of modern mortgage finance. MERS has dramatically improved the quality and availability of information in the residential mortgage process since its operations began in 1997.

The MERS® System is a database of information provided by mortgage lenders, servicers and investors. It is owned and operated by MERSCORP, Inc., the parent company of Mortgage Electronic Registration Systems, Inc. Using a standard Mortgage Identification Number (MIN), the MERS® System tracks changes in holders of loan servicing rights, owners of the mortgage note and holders of warehouse loans.

On the majority of mortgage loans today, borrowers agree at settlement to allow Mortgage Electronic Registration Systems, Inc. to be the mortgagee of record – as "nominee" for the promissory note holder – as the note is sold, aggregated and securitized. The mortgage lien and its priority position are properly established in the county recorder's office, while the ownership of the note and other mortgage rights move through the modern system of banking and capital markets, all the time being tracked closely by the MERS® System.

Allowing Mortgage Electronic Registration Systems, Inc. to serve as the mortgagee of record has relieved the pressures on the public land records caused by repeated transfers of mortgage rights (such as servicing and ownership rights), and thereby helps protect the accuracy and integrity of the chain of title. MERS also maintains a centralized "mailroom" on behalf of its members to receive and disseminate legal notices it receives as mortgagee of record.

The MERS® System supports the mortgage securitization process by giving banks, brokers, loan originators, servicers, investors and regulators the ability to track key information on every mortgage loan registered on the MERS® System. Since its inception, over 3,000 such market participants have registered more than 65 million loans with on the MERS® System. Today, over half of all outstanding mortgages are registered on the MERS® System.

MERS is also useful to borrowers, both directly and indirectly. MERS, for the first time, created a way for borrowers to track the servicer (and sometimes the investor) for their loan. This service is free online at http://www.mersinc.org/homeowners/ or by calling (888) 679-6377. Through the reduction of paperwork and other efficiencies, MERS has helped significantly reduce the costs of a mortgage which helps keep the mortgage market liquid and ultimately reduces costs to borrowers. In addition, MERS has decreased the time it takes to refinance a loan which can be a significant benefit to borrowers attempting to lower their interest rate or move from a variable interest rate loan to one with a fixed rate.

As the mortgagee of record, it is common for MERS to play a role in foreclosures. If Mortgage Electronic Registration Systems, Inc. is the mortgagee of record with the county land records, and the borrower is in default on the mortgage, foreclosure can be legally commenced either by Mortgage Electronic Registration Systems, Inc. on behalf of the note owner, or by servicer or other entity if the note owner instructs MERS to assign the mortgage to the servicer or other entity. The process varies in these two ways due to state laws and/or the preference of the servicer or investor. It is important to note that Mortgage Electronic Registration Systems, Inc. only initiates foreclosure when it has been instructed to do so by the owner of the mortgage and possesses the mortgage note.

For more information on MERS, go to www.mersinc.org.

*October 29, 2010*

**ATTACHMENT 3:**

**"Title Transfer Law 101," by Karen Gelernt**

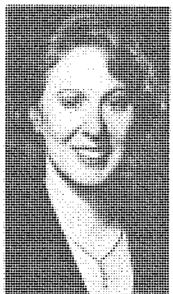
***American Banker*, October 19, 2010**

AMERICAN BANKER® 46
THE FINANCIAL SERVICES DAILY
*Tuesday, October 19, 2010*

VIEWPOINT

# Title Transfer Law 101

BY KAREN GELERNT



Recently, commentators have raised questions about whether certain transfers of residential mortgage loans (made in connection with secondary market transactions such as securitizations) were sufficient to transfer title to the new owner of the mortgage loans and whether such transfers of rights were sufficient to allow the new owner of the mortgages to commence foreclosure, where appropriate.

To better understand these issues, they must be put in their proper perspective based upon the law that underlies transfers of mortgage loans. The underlying tenet, however, is that residential mortgage notes are negotiable instruments which, by their nature, are intended to be liquid and easily transferable by certain key actions outlined in the law. Challenging this notion, irresponsibly questions a well-established body of law affecting trillions of dollars of mortgage loans as well as trillions of dollars of other types of negotiable instruments.

A mortgage loan consists of two important documents: the mortgage note, which constitutes the obligation of the mortgagor to pay its loan; and the mortgage, that constitutes the lien on the real property that secures the note. The note is a promissory note and notes secured by homes are typically negotiable instruments under law. Negotiable instruments have certain special characteristics under law. First, they are easily transferable (typically by endorsement).

Second, a holder in due course of a negotiable instrument takes the instrument free of most defenses to payment, thereby permitting the holder prompt payment. The intent behind the law of negotiable instruments was to enable such instruments to be as liquid as possible, to encourage commerce and lending. As sucb, residential mortgage loans are intended to be relatively liquid assets, easily transferred and easily realized upon.

In this way, a residential mortgage note is analogous to a check. In the case of the mortgage note, it is payable to the order of a mortgagee. Similar to a check, which is transferred by endorsement, a mortgage note is also transferred by endorsement. An endorsement can be specific (such as "Pay to the order of Joe Smith") or can be blank (such as "Pay to the order of ______"). When a note is endorsed in blank, it becomes bearer paper (in other words, the bearer, or holder, is presumed to be the owner). Tbe analogy would be a check made out to "cash." In both instances, the instrument can be physically transferred multiple times without the requirement of additional endorsements. If you presented a bank with a check made out to "cash" the bank should not question your ownership. Similarly, the ownership by an entity of a mortgage note endorsed in blank should not, in the ordinary course, be challenged.

In other words (and aside from the separate issue of whether the circumstances that are required to commence foreclose exist with respect to the mortgage loan), mere possession of a promissory note endorsed in blank (whether a check or a mortgage note) should provide the presumption of ownership of that promissory note by the current holder. So for example, a trustee for a securitization that has physical possession of the mortgage note, should be the presumed owner of that note. Any other outcome would put at risk the entire premise and foundation of negotiable instruments law.

In the end, an endorsement in blank does not, and should not, raise a question of ownership of the instrument.

The second component of a mortgage loan is the mortgage. The mortgage and the transfer of mortgage is governed by real property law. The mortgage must be recorded to put third parties on notice of the lienholder. This protects the mortgagee as well as other parties that might assert an interest in the property, like other lenders, judgment creditors or potential purchasers of the property. It protects the mortgagee because, if a third party were to assert an interest in the real property it would be required to give notice to all the interested parties of record, including the mortgagee of record under the mortgage. If an assignee did not record an assignment of mortgage, then the assignee would not be put on notice. However, this would be a risk borne by the assignee.

Historically, when a mortgage loan was transferred it was accompanied by an assignment of mortgage, oftentimes in blank. Because the secondary market was so active, buyers of mortgage loans frequently did not record the assignments in blank and merely delivered the assignments with the related mortgage notes endorsed in blank to the subsequent buyer. Frequently, the servicer of the mortgage loans remained the mortgagee of record and would receive any important notices regarding the related mortgaged properties. However, in order to facilitate easy transfers of mortgage loans, and to ease the burden of multiple recordations of assignments of mortgage in an active secondary market, MERS systems was developed. MERS is basically an agent for the mortgagee of record. So while a mortgage note may be transferred several times the mortgagee of record remains MERS and MERS tracks the intended mortgagee in its systems.

But at the end of the day, it is the owner of the mortgage note that dictates ownership of the mortgage (a premise commonly referred to as "the mortgage follows the note") as evidenced by Article 3 and Article 9 of the Uniform Commercial Code, in effect in all states.

Ideally, at foreclosure, the mortgagee of record should correspond to the holder of the note. However, any disparity should not be an acceptable basis to bar foreclosure, since the mortgage should not be the document that is dispositive of title to the mortgage loan. The holder of the note should be deemed the owner of the mortgage loan with standing and right to foreclose.

The chain of assignment of the mortgage may for various reasons be defective, or in the case of MERS, an agent for the holder may be identified as the mortgagee, but the principles of commercial law and negotiable instruments, if applied correctly, should ultimately prevail and allow the holder of the note to foreclose to the extent permitted by the mortgage loan documents and applicable state law. Any other outcome would call into question the foundations and liquidity of negotiable instruments and severely obstruct what was always intended as a relatively liquid market.

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Karen Gelernt is a partner in the capital markets department at Cadwalader, Wickersham & Taft.

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**ATTACHMENT 4:**

**"MERS Under Attack:**
**Perspective on Recent Decisions from Kansas and Minnesota,"**
**by Barkley and Barbara Clark**
***Clark's Secured Transactions Monthly***
**February 2010**

CLARKS'
SECURED TRANSACTIONS MONTHLY

# MERS Under Attack: Perspective on Recent Decisions from Kansas and Minnesota

by Barkley and Barbara Clark

February 2010

Due to the economic downtown, the business of securitizing loans into secondary markets has come under intense scrutiny. This is particularly true in the real estate area, where loans are routinely bundled into mortgage-backed securities and sold to investors. Since the original lender contemplates the immediate sale of the loan, it is common practice for originators to appoint a nominee, as third-party agent, who remains as mortgagee in the land records throughout the life of the loan. MERSCORP, INC., a privately held shareholder Delaware Corporation, operates the nationwide electronic registry for tracking interests in mortgage loans as they move through the securitization pipeline.

Mortgage Electronic Registration Systems, Inc. (MERS), a wholly owned subsidiary of MERSCORP, Inc. that serves as mortgagee in a nominee capacity for the lender and subsequent assignees—upfront and for the life of the loan---is generating nationwide litigation. Distressed borrowers are seizing on the fact that the name of the recorded mortgagee, and the identity of the investor as the beneficial owner of the mortgage loan, do not match. Borrowers (and some bankruptcy judges) are using the mismatch as ammunition for challenging foreclosure actions and avoiding mortgage obligations.

The legal issues have recently come to a head in significant decisions by the Kansas and Minnesota supreme courts. These cases are high-stakes challenges to the MERS registration system. We think the Kansas Supreme Court misconstrued the law in reaching its decision, but the Minnesota Supreme Court got it right.

**MERS loses in Kansas.** The Kansas case, decided on August 28, is *Landmark National Bank v. Kesler*, 216 P.3d 158 (Kan. 2009). The Kansas high court recently denied motions for reconsideration. There is a possibility that MERS will take the case to the U.S. Supreme Court in an effort to bolster its position as mortgagee and the mortgage showed an address for MERS on millions of recorded mortgages.

In *Landmark*, MERS was the mortgagee as the nominee for the beneficial owner of the junior mortgage loan. When the first mortgagee foreclosed, it did not notify MERS even though MERS was the recorded mortgagee. A default judgment wiped out the second mortgage and the property sold to a third party. The court did not decide the issue of whether MERS was entitled to notice and service of process in the initial foreclosure action, an issue fundamental to the MERS business model. Instead, it narrowly held that the trial court did not abuse its discretion in denying MERS' motion to vacate a default judgment and require joinder of MERS. Under the court's analysis, even if MERS was technically entitled to notice and service in the initial foreclosure action, MERS would not have had a "meritorious defense."

MERS is interpreting the Kansas court's holding narrowly, based on its procedural posture (the difficulty of overturning a judgment under the "abuse of discretion standard"), and is suggesting that the holding is limited because the court did not want to vacate a default judgment. Nevertheless, consumer advocates and some commentators are reading the decision as challenging MERS' basic right to notice of foreclosure actions. For example, Dan Schechter, a law professor at Loyola Law School in Los Angeles, suggests that the case "deprives the assignee of all economic benefit from the mortgage due to

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the involvement of MERS." He finds it "hard to quarrel with Kansas law" and posits that the law of "most states would be similar." Ominously, Professor Schechter concludes that dicta in the decision call into question "whether millions of MERS-administered mortgages are really enforceable." See 2009 Comm. Fin. News 72 (available on Westlaw).

**MERS wins in Minnesota.** *Jackson v. MERS*, 770 N.W. 2d 487 (August 13, 2009) is the Minnesota case. It came to the supreme court of Minnesota by way of a certified question from the federal district court. Borrowers facing foreclosure brought the lawsuit. Purporting to act on behalf of a class, they challenged MERS' right to proceed under Minnesota's foreclosure-by-advertisement statute, arguing that MERS had failed to comply with the statutory provisions requiring recording of an assignment of the underlying indebtedness. Minn. Stat. §§ 590.02 and 580.04 (2006). MERS serves as mortgagee for the lender as well as lender's assigns.

The Minnesota case turned on the legal question of what constitutes an assignment of a mortgage within the meaning of the foreclosure statute. The court answered the certified question in MERS' favor, holding that "transfers of the underlying indebtedness do not have to be recorded to foreclose a mortgage" under the foreclosure-by-advertisement statute. Therefore, MERS had no reason to re-record, and MERS was the proper mortgagee, with standing to bring the non-judicial foreclosure. Although the certified question focused on Minnesota's non-judicial foreclosure statute, the court's interpretation of the general law applicable to assignments of beneficial ownership interests is importaut.

**How MERS works.** Some background about how MERS works helps to put into context the legal issues before both courts. MERSCORP, Inc. tracks changes in the beneficial interests in mortgage loans in the secondary markets. MERSCORP, Inc. is similar to the book-entry systems used by the securities industry since the 1970s. A consortium of key players in the real estate financing industry developed MERSCORP, Inc. and MERS, including the GSEs (Fannie Mae, Freddie Mac, and Ginnie Mae) and the Mortgage Bankers Association; their purpose was to facilitate the operation of the mortgage markets. MERS registers about two-thirds of all residential loans in the secondary market--approximately 62 million mortgages. In a nutshell, MERS is mega.

Typically, the parties use the Fannie Mae/Freddie Mac Uniform Security Instrument. It is a three-party agreement among the borrower, lender, and MERS. The mortgage form names MERS as mortgagee of record in a nominee capacity for the original lender and lender's successors and assigns. The interest conveyed to MERS is "legal title." The document explicitly grants MERS the right to act on behalf of the lender as required by law or custom, including the right to foreclose and sell the property. Under the mortgage, the lender (and its assigns) retain "beneficial" title.

Put another way, the MERS' system intentionally names MERS as the original mortgagee while the originating lender remains as the payee on the note. When beneficial ownership interests transfer in the secondary market from one MERS member to another, (e.g. the note is negotiated and servicing rights are sold), MERSCORP, Inc. tracks these transfers electronically. The idea behind MERS is that the efficiency of the mortgage markets is vastly improved by maintaining MERS as the mortgagee on public records (in a nominee capacity for the lender and assigns) when transfers of mortgage interests (for mortgage loan sellers, warehouse lenders, mortgage investors, documents custodians, and mortgage servicers) are transacted privately pursuant to clearinghouse rules.

The MERS operating agreement also stipulates that MERS will act on behalf of the beneficial owner according to instructions from that member. Rules governing these agency relationships are set forth in member agreements. As a matter of contract, MERS becomes the agent for a new principal, the next purchasing member, each time there is a transfer. Special rules govern situations where parties that are not members of MERS purchase loans. Under these circumstances, the non-member can choose to keep using the MERS system if the servicer is a MERS member, or de-register the loan. When a non-member removes the loan from the MERS system, there is a recorded assignment of the mortgage to the new note holder.

**MERS model relies on fundamental legal principles.** Looking at the MERS system as a whole, it relies on well-recognized principles of real property law, the law of negotiable instruments, and basic contracts law. Important analogies in the UCC rules governing security interests in personal property also support the legal model. Here are the essential elements:

- **Use of a nominee on a security instrument is well established**: Both real estate law and the UCC recognize the validity of using a nominee. UCC § 9-502 (a) (2) states that a financing statement is sufficient if it provides the name of the secured party "or a representative of the secured party." This section codifies the holding of *In re Cushman Bakery*, 526 F2d 23 (1st Cir. 1975), cert. denied, 425 U.S. 937 (1976). That case also recognizes the validity of using a nominee as mortgagee on the mortgage for recording purposes on behalf of the note holder. See generally, 59 C.J.S. Mortgages § 80 at 116 (mortgages are valid even if the mortgagees of record are nominees or straw persons); 2 Milton R. Friedman, Friedman on Contracts & Conveyances of Real Property, § 6:1:3 (James Cbarles Smith ed., 7th ed. 2007). In addition, by private contract parties can establish agency relationships. UCC § 1-103(b) provides that common law agency principles may always supplement the rules governing secured transactions.

- **Article 9 rules apply even though note is secured by a mortgage.** UCC § 9-109(b) provides that "the application of this article to a security interest in a secured obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which this article does not apply." In other words, perfection of a security interest or the outright transfer of a note is not affected by the fact that the note is secured by a mortgage. The comments clearly state that "the security interest in the promissory note is covered" by Article 9 "even though the note is secured by a real-property mortgage."

- **Under Article 9, there is no need to record a mortgage assignment when the note is transferred.** The clear rules of Article 9 provide that when a note transfers, the security interest in the real estate securing the note also transfers. The principle that the "mortgage follows the note" is a common law principle that is codified in UCC § 9-203(g). UCC § 9-308(e) is the analogous rule for perfection. A promissory note evidences the underlying indebtedness. Negotiation occurs when the new note holder takes possession. There are complicated UCC rules that apply regarding the rights of holders, but the basic rule is that there is no requirement to file assignments of the document evidencing the debt.

- **A mortgagee can remain in place even though there are subsequent assignments of the note in accordance with private contractual agreements.** Under UCC § 9-310(c), if a secured party assigns a perfected security interest, an Article 9 filing is not required to continue the perfected status of the security interest against creditors from the original debtor. The original filing provides sufficient notice that there is a lien. Under real estate law, legal title can remain in a mortgagee without invalidating the security instrument even though the beneficial note holder is another party. Here again, the original mortgage does the trick. Both the UCC filing system and real property recordation statutes provide notice to creditors of the original debtor that there is a security interest or lien on the property. Even if the assignee takes no steps to record a new assignment of the mortgage so that it reflects the name of the new assignee, the security interest remains perfected against creditors and transferees of the original debtor. The comments to UCC § 9-310(c) and longstanding case law support this basic principle.

The basic legal model for MERS is a sound one. MERS' operational model relies on the rules set forth in so-called member agreements. In order for MERS to operate as a reliable and accurate registry, members are responsible for notifying MERS each time there is an event that occurs involving a registered loan in accordance with member rules. For detailed discussion of the relevant law, see Clark and Clark, *The Law of Secured Transactions under the UCC*, ¶¶ 1.08[10][a][iv] and 2.09[2].

**A closer look at the Kansas case.** The Kansas dispute dates back to 2004, when a borrower named Boyd Kesler took out a first mortgage on a piece of real property in Kansas. Landmark was the original lender on a $50,000 first mortgage. About a year later, Kesler took out a second mortgage. The second mortgage secured a loan for $93,100 from Millennia Mortgage Corp. Millennia was a MERS member; the parties used a MERS mortgage form identifying MERS as mortgagee. The structure of the deal indicates that Millennia contemplated selling the loan but intended to retain MERS as the mortgagee of record. The court assumes that this is exactly what happened. In hindsight, we know that the original lender on the second mortgage did, indeed, sell the loan to Sovereign Bank. Subsequently, the borrower filed for bankruptcy. Landmark got relief from the stay, and then filed a foreclosure action, eventually obtaining a default judgment.

**Crucial facts turn on notice.** The first-mortgage lender notified the original second-mortgage lender, named as lender in the mortgage and a MERS member. In other words, Landmark notified Millennia; however, Landmark did not notify MERS even though MERS was on the mortgage as nominee for the lender. Millennia failed to appear as a party, and apparently failed to notify MERS of the lawsuit. Compounding the notice problems, Millennia did not notify Sovereign, even though Sovereign purchased the loan from Millennia.

**MERS tries to intervene after new buyers purchased the property.** Landmark sold the property without anyone appearing to enforce the second lien. The sales price was enough to pay off Landmark's first lien and left a surplus of $37,000. The borrower tried to grab these funds, thinking it had the right to the money since the default judgment had effectively wiped out the second mortgage. At some point, Sovereign, as the beneficial owner of the second mortgage, learned what was happening and attempted to assert its rights. MERS also learned about the mess and filed motions to intervene, contending that it was a necessary party to the foreclosure action.

The district court denied both parties the right to intervene. The Kansas Court of Appeals affirmed the district court. 40 Kan.App.2d. 325, 192 P23d 177 (2008). The Supreme Court took the case on a petition to review, as a matter of first impression in Kansas. The question before the court came down to a determination of whether the trial court had "abused its discretion" by refusing to permit MERS to join the litigation as a necessary party. Did MERS have a "meritorious defense" or a sufficient property interest to require joinder?

**Reading between the lines: the court had trouble with the facts.** Reflecting back on the court's description of the factual scenario, a couple of points jump out:

- The court spends a lot of time wrestling with the language used in the mortgage document and grapples with its terms, finding the document confusing and conflicting with respect to how it described MERS' role. Under the terms of the mortgage, the lender retains the right to enforce the mortgage but if "necessary to comply with law or custom," the mortgage provides that MERS can enforce the interests of the lender and assigns.

- Even though the mortgage gave MERS the right to foreclose, the mortgage directed that Millennia, as lender, receive notice. The court had a hard time reconciling the notice provision with MERS' argument that it was entitled to notice as mortgagee of record.

- The court seems to have trouble sympathizing with MERS, given the facts. MERS is trying to set aside a default judgment after the sale of the property. The way the court tells the story, there are hints that MERS waited too long to object because MERS' own rules and procedures malfunctioned.

**Kansas court misapplies the law.** Notwithstanding the tough facts, we think the court should have ruled in MERS favor on the law. The court ruled that MERS, as straw man nominee, essentially lost the power to act for the lender when the note transferred to a new note holder. The court mistakenly failed to recognize that a mortgagee, holding "legal" title under the terms of the mortgage, retains a sufficient interest in the property to act on behalf of a subsequent assignee of the note. Essentially, the court lost sight of long-standing principles regarding the use of nominees on security instruments and ignored fundamental common law principles of agency law. It misconstrued the principle that "the mortgage follows the note." It wrongly interpreted the maxim as standing for the proposition that when a separation occurs between the note and holder of the legal title to the mortgage, the mortgage lien is wiped out. To the contrary, under Article 9, a new assignment of the mortgage is not required and the original mortgagee continues to act as a vehicle for the purpose of notice for recording purposes. The mortgage remains in place and is just fine.

**A closer look at the Minnesota case.** This principle that "the mortgage follows the note," construed correctly, saved the day for MERS in the Minnesota case. In Jackson, the borrowers facing foreclosure argued that the assignees of their mortgage interests were required to record new mortgage assignments in the land records before they had the authority to foreclose under the Minnesota foreclosure-by-advertisement statute. According to the borrowers, subsequent assignments of the underlying debt required recording of new mortgage assignments under Minnesota law.

The Minnesota supreme court properly rejected these arguments, relying on: (a) longstanding rules sanctioning the use of nominees; (b) the principle that since "the mortgage followed the note," new mortgage assignments were not required in order to keep the mortgage alive and perfected; and (c) a literal reading of the plain language used in Minnesota's non-judicial foreclosure statutes. This language requires recording of mortgage assignments when there is a change in mortgagees. Since the parties had retained MERS as mortgagee down the assignment line, the court was able to conclude that there had been no assignment of mortgage rights. We agree with the court's decision and its reasoning.

**Damage control.** Without doubt, MERS is unhappy with the Kansas situation, both the Supreme Court decision and the way notice of the foreclosure suit escaped detection in the MERS system for too long. To prevent another fiasco, MERS is reminding its members:

- Notify MERS when it is named as a defendant in a foreclosure case even though the member no longer has any ownership interest in the mortgage loan.

- In the situation where there are multiple mortgage holders and the mortgage holders are MERS members, MERS will be wearing multiple hats in any foreclosure action, acting as nominee for the plaintiff and nominee for the defendant. Under these circumstances, the foreclosing party should notify MERS and name it as a defendant. This creates the strange situation where MERS is both plaintiff and defendant.

- Be certain that recorded mortgages reflect MERS as mortgagee and the indexing system reflects MERS as mortgagee.

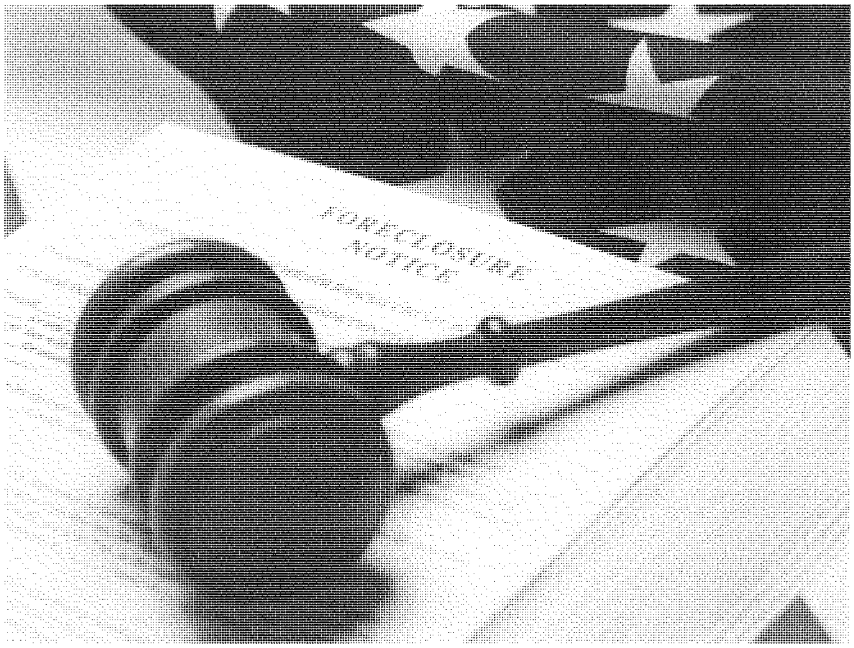
(MERS Announcement Number 2009-06, dated October 1, 2009, posted on the MERS website).

**Bottom line.** Given the fallout from the Kansas case, it is not surprising that MERS is looking seriously at an appeal to the United States Supreme Court. We suspect that borrowers will rely inappropriately on *Landmark* as authority for wiping out mortgage liens in foreclosure cases and will use the case to challenge MERS' ability to enforce liens in bankruptcy court using standing and real party in interest arguments. *Jackson* is the better precedent. Even with *Jackson* in hand, there may be times when the simple fact that MERS is the mortgagee of record is not enough. Depending on the jurisdiction and posture of the litigation, MERS may need to connect the dots for the court by coming prepared with evidence documenting its agency relationship with the investor as owner of the underlying debt. Documenting the link, however, is an evidentiary matter. It does not change the law.

**Note: One of the editors of this newsletter, Barkley Clark, is a partner in the firm of Stinson Morrison Hecker LLP, which represented MERS in the Kansas case. He did not participate in the case.**

**ATTACHMENT 5:**

**"Judicial Versus Non-Judicial Foreclosure"**
**Mortgage Bankers Association**
**October 2010**




# Judicial Versus Non-Judicial Foreclosure

# Judicial Versus Non-Judicial Foreclosure

In many discussions about mortgage foreclosures the terms **judicial** and **non-judicial** foreclosure are used. They involve very different processes. These terms refer to how individual states handle real estate foreclosure. Under both systems, time frames and terms vary widely from state to state. The following is a brief, general, description of both processes. The accompanying chart (see last page) depicts the varying time frames involved in the judicial foreclosure process.

## Judicial Foreclosures

A judicial foreclosure is a court proceeding that begins when the lender files a complaint and records a notice in the public land records announcing a claim on the property to potential buyers, creditors and other interested parties. The complaint describes the debt, the borrower's default and the amount owed. The complaint asks the court to allow the lender to foreclose its lien and take possession of the property as a remedy for non-payment.

The homeowner is served notice of the complaint, either by mail, direct service or publication of the notice. The defendant (borrower) is permitted to dispute the facts (such as show that payments were made), offer defenses or present counterclaims by answering the complaint, filing a separate suit, and / or by attending a hearing arranged by the court. If the defendant shows there are differences of material facts, a trial will be held by the court to determine if foreclosure should occur. In the vast majority of cases, however, the foreclosure action is undisputed because the borrower is in default and cannot offer facts to the contrary. If the court determines the homeowner did default and that the debt is valid, it will issue a judgment in favor of the servicer for the total amount owed, including costs for the foreclosure process. In order for the judge to determine the amount of the judgment, the servicer submits paperwork through an affidavit that itemizes the amounts due.

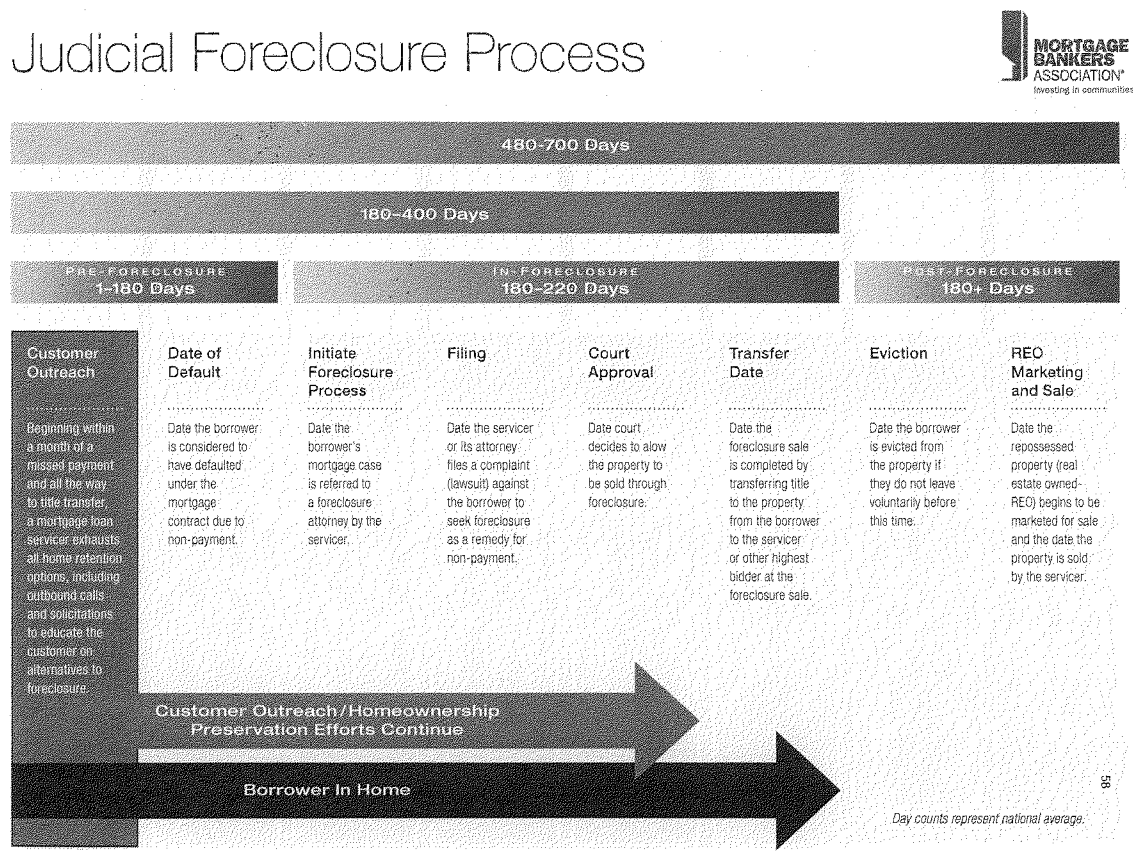
**Twenty two states use judicial procedures as the primary way to foreclose. These include: Connecticut, Delaware, Florida, Hawaii, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, New Jersey, New Mexico, New York, North Dakota, Ohio, Oklahoma, Pennsylvania, South Carolina, South Dakota, Vermont and Wisconsin.**

**In all other states, foreclosure is usually handled by attorneys who follow a state-provided process. In the mortgage documents, borrowers give lenders the "power of sale" outside of judicial process in the event of an uncured default. Documentation or affidavit issues are not common in these states because of the non-judicial nature of the process.**

Next, the court will authorize a sheriff's sale. The sale is an auction of the property open to anyone, and must be held in a public place. Procedures for a sheriff's sale in each locality differ, but the individual with the highest bid is granted the property. After the sale is confirmed by the court, the deed, which transfers ownership, is prepared, recorded and the highest bidder becomes the owner of the property. In most cases, the highest bidder is the servicer, who takes title of the property. The servicer then can sell the property. At this point, it is called **real estate owned (REO).**

## Non-Judicial Foreclosures

The requirements for non-judicial foreclosure are established by state statue; there is no court intervention. When the default occurs, the homeowner is mailed a default letter and in many states a Notice of Default is recorded, at or about the same time. The homeowner may cure the debt during a prescribed period; if not, a Notice of Sale is mailed to the homeowner, posted in public places, recorded at the county's recorder's office, and published in area newspapers/legal publications. When the legally required notice period (determined by each state) has expired, a public auction is held and the highest bidder becomes the owner of the property, subject to recordation of the deed. Prior to the sale, if the borrower disagrees with the facts of the case, he or she can try to file a lawsuit to enjoin the trustee's sale.



Judicial Foreclosure Process
MORTGAGE BANKERS ASSOCIATION®
Investing in communities
480-700 Days
180-400 Days
PRE-FORECLOSURE
1-180 Days
IN-FORECLOSURE
180-220 Days
POST-FORECLOSURE
180+ Days
Customer Outreach
Beginning within a month of a missed payment and all the way to title transfer, a mortgage loan servicer exhausts all home retention options, including outbound calls and solicitations to educate the customer on alternatives to foreclosure.
Date of Default
Date the borrower is considered to have defaulted under the mortgage contract due to non-payment.
Initiate Foreclosure Process
Date the borrower's mortgage case is referred to a foreclosure attorney by the servicer.
Filing
Date the servicer or its attorney files a complaint (lawsuit) against the borrower to seek foreclosure as a remedy for non-payment.
Court Approval
Date court decides to alow the property to be sold through foreclosure.
Transfer Date
Date the foreclosure sale is completed by transferring title to the property from the borrower to the servicer or other highest bidder at the foreclosure sale.
Eviction
Date the borrower is evicted from the property if they do not leave voluntarily before this time.
REO Marketing and Sale
Date the repossessed property (real estate owned-REO) begins to be marketed for sale and the date the property is sold by the servicer.
Customer Outreach/Homeownership Preservation Efforts Continue
Borrower In Home
Day counts represent national average.
58

MERS®

**BIOGRAPHY: R.K. Arnold, President & CEO, MERS**

**R.K. Arnold** serves as President & CEO of MERSCORP, Inc. and its subsidiary, Mortgage Electronic Registration Systems, Inc. He joined MERS at its inception in 1996, and served as Senior Vice President & General Counsel until his promotion to President in 1998. He is a member of the MERS Board of Directors. His team has built MERS into the central electronic registry for the mortgage finance industry.

MERS achieved profitability in 2001 and now registers more than half the mortgage loans originated in the United States. The company's goal is a 100% market share nationwide. MERS enables its members to eliminate the need to record assignments by acting as a placeholder for all its members in the local land records. This reduces unnecessary paperwork and makes buying a home more efficient and less expensive. MERS registers loans in every county in every state and serves both the residential and commercial markets. Most recently, the company launched the MERS® eRegistry, which tracks electronic promissory notes and represents the future of mortgage lending.

As General Counsel, **R.K.** managed the successful effort to gain regulatory approval for MERS to serve as original mortgagee of record on uniform security instruments. He orchestrated approval of the Rules Governing Membership in MERS and played a major role in defining the business requirements for development of the MERS® System. Before joining MERS, he served as Vice President & Corporate Counsel at AT&T Universal Card, practiced law with Holloway, Dobson, Hudson & Bachman, and held management positions with USAA and Johnson & Johnson.

**R.K.** is a former U.S. Army Ranger. He and his wife, Lynne, are both from Oklahoma. He holds a B.B.A. in Finance from the University of Oklahoma, an M.B.A. from the University of Dallas and a J.D. from Oklahoma City University.

# RESPONSE OF MERSCORP, INC.

# TO QUESTIONS FROM THE

# SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

# HOUSE COMMITTEE ON FINANCIAL SERVICES

# NOVEMBER 18, 2010

- **Please describe the origin and role of MERS in recording ownership of real property in the United States.**

MERS[1] is a private company that supports the mortgage finance industry by improving access to, and the reliability of, mortgage loan information, and by making the mortgage finance process more efficient. MERS serves two important functions. First, it maintains a database or registry of mortgage loans, keeping track of changes in servicing rights and beneficial ownership interests in the promissory note over the life of the loan. Second, it can be designated by its members to serve as the mortgagee, or the holder, of the mortgage lien in the public land records.

MERS owns and operates the MERS® System, a central database that tracks the ownership of mortgage loan promissory notes and the servicing rights for mortgage loans. MERS was created by the mortgage finance industry in the mid-1990s as an industry solution to the challenge of tracking loan ownership and servicing information, and the growing volume of mortgage assignments that increased both the expense of mortgage loans and the potential for errors in the public land records when the mortgages are recorded. MERS was conceived and implemented to build upon and supplement, but not displace, the existing public land record system. MERS operates by

[1] Unless otherwise stated, the term "MERS" is used in these answers to collectively refer to MERSCORP, Inc., a Delaware Corporation which owns and operates the MERS® System, an industry database utility, and to Mortgage Electronic Registration Systems, Inc., a wholly owned, bankruptcy remote subsidiary of MERSCORP, Inc. which, as a common agent for the mortgage industry, serves as mortgagee in the county land records as a nominee for the owner of the mortgage loan. The respective roles of MERSCORP, Inc., the MERS® System, and Mortgage Electronic Registration Systems, Inc. are further discussed in these answers and in the MERS testimony.

charging fees to its members (not homeowners), which include 3,000 banks and mortgage lenders across the country.

To understand the role that MERS plays, and the value it brings to consumers, the industry, and the general public, it is important to understand the basics of the mortgage loan process. A real estate loan fundamentally involves two parties—the borrower and the lender—and two documents—a promissory note and a security instrument, commonly called a mortgage.[2] Also involved are servicers (who act as agent for the note owner) and MERS, which plays a unique and vital role in the overall system as further described in these responses.

When a home loan is originated, the borrower and lender create a written contractual agreement of the terms and conditions for the loan, known as the promissory note. The lender provides money to purchase the house, and in return becomes the owner of the promissory note, with the right to collect payments and enforce the loan terms.

As a further protection for the lender, the borrower and the lender also create a mortgage. The mortgage establishes a lien against the property as collateral for the promissory note's loan, and allows the note owner to foreclose on the property if the borrower does not repay the loan according to the terms of the promissory note.[3]

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[2] In some states, the security instrument will be a mortgage; in others, it will be a deed of trust. The legal differences between these two forms of security instruments are not germane in this context. For the purposes of this testimony, we will use the term "mortgage" to refer to both mortgages and deeds of trusts.

[3] One might assume that the mortgagee (the party with the right to enforce the mortgage) would be the lender or the note owner, but this is often not the case. As discussed later in this testimony, the note owner may elect to conduct business through one or more agents, including having an agent listed as the mortgagee on their behalf. A prime

Together, the promissory note and the mortgage create a "mortgage loan." While these two documents are linked, they are not the same, and are treated differently upon closing.

Immediately after closing on the loan, the mortgage is recorded at the county land record office, where it is entered into the local index and an official imaged copy is stored. The original mortgage document is returned to the note owner and goes into the master loan file. Recording the mortgage is done for the benefit of the note owner and conveys three essential benefits: 1) it establishes the priority of the note owner's claim to the property against other creditors; 2) it establishes a right to receive legal notice for any actions against the property that could impact the note owner's interests; and 3) it puts the world on notice that there is a legal claim against the property. There is generally no requirement to record a mortgage, and a mortgage may be enforced even if it hasn't been recorded. However, until the mortgage is recorded, the note owner does not receive any of the benefits or protections as described above.

By contrast, after the closing, the note is sent to a custodian (usually a regulated depository institution) for safekeeping on behalf of the note owner.[4] The note is a negotiable instrument, which means that it can be (and usually is) sold by the original lender to other banks or investors, who may in turn sell the note again in the normal

example of this is Fannie Mae, which owns countless loans but is never listed in the land records as a mortgagee for residential loans.

[4] Unlike the mortgage, the note is not (and never has been) recorded or stored in the county land records.

course of financial activity.[5] The Uniform Commercial Code (UCC) Article 3 governs this activity in all fifty states.[6]

The legal principle underlying promissory notes is that legal possession of the note also conveys all of the legal rights inherent in the note; the noteholder is entitled to receive the payments and enforce the loan in the event of a default.[7] The mortgage is subordinate to the promissory note, which is to say that the rights established in the mortgage flow directly from (and are dependent upon) the rights and the duties established in the note. Without the note, the mortgage has no effect. Likewise, it is commonly said that the "mortgage follows the note" so that when the note changes hands, the mortgage interest automatically follows.

The owners of promissory notes frequently decide that they do not want to be involved with the day-to-day management of the loan. Instead, they will engage a "servicer," a company that will be responsible for collecting the loan payments and dealing with the borrower on behalf of the note owner. The servicer becomes the agent of the note owner, and it is the servicer (not the note owner) that most people think of

[5] While the note's owner may change, the terms of the note do not—the borrower still has the duty to repay the loan, subject to the original terms and conditions. The new owner simply steps into the role of the original lender, with the same rights and obligations. The standard form of note used in the industry discloses that the note may be sold without notice to (or consent by) the borrower and by executing the note, the borrower has agreed to that.

[6] The transfer of a note is performed through an established process of endorsement and delivery from the seller to the note purchaser, and is similar to the process for another type of negotiable instrument—the common check. As with a check, the seller endorses (signs) the note on the back of the document with instructions transferring their rights to the new owner. The endorsement could name the new purchaser, but is typically made "in blank", not naming the new owner. A note endorsed in blank is the equivalent of a check made out to cash—it becomes bearer paper, and any person holding the check (or note) has the right to enforce it. A further explanation of this process is provided in Testimony Attachment Three, Karen Gelernt's American Banker article, *Title Transfer Law 101*, October 19, 2010.

[7] The holder of a note (i.e., the party in possession) may or may not be the ultimate owner; there are times when the owner of the note permits another party to be the holder of the note on their behalf, including when necessary to prosecute a foreclosure.

as "the mortgage company."[8] Just as ownership of the note can change hands, servicing for a loan may also change from one company to another.

MERS is the final element of this system. When servicing rights or promissory notes are sold for loans where MERS is not the mortgagee, the usual practice is for the seller to execute and record an instrument assigning the mortgage lien to the purchaser (commonly referred to as an "assignment"). Assignments are not required by law to be recorded in the land records. The primary reason assignments are recorded (in cases where MERS is not the mortgagee) stems from the appointment of servicers to administer the loan on behalf of the mortgage loan owner. In which case, the servicer will be assigned the mortgage lien (thus becoming the mortgagee) in order to receive the service of process related to that mortgage loan. When Mortgage Electronic Registration Systems, Inc. is the mortgagee (i.e., holds the legal title to the mortgage lien), there is no need for an assignment between its members because it is the common agent for them. It is not the case that the assignments are now being done electronically through the MERS® System instead of being recorded in the land records. The need for an assignment is eliminated because title to the mortgage lien has been grounded in Mortgage Electronic Registration Systems, Inc. Moreover, transfers of mortgage notes and servicing rights are not recordable transactions (and have never been reflected in the land records) because they are not a conveyance of an interest in

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[8] The servicer is similar to a landlord in a rental building. The landlord doesn't own the building, but it collects the rent, deals with the tenants, and handles all of the issues associated with the building on behalf of the owners. And just as a building owner can choose to hire or fire a landlord, a note owner can choose to switch servicers.

real property that is entitled to be recorded. Only the transfer of the lien is a conveyance. A promissory note is sold by the seller endorsing the note, and delivering it, to the purchaser. Servicing rights are non-recordable contracts rights. Mortgage Electronic Registration Systems, Inc. remains the mortgagee regardless of the number of these non-recordable transfers that may occur during the life of the loan. Upon such sales, the seller and purchaser update the MERS® System of the transfer with an "electronic handshake" process whereby both parties to a transaction verify and validate the record updates.

To address the inefficiencies and errors created by this process, the mortgage industry—through an open and public process—set out to create a mortgage information clearinghouse and common agent that could step into the place of the servicers as mortgagee, and thereby eliminate the need for the assignments that occurred due to changes in servicing rights. The designation of MERS as the mortgagee is clearly set forth in the mortgage documents that are signed by the borrower at settlement, and the mortgage identifying MERS is what is filed in the land records. The introduction of MERS into this process did not decrease the amount of information available to the public—it actually increased it, by linking the information in the public land records with a central database that provides reliable information regarding a loan's servicer and owner. Prior to the creation of MERS (when servicers routinely held the mortgage lien for the note owner), the information in the public land records was not accurate due to delays in recording assignments or missing assignments that never got recorded.

MERS is an industry-created utility that performs three essential and related functions:

- First, MERS maintains the MERS® System, a database that tracks changes in the beneficial ownership of the servicing rights and beneficial ownership interests in the promissory note over the life of the loan.[9] MERS members provide and update the data on the MERS® System, and MERS works with its members to ensure the accuracy and integrity of the data. The borrower can access the information on the MERS® System to determine the servicer for his or her loan and the ownership of the loan; the information is also available to MERS members on a need-to-know basis.[10]
- Second, Mortgage Electronic Registration Systems, Inc.[11] serves as a common agent for the mortgage finance industry in the county land records. MERS is the legal owner of the mortgage lien on behalf of its members as their nominee (a limited form of agency). The designation of MERS as nominee and mortgagee is

[9] MERS tracks the loans registered on its system by means of the Mortgage Identification Number (MIN), an 18-digit identification number that is assigned to each loan. This number is assigned at the early stages of the loan creation process, and remains unchanged for the entire life of the loan, regardless of changes in the loan's ownership or servicing.

[10] MERS complies with the consumer privacy protection laws promulgated by the Graham Leach Bliley Act and the provisions of the Fair Credit Reporting Act.

[11] As noted earlier, Mortgage Electronic Registration Systems, Inc., is a wholly owned, bankruptcy remote subsidiary of MERSCORP, Inc. The bankruptcy-remote status of this subsidiary is critical, because it ensures that in the event that MERSCORP, Inc. where to ever suffer a bankruptcy or a fiscal crisis, MERSCORP, Inc.'s creditors could not seize or otherwise impair the mortgages to which Mortgage Electronic Registration Systems, Inc. holds legal title on behalf of its members.

prominently displayed on the mortgage document and is affirmatively approved by the borrower at settlement.[12]

- Third, MERS receives the mortgage-related mail and legal notices concerning the properties for which it serves and mortgagee, and efficiently and expeditiously routes this mail to the appropriate person(s) at the relevant mortgage servicing company.

The role and function of MERS were initially crafted in conformance with, and continues to rest, on long established law and legal principles. For example, the practice of distinguishing a mortgage's legal interest (i.e., the party that owns legal title to the mortgage and appears as mortgagee) and the beneficial interest (i.e., the party that owns the note, is therefore entitled to receive the payments from the mortgage loan, and is therefore the party intended to "benefit" from the lien created by the mortgage) dates back to the creation of the Federal Housing Administration in the 1930s. Fannie Mae, Freddie Mac and many others adopted this model long before MERS was ever conceived.

The MERS® System acts as an extension and expansion of the existing public land records system. MERS does not remove or alter any information in the public land records, nor does MERS replace the public land records.[13] MERS mortgages and mortgage assignments are still recorded in the county land records. However, the MIN

[12] A copy of a sample mortgage document can be found in Testimony Attachment One. A short summary of MERS prepared by the Mortgage Bankers Association can be found in Testimony Attachment Two entitled "MBA Fact Sheet: The Role of Electronic Mortgage Registrations."

[13] MERS is not involved with the custody or maintenance of mortgage loan documents; the mortgage loan owner and/or servicer handle this. MERS does not have either paper or digital originals or copies of any notes or mortgages.

and the MERS® System now allows public land record information to be linked to information regarding the loan's servicer and holder of the beneficial interest.

- **How many servicers participate in MERS? Which major servicers do not participate? In what ways does non-participation impact MERS' ability to provide accurate and up-to-date information on mortgages?**

MERS functionality is incorporated into virtually all of the servicing software in use today, and through this software (and a MERS membership) all servicers have the ability to access and use the MERS® System (i.e., the MERS database). All major servicers are members of MERS and actively participate in the MERS® System.

The most common example of a "servicer" that does not participate in MERS would be a small community bank or credit union that originates and holds a mortgage loan on its own books, and provides the servicing for the full life of the loan. Also, some mortgage companies only use MERS when they purchase loans from correspondent lenders and brokers. It should be noted that in these cases, the loan is never registered on the MERS® System, and the mortgage is not in the name of MERS.

MERS is able to provide accurate and up-to-date information regarding the loans registered on the MERS® System. As discussed in the written testimony, MERS members have a substantial interest in maintaining accurate and up-to-date information. The "electronic handshake" process whereby both parties to a transaction verify and validate the record updates, helps to ensure that the system remains accurate. MERS also performs regular system data audits with its members to ensure the integrity of the data on the MERS® System.

However, MERS does not have information on mortgages that are not registered on the MERS® System. Although all of the top 100 lenders and servicers are members of MERS (and use MERS for some part of their business), our best estimate is that half of all home loans are registered on the MERS® System. If all home loans were registered on the MERS® System, it could provide a complete view of the mortgage finance system. Such a global purview would provide greater accountability and transparency, and could be used even more effectively to prevent fraud and abuse. However at present, non-registered loans represent a significant gap in the informational picture.

- **To what extent are MERS members required to update the MERS database with information reflecting the current owner of the beneficial interest in a mortgage loan?**

Our rules and procedures require that the MERS database be updated by the members within a specific time frame whenever there is a closing of a new loan, or transfer of: (1) the beneficial interest in the mortgage loan or (2) the servicing rights, or payoff or foreclosure.

The MERS® System is a tracking system that contains a record of both the servicing rights and beneficial interest information for mortgage loans. There are many reasons why maintaining the accuracy of the data is important to MERS and its members. One of the most important reasons is that members and the public (including homeowners) rely on the information that is made available through MERS® Servicer ID and MERS® Investor ID, tools by which MERS provides the free public access (via the internet or a toll free telephone number) to information on the database about the note owner and servicer for each registered loan.

The MERS® System holds just a small subset of the universe of information regarding a mortgage loan, and should not be confused with the far more extensive information maintained in the loan file that is held and maintained by the servicer. Information regarding a borrower's payment history and status, loan modification or foreclosure activity is maintained in the servicer's loan file—not on MERS.

As noted in my testimony, a key service provided by MERS is the routing of mail and legal notices regarding a mortgaged property to the appropriate servicer and/or owner for appropriate response and resolution. Failure to receive this information can have serious, negative legal consequences for the servicer and/or owner, up to and including loss of the property interests and the right to enforce the note. This creates a significant incentive for MERS members to maintain an accurate database.

This is re-enforced by the "electronic handshake" that is required to update a record on the MERS® System. Because both parties to a transaction must verify and validate the information whenever a record is changed, there is a mutual pressure to execute the updates promptly and accurately. Failure to do so triggers an audit flag for the

MERS team and the servicers, who work together to rapidly resolve any discrepancy and ensure that information is correct.

Furthermore, MERS performs regular system audits and data reconciliations with its members as a further check to ensure the accuracy of the system.

- **To what extent are MERS members required to update the MERS database with information reflecting the location or identity of the entity in possession of promissory notes?**

The MERS® System does not require information regarding the location or custody of the promissory notes for the loans registered on its system. The MERS® System was fundamentally designed to track serving rights and beneficial interests, and does not keep or track any of the underlying mortgage loan documents in any form—physical or digital. The MERS® System provides for the identity of the custodian, the organization that holds the note on behalf of the owner, but the use of that field is optional. If we needed to determine the location of the note for some reason, we would contact the party registered in the investor (i.e., beneficial owner of the note) field to obtain that information.[14]

[14] If a judicial foreclosure proceeding is prosecuted in the name of MERS, then our rules require that a MERS certifying officer must be in possession of the note.

- **How does the voluntary nature of updating the MERS database on beneficial ownership assignment conceal the multiple assignment of the same loans to multiple securitization trusts? How does MERS verify that multiple loans have not been pledge to more than one trust?**

First, it should be understood that MERS and the MERS® System have limited involvement in the securitization process. MERS has no role in determining whether any loan will be securitized, into what asset pool or trust that loan might be placed, or the creation of any security that might be issued in reliance upon that loan. All of this activity is controlled by the owners of the loans and legally occurs outside of the MERS® System. It is the obligation of the trustee and its custodian to verify and ensure that the conveyance of loans to the trust is done correctly. MERS is fundamentally a database that tracks servicing rights and beneficial interests based on information provide by its members.[15]

Although MERS is not involved in the creation or issuance of mortgage-backed securities, there may still be ways that other parties could utilize the MERS® System to help detect and prevent fraudulent activity with regard to securities. First, every loan registered on the MERS® System is assigned a unique 18 digit Mortgage Identification Number (MIN), which stays with the loan during the entire life of the loan and never changes. If issuers were required to disclose the MIN for each loan associated with the mortgage-backed security, then it should be easy to detect any attempt to associate a

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[15] The rating agencies, however, do require that the name of the trustee (or the trust) be registered in the investor field on the MERS® System following the sale of the loan to the securitization trust.

loan with multiple securities. It would also be possible to query the MERS® System to determine if the Investor ID information on the system is consistent with the information contained in the security's disclosure package.

The Securities and Exchange Commission is currently in the process of developing and implementing new regulations regarding standard disclosure requirements for asset-backed securities, including residential mortgage-backed securities and loan-level detail. MERS has submitted comments and is actively participating in this process. It is our belief that MERS, the MIN, and the MERS® System can and should be part of the solution that results in greater transparency for the mortgage-backed securities market.

- **MERS security agreements state that "MERS is the mortgagee" with respect to a loan. Yet, the Supreme Court of Maine recently held that MERS is not actually mortgagee under that state's real property law. How do you reconcile this contradiction?**

The Maine case of *Mortgage Electronic Registration Systems, Inc. v. Saunders*, 2010 ME 79, Cum-09-640 (MESC), August 12, 2010, was remanded back to the trial court for further determination, so there has been no final ruling. We do not believe that it in any way conflicts with, or otherwise repudiates the basic legal principles upon which the MERS business model is based.

When MERS is named as mortgagee in a mortgage document, it holds the legal title to that mortgage, while the beneficial interest in that mortgage flows to the owner of the promissory note.[16] A MERS mortgage makes clear that MERS is acting as the nominee (agent) of the lender—the original owner of the beneficial interest in the mortgage—and holds the legal title to the mortgage in this capacity.

A foreclosing party—be it MERS or anyone else—must both hold the note and be the mortgagee of record. As the *Saunders* court noted, Maine's adoption of the Uniform Commercial Code (UCC) specifically allows the holder of the promissory note the right to enforce its terms. The note is the primary evidence of the borrower's obligation to repay the debt, and the mortgage is subordinate to the note.

For this reason, MERS rules require that before it will move forward with a foreclosure, MERS must be the mortgagee <u>and</u> the holder of the note.[17] MERS has established rules and procedures for foreclosures to ensure that the necessary evidence is presented to the court and the claim is clearly presented in the pleading. When these rules and procedures are followed, MERS foreclosures are successful. It has been noted in the press and elsewhere that some courts have held that MERS did not have the right to foreclose, despite the fact that MERS is named as the mortgagee on the document. However, these cases are typically the result of a MERS member and/or certifying officer failing to follow the established rules and procedures for a foreclosure. If the MERS member fails to provide the court the proper evidence and plead the case

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[16] The practice of separating the legal and beneficial ownership of a mortgage long pre-dates the creation of MERS in 1995. It became a widespread practice in the 1930s following the creation of the FHA, and was subsequently adopted by Fannie Mae, Freddie Mac, and countless others as a standard practice in the mortgage finance industry.

[17] The promissory note may be transferred from the owner to MERS by means of a specific endorsement naming MERS, or (more commonly) by means of an endorsement in blank, which renders the note enforceable, by any holder (including MERS).

appropriately, then they will be unable to establish standing and claim for MERS. The most common failing in these cases is the failure to provide a copy of the note.

The court in Maine recognized and agreed that MERS held legal title. We are aware of no case where MERS has been the mortgagee and presented the note as the noteholder where the court has found that MERS does not have standing to foreclose.[18]

- **What entity owns legal title to mortgages registered on the MERS system?**

For the mortgages where Mortgage Electronic Registration Systems, Inc. is named as mortgagee on the mortgage document executed by the borrower, it holds the legal title to that mortgage; the lender (and successive owners of the loan's promissory note) have beneficial and equitable (as opposed to legal) ownership of the mortgage because Mortgage Electronic Registration Systems, Inc. is their common agent. This mortgage document is recorded in the county land records and is listed in the index by the recorder (or clerk) to Mortgage Electronic Registration Systems, Inc.

It is the signing of the mortgage document—not registration on the MERS® System—that creates the legal ownership. The MERS® System is a tracking system, and no legal rights or interests are transferred on, by, or through the MERS® System.

It should also be noted that while most loans registered on the MERS® System are loans where MERS is named the mortgagee, this is not always the case. Using the

[18] This answer is not a formal legal pleading and does not attempt to present all of the legal claims and arguments that MERS may choose to present should this matter move forward in the courts. Nothing in this answer should be construed as an admission or waiver of any legal or material fact, claim or defense.

iRegistration service, mortgage companies are able to register mortgages that are not in the name of MERS on the MERS® System for fraud detection purposes and to comply with requirements of municipalities to provide property preservation contact information on vacant properties owned by the member. In these cases, MERS is not the mortgagee.

- **How does one become a Vice President and/or Assistant Secretary of MERS? What are the qualifications for a person to become a Vice President and/or Assistant Secretary of MERS? What compensation do Vice Presidents and/or Assistant Secretaries of MERS receive? Approximately how many Vice Presidents and/or Assistant Secretaries does MERS, Inc. have? What is MERS policy on conflicts of interest regarding Vice Presidents and/or Assistant Secretaries that are employed by banks or investors that may have other, conflicting interests in a mortgage loan?**

Just like all corporations, MERS conducts business through its corporate officers. Certifying officers conduct much of the business of Mortgage Electronic Registration Systems, Inc. These individuals are employees and officers of MERS members who are appointed as limited officers of Mortgage Electronic Registration Systems, Inc. with the title of vice president and/or assistant secretary by means of a corporate resolution. These certifying officers have a narrow and carefully proscribed scope of limited authority to act on behalf of MERS.[19] Their appointing resolution also requires that they act in compliance with both MERS rules and the legal requirements of their local jurisdiction.

It is important to note that the certifying officers are the same officers whom the lenders and servicers use to carry out these functions even when MERS is not the mortgagee. MERS has specific controls over who can be identified by its members as a certifying officer. To be a MERS certifying officer, one must be a company officer of the member institution, have basic knowledge of MERS, and pass a certifying examination administered by MERS.

Under the corporate law in Delaware (where MERS is incorporated), there is no requirement that an officer of a corporation also be an employee of that corporation. A corporation is allowed to appoint individuals to be officers without having to employ those individuals or even pay them. This concept is not limited to MERS. Corporations cannot operate without officers; they can and often do operate without employees. It is not uncommon for large organizations to have all its employees employed by an operating company and for those employees to be elected as officers of affiliated companies that are created for other purposes (all corporations are required by law to have officers to act for it). Even for loans where MERS is not the mortgagee, employees of the servicer are generally delegated the power to take actions (e.g., initiate

[19] The authority granted to these officers is limited to: (1) executing lien releases, (2) executing mortgage assignments, (3) initiating foreclosures, (4) executing proofs of claims and other bankruptcy related documents (e.g., motions for relief of the automatic stay), (5) executing modification and subordination agreements needed for refinancing activities, (6) endorsing over mortgage payment checks made payable to MERS (in error) by borrowers, and (7) taking such other actions and executing documents necessary to fulfill the member's servicing duties.

foreclosures) and execute documents (e.g., lien releases and assignments) on behalf of the owner of the loan (and the servicer, in turn, may further delegate such authority to a third-party vendor).

Certifying officers are selected by the MERS member organization, which submits the candidates' names to MERS for approval. As part of the application process, every candidate must take an online examination to confirm that they understand the nature of their relationship to MERS and their duties as a certifying officer. If the appropriate information has been provided, MERS issues a corporate resolution appointing the candidate a limited corporate officer of Mortgage Electronic Registration Systems, Inc.

MERS rules require that certifying officers must hold similar or greater authority on behalf of their MERS member employers, which is to say that they must also have signing authority on behalf of their direct employers.

As of November 15, 2010, MERS has 20,302 certifying officers who work with the more than 31 million active loans registered on the MERS® System.

As noted above, the certifying officers are the same officers whom the lenders and servicers use to conduct activities related to the mortgage loan (even when MERS is not the mortgagee). A conflict of interest does not exist between MERS and its member lenders and servicers because the interest in the mortgage loans held by MERS is co-terminus with that of its members.

- **There have been recent allegations that some banks have used "robo-signers" to process foreclosure paperwork. Are any of these robo-signers Vice Presidents and/or Assistant Secretaries of MERS? How many?**

The term "robo-signers" is a recently coined-term that is used by the media but has no fixed definition. As such, we are not in a position to determine who may or may not have been an alleged "robo-signer." However, we understand the term to generally refer to bank and/or servicer employees who signed numerous affidavits on mortgage loan foreclosures without (1) individually reviewing each file and/or (2) signing in the presence of a notary public. Mid-level executives at several firms have said in legal depositions that they signed affidavits without *personal* knowledge of the accuracy of these documents.

Over the past several years, through news reports, deposition, litigation, and interaction with our members, MERS became aware that some employees at some servicers may not have been respecting the established legal requirements and or properly following the protocols for foreclosures or other legal matters. We have also determined that some of these individuals were MERS certifying officers. In these cases, MERS has taken steps to remediate the problem. These remedial efforts include:

- Requiring the retraining and recertification of the certifying officer on MERS procedures for certifying officers;
- Suspending or terminating the certifying officer's relationship with MERS if retraining is unsuccessful in addressing the problem;

- Fining member organizations that have failed to follow MERS rules;
- Terminating the relationship between MERS and its members that are recalcitrant in following MERS rules.

MERS has a culture of being proactive and responsive when issues come to our attention:

- In 2005, upon seeing evidence that the lost note affidavit process was being abused in Florida, MERS also instituted a national policy prohibiting any foreclosure in the name of MERS based upon a lost note affidavit.
- When it became clear to MERS that there was a significant problem with the foreclosure practices in Florida, MERS instituted a moratorium on foreclosures in the name of MERS in that state.[20]
- When MERS learned that some members were having subordinate employees appointed as MERS certifying officers, MERS instituted a new requirement that certifying officers must also be officers and/or hold signing authority for their sponsoring MERS member.

MERS continues to gather information about potential problems with certifying officers (including information from news reports earlier this year) and we are working to further improve our standards and processes for certifying officers. Planned improvements include:

20 MERS certifying officers retained the authority to perform mortgage assignments.

- Requiring that all MERS certifying officers recertify on an annual basis to ensure that the certifying officer understands his or her duties, authorities, relationship and responsibilities as a MERS limited corporate officer.
- Requiring that all MERS certifying officers participate in a live, face-to-face training session through the MERS annual national conference, regional conference, or an online "webinar."
- Increasing random and targeted auditing of certifying officer activities to verify compliance with MERS rules and identify candidates for further training or other appropriate remediation efforts.

**Embargoed until delivery**

**Written Testimony of Phyllis Caldwell,**
**Chief of Homeownership Preservation Office,**
**U.S. Department of the Treasury**
**Hearing before the House Financial Services Subcommittee on Housing and Community Opportunity on**
**"Robo-Signing, Chain of Title, Loss Mitigation and Other Issues in Mortgage Servicing"**
**November 18, 2010**

Chairwoman Waters, Ranking Member Capito, and Members of the Subcommittee, thank you for the opportunity to testify today regarding loss mitigation and issues surrounding mortgage servicing. The testimony will cover two key areas: first, the steps we are taking to ensure that servicers participating in the Making Home Affordable (MHA) program are adhering to program guidelines in light of the recent foreclosure issues, and second, the accomplishments of MHA to date and its impact on mortgage servicing.

The reports of "robo-signing", faulty documentation and other improper foreclosure practices by mortgage servicers are unacceptable. If servicers have failed to comply with the law, they should be held accountable. The Administration is leading a coordinated interagency effort to investigate misconduct, protect homeowners and mitigate any long-term effects on the housing market. While Treasury does not have the authority to regulate the foreclosure practices of financial institutions, nor to ensure that those practices conform to the law, it is working closely with agencies that do have such authority.

The Financial Fraud Enforcement Task Force, a broad coalition of law enforcement, investigatory, and regulatory agencies that brings together more than 20 federal agencies, 94 U.S. Attorneys Offices, and dozens of state and local partners, is working to ensure that foreclosure practices are thoroughly investigated and any criminal behavior is prosecuted. The Federal Housing Administration (FHA) has been reviewing servicers for compliance with loss mitigation requirements. Additionally, the Office of the Comptroller of the Currency has directed all large national bank servicers to review their foreclosure management processes – including file reviews, affidavit processing, and signatures – to ensure that the processes are fully compliant with all applicable state laws. The other independent banking regulatory agencies are doing similar reviews of institutions under their jurisdiction. Attached to my testimony is a fact sheet providing more detail concerning the activities of the coordinated interagency effort.

Because MHA and its first lien program, the Home Affordable Modification Program (HAMP), are pre-foreclosure programs, the recent reports of robo-signing of affidavits and improper foreclosure documentation do not directly affect the implementation of HAMP. But these documentation failures reflect the fact that servicers did not have the proper resources in place, nor did they have procedures and controls in place to prevent this crisis. As we have learned in implementing HAMP, servicers were historically structured and staffed to perform a limited role—primarily collecting payments. They did not have the systems, staffing, operational capacity or incentives to engage with homeowners on a large scale and offer meaningful relief from unaffordable mortgages.

The foreclosure problems underscore the continued critical importance of the Making Home Affordable Program launched by the Obama Administration. Preventing avoidable foreclosures through modifications and other alternatives to foreclosure continues to be a critical national priority. Foreclosure is painful for homeowners; it is also costly to servicers and investors. Foreclosures dislocate families, disrupt the communities, and destabilize local housing markets. For this reason, the Obama Administration launched the Making Home Affordable program in the spring of 2009, of which HAMP is a key component. HAMP is intended to prevent avoidable foreclosures by providing financial incentives to servicers, investors and borrowers to voluntarily undertake modifications of mortgages for responsible homeowners in a way that is affordable and sustainable over time. In cases where a modification is not possible, the participating servicers must consider other alternatives to foreclosure.

As a result, throughout the last 20 months, we have worked to develop systems and procedures to ensure that responsible homeowners are offered meaningful modifications and other foreclosure alternatives. To remedy servicer shortcomings, we have urged servicers to rapidly increase staffing and improve customer service. We have developed specific guidelines and certifications on how and when borrowers must be evaluated for HAMP and other loss mitigation options prior to foreclosure initiation. We have also continued our compliance efforts to ensure borrowers are fairly evaluated and that servicer operations reflect Treasury guidance. MHA has strong compliance mechanisms in place to ensure that servicers follow our program's guidelines.

**<u>HAMP Procedural Safeguards and Compliance Efforts</u>**

Treasury has built numerous procedural safeguards in HAMP to avoid foreclosure sales. Specifically, program guidelines require participating mortgage servicers to:

- Evaluate homeowners for HAMP modifications before referring them for foreclosure. The focus here is on early intervention. Servicers must reach out to all potentially eligible borrowers when they are only two months delinquent and there is a still a viable opportunity to save the loan;
- Suspend any foreclosure proceedings against homeowners who have applied for HAMP modifications, while their applications are pending;
- Evaluate whether homeowners who do not qualify for HAMP (or who have fallen out of HAMP) qualify for alternative loss mitigation programs or private modification programs;
- Evaluate whether homeowners who cannot obtain alternative modifications may qualify for a short sale or deed-in-lieu of foreclosure; and
- Provide a written explanation to any borrower who is not eligible for modification and delay foreclosure for at least 30 days to give the homeowner time to appeal.

Servicers may not proceed to foreclosure sale unless and until they have tried these alternatives. They must also first issue a written certification to their foreclosure attorney or trustee stating that "all available loss mitigation alternatives have been exhausted and a non-foreclosure option could not be reached." On October 6, Treasury clearly reminded servicers of this existing requirement that they are prohibited from conducting foreclosure sales until these pre-foreclosure certifications are executed.

The MHA compliance program is designed to ensure that servicers are meeting their obligations under the MHA servicer contracts for loans where Fannie Mae or Freddie Mac is not the investor, and uses a variety of compliance activities to assess servicers from different perspectives. Treasury has engaged a separate division of Freddie Mac, Making Home Affordable-Compliance (MHA-C), to perform these compliance activities. Employing a risk-based approach, compliance activities are performed ranging generally monthly for servicers with the largest percentages of potentially eligible borrowers, to at least twice annually for the smaller-sized servicers.

Our compliance activities focus on ensuring that homeowners are appropriately treated in accordance with MHA guidelines. As the program has evolved, servicers have adapted their processes to incorporate MHA programs. Treasury has implemented non-financial remedies that have shaped servicer behavior in order to address the most vital issue: the ultimate impact on the homeowner.

As information regarding irregularities in servicer foreclosure practices arose, Treasury acted swiftly and instructed MHA-C to review the ten largest servicers' internal policies and procedures for completing these pre-foreclosure certifications before initiating the foreclosure proceedings, and to assess a limited sample of foreclosure sales that have occurred since the effective date of the guidance. The results of the review are not yet available. However, if MHA-C identifies any incidents of non-compliance with HAMP guidelines, Treasury will direct servicers to take appropriate corrective action, which may include suspending foreclosure proceedings and re-evaluating the affected homeowners for HAMP, as well as undertaking changes to servicing processes to help ensure that HAMP guidelines are followed prior to initiating the foreclosure process.

**HAMP's Accomplishments and Its Impact on the Mortgage Industry**

To date, HAMP has achieved three critical goals: it has provided immediate relief to many struggling homeowners; it has used taxpayer resources efficiently; and it has helped transform the way the entire mortgage servicing industry operates.

Twenty months into the program, close to 1.4 million homeowners have entered into HAMP trials and experienced temporary reductions in their mortgage payments. Of these, almost 520,000 homeowners converted to permanent modifications. These homeowners are experiencing a 36 percent median reduction in their mortgage payments—averaging more than $500 per month—amounting to a total, program-wide savings of nearly $3.7 billion annually for homeowners.

Early indications suggest that the re-default rate for permanent HAMP modifications is significantly lower than for historical private-sector modifications—a result of the program's focus on properly aligning incentives and achieving greater affordability. For HAMP modifications made in the fourth quarter of 2009, at six months, fewer than 10 percent of permanent modifications are 60+ days delinquent. According to the OCC's Mortgage Metrics Report, the comparable delinquency rates for non-HAMP modifications made in the same quarter were 22.4 percent. Regarding HAMP re-defaults, the OCC states, "These lower early post-modification delinquency rates may reflect HAMP's emphasis on the affordability of monthly payments and the requirements to verify income and complete a successful trial period."

Borrowers who do not ultimately qualify for HAMP modifications often receive alternative forms of assistance. Based on survey data from the eight largest servicers, approximately one-half of homeowners who apply for HAMP modifications but do not qualify have received some form of private-sector modification. Less than ten percent have lost their homes through foreclosure sales.

HAMP uses taxpayer resources efficiently. HAMP's "pay-for-success" design utilizes a trial period to ensure that taxpayer-funded incentives are used only to support borrowers who are committed to staying in their homes and making monthly payments, and the investor retains the risk of the borrower re-defaulting into foreclosure. No taxpayer funds are paid to a servicer or an investor until a borrower has made three modified mortgage payments on time and in full. The majority of payments are made over a three to five-year period only if the borrower continues to fulfill this responsibility. These safeguards ensure that spending is limited to high-quality modifications.

***MHA Has Been a Catalyst—Setting the Benchmark for Sustainable Modifications***

MHA has transformed the way the mortgage servicing industry deals with alternatives to foreclosure. Because of MHA, servicers have developed constructive private-sector options. Where there was once no consensus plan among loan servicers about how to respond to borrowers in need of assistance, HAMP established a universal affordability standard: a 31 percent debt-to-income ratio, which dramatically enhanced servicers' ability to reduce mortgage payments to sustainable levels while simultaneously providing the necessary justification to investors for the size and type of modification.

In the year following initiation of HAMP, home retention strategies changed dramatically. According to the OCC/ OTS Mortgage Metrics Report, in the first quarter of 2009, nearly half of mortgage modifications increased borrowers' monthly payments or left their payments unchanged. By the second quarter of 2010, 90 percent of mortgage modifications lowered payments for the borrower. This change means borrowers are receiving better solutions. Modifications with payment reductions perform materially better than modifications that increase payments or leave them unchanged.

Moreover, even holding the percentage payment reduction constant, the quality of modifications made by servicers appears to have improved since 2008. For modifications made in 2008, 15.8 percent of modifications that received a 20 percent payment reduction were 60 days or more delinquent three months into the modification. For modifications made in 2010, that delinquency rate has fallen almost in half, to 8.2 percent. The OCC's Mortgage Metrics Report from 2010:Q2 attributes the improvement in mortgage performance to "servicer emphasis on repayment sustainability and the borrower's ability to repay the debt."

Spurred by the catalyst of the HAMP program, the number of modification arrangements was nearly three times greater than the number of foreclosure completions between April 2009 and August 2010. More than 3.7 million modification arrangements were started, including the close to 1.4 million trial HAMP modification starts, more than 568,000 FHA loss mitigation and early delinquency interventions, and more than 1.6 million proprietary modifications by servicing members of the HOPE NOW Alliance.

Further, it is important to keep in mind that MHA is only one of many Administration housing efforts targeting these challenges: the Administration has also provided substantial support for the housing markets through support for Fannie Mae and Freddie Mac to help keep mortgage rates affordable; purchase of agency mortgage-backed securities; and an initiative to provide support and financing to state and local Housing Finance Agencies (HFAs). These HFAs provide, in turn, tens of thousands of affordable mortgages to first time homebuyers and help develop tens of thousands of affordable rental units for working families.

## Responding to a Changing Housing Crisis

MHA was designed to be a versatile program. MHA includes a second lien modification program, a foreclosure alternatives program that promotes short sales and deeds-in-lieu of foreclosures, and an unemployment forbearance program. Treasury expanded HAMP to include FHA and Rural Development mortgage loans through the FHA-HAMP and RD-HAMP program, and also introduced a principal reduction option. Finally, Treasury introduced a program to allow the hardest-hit states to tailor housing assistance to their areas, and worked with FHA to introduce an option for homeowners with high negative equity to refinance into a new FHA loan if their lender agrees to reduce principal on the original loan by at least ten percent.

### *Second Lien Modification Program*

The Second Lien Modification Program (referred to as 2MP) requires that when a borrower's first lien is modified under HAMP and the servicer of the second lien is a 2MP participant, that servicer must offer to modify the borrower's second lien according to a defined protocol. 2MP provides for a lump sum payment from Treasury in exchange for full extinguishment of the second lien, or a reduced lump sum payment from Treasury in exchange for a partial extinguishment and modification of the borrower's remaining second lien. Although 2MP was initially met with reluctance from servicers and investors who did not want to recognize losses on their second lien portfolios, as of October 3, 2010, Treasury has signed up seventeen 2MP servicers, which includes the four largest mortgage servicers, who in aggregate service approximately 60 percent of outstanding second liens. The program uses a third-party database to match second lien loans with first lien loans permanently modified under HAMP. Servicers are required to modify second lien loans within 120 days from the date the servicer receives the first lien and second lien matching information. The implementation of this database began over the summer. Five 2MP Servicers have already begun matching modified first liens with their corresponding second liens, while the other twelve are in some phase of developing systems capacity to do so. Information on the second lien program will be included in upcoming Monthly Servicer Performance Reports as data becomes available.

***Home Affordable Foreclosure Alternatives Program***

Any modification program seeking to avoid preventable foreclosures has limits, HAMP included. HAMP does not, nor was it ever intended to, address every delinquent loan. Borrowers who do not qualify for HAMP may benefit from an alternative program that helps the borrower transition to more affordable housing and avoid the substantial costs of a foreclosure. Under HAFA, Treasury provides incentives for short sales and deeds-in-lieu of foreclosure for circumstances in which borrowers are unable to complete the HAMP modification process or decline a HAMP modification. Borrowers are eligible for a relocation assistance payment, and servicers receive an incentive for completing a short sale or deed-in-lieu of foreclosure. In addition, investors are paid additional incentives for allowing some short sale proceeds to be distributed to subordinate lien holders. The Home Affordable Foreclosure Alternatives (HAFA) Program became effective on April 5, 2010.

***Unemployment Program***

In March 2010, the Obama Administration announced enhancements to HAMP aimed at unemployment problems by requiring servicers to provide temporary mortgage assistance to many unemployed homeowners. The Unemployment Program (UP) requires servicers to grant qualified unemployed borrowers a forbearance period during which their mortgage payments are temporarily reduced for a minimum of three months, and up to six months for some borrowers, while they look for a new job. Servicers are prohibited from initiating a foreclosure action or conducting a foreclosure sale (a) while the borrower is being evaluated for UP, (b) after a foreclosure plan notice is mailed, (c) during the UP forbearance or extension, or (d) while the borrower is being evaluated for or participating in HAMP or HAFA following the UP forbearance period. UP went in to effect August 1, 2010. Because no incentives are paid under UP, data reports will be based on servicer surveys.

***Principal Reduction Alternative***

The Administration announced further enhancements to HAMP in March 2010 by encouraging servicers to write down mortgage debt as part of a HAMP modification (the Principal Reduction Alternative, or PRA). Under PRA, servicers are required to evaluate the benefit of principal reduction and are encouraged to offer principal reduction whenever the net present value (NPV) result of a HAMP modification using PRA is greater than the NPV result without considering principal reduction. The principal reduction and the incentives based on the dollar value of the principal reduced will be earned by the borrower and investor based on a pay-for-success structure. Under the contract with each servicer, Treasury cannot compel a servicer to select PRA over the standard HAMP modification even if the NPV of PRA is greater than the NPV of regular HAMP. However, Treasury has required servicers to have written policies for PRA to help ensure that similarly situated borrowers are treated consistently. The program became operational October 1, 2010 and the four largest servicers have indicated an intention to offer PRA to homeowners.

### *FHA Refinance*

Also in March 2010, the Administration announced adjustments to existing FHA refinance programs that permit lenders to provide additional refinancing options to homeowners who owe more than their homes are worth because of large declines in home prices in their local markets. This program, known as the FHA Short Refinance option, will provide more opportunities for qualifying mortgage loans to be restructured and refinanced into FHA-insured loans.

In order to qualify for this program, a homeowner must be current on their existing first lien mortgage; the homeowner must occupy the home as a primary residence and have a qualifying credit score; the mortgage owner must reduce the amount owed on the original loan by at least 10 percent; the new FHA loan must have a balance of no more than 97.75% of the current value of the home; and total mortgage debt for the borrower after the refinancing, including both the first lien mortgage and any other junior liens, cannot be greater than 115% of the current value of the home – giving homeowners a path to regain equity in their homes and affordable monthly payments. Program guidance was issued to participating FHA servicers in September 2010.

### *HFA Hardest-Hit Fund*

On February 19, 2010, the Administration announced the Housing Finance Agency Innovation Fund for the Hardest Hit Housing Markets (HFA Hardest-Hit Fund) for state HFAs in the nation's hardest-hit housing markets to design innovative, locally targeted foreclosure prevention programs. In total, $7.6 billion has been allocated to 18 states (Alabama, Arizona, California, Florida, Georgia, Illinois, Indiana, Kentucky, Michigan, Mississippi, Nevada, New Jersey, North Carolina, Ohio, Oregon, Rhode Island, South Carolina, and Tennessee) and the District of Columbia in four rounds of funding under the HFA Hardest-Hit Fund. As of October 2010, three states were either accepting applications or providing assistance (Arizona, Michigan and Ohio). By the end of 2010 another three states are expected to begin providing assistance. The remaining states are expected to begin providing assistance in the first half of 2011.

Allocations under the HFA Hardest-Hit Fund were made using several different metrics. Some of the funds were allocated to states that have suffered average home price drops of more than 20 percent from their peak, while other funds were allocated to states with the highest concentration of their populations living in counties with unemployment rates greater than 12 percent or unemployment rates that were at or above the national average. In addition, some funds were allocated to all the states and jurisdictions already participating in the HFA Hardest-Hit Fund to expand the reach of their programs to help more struggling homeowners. The applicable HFAs designed the state programs themselves, tailoring the housing assistance to their local needs. A minimum of $2 billion of the funding is required to be used by states for targeted unemployment or under-employment programs that provide temporary assistance to eligible homeowners to help them pay their mortgages while they seek re-employment or additional employment or undertake job training. Treasury also required that all of the programs comply with the requirements of EESA, which include that they must be designed to prevent avoidable foreclosures. All of the funded program designs are posted online at http://www.FinancialStability.gov/roadtostability/hardesthitfund.html.

**Transparency, Accountability, and Compliance**

I would like to provide you with further detail regarding the compliance efforts regarding HAMP. To protect taxpayers and ensure that TARP dollars are directed toward promoting financial stability, Treasury established rigorous transparency and accountability measures for all of its programs, including all housing programs. In addition, every borrower is entitled to a clear explanation if he or she is determined to be ineligible for a HAMP modification. Treasury requires servicers to report the reason for modification denials in the HAMP system of record. MHA-C's compliance activities, through Second Look loan file reviews and other on-site assessments, evaluate the appropriateness of the denials as well as the timeliness and accuracy of the denial notification to the affected borrowers.

In order to improve transparency of the HAMP NPV model, which is a key component of the eligibility test for HAMP, Treasury increased public access to the NPV white paper, which explains the methodology used in the NPV model. To ensure accuracy and reliability, MHA-C conducts periodic audits of servicers' NPV practices. MHA-C conducts two types of reviews related to NPV. For those servicers that have re-coded the requirements of the NPV model in their processing systems, MHA-C conducts on-site and off-site reviews of model accuracy, model management, and data integrity and inputs. For those servicers using the MHA Servicer Portal, MHA-C conducts reviews of data integrity and inputs. Where non-compliance is found, Treasury requires servicers to take remedial actions, which can include re-evaluating borrowers with appropriate inputs, process changes, corrections to recoded NPV implementations, and, for servicers who have re-coded the NPV model, reverting back to the MHA Servicer Portal for loans with negative NPV results from the servicers' re-coded NPV model until necessary corrections have been re-evaluated by MHA-C. In addition, as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act, Treasury is preparing to establish a web portal that borrowers can access to run a NPV analysis using input data regarding their own mortgages, and to provide to borrowers who are turned down for a HAMP modification the input data used in evaluating the application.

As stated above, servicers are subject to various other compliance activities, including periodic, on-site compliance reviews as well as on-site and off-site loan file reviews. These various compliance activities performed by MHA-C assess servicers' compliance with HAMP requirements. Treasury works closely with MHA-C to adapt and execute our risk based compliance activities quickly based on changes in the program as well as observed trends. The current assessment of the top ten servicers' adherence to our pre-foreclosure certifications and requirements is one example of how we adapt our compliance activities. MHA-C provides Treasury with the results from each of the various compliance activities conducted. Treasury performs quality reviews of these activities and evaluates the nature and scope of any instances of non-compliance, and assesses appropriate responses, including remedies, in a consistent manner. As stated earlier, during the beginning of the program, and as additional features (*e.g.*, the Second Lien Program) are introduced, Treasury's compliance activities and associated remedies focus on shaping servicers' behavior and improving processes as servicers ramp up or modify their implementation of HAMP. As the program and servicers' processes mature, financial remedies may become more appropriate and effective in reinforcing Treasury's compliance and performance expectations.

**Looking Ahead for Housing**

Servicers need to increase efforts in helping borrowers avoid foreclosure through modification, as well as other alternatives to foreclosure, such as short sales. Furthermore, as we have learned through HAMP, servicers must be held accountable for ensuring that their foreclosure processes have integrity and are used after all loss mitigation options have been exhausted. Treasury's main priority is to ensure that *first*, participating servicers are doing everything that they can to reach, evaluate, and start borrowers into HAMP modifications, *second*, if a HAMP modification is not possible, every servicer is properly evaluating each homeowner for all other potential options to prevent a foreclosure, including HAFA or one of their own modification programs, and *third*, servicers are utilizing programs such as UP or the HFA Hardest-Hit Fund to their fullest ability in order to prevent avoidable foreclosures.

Over the past 20 months, we have been actively engaged with stakeholders from across the housing sector to find ways to increase the pace of new HAMP modifications, improve the characteristics of those modifications, and improve the borrower experience. We sincerely appreciate the assistance that we have gotten from Members of Congress and the advocacy community in strengthening borrower protections, incentivizing principal reduction, and assisting the unemployed. And most importantly, we value the efforts that Members of Congress, counselors and advocates have made in holding servicers accountable.

Yet, as we deploy a comprehensive suite of loss mitigation options, we must remember, as the President noted, not every foreclosure can be prevented. Any broad-based solution must aim at achieving both an efficient and equitable allocation of resources. This means a balance must be struck between affording homeowners opportunities to avoid foreclosure while expeditiously easing the transition in those cases where homeownership is not an economically sustainable alternative. This is especially important in order to lay the foundation for future appreciation which will provide a meaningful path to sustainable homeownership.

In the coming months, we will begin to see the impacts of the newly launched MHA programs. These programs will reach more distressed homeowners and provide additional stability to the housing market going forward. In much the same way that HAMP's first lien modification program has provided a national blueprint for mortgage modifications, these new programs will continue to shape the mortgage servicing industry and act as a catalyst for industry standardization of short sale, refinance and principal reduction programs. The interplay of all these programs will provide a much more flexible response to changes in the housing market over the next two years.

**THE WHITE HOUSE**
Office of the Press Secretary

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FOR IMMEDIATE RELEASE
October 20, 2010

**FACT SHEET: Federal Government Efforts to Support Accountability, Stability and Clarity in the Housing Market**

Today the Department of Housing and Urban Development, the Department of the Treasury, the Department of Justice, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Trade Commission, the Securities and Exchange Commission, the Federal Housing Finance Agency and the Office of Thrift Supervision met to discuss ongoing interagency action to support accountability, stability, and clarity in the housing market and residential mortgage backed securities market.

We are working together to review practices that do not comply with state foreclosure law or applicable federal laws, including taking the following actions:

- The Federal Housing Administration (FHA) has been reviewing servicers for compliance with loss mitigation requirements. These reviews are being broadened to include a larger range of processes, focusing in particular on servicer procedures during the final stages of the foreclosure process. These reviews are expected to be complete within nine weeks.

- The Financial Fraud Enforcement Task Force, led by the Department of Justice, has brought together more than 20 federal agencies, 94 US Attorney's Offices and dozens of state and local partners to share information about foreclosure and servicing practices. The Task Force's collaborative efforts are ensuring that the full resources of the federal and state regulatory and enforcement authorities are being brought to bear in addressing this issue.

- The Financial Fraud Enforcement Task Force has also been coordinating with State Attorneys General in their joint review of "robo-signing" practices in foreclosure cases.

- The Department of Justice, including through the Executive Office for U.S. Trustees, is also working with regulators to investigate and, where appropriate, litigate against servicers, their law firms, and third-party providers regarding their foreclosure and bankruptcy processes.

- The Federal Housing Finance Agency (FHFA) directed Fannie Mae and Freddie Mac to remind servicers of their contractual and legal responsibilities in foreclosure processing. On October 13, FHFA directed Fannie Mae and Freddie Mac to implement a policy framework for dealing with possible foreclosure process deficiencies that requires servicers to review their foreclosure processes and fix any processing problems they identify. The FHFA policy framework includes specific steps servicers should take to remedy mistakes in foreclosure affidavits so that the information contained in the affidavits is correct and that the affidavits are completed in compliance with applicable law.

- The Office of the Comptroller of the Currency (OCC) directed all large national bank servicers on September 29 to review their foreclosure management processes, including file review, affidavit processing and signatures, to ensure that the processes are fully compliant with all applicable state laws.

- The Office of the Comptroller of the Currency and the Federal Reserve System are jointly examining foreclosure and securitization practices at the nation's largest servicers. The examinations will include intensive review of the firms' policies, procedures, and internal controls related to loan modifications, foreclosures and securitizations. The reviews will also evaluate controls over the selection and management of third-party service providers.

- In coordination with the work of the other agencies, the Office of Thrift Supervision (OTS) is reviewing the mortgage related policies, foreclosure processes and staffing levels of the largest servicers it supervises. The OTS has gathered preliminary information through its regional offices about the servicer practices across the country. It also issued correspondence on October 8 to all savings associations involved in servicing residential mortgages requiring the immediate review of their actual practices associated with the execution of documents related to the foreclosure process.

- The Federal Deposit Insurance Corporation is participating in the reviews by the OCC, the Federal Reserve System, and the OTS of the foreclosure and securitization practices of the largest mortgage servicers in its role as back-up supervisor. The FDIC also is verifying that the servicers it supervises do not exhibit the problems that others have identified as well as reviewing the processes used by servicers of loans subject to loss share agreements and other loans from receiverships of failed banks. The regulators are also evaluating foreclosure and securitization practices in electronic registration systems.

- The Federal Trade Commission (FTC) is monitoring servicers under existing public orders to confirm proper servicing and foreclosure processes, is conducting reviews in line with past servicing abuses and monitoring the market closely for any fraud or foreclosure scams.

- The US Treasury has implemented a strong compliance framework for the Home Affordable Modification Program (HAMP) servicers. On October 6, Treasury issued a notice to HAMP servicers reminding them of their requirement to comply with all applicable state and federal laws, as well as a reminder that prior to foreclosure sale, servicers must certify to the foreclosure attorney or trustee that all loss mitigation options have been considered and exhausted. Treasury also recently instructed its HAMP compliance agent to review internal policies, procedures, and processes for completing the pre-foreclosure certifications at the ten largest servicers.

- In addition to its role enforcing the federal securities laws, the Securities and Exchange Commission (SEC) has issued proposed rules that would provide greater transparency and disclosures in the securitization market and provide investors with additional tools to evaluate actions in the securitization market.

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**Statement of**

**Edward J. DeMarco, Acting Director**

**Federal Housing Finance Agency**

**Before the Subcommittee on Housing and Community Opportunity**
**of the Committee on Financial Services,**
**U.S. House of Representatives**
**"Robo-Signing, Chain of Title, Loss Mitigation and Other Issues in Mortgage Servicing"**

**November 18, 2010**

Embargoed until 10:00 AM EDT

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**Federal Housing Finance Agency**

**Before the Subcommittee on Housing and Community Opportunity**
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**November 18, 2010**

## Introduction

Chairwoman Waters, Ranking Member Capito and members of the Subcommittee, thank you for inviting me to speak with you today about weaknesses in the foreclosure process. The recently-identified deficiencies in the preparation and handling of legal documents to carry out foreclosures are unacceptable. While those deficiencies undoubtedly reflect strains on a system that is operating beyond capacity and was never designed to handle the volume of nonperforming loans that we are seeing today, they also represent a breakdown in corporate internal controls and the integrity of mortgage servicing and foreclosure processing. Servicers and others within the industry may have attempted to expand the resources available to deliver appropriate loss mitigation services, including timely and accurate foreclosure processing, but in some instances those efforts have been inadequate.

Since this latest set of difficulties was identified, I have had a team of managers and staff from the Federal Housing Finance Agency (FHFA) working closely with Fannie Mae and Freddie Mac (the Enterprises) to gauge the full scope of the foreclosure processing problem and to move forward on foreclosures where appropriate. Our goals are two-fold: to ensure that foreclosure processing is done in accordance with the servicer contract and applicable laws, and to protect taxpayers from further losses on defaulted mortgages. Moving forward on foreclosures where appropriate limits taxpayer losses and contributes to the ultimate recovery of domestic housing markets. Of course, before any foreclosure is completed, we expect servicers to exhaust all alternatives.

With those objectives in mind, I will review the actions that FHFA has taken to date, as well as those underway. Before doing so, I will provide context for understanding the problems that have arisen, including consideration of:

- the role of the servicers, attorneys, and their contractual relationship with the Enterprises when performing loss mitigation and foreclosures and
- the complexities of the system in which state and local laws create a diverse range of requirements that can extend foreclosure timelines, leaving homeowners and homebuyers in limbo, putting home values at risk in neighborhoods with abandoned or vacant properties and slowing the recovery of the housing market.

Today, Fannie Mae and Freddie Mac own or guarantee 30 million mortgages; of those, more than 1.3 million are more than 90 days seriously delinquent. As I have reported to the full Committee on numerous occasions, the Enterprises have sought to minimize losses on delinquent mortgages by offering distressed borrowers loan modifications, repayment plans, or forbearance. These loss mitigation techniques reduce the Enterprises' losses on delinquent mortgages *and* help homeowners retain their homes. Servicers of Enterprise mortgages know that these loss mitigation options are the first response to a homeowner who falls behind on their mortgage payments.

Yet, for some delinquent borrowers, their mortgage payments are simply not affordable due to unemployment or other hardship and a loan modification is not a workable solution. In other cases, homeowners have decided not to continue payment on their mortgages, perhaps because of the decline in value of their house or because personal circumstances have changed their desire or ability to retain their home. For these cases, the Enterprises offer foreclosure alternatives in the form of short sales and deeds-in-lieu of foreclosure. Such foreclosure alternatives generally are better for the homeowner, the neighborhood, and the Enterprise. Despite these options for a graceful exit from a home, foreclosure remains the final and necessary option in many cases.

The sheer volume of delinquent homeowners has put intense pressure on servicers, including their loan workout efforts and their foreclosure processes. Other hearings and studies have analyzed how and why this has happened. The subject of this hearing and our challenge today is to identify the full scope and implications of foreclosure processing problems and to improve the integrity of the foreclosure process at servicers and related parties that are failing to perform to required standards.

**Breakdowns in the Foreclosure Process and FHFA's Initial Response**

As reports of foreclosure documentation deficiencies emerged at several major servicers, FHFA sought to ascertain the full scope and nature of the problem. On October 1, I issued a statement that said, in part:

> "FHFA, as conservator for Fannie Mae and Freddie Mac, supports efforts by the Enterprises to remind servicers and other parties engaged in processing foreclosures to do so in accordance with their seller-servicer agreements and applicable laws and regulations. Where deficiencies have been identified, FHFA has directed the Enterprises to work collectively to develop and implement a consistent approach to address any problems. In addition, FHFA is coordinating with appropriate regulators on this issue. Our goal is to assure the integrity of the foreclosure process and to see that any corrections in processes be tailored to the problem, protecting the rights of borrowers and investors without causing any undue disruption to the mortgage markets."

On October 13, FHFA built upon its earlier statement by providing the Enterprises and servicers a four-point policy framework for handling foreclosure process deficiencies, including specific steps FHFA expects them to take to assess and remedy the problems. The four points are simply stated:

1. Verify that the foreclosure process is working properly;
2. Remediate any deficiencies identified in foreclosure processing;
3. Refer suspicions of fraudulent activity; and

4. Avoid delay in processing foreclosures in the absence of identified problems.

Pursuant to that guidance, the Enterprises continue to gather information on the full nature and extent of servicer problems. Since then, only a small number of servicers have reported back to the Enterprises as having some problem with their foreclosure processing that needs to be addressed. Still, these firms represent a sizeable portion of the Enterprises combined books of business. The issues identified to-date range in size and scope, and may not affect every delinquent mortgage that a particular servicer is handling. Thus, it is difficult to say just how many delinquent Enterprise mortgages may be affected and the degree of difficulty in remediating the deficiencies. The Enterprises are currently working directly with their servicers to ensure that all loans are handled properly and corrections and refiling of paperwork are completed where necessary and appropriate. Because the file reviews are being performed case-by-case, the full evaluation will take a substantial amount of time and resources.

As made clear in FHFA's October 13th policy framework, if wrongful aets in foreclosure processing are discovered, the appropriate remedies should be undertaken by servicers, regulators, and law enforcement. Simply put, it is not acceptable that servicers and other parties involved in foreclosure processing may not have adhered to state and local laws. As Conservator of the Enterprises, FHFA expects all companies servicing Enterprise mortgages to fulfill their contractual responsibilities, which include compliance with both the Enterprises' seller/servicer guides and applicable law. We expect the same of other parties as well, including law firms working on foreclosure processing of Enterprise loans. Finally, to reinforce the duties undertaken by servicers, the Enterprises have indicated that they may pursue remedies for contractual violations.

**The Role of the Servicer**

When an Enterprise purchases a mortgage from an originating lender, it contracts with that lender or another bank or financial institution to service the loan. The servicer is the main communication point for the borrower, accepting all payments and crediting the borrower's account.

When homeowners get behind in payments, the servicer is expected to work with the delinquent borrower to set up a repayment plan, modify the loan, or, if foreclosure alternatives are not viable, begin foreclosure proceedings. Although the Enterprises hold the actual promissory notes through document custodians who maintain these records separate from the servicers, Fannie Mae and Freddie Mac do not themselves accept or process payments or move to modify or foreclose.

For their work, the servicers get paid by the Enterprises and, under the terms of their contracts, each servicer is obligated to follow the procedures established by the Enterprise, including compliance with all appropriate laws. The Enterprises also provide policy guidelines to their seller/servicers. A servicer is contractually bound to comply with this guidance; however, the Enterprises do not review loan files for each and every mortgage they guarantee or purchase. Instead, the Enterprises rely on a representation and warranty (rep and warrant) model under which the loan originator and loan servicer commit that the loan origination and servicing complies with the Enterprise's seller/servicer guide. Under the terms of the servicer contracts, the Enterprises can require the servicer to pay damages if the servicer does not follow the seller/servicer guidelines or force the servicer to buy back the loan if the loan fails to meet the Enterprises' eligibility guidelines.

The majority of Enterprise loans are serviced by a few very large banks. However, there are hundreds of servicers that hold contracts with each Enterprise; many are relatively small institutions. Each servicer typically works on behalf of many investors, including trustees for private label securities, and must follow the procedures and processes set forth in each investor contract. As I will describe further below, we are working with other government agencies to review foreclosure servicing practices and operations, and where we find firms with operational deficiencies, these must be remedied.

**Attorneys Specializing in Foreclosure Processing**

In order to complete foreclosures, particularly in judicial foreclosure states, servicers often contract with law firms from the Enterprises' approved attorney networks (for servicers of one Enterprise this is required, for the other, it is optional to use the approved network). These law firms have been evaluated by the Enterprises before being added to that Enterprise's attorney network. By adding a firm to its network, the Enterprise has concluded the firm has sufficient capacity and expertise to assist a servicer in need of foreclosure processing services. Recently the capacity of some of these law firms has also been strained by the volume of foreclosures and the burden on the court systems. In light of processing problems we are discussing today, it is evident that both Enterprises must take steps to improve their selection and oversight of the attorneys in their networks.

**State Foreclosure Processes and Foreclosure Timelines**

Foreclosure proceedings and requirements are established at the state level. Almost half of the states have a judicial foreclosure process that relies on the court system. By contrast, foreclosures in non-judicial states are managed according to state and local laws but handled outside of the court system.

Both systems have protections for homeowners, and to a large extent the essential paperwork and documentation elements are the same across all states, although particular requirements vary from jurisdiction to jurisdiction. In judicial foreclosure states, individual judges may set specific requirements within their courtrooms that are in addition to, or differ from, terms established by other judges in that state. Servicers and law firms involved in processing foreclosures must be aware of and responsive to such particular requirements.

Both judicial and non-judicial states are experiencing growing numbers of foreclosures, which are contributing to long delays between a borrower's default and the completion of an associated foreclosure.

Currently, the time from start to completion of a foreclosure for Enterprise loans in non-judicial states typically takes six months to a year. In judicial foreclosure states, it takes even longer, often 6 months longer than in non-judicial states and in certain judicial states the difference is even greater. Bear in mind, these foreclosure periods begin *after* the loan becomes seriously delinquent, typically about four months.

Some reasonable delays in the foreclosure process have been expected, appropriately so over the past two years, as new loss mitigation programs, such as loan modifications, have been introduced. These programs have often been accompanied by temporary foreclosure moratoria so that homeowners in the foreclosure process could be assessed for a modification. Servicers are obligated to follow Enterprise guidelines, including evaluating homeowners' for eligibility for the various foreclosure mitigation programs I described earlier.

While FHFA remains committed to ensuring borrowers are presented with foreclosure alternatives, it is important to remember that FHFA has a legal obligation as Conservator to preserve and conserve the Enterprises' assets. As I have said before, this means minimizing losses on delinquent mortgages. Clearly, foreclosure alternatives, including loan modifications, can reduce losses relative to foreclosure and benefit homeowners and neighborhoods, adding some measure of stability to local housing markets. But when these alternatives do not work, timely and accurate foreclosure processing is critical for minimizing taxpayer losses. The direct effect on taxpayers is thus: when an Enterprise-guaranteed mortgage is delinquent four months, the Enterprise removes the mortgage from the mortgage-backed security in which it was funded, paying off the security investors at par. The delinquent mortgage then goes on the balance sheet of the Enterprise, funded with debt issued by the Enterprise, debt supported by the Treasury Department's Senior Preferred Stock Purchase Agreement. While awaiting foreclosure (or some foreclosure alternative), that loan is generating no revenue because the borrower has stopped paying, but the Enterprise must keep paying interest on the debt supporting the mortgage. The cost of the delay is why it is critical to FHFA's responsibilities as Conservator to ensure timely processing of foreclosure actions – the cost is ultimately borne by the taxpayer.

Servicers typically start the foreclosure process when a loan has been delinquent about four months, even when modification efforts are underway. The Enterprises have instructed servicers to suspend foreclosure processing when loss mitigation activities reach certain milestones. The simultaneous actions are necessary because of the long timeframes of the foreclosure process. While the Enterprises have established foreclosure time limits in their seller/servicer guides, no servicers have been penalized in recent years for exceeding those limits, largely because state and local legal requirements, loan modification efforts, the unprecedented volume, and various foreclosure moratoria have greatly contributed to delays. During this year, FHFA has been working with each Enterprise to improve servicers' adherence to these timelines, and to apply penalties where justified, but the recent set of issues have further complicated that effort.

Deficiencies in the foreclosure process, including problems with affidavits, notaries, and improper practices, appear to be the result of inadequate resources for and oversight of servicing operations. The pressure from high volumes of foreclosures working through the system has surfaced fault lines in the foreclosure process that remain the responsibility of management at these companies to identify and fix.

**Other Actions Being Taken & Matters for Consideration**

All of us – regulators, lawmakers, investors, and the general public – want answers to the questions raised by this most recent breakdown in our housing finance market and we want them now. Much work is underway to assess the characteristics, extent, and location of these problems and conclusions must await the completion of this work. Regulatory agencies including FHFA are carrying out important examination activities that will better inform the issue. Thus, identification of further actions or regulatory responses must await the results of these examinations and evaluation of the information developed.

My colleagues can speak to the examination activities they are leading, some of which include FHFA participation. In particular, FHFA is participating in a multi-agency examination of the Mortgage Electronic Registration Systems (MERS). FHFA is reviewing the Enterprises' practices with regard to oversight of their counterparties, which have been lacking in the past. Neither FHFA nor the Enterprises have any regulatory authority with regard to mortgage servicers. FHFA's authority is limited to the Enterprises and, as I have noted, the Enterprises' relationships with mortgage servicers are contractual, not regulatory.

You have asked about a foreclosure moratorium. I do not support a blanket moratorium on foreclosures. The adverse consequences of a moratorium outweigh the argued benefits. The costs to neighborhoods, taxpayers, and investors would be enormous. Our focus should be on fixing problems where they are found and then moving forward expeditiously with foreclosure proceedings where foreclosure alternatives have been exhausted and where no process deficiencies have been identified or they have been remedied. Delay is costing taxpayers money and creates undesirable incentives for homeowners to stop paying their contracted mortgage obligations.

To date, Fannie Mae and Freddie Mac, as well as other parts of the housing finance industry, have relied on a rep and warrant model, whereby one party commits to follow a set of standards and the other party trusts that commitment, unless and until a clear violation or breach is identified. FHFA is reviewing the Enterprises' practices in enforcing reps and warrants and FHFA expects adherence to those contract terms with regard to mortgages they purchase and with regard to mortgage servicing.

FHFA remains committed to working with fellow regulators to enhance our oversight of the foreclosure process and to ensure market participants adhere to state and federal laws. To further our efforts at bringing stability to housing finance, our approach needs to continue to focus on offering troubled homeowners an opportunity to remedy their payment difficulties. Failing that, homeowners should be offered foreclosure alternatives but, after that, foreclosure must proceed in a legal and timely manner for the sake of neighborhoods, investors, and taxpayers.

Thank you for this opportunity to testify. I would be glad to answer any questions.

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Statement by

Elizabeth A. Duke

Member

Board of Governors of the Federal Reserve System

before the

Subcommittee on Housing and Community Opportunity

Committee on Financial Services

U.S. House of Representatives

November 18, 2010

Chairwoman Waters, Ranking Member Capito and members of the Subcommittee, I am pleased to appear today to discuss issues related to mortgage loan servicing and the mishandling of documentation in foreclosure proceedings. The Federal Reserve is focused on a range of issues related to mortgage lending, such as loan underwriting and origination practices, loan servicing, loan modification, neighborhood stabilization and foreclosure. We take all of these matters seriously and are quite concerned about reported irregularities in foreclosure practices.

The Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the Federal Deposit Insurance Corporation (FDIC), and the Federal Reserve are conducting an in-depth review of practices at the largest mortgage servicing operations. The interagency examination and review focuses on foreclosure practices generally, but with an emphasis on the breakdowns that led to inaccurate affidavits and other questionable legal documents being used in the foreclosure process. The regulators expect the initial on-site portion of our work to be completed this year and currently plan to publish a summary overview of industry-wide practices in early 2011. At that time we will have more information about the extent and significance of these very troubling practices, as well as what must be done to prevent them from occurring in the future.

Losing a home is a tragic event for families and the communities in which they live. It is imperative that mortgage lenders and servicers provide borrowers every opportunity to modify the loan and retain their homes or, if that is not possible and foreclosure becomes necessary, that they give borrowers all the protection afforded by following due process as required by law. The issues raised as foreclosure improprieties came to light have cast a pall of uncertainty across the entire housing market. The Federal Reserve is actively working to accurately understand and size the threat to determine the appropriate response. Any response must ensure that actions taken with respect to borrowers and their homes are valid and in accordance with the law; at the same time, those actions should help remove uncertainty and restore smooth functioning to housing and financial markets. Although it is difficult to determine the incremental effect of further procedural delays in foreclosures, delays and uncertainty resulting from flaws in the foreclosure process have the potential to delay recovery in housing markets and to undermine confidence in our financial and legal systems.

In my testimony I will discuss the potential risks to consumers, financial institutions, housing markets, and the broader economy regarding failures to follow proper procedures. I will cover in more detail our interagency reviews of servicer performance and potential remedies if procedures are not being followed. And I will return to the important role of loan modifications in reducing the number of foreclosures to be processed.

**Risks to Consumers**

Consumers and consumer counselors have been quite vocal in their frustration over unreturned phone calls, lost documents and changing decision criteria that have plagued the loan modification process. In light of such experiences, evidence of improper procedures in foreclosure cases causes consumers, at a minimum, to further mistrust the loan servicing process. At worst, it can result in improper loss of a home or premature eviction from that home. For individual borrowers, uncertainty about the prospect or timing of foreclosure makes everyday decisions difficult. Borrowers who are uncertain about their ability to keep their homes have little incentive to invest in or maintain those homes, resulting in damage to neighborhoods and lowering the value of surrounding properties.

And, with wide-spread stories of foreclosure improprieties, families in the process of buying a home or considering the purchase of a home have become concerned about the validity of their titles. Others who have purchased homes in foreclosure have had their closings delayed while documents are reviewed. Consumers have already fallen victim to foreclosure rescue scams as charlatans posing as mortgage counselors claimed to be able to obtain mortgage modifications for a fee. In light of new stories of mortgage abuse, new incarnations of those scams are sure to proliferate.

**Risks to Financial Institutions and the Financial System**

Financial institutions face a number of risks if inadequate controls result in faulty foreclosure documents or failure to follow legal procedures. Recent events have shown that even the possibility of problems can lead to costly delays and reviews. In cases where actual problems are found, regulators will require lenders and servicers to correct not only the faulty documents themselves but the faulty systems that allowed them to occur. Institutions with widespread problems may be subject to fines and fees in addition to the costs associated with correcting the errors.

Cost associated with foreclosure documentation problems, including "robo-signing" (discussed in more detail later), are not the only potential liabilities facing financial institutions. Investors in mortgage-backed securities and purchasers of unsecuritized "whole loans" have begun to explore and in some cases assert contractual and securities law claims against the parties that originated the loans, sold the loans, underwrote securities offerings, or had other roles in the process. The essence of these claims is that the mortgages in the securitization pools or that had been sold as unsecuritized whole loans did not conform to the representations made about their quality—specifically, that the loan applications contained misrepresentations or the underwriting was not in conformance with stated underwriting guidelines.

With respect to the contract claims, this potential liability is usually called "put back" risk, because many of the relevant agreements permit the buyer of the loans to put the loans back to the seller (or other party that makes representations). That is, the buyers can demand that the seller repurchase the loans at par if defects are found in the loan underwriting contrary to representations and warranties in the pooling and servicing agreement that created the securitization trust or the whole loan mortgage purchasing agreement. At the time of the put-back, the loan has usually gone into default, sparking a review of the original loan application file. The defaulted loan, given current market conditions, is typically worth substantially less than par, thus the put-back transfers any potential loss from the buyer back to the seller. Although the representations and warranties in the various agreements vary considerably, they frequently require that the defect materially and adversely affect the value of the loan before put-back rights can be exercised.

There are also pending claims by some that underwriters and sponsors of securitizations failed to comply with the Federal securities laws covering offering documents and registration statements. These suits specifically reference descriptions of the risks to investors, the quality of assets in the securitization, the order in which investors would be paid or other factors. Most of these lawsuits are in the early stages, and it is difficult to ascertain the probability that investors will be able to shift a substantial portion of the losses on defaulted mortgages, specifically, or mortgage-backed securities back to the parties that sold the loans or underwrote the offerings. Nevertheless, the Federal Reserve has been conducting a detailed evaluation of put-back risk to financial institutions. Losses due to put-backs are not new; buyers, insurers of loans (private mortgage insurers), and guarantors of securitizations (GSEs) of defaulted mortgages have been seeking to put back defective loans since well before the mortgage crisis began. This practice has accelerated during the current mortgage crisis. Financial institutions have been resolving these claims throughout the crisis. However, just as holders and guarantors of mortgages and mortgage-backed securities are pressing their claims, financial institutions are vigorously defending against many of the claims that seek to impose substantial liability on them. We are gathering information to ensure that the institutions we supervise have adequately assessed these risks and have accounted for them properly.

**Risk to Mortgage Market and Housing**

In addition to the potential harm to consumers, financial institutions and the financial system, the Federal Reserve is evaluating the potential macroeconomic effects of foreclosure documentation problems to the mortgage and housing markets. The number of foreclosures initiated on residential properties has soared from about 1 million in 2006, the year that house prices peaked, to 2.8 million last year. Over the first half of this year, we have seen a further 1.2 million foreclosure filings, and an additional 2.4 million homes were somewhere in the foreclosure pipeline at the end of June. All told, we expect about 2.25 million foreclosure filings this year and again next year, and about 2 million more in 2012. While our outlook is for filings to decline in coming years, they will remain extremely high by historical standards. Currently, almost 5 million mortgage loans are 90 days or more past due or in foreclosure.

The Federal Reserve believes that the best way to assist struggling borrowers is with a mortgage modification that allows borrowers to retain their homes with an affordable mortgage payment. Foreclosures are costly to all parties and, more broadly, to our economy. Lenders and investors incur financial losses arising from the litigation expenses associated with the foreclosure process and the loss on the defaulted mortgage when the foreclosed property sells at a "fire sale" price for substantially less than the loan balance. Local governments must contend with lower property tax revenue and the ramifications of neglected properties that may threaten public safety. Additionally, neighbors and neighborhoods suffer potential spillover effects from foreclosure sales because foreclosures may reduce the attractiveness of the neighborhood or may signal to potential buyers a forthcoming decline in neighborhood quality.

Problems with foreclosure documentation procedure could lead to further delays in an already lengthy foreclosure process. Recent estimates suggest that the average time to foreclosure in the United States has already increased from 251 days in January 2008 to more than 440 days in 2010. While a mortgage modification is always preferable to foreclosure, when a sustainable loan modification is not possible, long and uncertain delays in the foreclosure process can be harmful to neighborhoods and the housing market more generally. Vacant properties may fall into disrepair or be vandalized. Even when borrowers continue to live in their homes, those unable to make their mortgage payments may not have the resources or the incentive to adequately maintain their properties. In the end, an overhang of homes awaiting foreclosure is unhealthy for the housing market and can delay its recovery as well as that of the broader economy.

In addition, the lack of certainty and price discovery created by the glut of foreclosures has further weakened property values and has contributed to a slowing in the recovery of the housing market more generally. The most important action policymakers can take to address the rising foreclosures and the lack of mortgage activity is to craft policies that encourage market participants to act in a particular manner that will allow the economy to achieve a sustainable recovery. Over the course of the past two years, the Federal Reserve has taken forceful action in response to the financial crisis to help improve financial market conditions and to promote the flow of credit to households and businesses. More specifically, our purchases of long-term mortgage-backed securities, government agency debt, and Treasury securities served to reduce mortgage rates which in turn allowed mortgage holders to refinance into lower payments and made home loans more affordable for new purchasers.

**Foreclosure Process**

Before I turn to specific examination procedures underway, it might be helpful to review the foreclosure process and the role of investors and loan servicers. Foreclosure is a legal process initiated to terminate a borrower's interest in a property and is permitted only when the borrower has defaulted on the debt obligation for a specified period. To the extent a loan is secured by the property, the process allows the lender to sell the property and apply the proceeds in full or partial satisfaction of the borrower's unpaid debt. Foreclosure requirements are generally established by state law, and each state has its own statutes, rules, and court decisions pertaining to foreclosures. For this reason, a financial institution needs to understand the foreclosure procedures and documentation practices for each state in which it operates.

Some 23 states, known as judicial foreclosure states, require foreclosures to be reviewed and approved by a court in advance. Nonjudicial foreclosure states have varying waiting periods and documentation, filing, and notice requirements after a default occurs before a foreclosure sale may take place. In judicial foreclosure states, homeowners can challenge the foreclosure either by appearing in and defending the action already brought by the lender or by filing for bankruptcy. In nonjudicial foreclosure states, to challenge the foreclosure, the homeowner must take the initiative to file suit in state court to enjoin the foreclosure or file for bankruptcy. Almost half of all of the states have statutes that allow the borrower to cure a default by paying any amount already due, plus any allowable costs and fees, prior to the foreclosure sale without having to pay off the entire principal amount of the mortgage loan.

Mortgage servicers are a critical link between borrowers and mortgage holders as they maintain the official accounting of all amounts paid and owed by borrowers. In addition, servicers handle loan default management, including negotiating repayment of loss mitigation plans with borrowers. In the event that loan modification efforts are not successful, the servicer would initiate foreclosure, often as the agent for third parties, such as securitization trusts. In this regard, servicers have responsibilities to investors holding residential mortgage-backed securities. These securities are held by a broad range of investors including state pension funds and retirement systems. Servicers also have responsibilities to borrowers to maintain accurate and complete records of payments received, amounts advanced, notifications made to borrowers, and any mortgage modification discussions.

Foreclosure documentation typically requires an assertion that the agent bringing forth the action has the legal right to foreclose and that the loan is in default. The document filing would contain details of the transaction and the amounts owed. Problems associated with so-called robo-signing of documents include documents signed by individuals who do not have personal knowledge of the facts being asserted, documents signed by individuals who are not properly authorized to make such claims or assertions, notarized signatures on documents that were not executed in the presence of a notary or that have other violations of proper notary procedures, and documents that contain inaccurate amounts, dates, or other facts. Lenders and servicers are responsible for ensuring that the person who signs a document is duly authorized and has appropriate knowledge obtained from a review of the case. In addition, servicers and lenders are responsible for ensuring the accuracy of records and the facts recited in the documents.

State law and local real estate recording requirements govern recordation of real estate and mortgage title transfers. Given the multiple transfers of mortgage loans over time, concerns have been raised about investors' or servicers' right to foreclose. Although state-by-state practices vary considerably, generally the note holder has the right to initiate foreclosure if an original note can be produced and the current holder's ownership is able to be verified in some fashion. If there is no controversy concerning ownership of the note, but rather an inability to locate original documents, processes usually exist that allow for a foreclosure to proceed, albeit at some cost and delay. If there is some question of ownership, the investor or servicer may be required to produce evidence of ownership before a foreclosure can proceed.

Matters regarding real estate titles and foreclosures are generally governed by state law, and the 50 state attorneys general have undertaken a joint review of lenders and servicers and the reported problems in foreclosures. In addition, numerous federal agencies have launched investigations, including examinations in process by the federal financial regulators.

**Interagency Examinations**

The Federal Reserve has supervisory and regulatory authority for bank holding companies, approximately 800 state-chartered banks that are members of the Federal Reserve System (state member banks), and certain other financial institutions and activities. We work with other federal and state supervisory authorities to ensure the safety and soundness of the banking industry, foster the stability of the financial system, and provide for fair and equitable treatment of consumers in their financial transactions. As the consolidated supervisor of bank holding companies, including financial holding companies, the Federal Reserve conducts inspections of those institutions. The Federal Reserve is involved in both regulation, which involves establishing the rules within which banking organizations must operate, and supervision, which entails ensuring that banking organizations abide by those rules and remain, overall, in safe and sound condition.

As I indicated at the beginning of my statement, the OCC, the OTS, the FDIC, and the Federal Reserve are in the process of conducting interagency targeted examinations of the foreclosure policies and practices of the financial institutions that control a majority of outstanding mortgage loans. The agencies expect to conclude the on-site portion of our examination process by the end of this year and plan to review the findings immediately thereafter. We want to ensure that our analysis is comprehensive and provides a basis for development of remedial actions. Currently, the banking agencies plan to publicly release a summary report highlighting the industry-wide findings in early 2011.

In our examinations, the agencies are reviewing firms' policies, procedures, and internal controls related to foreclosure practices and are sampling loan files to test the effectiveness of those policies, procedures and internal controls. We are prepared to take supervisory action where necessary and appropriate to hold institutions accountable for poor practices.

Specifically, we are examining the firms' internal governance processes related to: (1) foreclosure policies and procedures; (2) organizational structure, approval process, and staffing levels; (3) vendor management of outside law firms; (4) quality control processes and internal audit; and (5) foreclosure workflow process and loan documentation procedures. We have also solicited information from consumer organizations to help us better direct our actions to detect problems at specific servicers and to determine whether systematic weaknesses are leading to improper foreclosures.

For additional insights into foreclosure processes, we have sent a self-assessment questionnaire to other Federal Reserve-regulated institutions that have mortgage servicing activity but were not part of the interagency horizontal examination effort. The staff will analyze the responses from the firms and determine what follow-up work is required to validate the information they provide.

The Federal Reserve requires supervised institutions to have sufficient corporate governance and maintain adequate risk-management programs to ensure the institution's safety and soundness, as well to comply with consumer protection laws and regulations. Institutions with identified weaknesses will be directed to take remedial actions. Any remedial action mandated by the Federal Reserve will be consistent with the goals and objectives of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 to promote best practices and financial stability.

**Supporting Loan Modifications**

Notwithstanding the right of lenders to pursue foreclosure, the Federal Reserve encourages mortgage servicers to first pursue a sustainable loan modification for the borrower. To ensure that modification requests are handled appropriately, we have leveraged the information from our consumer complaint investigation process. As a result of complaints received from consumers and members of the Congress on behalf of their constituents, in October 2009 the Federal Reserve began a review of the loan modification practices of loan servicers for which we have supervisory responsibility. These reviews include on-site examinations that began in the second quarter of this year and are still underway.

The Federal Reserve has emphasized the importance of using loan modifications as a means to avoid unnecessary foreclosures and continues to encourage effective loan modifications. Prudent modifications that are consistent with safe and sound lending practices are generally in the long-term best interest of both financial institutions and borrowers. We have sponsored numerous modification fairs and events to bring lenders and borrowers face-to-face to explore alternatives to foreclosure. In addition to promoting loan modifications, the Federal Reserve has actively supported efforts to help communities that have been hard hit by vacancies and foreclosures. Federal Reserve staff members in our research, community development, and supervision and regulation divisions are collaborating to encourage foreclosure prevention at the local level and promote neighborhood stabilization initiatives. Further, Federal Reserve staff members are conducting empirical research on mortgage- and foreclosure-related topics, and they are reaching out to industry and consumer experts as well.

A key initiative developed under the leadership of the Federal Reserve Bank of Chicago has been the Mortgage Outreach and Research Effort (MORE). MORE involves all 12 Federal Reserve Banks and the Board of Governors in a collaboration that pools resources and combines expertise to inform and engage policymakers, community organizations, financial institutions, and the public at large. In September 2010, MORE sponsored a discussion among experts and policymakers on effective strategies for stabilizing neighborhoods weakened by real estate owned by financial institutions and vacant properties. This meeting also included a publication developed by the Board and the Boston and Cleveland Federal Reserve banks that featured analysis and promising practices from leading practitioners and applied researchers.[1] Another important resource published this year by MORE summarizes key actions that the Federal Reserve has taken to address the foreclosure crisis.[2]

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[1] Federal Reserve Bank of Boston, Federal Reserve Bank of Cleveland, Board of Governors of the Federal Reserve System, and others (2010), *REO & Vacant Properties: Strategies for Neighborhood Stabilization,* www.federalreserve.gov/events/conferences/2010/reovpsns/downloads/reo_20100901.pdf )

[2] Federal Reserve System, Mortgage Outreach and Research Efforts (MORE) Initiative (2010), *Addressing the Impact of the Foreclosure Crisis: Federal Reserve Mortgage Outreach and Research Efforts* (Chicago: Federal Reserve Bank of Chicago),
www.chicagofed.org/digital_assets/others/in_focus/foreclosure_resource_center/more_report_final.pdf

In addition to encouraging loan modifications by other holders of mortgage loans, the Federal Reserve has worked with servicers of mortgages it acquired in actions taken to stabilize the financial system. On January 30, 2009, the Board of Governors adopted a policy requiring the pursuit of mortgage modifications prior to initiating foreclosure on loans held in the Federal Reserve System.

**Conclusion**

In summary, the Federal Reserve has been actively working to mitigate the harm to consumers and markets caused by problems in mortgage loan origination, securitization, and loan foreclosures. We are participating in interagency examinations of the foreclosure processes and controls in the financial institutions that control the majority of the nation's mortgages. We are conducting examinations of lenders' and servicers' loan modification efforts. In response to the fallout from the financial crisis, the Federal Reserve has helped stabilize the mortgage market and improve financial conditions more broadly, thus promoting economic recovery. As the foreclosure crisis has intensified, Federal Reserve staff in our research, community development, and supervision and regulation divisions have actively collaborated to support foreclosure prevention at the local level and promote neighborhood stabilization initiatives. These efforts reflect a continuation of actions undertaken by the Federal Reserve System since the start of the financial crisis. We remain committed to the goal of stabilized financial markets that promote economic recovery.

Thank you for holding this important hearing today, and I would be happy to answer any questions that you may have.

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**Testimony of**

**Linda E. Fisher**
**Professor of Law, Seton Hall University School of Law**

**Before the Subcommittee on Housing and Community Opportunity, House Financial Services Committee**

***Hearing on Robo-Signing, Chain of Title, Loss Mitigation & Other Issues***

**November 18, 2010**

Thank you for providing me the opportunity to participate in this hearing. I am a law professor and attorney with expertise in the areas of predatory lending, foreclosure defense and other public interest litigation. I also teach civil procedure and professional responsibility. With the assistance of law students in my Civil Litigation Clinic, I have been involved in predatory lending, mortgage fraud, and foreclosure litigation for over ten years. The Clinic's clients are low and moderate income residents of urban North Jersey. In addition, I work closely with the Newark/Essex Foreclosure Task Force, a coalition of government and nonprofit agencies addressing the foreclosure crisis in the greater Newark, New Jersey area.

My testimony focuses primarily on the relationship between faulty foreclosure practices and fraud, as well as on the consequences for homeowners and neighborhoods. I describe the steps in a judicial foreclosure in which robo-signing problems can occur. I also draw links between widespread origination fraud in subprime lending, opportunistic fraud such as foreclosure rescue scams, and the assembly-line foreclosures – often involving illegalities – that are further destabilizing urban communities. I will provide examples from my own cases as well as from lawyers and housing counselors with whom I work. In many of these instances, homeowners were induced and duped into taking out loans they could not afford, or they were defrauded of title to their homes by foreclosure rescue scammers.

The current crisis is exacerbating the disparities between poor and wealthy families and neighborhoods, in part because vacant foreclosed properties depress property values and facilitate crime.[1] Widespread foreclosures invite further opportunistic fraud and increase inequality between urban minorities and the rest of the country.[2] Additional regulation and enforcement of existing law are necessary, but perhaps the most critical need is for serious mortgage modifications allowing homeowners who can make reasonable mortgage payments to remain in their homes. Absent realistic modifications, many hard-working, law-abiding homeowners --who may have been victims of fraud, illegal fee padding, or inaccurate accounting -- will lose their homes, uprooting their families in the process.

First, what is "robo-signing"? While this newly coined phrase is hardly a term of art, it generally refers to the practice of servicer employees signing high volumes of affidavits in foreclosure cases[3] with false attestations that they have personal knowledge of the facts recounted and that they have reviewed supporting documentation.[4] These affidavits can violate state false swearing and unfair and deceptive acts and practices

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[1] Studies have documented the relationship between vacant and abandoned foreclosed properties, depressed property values, and increased crime in neighborhoods with high rates of foreclosures. *See* Dan Immergluck, *Intrametropolitan Patterns of Foreclosed Homes*, Community Affairs Discussion Paper, Federal Reserve Bank of Atlanta (2009).

[2] *See* Linda E. Fisher, *Reverse Redlining, Racialized Consumer Fraud and Target Marketing of Subprime Loans*, 18 Brooklyn J. of L. & Pol'y. 101 (2009).

[3] Twenty-three states, including New Jersey, have a judicial foreclosure process in which evidence must be submitted to a court, and judgment entered, before a foreclosure sale can take place.

[4] For a further description of the problem and its potential consequences, *see* the report of the Congressional Oversight Panel released this past Tuesday. *November Oversight Report: Examining the Consequences of Mortgage Irregularities for Financial Stability and Foreclosure Mitigation,* Nov. 16, 2010.

statutes, as well as the due process rights of homeowners. When an attorney is involved, court rules requiring an evidentiary basis for all filed submissions may be violated. For instance, an affidavit may falsely state that a homeowner has been served with process, that the foreclosure plaintiff is the holder of the mortgage obligation, that an assignment of a mortgage and note timely took place, or that inflated amounts are owed to the lender. When the plaintiff is not the party entitled to foreclose because the wrong party was named or because the plaintiff trust did not hold the obligation at the time of filing, it does not have standing and is not entitled to judgment.[5]

Yet every day foreclosures proceed to judgment because a court relied on a plaintiff's inaccurate attestations.[6] For the past several years, I have been involved in cases in which the wrong entity filed a foreclosure because of a documentation error, while alleging that it held the note and owned the mortgage. I have been involved in many additional cases in which plaintiffs erroneously attested that a mortgage and note were timely assigned into a trust, when the assignments and transfers actually occurred after default and after the foreclosure case was filed, depriving the plaintiff of standing. Without representation, it is unlikely that these errors would ever have been discovered, as courts frequently lack the resources to closely scrutinize all submissions. However, homeowners generally are unable to contest and raise defenses in foreclosure because they cannot afford counsel. For instance, until recently, well over 90% of New Jersey foreclosure defendants were unrepresented; that figure has declined only a little in the past year. Providers of legal services to the indigent are overwhelmed with requests for assistance and can represent only a fraction of the people seeking their assistance with foreclosures. It is likely that many of these unrepresented borrowers are losing their homes because of servicer errors.

These violations are serious in themselves and far from technical, yet robo-signing and other false attestations are only the tip of the foreclosure iceberg. The iceberg

[5] I will not go into detail concerning the various chain of title issues that can arise when a securitized trust attempts to foreclose because others have already described these issues at some length. The November Congressional Oversight Panel report provides a comprehensive and accurate description of the problems.

[6] A colleague calls these widespread practices "servicer civil disobedience."

includes the entire servicing and default servicing system, with its rampant inaccuracies, lack of verification procedures and lack of accountability. Automation, cost-cutting, and financial incentives to foreclose have combined to create a treadmill that cannot stop to rectify errors or modify mortgages so that qualified homeowners can remain in their homes and investors can continue to receive a stream of income. I have repeatedly been told by counsel for foreclosure plaintiffs that even they are unable to contact their servicer clients to request reasonable settlements in cases. I also have tried in vain to reach servicers on behalf of my clients, only to end up in a loop of endless telephone transfers to equally ineffectual employees after our paperwork was lost repeatedly. Much less are housing counselors able to stop the "left-hand, right-hand problem" in which foreclosures proceed even after mortgage modification agreements have been reached. This problem is quite common both in New Jersey and across the country.

Origination and opportunistic foreclosure fraud – frequently occurring during the peak subprime lending years of 2004 to 2007 -- are another piece of the subprime foreclosure iceberg, since fraudulent loans tend to end up in assembly-line foreclosures with little hope of redress. The securitization machine that originated so many fraudulent loans is the same machine that now forecloses even when reasonable alternatives may be available. In the rush to originate new subprime and Alt-A mortgages to distribute to securitizations – whose demand for these products was seemingly insatiable -- lenders abandoned strict underwriting standards in favor of "low-doc" and "no-doc" underwriting. The lack of verification procedures and failure to investigate telltale signs of fraud allowed many fraudulent originations to occur, particularly in wholesale lending channels involving mortgage broker originations, where fraud was known to be rampant. Myriad types of fraud occurred during this period. In my own practice, I have frequently seen false mortgage applications prepared and submitted by brokers and loan officers – with little input from the clients and sometimes with forged signatures – that vastly overstate the clients' income and assets, and sometimes list false employment.[7] Inflated appraisals have been near universal in the cases I have litigated. Where borrowers in these cases can

[7] Such practices were widespread during the peak subprime lending years. Abuses by Ameriquest, Household Finance, and Countrywide have been particularly well-documented, though many other entities were involved as well.

make reasonable monthly payments, servicers should pursue reasonable alternatives to foreclosure, even if principal writedowns are required to bring the loan into line with actual market value.

Various types of foreclosure rescue scams were also commonplace during the peak lending years. Lenders frequently provided funding for rescue scams in which desperate homeowners facing foreclosure were duped into "temporarily" signing over title to their homes to a straw buyer with decent credit.[8] In return, they received assurances that the buyer would obtain and pay a new mortgage, while the former owners could remain in the property and pay rent, with an option to repurchase the home once they improved their credit. Despite the existence of common red flags indicating a scam, the straw buyers were able to take out new loans, which they almost universally stopped paying before disappearing, rapidly causing a new foreclosure. Yet because the loans were securitized, existing financial incentives encouraged such behavior. The same cost-cutting, profit making system that produced robo-signing facilitated and enabled these frauds.

We currently have a case in which the former homeowners paid a straw buyer in full for a year and a half, only to have her default and disappear. They have intervened in the foreclosure action against the straw buyer to assert their own claims and defenses.[9] These clients continue to make full payments into an escrow account while the litigation proceeds. In another current case, an elderly, disabled woman who had owned her home for forty years was duped into signing it over to a rescue scammer. After two strokes, her cognitive capacities were impaired, making her easy prey. She and her family can now make reasonable mortgage payments and pay off the arrears under a reasonable installment plan if one were offered. Similar stories abound. A common feature of all is

[8] For an explanation of these scams and how a foreclosure court can address them, *see* Linda E. Fisher and Leena Khandwala, *Foreclosure Rescue Scams,* Real Estate Financing Treatise, Matthew Bender Pub. 592, release 91 (2010), available on Lexis.

[9] Securitized trusts may be liable for the originator's actions if they are not holders in due course.

that the straw buyers were easily able to obtain new mortgages despite indications of underlying fraud. Another common feature is that these homes end up in foreclosure. [10]

Any policy solution to the foreclosure crisis must take borrowers' rights and situations into account, as well as the rights of lenders and concerns for the broader housing market and national economy. Banks should be required to engage in serious mortgage modification efforts before foreclosing, even if principal writedowns are required. Servicers must be subject to meaningful federal regulation. In the short term, independent monitors and auditors should be appointed to investigate the servicer practices that have contributed so heavily to the current crisis.

[10] Another common scam involves credit repair and mortgage modification operations that promise to assist homeowners with saving their homes, generally for an upfront fee of about $3000. Lawyers frequently are involved. After obtaining the fee, the scammers disappear, leaving the borrowers in even worse shape than they were before being scammed. As an example of how common these scams are, without my mentioning the type of work I do, a D.C. cabdriver told me last week that he was the victim of such a scam. Clients of mine have also been scammed in this fashion, as have many others in the greater Newark area and across the country. A lack of serious opportunity to modify mortgages contributes to the proliferation of these scams.

# Testimony of Julia Gordon
# Center for Responsible Lending

## Before the U.S. House of Representatives
## Subcommittee on Housing and Community Opportunity
## of the Committee on Financial Services

## "Robo-Signing, Chain of Title, Loss Mitigation and Other Issues in Mortgage Servicing"

***November 18, 2010***

Good morning Chairman Waters, Ranking Member Moore, and members of the subcommittee. Thank you for the invitation to discuss the mortgage servicing industry's response to the foreclosure crisis that has devastated families, destroyed neighborhoods, and triggered a global financial crisis. We believe servicers have failed to prevent a very large proportion of unnecessary foreclosures, and that significant additional steps are required to ensure that foreclosures only occur when the alternatives do not produce a more economically favorable outcome.

I serve as Senior Policy Counsel at the Center for Responsible Lending (CRL), a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, a nonprofit community development financial institution. For thirty years, Self-Help has focused on creating asset building opportunities for low-income and minority families, primarily through financing safe, affordable home loans. In total, Self-Help has provided over $5.6 billion of financing to 64,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across America.

### I. Introduction and Summary

Almost four years ago, our organization released a report warning that the reckless and abusive lending practices of the previous two decades would lead to approximately 2 million subprime foreclosures. At the time, our report was denounced by the mortgage industry as absurdly pessimistic. Sadly, the system was even more larded with risk than we had understood, and the damage has been far worse, spreading from the subprime to the prime sectors, catalyzing a housing-lead recession, and triggering historic levels of unemployment.

Since we issued the report, there have already been more than 2.5 million homes lost, and Wall Street analysts recently predicted there could be as many as 11 million more foreclosures filed.[1] The foreclosure crisis has had catastrophic consequences for families and communities, especially communities of color. First, millions of homeowners ended up in dire straits due to abusive mortgage originations, incompetent and predatory mortgage practices, ineffective government oversight, and a complex securitization system that lacks accountability all the way up and down the chain. Now, millions more are in danger due to the toxic combination of underwater loans and unemployment that festers in so many areas.

In this situation, the mortgage servicing system should serve as a resource for both homeowners and investors harmed by unscrupulous originators and securitizers. Instead, the servicing system is compounding the problem. It has become crystal clear to even the casual observer that the servicing system cannot or will not serve either the best interests of homeowners or investors for a variety of reasons, including that the system's capacity is too strained to function correctly and that crosscutting financial incentives mean that when servicers and their subcontractors act in their own best interest, it is not necessarily also in the best interest of either investors or homeowners.

Ultimately, the fate of these homeowners impacts all of us. Foreclosures bring down home values across the board and devastate communities and municipal budgets. Even worse, since the housing sector historically has led the way out of economic downturns, weakness in the housing sector is slowing economic recovery and hampering efforts to create jobs and reduce unemployment.

Things did not need to be this bad. If the Bush Administration had moved quickly back in 2007, or if the Obama Administration and Congress had acted more forcefully in early 2009, we could have significantly limited the breadth and depth of the foreclosure crisis. In particular, reforming the bankruptcy code to permit judges to modify the loans on principal residences could have made a significant impact on the problem. Instead, the response ultimately consisted of initiatives that relied exclusively on voluntary assistance from servicers in return for minor monetary incentives.

In evaluating how well this approach has worked, the facts speak for themselves: nearly three million have already lost their homes, and almost six million more are in danger of joining them. [2] The principal federal response to the crisis, the Home Affordable Modification Program (HAMP), has produced fewer than a half million permanent modifications. More than 60% of borrowers have not even been evaluated for a modification.[3] Servicers have routinely failed to follow the loss mitigation guidelines contained both in the HAMP program and in the contracts of investors such as FHA and the GSEs, and the dual-track system of loss mitigation while also proceeding to foreclosure has resulted in foreclosures taking place before evaluation for loan modifications or other alternative has occurred, while that process is occurring, or even after a successful modification agreement has already been reached.

Beyond loss mitigation failures, mortgage servicers also are engaging in other shoddy, abusive, and even illegal accounting and legal practices. Recently, the public has learned about profound problems with the system for proving that the foreclosing party has the legal right to do so. Servicers also have a track record of poor accounting practices, including misapplying payments and force-placing insurance improperly. These various problems have resulted in the so-called "robosigning" scandal, in which employees have lied about having personally reviewed the information alleged in their summary judgment affidavits -- in part to save costs by cutting corners, but in part because the servicer simply does not have the ability to produce the mortgage note or prove that other facts alleged in the affidavit are true.

It is shocking that servicers have characterized these problems as "technical" ones that somehow don't matter because the homeowners are in default in any account.[4] re simply "technical" issues, case after case demonstrates that is not true. Regardless of the homeowner's default status, one of the bedrock principles of our legal system is that a person cannot have their private property taken without due process. But more than that, while the lack of regulatory oversight has resulted in a paucity of relevant data, the sheer volume of anecdotal accounts of profound mistakes and abuses suggests that in a significant number of cases, people are experiencing wrongful foreclosure.[5]

Much recent discussion has focused on whether calls for a foreclosure moratorium given the servicing problems will hurt the economy by delaying market clearing. We do not think this is the right question. Instead, we should be asking whether the servicing system currently is able to distinguish properly between those instances where foreclosure is unavoidable and those where another option would produce a more favorable financial result.

Unfortunately, every available piece of evidence suggests the system cannot yet reliably make this distinction. This failure to prevent foreclosures that would save money for both investors and homeowners is both perverse and bad for economic recovery. Additionally, to get the housing market back on track, buyers need assurances that the foreclosures are legal and not vulnerable to challenge. Having banks claim to "fix" thousands of mortgages within a couple of weeks without more information is unlikely to restore public confidence in the system. Consequently, a temporary pause in pursuing foreclosures during which defined, objective, and transparent measures are taken to ensure the integrity of the system is likely to be the best way to stabilize the market.

Today, we urge everyone concerned about the stability of the housing market and the sustainability of our economic recovery to address the foreclosure problem head-on with every tool available. For too long, we have listened to the insistence of the servicers that they can solve this problem on their own. While it always seemed improbable that would be the case, after almost four years, we now know that is impossible.

It is high time for Congress, the Administration, banking regulators, federal and state law enforcement officials, and state legislatures to employ *every tool at their disposal* to end a crisis that has spiraled out of control for years now, unnecessarily, wasting billions (maybe even trillions) of dollars and standing in the way of broad economic recovery . In these recommendations, we describe many ways in which these various actors can help produce the results that will best serve investors, homeowners, and the market as a whole.

**Recommendations for Congress**

- Change the bankruptcy code to permit modifications of mortgages on principal residences.
- Mandate loss mitigation prior to foreclosure.
- Level the playing field in court by funding legal assistance for homeowners.
- Ensure that homeowners receiving mortgage debt forgiveness or modifications do not find their new financial security undermined by a burdensome tax bill.

**Recommendations for Federal Agencies (non-HAMP-related)**

- The federal prudential banking regulators should immediately focus on the servicing operations of their supervisees.
- The Consumer Financial Protection Bureau should make regulating servicers one of its first priorities.
- Fannie Mae and Freddie Mac should serve as models to the industry.
- HUD, VA, and other government housing programs should enforce their servicing rules, especially those related to mandatory loss mitigation.

**Recommendations for Improving HAMP**

- Aggressively enforce HAMP guidelines through serious penalties and sanctions for noncompliance.
- Create an independent, formal appeals process for homeowners.
- Evaluate all borrowers for HAMP, 2MP, and HAFA or other sustainable proprietary solutions before proceeding with foreclosure.
- To ensure that loan modifications are sustainable, require servicers to reduce principal whenever the alternative waterfall yields a positive net present value (NPV) or at least to disclose the positive NPV to investors, require servicers to reduce principal on second liens proportional to any reduction of principal undertaken with respect to the first lien, and require servicers to reduce principal appropriately when the underlying mortgage exhibits predatory characteristics.
- Increase the mandatory forbearance period for unemployed homeowners to six months and reinstitute the counting of unemployment benefits as income.
- Mandate automatic conversions of successful trial modifications and reimburse homeowners who pay their trial modifications but are not converted for any interest and fees paid during that period.
- Require servicers to provide the homeowner with the relevant written documentation any time a modification is denied due to investor restrictions.
- Share loan-level data with the public to ensure that everyone has access to the most complete source of data on foreclosure prevention.
- Permit homeowners who experience additional hardship to be eligible for a new HAMP review and modification.
- Mandate an additional 30 days after HAMP denial to apply for Hardest Hit Program monies and HAMP reconsideration if the HHP application is approved.
- Clarify existing guidelines to streamline the process and carry out the intention of the program.

**Recommendations for States**

- State legislatures should mandate loss mitigation prior to foreclosure.
- States should exercise their supervisory and enforcement authority over servicers doing business in their jurisdiction.

## II. Background: The foreclosure crisis has impacted tens of millions of people directly or through spillover effects, with a particularly severe impact on minority communities, and mortgage servicers have routinely engaged in careless, predatory and illegal practices.

### A. The foreclosure crisis impacts millions of people, both directly and through spillover effects.

With one in seven borrowers delinquent on their mortgage or already in foreclosure[6] and nearly one in four mortgages underwater,[7] continued weakness in the housing sector is already impairing economic recovery and hampering efforts to create jobs and reduce unemployment. According to industry analysts, the total number of foreclosures by the time this crisis abates could be anywhere between 8 and 13 million.[8] A recent study by CRL estimated that 2.5 million foreclosure sales were completed between 2007 and 2009 alone, while another 5.7 million borrowers are at imminent risk of foreclosure[9]

Beyond the impact of the foreclosures on the families losing their homes, foreclosure "spillover" costs to neighbors and communities are massive. Tens of millions of households where the owners have paid their mortgages on time every month are suffering a decrease in their property values that amounts to hundreds of billions of dollars in lost wealth just because they are located near a property in foreclosure. Depending upon the geography and time period, the estimated impact of each foreclosure ranges from 0.6 percent to 1.6 percent in lost value to nearby homes. CRL estimates that the foreclosures projected to occur between 2009 and 2012 will result in $1.86 trillion in lost wealth, which represents an average loss of over $20,000 for each of the 91.5 million houses affected.[10] These losses are on top of the overall loss in property value due to overall housing price declines.[11]

Furthermore, since African-American and Latino borrowers have disproportionately been impacted by foreclosures, these spillover costs will disproportionately be borne by communities of color. CRL has estimated that African-American and Latino communities will lose over $360 billion dollars in wealth as a result of this spillover cost.

In addition, foreclosures cost states and localities enormous sums of money in lost tax revenue and increased costs for fire, police, and other services because vacant homes attract crime, arson, and squatters. As property values decline further, more foreclosures occur, which only drives values down still more. The Urban Institute estimates that a single foreclosure results in an average of $19,229 in direct costs to the local government.[12]

The crisis also severely impacts tenants in rental housing. According to the National Low-Income Housing Coalition, a fifth of single-family (1-4 unit) properties in foreclosure were rental properties and as many as 40 percent of families affected by foreclosure are tenants.[13] While tenants now have some legal protection against immediate eviction,[14] most of them will ultimately be forced to leave their homes.[15] Furthermore, a great deal of housing stock is now owned by the banks rather than by new owners. Banks are not in the business of renting homes and are not well suited to carry out the duties required of a landlord.

Compounding the problem of renters losing homes to foreclosures is the impact that the crisis has on other sources of affordable housing. A policy brief from the Joint Center for Housing Studies reports that dramatic changes at Freddie Mac and Fannie Mae and coincident changes in credit markets have disrupted and increased the cost of funding for the continued development of multi-family (5+ units) properties, despite the fact that underwriting and performance has fared better in this segment than in single-family housing.[16] As a result, even though a general over-supply of single-family housing persists, the deficit in the long-term supply of affordable rental housing is at risk of increasing.[17]

### B. Toxic loan products lie at the heart of the mortgage meltdown.

In response to the foreclosure crisis, many in the mortgage industry have evaded responsibility and fended off government efforts to intervene by blaming homeowners for mortgage failures, saying that lower-income borrowers were not ready for homeownership or that government homeownership policies dictated the writing of risky loans.[18] This argument is both insulting and wrong. Empirical research shows that the elevated risk of foreclosure was an inherent feature of the defective nonprime and exotic loan products that produced this crisis, and that these same borrowers could easily have qualified for far less risky mortgages that complied with all relevant government policies and regulations.

A number of studies demonstrate that loan performance and loan quality are strongly related. For example, Vertical Capital Solutions found that the least risky loans[19] significantly outperformed riskier mortgages during every year that was studied (2002-2008), regardless of the prevailing economic conditions and in every one of the top 25 metropolitan statistical areas.[20] That study also confirmed that loan originators frequently steered customers to loans with higher interest rates than the rates for which they qualified and loans loaded with risky features, and that 30 percent of the borrowers in the sample (which included all types of loans and borrowers) could have qualified for a safer loan. The Wall Street Journal commissioned a similar study that found 61 percent of subprime loans originated in 2006 "went to people with credit scores high enough to often qualify for conventional [i.e., prime] loans with far better terms."[21]

Even applicants who did not qualify for prime loans could have received sustainable, thirty-year, fixed-rate subprime loans for—at most—half to eight tenths of a percent above the initial rate on the risky ARM loans they were given.[22]

CRL's own research has demonstrated that common subprime loans with terms such as adjustable rates with steep built-in payment increases and lengthy and expensive prepayment penalties presented an elevated risk of foreclosure *even after accounting for differences in borrowers' credit scores.*[23] A complementary 2008 study from the University of North Carolina at Chapel Hill supports the conclusion that risk was inherent in the structure of the loans themselves.[24] In this study, the authors found a cumulative default rate for recent borrowers with subprime loans to be more than three times that of comparable borrowers with lower-rate loans. Furthermore, the authors found that adjustable interest rates, prepayment penalties, and mortgages sold by brokers were all associated with higher loan defaults. In fact, when risky features were layered into the same loan, the resulting risk of default for a subprime borrower was four to five times higher than for a comparable borrower with the lower- and fixed-rate mortgage from a retail lender.

Finally, CRL conducted a more targeted study to focus on the cost differences between loans originated by independent mortgage brokers and those originated by retail lenders. In that study, we found that for subprime borrowers, broker-originated loans were consistently far more expensive than retail-originated loans, with additional interest payments ranging from $17,000 to $43,000 per $100,000 borrowed over the scheduled life of the loan.[25] Even in the first four years of a mortgage, a typical subprime borrower who used a broker paid $5,222 more than a borrower with similar creditworthiness who received a loan directly from a lender.[26] The data overwhelmingly supports that irresponsible lending and toxic loan products lie at the heart of the crisis.

**C. Minority families and communities of color bear a disproportionate burden of the foreclosure crisis.**

It is well documented that African-American and Latino families disproportionately received the most expensive and dangerous types of loans during the heyday of the subprime market.[27] New CRL research released this summer shows that, not surprisingly, minorities are now disproportionately experiencing foreclosure.

In June, our report entitled "Foreclosures by Race and Ethnicity: The Demographics of a Crisis" shows that African-Americans and Latinos have experienced completed foreclosures at much higher rates than whites, even after controlling for income.[28] While an estimated 56% involved a white family, when looking at rates within racial and ethnic groups, nearly 8% of both African-Americans and Latinos have already lost a home, compared to 4.5% of white borrowers. We estimate that, among homeowners in 2006, 17% of Latino and 11% of African-American homeowners have lost or are at imminent risk of losing their home, compared with 7% of non-Hispanic white homeowners. The losses extend beyond families who lose their home: From 2009 to 2012, those living near a foreclosed property in African American and Latino communities will have seen their home values drop more than $350 billion.

Another CRL report issued in August, "Dreams Deferred: Impacts and Characteristics of the California Foreclosure Crisis," shows that more than half of all foreclosures in that state involved Latinos and African Americans.[29] Contrary to the popular narrative, most homes lost were not sprawling "McMansions," but rather modest properties that typically were valued significantly below area median values when the home loan was made.

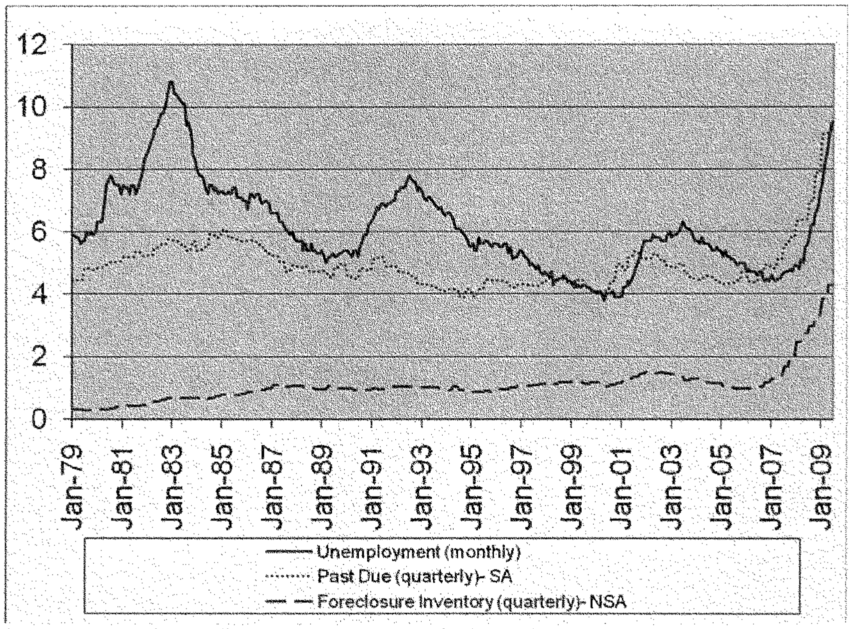
The impact of this crisis on families and communities of color is devastating. Homeownership is the primary source of family wealth in this country, and people often tap home equity to start a new business, pay for higher education and secure a comfortable retirement. In addition, home equity provides a financial cushion against unexpected financial hardships, such as job loss, divorce or medical expenses. Perhaps most important, homeownership is the primary means by which wealth is transferred from one generation to the next, which enables the younger generation to advance further than the previous one. Minority families already have much lower levels of wealth than white families, and therefore this crisis is not only threatening the financial stability and mobility of individual families, but it is also exacerbating an already enormous wealth gap between whites and communities of color.[30]

### D. Unemployment is exacerbating the crisis but didn't cause it.

High unemployment did not cause the foreclosure crisis, but because of the crash of the housing market, unemployment is now far more likely to trigger mortgage default than in the past, largely due to widespread negative equity. In past recessions, homeownership served as a buffer against income interruptions because homeowners facing unemployment could sell their homes or tap into their home equity to tide them over. Today, selling homes is difficult to impossible in many markets, and even when sales take place, the seller sees no net proceeds from the sale. Figure 1 below shows that during previous periods of very high unemployment, foreclosure numbers remained essentially flat. Delinquency levels did rise somewhat, but they rose far less than they have risen during the recent crisis.[31] Other research confirms that the risk of default due to unemployment rises when homeowners are underwater on their mortgage.[32]

And why are so many homeowners underwater? It is because the glut of toxic mortgages contributed to inflating the housing bubble and then led to the bursting of the bubble, followed by a self-reinforcing downward spiral of home prices.

**Figure 1: Historical relationship of unemployment and foreclosure rate**

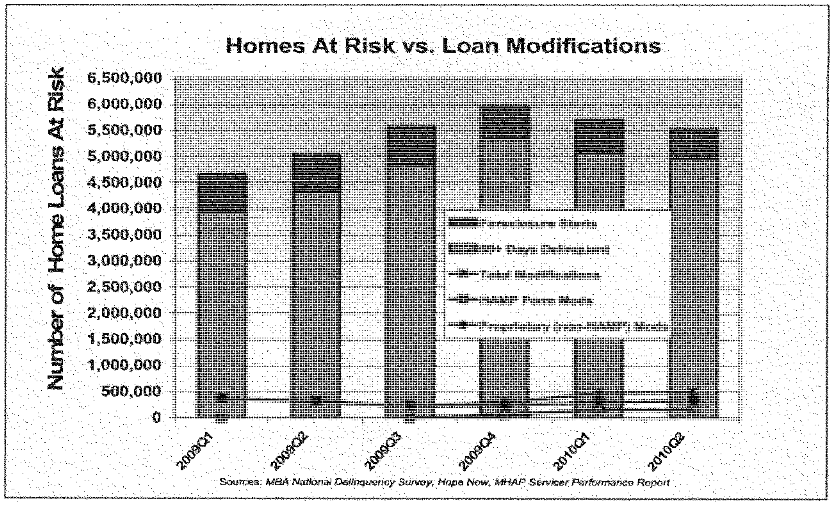



Sources: MBA National Delinquency Survey, Bureau of Labor Statistics.

**E. Foreclosures continue to outstrip loan modifications.**

Despite both HAMP and proprietary modifications, the number of homeowners in need of assistance continues to overwhelm the number of borrowers who have received a permanent loan modification by ten to one (see Figure 2).

**Figure 2. Demand for Relief Continues to Outpace Loan Modifications**




About 4.6 million mortgages are in foreclosure or 90 days or more delinquent as of June 30.[33] New foreclosure starts were over 225,000 per month in July and August, having fallen below 200,000 in each of the previous three months. There were roughly 33,000 permanent HAMP modifications in August and 116,000 proprietary modifications.[34] According to the State Foreclosure Prevention Working Group, more than 60% of homeowners with serious delinquent loans are still not involved in any loss mitigation activity.[35]

### F. Mortgage servicers engage in a range of predatory and illegal practices both in the foreclosure process and leading up to foreclosure.

For at least a decade, community-based organizations, housing counselors and advocates nationwide have documented a pattern of shoddy, abusive and illegal practices by mortgage servicers whose staff are trained for collection activities rather than loss mitigation, whose infrastructure cannot handle the volume and intensity of demand, and whose business records are a mess.[36]

The most egregious of these abuses include:

- misapplication of borrower payments, which results in inappropriate and unauthorized late fees and other charges, as well as misuse of borrower funds improperly placed in "suspense" accounts to create income for servicers.
- force-placing very expensive hazard insurance and charging the borrower's account when the borrower's hazard insurance has not lapsed, often driving an otherwise current borrower into delinquency and even foreclosure.

- charging unlawful default- and delinquency-related fees for property monitoring and broker price opinions.
- failing or refusing to provide payoff quotations to borrowers, preventing refinancings and short sales.
- improperly managing borrower accounts for real estate tax and insurance escrows, including failure to timely disburse payments for insurance and taxes, causing cancellation and then improper force-placing of insurance as well as tax delinquencies and tax sales.
- abuses in the default and delinquency process, including failing to properly send notices of default, prematurely initiating foreclosures during right to cure periods and immediately following transfer from another servicer and without proper notices to borrowers, initiating foreclosure when borrower is not in default or when borrower has cured the default by paying the required amount, and failing to adhere to loss mitigation requirements of investors.

These practices have become so ingrained in the servicing culture that they are now endemic in the industry. The harm to which borrowers have been subjected as a result of these abuses cannot be overstated. Numerous homeowners are burdened with unsupported and inflated mortgage balances and have been subjected to unnecessary defaults and wrongful foreclosures even when they are not delinquent. Countless families have been removed from their homes despite the absence of a valid claim that their mortgage was in arrears.

Perverse financial incentives in pooling and servicing contracts explain why servicers press forward with foreclosures when other solutions are more advantageous to both homeowner and investor. For example, servicers are entitled to charge and collect a variety of fees after the homeowner goes into default and can recover the full amount of those fees off the top of the foreclosure proceeds.[37] The problem of misaligned incentives is compounded by a lack of adequate resources, management, and quality control.

What's more, recent legal proceedings have uncovered the servicing industry's stunning disregard of basic due process requirements.[38] Numerous servicers have engaged in widespread fraud in pursuing foreclosures through the courts and, in non-judicial foreclosure states, through power of sale clauses. It is becoming more and more apparent that servicers falsify court documents not just to save time and money, but because they simply have not kept the accurate records of ownership, payments and escrow accounts that would enable them to proceed legally. The public is also now learning what foreclosure defense attorneys have asserted for years: the ownership of potentially millions of mortgages is in question due to "innovations" and short-cuts designed to speed the mortgage securitization process.[39]

As noted above, the illegal practices of servicers during the foreclosure process are not simply a technical problem. Due process when taking private property is a cornerstone of our legal system, and case after case reveals that this is not just a question of dotting the I's and crossing the T's, but of unnecessary and even wrongful foreclosures. The rules that the banks have broken in their rush to foreclose were put in place specifically to give people a fair chance to save their homes, and without them, homeowners are powerless to save their homes.

## III. It is time for a comprehensive approach to foreclosure prevention that uses all the tools in the toolbox.

### A. Congress can pass legislation that would meaningfully realign incentives among servicers, investors, and homeowners.

#### 1. Change the bankruptcy code to permit modifications of mortgages on principal residences.

Our country's well established system for handling problems related to consumer debt is bankruptcy court. The availability of this remedy is so crucial for both creditors and debtors that the Framers established it in the Constitution, and the first bankruptcy legislation passed in 1800. Today, bankruptcy judges restructure debt for corporations and individuals alike.

Shockingly, however, when it comes to the family home -- the primary asset for most people in our country -- these experienced judges are powerless: current law makes a mortgage on a primary residence the only debt that bankruptcy courts are not permitted to modify in Chapter 13 payment plans. Owners of vacation homes, commercial real estate and yachts can have their mortgage modified in bankruptcy court (and the peddlers of predatory mortgages such as New Century or over-leveraged investment banks like Lehman Bros. can have all their debt restructured) but an individual homeowner is left without remedy.

Addressing this legal anomaly would solve almost in one fell swoop a range of problems that have beset efforts to combat foreclosures. First and foremost, bankruptcy does not leave foreclosure prevention to the voluntary efforts of servicers. Instead, a trusted third party can examine documents, review accounting records, and ensure that both the mortgagor and mortgagee are putting all their cards on the table. Moreover, the homeowner is the one who controls when this remedy is sought, rather than the servicer.

Second, in bankruptcy, the judge can reduce the level of the mortgage to the current market value of the property. This stripdown (some call it cramdown), or principal reduction, can help put homeowners in a position to begin to accumulate equity on their home again, thereby shielding them against future income shocks and increasing their incentive to make regular mortgage payments.

Third, a bankruptcy judge has the power to deal with the full debt picture of the homeowner, including any junior liens on the family home and other consumer debt such as medical bills, credit cards, or student loans. Second liens have proven to be one of the most vexing problems facing many foreclosure prevention efforts, and high consumer debt can threaten the sustainability of any mortgage modification made in a vacuum.[40]

Fourth, bankruptcy addresses "moral hazard" objections, meaning the concern that people will want relief even when they don't need or deserve it. Filing a Chapter 13 claim is an onerous process that a person would rarely undertake lightly. Any relief from debt comes at a substantial cost to the homeowner -- including marring the homeowner's credit report for years to come and subjecting the homeowner's personal finances to strict court scrutiny.

Fifth, the availability of this remedy would in large part be the very reason why it would not need to be used very often. Once mortgages were being restructured regularly in bankruptcy court, a "template" would emerge as it has with other debts, and servicers would know what they could expect in court, making it much more likely that servicers would modify the mortgages themselves to avoid being under the control of the court. Similarly, the fact that a homeowner had the power to seek bankruptcy would serve as the now-missing stick to the financial incentive carrots provided by other foreclosure prevention programs.

Permitting judges to modify mortgages on principal residences, which carries *zero cost to the U.S. taxpayer*, could potentially help more than a million families stuck in bad loans keep their homes.[41] As foreclosures continue to worsen, more and more analysts and interested parties are realizing the many benefits this legislation could have.[42] Recently, the Federal Reserve Bank of Cleveland published an analysis of using bankruptcy courts to address the farm foreclosure crisis of the 1980s, concluding that using bankruptcy to address that crisis did not have a negative impact on availability or cost of credit.[43]

### 2. Mandate loss mitigation prior to foreclosure.

Congress has the power to require that all servicers, industry-wide, must engage in loss mitigation, and that the failure to do so is a defense to foreclosure. For many servicers, only a legal requirement will cause them to build the systemic safeguards necessary to ensure that such evaluations occur.

Almost two years ago now, Chairman Waters introduced legislation that would require loss mitigation.[44] This legislation also would have addressed many of the other shoddy servicing practices that have resulted in the problems we see today. We strongly suggest that this legislation be updated to reflect current understandings of the issues and be reintroduced in the 112th Congress.

### 3. Level the playing field in court by funding legal assistance for homeowners.

All banks and servicers are represented by attorneys, but most homeowners in default or foreclosure cannot afford an attorney. Housing counselors can help people with their mortgages, but only attorneys can contest foreclosures in court. Programs offering free legal assistance can play an integral role in foreclosure prevention, including:

- identifying violations of mortgage lending laws and laws related to the foreclosure process.
- assisting with loan modification applications and the modification process.
- advising homeowners on existing bankruptcy options.
- helping homeowners seek alternatives to foreclosure.
- defending tenants who are being forced out following foreclosure.
- educating homeowners and tenants about the foreclosure process and legal rights.

Recognizing the importance of borrower representation, the Dodd-Frank Act authorized $35 million to establish a Foreclosure Legal Assistance Program through HUD that would direct funding to legal assistance programs in the 125 hardest hit metropolitan areas. Unfortunately, that money has not yet been appropriated.

As the foreclosure crisis continues unabated, other funding for foreclosure legal assistance is drying up. State-administered Interest on Lawyer Trust Account (IOLTA) revenue, a major source of funding for legal aid programs, has declined 75 percent due to interest rate decreases. State budget crises have forced the slashing of legislative appropriations that fund legal aid. Another major private source of funding for anti-foreclosure work, a grant program run by the Institute for Foreclosure Legal Assistance (IFLA), has already made the last grants it can make under current funding and will end in 2011.[45]

Without additional funding, the attorneys who have developed expertise in this area may well lose their jobs, and legal aid groups will not be able to keep pace with the spike in foreclosure-related needs. Already, legal aid programs turn away hundreds of cases. For these reasons, it is crucial to fund the $35 million Foreclosure Legal Assistance Program authorized by the Dodd-Frank Act.

Congress also should clarify that foreclosure prevention funds allocated under TARP and being used in the HAMP and Hardest Hit Programs can be used for legal assistance when appropriate.[46] We know now that there are many types of servicing abuses that cannot be handled by a housing counselor alone.

**4. Ensure that homeowners receiving mortgage debt forgiveness or modifications do not find their new financial security undermined by a burdensome tax bill.**

Even principal forgiveness or the most carefully structured loan modifications can be seriously undermined if struggling homeowners must treat the forgiven mortgage debt as taxable income. Solving this tax problem has been flagged as a priority by the IRS's Office of the National Taxpayer Advocate.[47]

When lenders forgive any mortgage debt, whether in the context of a short sale, a deed-in-lieu-of-foreclosure, foreclosure, or principal reduction in a loan modification, that amount of forgiven debt is considered income to the homeowner and tax must therefore be paid on it unless the homeowner qualifies for some kind of exclusion to that tax. In 2007, Congress passed the Mortgage Forgiveness Debt Relief Act of 2007 to prevent adverse tax consequences to homeowners in trouble. After passage of this bill, most policymakers considered the problem to have been solved.

Unfortunately, many homeowners are not covered by that legislation because they took cash out of their home during a refinancing to make home repairs, pay for the refinancing, or consolidate other debt.[48] Moreover, even those homeowners already fully covered by the Mortgage Forgiveness Debt Relief Act often fail to take advantage of this exclusion because it is complicated and they do not understand the need to do so to avoid owing additional taxes. [49]The National Taxpayer Advocate reports that in 2007, less than one percent of electronic filers eligible for the exclusion claimed it.[50] If the definition of qualified mortgage debt is expanded, the IRS can take steps through its tax forms to simplify the process for taxpayers claiming the mortgage debt exclusion.

Finally, while the sunset date on this legislation was already extended through 2012, it needs to be extended further, and preferably made permanent, since this particular part of the tax code was originally aimed at corporate deals (where the vast majority of the related tax revenues are generated) rather than at individual consumer debt issues.

**B. Federal agencies have significant authority that should be employed to help fight foreclosures.**

There are a number of federal regulatory agencies with authority to help fight foreclosures. In a later section, we will provide extensive recommendations for improvements that Treasury can make to HAMP. In this section, we provide other suggestions.

**1. The federal prudential banking regulators should immediately focus on the servicing operations of their supervisees.**

Federal supervisory banking regulators should use their examination authority and supervisory authority to focus on the servicing operations of their supervisees, with a focus on the legality and propriety of accounting inaccuracies, inappropriate fees and charges, failure to comply with loss mitigation requirements, and other problems identified in this testimony. The methodology and results of these investigations should be made available to the public as extensively as possible. To the extent that problems are found, the regulators should move to correct them quickly and thoroughly through an open and transparent process, and when necessary, referrals should be made to the appropriate enforcement authorities.

**2. The Consumer Financial Protection Bureau should make regulating servicers one of its first priorities.**

The Consumer Financial Protection Bureau (CFPB) is ideally positioned to provide consumers with a strong voice in the foreclosure fight -- a voice that has largely been absent in the regulatory structure and executive branch. The CFPB already has concurrent supervision authority with federal banking regulators over large banks to examine them for compliance and to assess risks to consumers and markets.[51] Right now, the nation's three largest banks (Bank of America, Wells Fargo, and JP Morgan Chase) account for approximately 50% of all mortgage servicing, so exercising this supervisory function with respect to the operations of these banks can begin immediately. Banks should be examined for compliance with all relevant laws and regulations as well as adherence to the provisions of contracts with investors and government agencies such as FHA and VA.

Moreover, as of July 2011, the CFPB will acquire rule-making authority to prevent abusive, unfair, deceptive and harmful acts and practices and to ensure fair and equal access to products and services that promote financial stability and asset-building on a market-wide basis. For an example of useful rules, the CFPB can look to what some states have already done.[52] It will also have strong enforcement tools, and the States will have concurrent authority to enforce the rules against violators in their jurisdictions. The CFPB should begin now to prepare to use its authority and tools to prevent predatory servicing practices.

Finally, apart from specific regulatory authority, as the voice of consumers in the regulatory structure, the CFPB can help to educate both policymakers and the public about this issue and thereby to help ensure that proposed solutions are as responsive to consumer interests as they are to bank interests.

**3. Fannie Mae and Freddie Mac should serve as models to the industry.**

Fannie Mae and Freddie Mac (the GSEs), now in conservatorship and supported by taxpayers, should serve as a model for how to prevent unnecessary foreclosures. While it has been a GSE priority to ensure that foreclosures proceed in a timely way, it is important that the desire to avoid delay does not prevent their servicers and attorneys from scrupulously adhering to all laws and guidelines, particularly those regarding loss mitigation reviews. In playing this important role, we recommend that the FHFA revisit its decision not to reduce principal on mortgage loans. Permitting modifications that produce both a positive net present value and a more sustainable loan modification will have a long-term, beneficial impact that needs to be weighed fairly against short-term profitability concerns.

**4. HUD, VA, and other government housing programs should enforce their servicing rules, especially those related to mandatory loss mitigation.**

FHA, VA, and other government-insured housing finance programs should ensure that their servicers are conducting the required loss mitigation reviews and following all relevant laws and guidelines. In a recent press conference, HUD Secretary Shaun Donovan admitted that an internal HUD investigation indicated that FHA servicers were not always conducting the loss mitigation reviews required by FHA. In addition to recommending that HUD terminate contracts with servicers that are not adhering to the provisions of those contracts, we recommend that HUD release public information concerning the loss mitigation track records of its servicers.

### C. The Treasury Department should continue to improve HAMP and its associated programs.

As of September, approximately 470,000 homeowners had received and were still active in a permanent modification.[53] While saving almost a half million homes is a significant accomplishment, it falls far short of the original estimate that HAMP would assist 3-4 million borrowers.[54] The number of new trial modifications also has dropped significantly since HAMP changed its guidelines to require up-front underwriting of the modifications, and the number of conversions to permanent modifications is also declining, with fewer than 28,000 permanent modifications made in September. Given that trajectory, it seems unlikely that the total number of permanent modifications by the end of 2012 will exceed one million.[55]

Part of the reason for the lack of HAMP permanent modifications is the fact that the vast majority of modifications continue to be made outside of HAMP. As of August of this year, only 470,000 permanent modifications were made through HAMP, compared to 3.2 million proprietary modifications.[56] Servicers routinely ask borrowers to waive their right to a HAMP modification.[57] Sometimes, servicers transfer their accounts to other entities that are not bound by the HAMP contract with Treasury. While we do not know all the reasons why this happens, some possibilities are: (1) servicers profit more from the proprietary modifications because the HAMP incentives are insufficient to overcome other financial incentives; (2) the design of the HAMP program does not fit the majority of borrowers; (3) servicers do not want to fill out the detailed reports required by HAMP; or (4) servicers wish to avoid oversight. Whatever the reason, the lack of transparency about proprietary modifications makes it very difficult to compare them with HAMP modifications or to analyze their ultimate suitability for borrowers.

Similarly, the fact that servicers have violated HAMP guidelines and have resisted any kind of independent appeals process has resulted in the widespread negative experience that so many homeowners and their advocates have had with the program. For a whole range of reasons ranging from lack of capacity to conflicts of interest, mortgage servicers in many cases fail to provide many homeowners with a HAMP review that is timely, accurate, and adheres to HAMP guidelines. Stories abound of servicers who have had stunningly bad experiences when servicers ignore HAMP guidelines.

Despite its shortcomings, however, HAMP remains the principal federal response to the foreclosure problem, and without HAMP, homeowners would be even worse off than they are now. We make the following recommendations to refine HAMP's design and improve its performance.

#### 1. Aggressively enforce HAMP guidelines through serious penalties and sanctions for noncompliance.

Over its year and a half of operations, Treasury has improved the HAMP program in a number of ways in response to concerns expressed by homeowners, advocates, and servicers. Unfortunately, servicers do not always comply with all the HAMP guidelines. Although we are told that errors are corrected when they are found during the Freddie Mac compliance process, the continuous flow of reports to the contrary from advocates and the press illustrates that many guidelines are being evaded or ignored.

We recommend that Treasury develop a clear, impartial system of penalties and sanctions for failure to comply with HAMP guidelines. Some HAMP guidelines are more crucial than others (see, for example, the section below on foreclosure stops), and violation of those guidelines should result in stiffer penalties. In addition, Treasury should release full information on the compliance records of each servicer, along with the number of corrective actions that have been taken, and develop a system for logging and investigating complaints from advocates about noncompliance with HAMP guidelines.

**2. Create an independent, formal appeals process for homeowners who believe their HAMP denial was incorrect or who cannot get an answer from their servicer.**

When a borrower is rejected for a HAMP modification, that borrower should have access to an independent appeals process where someone who does not work for the servicer can review and evaluate the situation. The existing HAMP escalation procedures are inadequate. (Freddie Mac does conduct compliance reviews and will require a servicer to fix any errors it finds, but this process cannot be triggered by request of an individual homeowner.) Since HAMP changed its procedures in January 2010 to require that servicers send letters with reasons for denial, and even more so as HAMP implements the directive contained in the Dodd-Frank Act that servicers disclosure the inputs used to make those decisions, homeowners have increased access to information about their denial, but they still have no way to make a change if that information indicates their denial to be in error.

We recommend that the Treasury establish an Office of the Homeowner Advocate to serve an appeals and ombudsman role within the program, along the lines of the National Taxpayer Advocate. There is legislation currently pending that would establish such an office, although it is unlikely to pass during the 111th Congress (this idea did already succeed in a Senate floor vote with bipartisan support when it was offered as an amendment to another bill, the initial underlying legislation failed.[58] For states or localities that have foreclosure mediation programs, those programs could also be used to handle this type of appeal.

**3. Review all borrowers for HAMP, 2MP, and HAFA eligibility or other sustainable proprietary solutions before proceeding with foreclosure.**

Prior to June 2010, servicers routinely pursued HAMP evaluations and foreclosures simultaneously. Homeowners trapped in those parallel tracks received a confusing mix of communications, including calls and letters concerning evaluation for a modification, and other formal notifications warning of an impending foreclosure sale. These mixed messages contributed to the failure of some borrowers to send in all their documentation, the early re-default of many trial modifications, and the difficulty servicers have reaching certain borrowers.

Although HAMP guidelines prohibited the actual foreclosure sale from taking place prior to a HAMP evaluation, sales were taking place anyway because the foreclosure proceedings are handled by outside law firms and communications between servicers and foreclosure attorneys regarding HAMP are extremely minimal.[59] Adding insult to injury, when continuing the foreclosure process during HAMP evaluation servicers' lawyers were billing thousands of dollars in attorneys fees that the homeowners were then expected to pay.

With Supplemental Directive 10-02, Treasury directed that for all new applicants, servicers were supposed to complete the HAMP review prior to referring the case to foreclosure. Furthermore, if an applicant was already in foreclosure, services were to stop additional steps toward a foreclosure once that borrower was in a verified trial modification.

Not surprisingly, despite Supp. Dir. 10-02, advocates are still routinely seeing homeowners placed into the foreclosure process even when they have not yet had their HAMP review. In some cases, this is because the homeowner did not qualify for the "foreclosure stop"; in other cases, servicers simply are not complying with the guidelines; in still other cases, the rules are ambiguous. For example, while servicers may not refer a case to a foreclosure attorney before the review, in a non-judicial state, it may not be clear that the foreclosure cannot actually be filed.

Foreclosures and foreclosure sales prior to HAMP evaluation are perhaps the biggest reason for the public's loss of confidence in the program. We recommend that when a borrower applies for HAMP,[60] the servicer should stop all foreclosure referrals, filings, or any actions to advance any goal other than HAMP review. As noted in Recommendation #1 above, when a servicer is found to proceed with a foreclosure prior to evaluation, strict penalties should ensue swiftly.

**4. To ensure that loan modifications are sustainable, require servicers to reduce principal whenever the alternative waterfall yields a positive NPV or at least to disclose the positive NPV to investors, require servicers to reduce principal on second liens proportional to any reduction of principal undertaken with respect to the first lien, and require servicers to reduce principal appropriately when the underlying mortgage exhibits predatory characteristics.**

Millions of Americans now owe more on their mortgages than their homes are worth. While the overall number of mortgages underwater is estimated to be almost one in four,[61] this ratio is far higher for homeowners who are having trouble affording their mortgage, and the average HAMP borrower owes $1.14 for ever $1.00 the house is worth.[62] Homeowners who are underwater have no cushion to absorb future financial shocks, and they have fewer incentives to sacrifice to stay in the home or to make ongoing investments in maintenance.[63] For these homeowners, even the reduction of monthly payments to an affordable level does not fully solve the problem. As a result, a homeowner's equity position has emerged as a key predictor of loan modification redefault.[64]

Many stakeholders believe that principal reduction is ultimately the only way to help the housing market reach equilibrium and begin to recover.[65] However, even as loan modification activity has ramped up in the overall market, principal reduction has remained relatively rare. One context in which it occurs is in portfolio loans with no second liens, which suggests that banks understand the usefulness of principal reduction but that for securitized loans, there is a conflict of interest between the banks that own the second liens (and who also own the servicers) and the investors who do not want to agree to a write-down on the first lien unless the second lienholder does the same.

In recognition of these realities, HAMP has initiated two programs: the "alternative waterfall" principal reduction program, and 2MP, the second lien program. Unfortunately, although HAMP offers generous financial incentives to cover the write-down, HAMP does not *require* servicers to engage in principal reduction even when it's in the best interests of the investor.[66]

Since the alternative waterfall program just began this month, we do not yet know how it will work. It is likely that the only way principal reduction is ever going to happen on a widespread basis is if it is required. Similarly, although 2MP has existed for over a year and although all four major banks have signed up, it is unclear why that program has only been used 21 times to date.[67] For this reason, HAMP should either require the write-downs or require the servicers to disclose the results of the positive NPV calculations to the investor.

Finally, HAMP should provide a commensurate reduction in principal for loans that exhibit predatory characteristics, such as 2/28s, 3/27s, and non-traditional loans such as interest-only or negatively amortizing loans not underwritten to the fully indexed rate or fully amortizing payment.

**5. Increase the mandatory forbearance period for unemployed homeowners to six months and reinstitute the counting of unemployment benefits as income.**

Another attempted improvement to HAMP this year was the establishment of a forbearance program for homeowners who lose their job (UP). Under UP, unemployed homeowners get at least three months (more if the servicer chooses) of reduced payments that will end when the homeowner becomes reemployed.

Unfortunately, this program does not adequately address the issue of unemployed homeowners. First, servicers were already doing a lot of three-month forbearances on their own. The problem is that most homeowners need longer than three months, as the average length of unemployment during this downturn is well over six months.[68] Second, when UP was announced, the HAMP guidelines changed so that unemployment income was no longer counted as "income" for a HAMP modification, even if it was guaranteed for at least nine months. Many families have sufficient income in addition to unemployment benefits to qualify for HAMP, and generally they would be better served by a HAMP modification than by a temporary forbearance.

Finally, HAMP should clarify the relationship between UP, HHF, and the new HUD bridge loan program.

**6. Mandate automatic conversions of successful trial modifications and reimburse homeowners who pay their trial modifications but are not converted for any interest and fees paid during that period.**

First, for borrowers who entered into verified income trial modifications, servicer delays in converting trial modifications to permanent modifications are simply unacceptable. They increase costs to homeowners and create significant periods of uncertainty. There is no reason why trial modifications should not automatically convert to permanent modifications if the borrower makes three timely trial modification payments.

Second, homeowners who have received a stated income trial modification in good faith, have made all their trial payments in a timely way, but have been denied a permanent modification should not end up financially worse off than they were before the trial modification. Currently, however, they often do end up worse off. Throughout the entire period, which is usually longer than three months since servicers are so backed up, these borrowers who are doing everything that is asked of them continue to be reported to credit bureaus as delinquent on their mortgage. Moreover, since the trial modification payments are by definition less than the full contract payment under the mortgage and the terms of the mortgage are not altered during the trial modification, homeowners finish a trial modification owing more on their homes than when they started. We have seen servicers use these arrears, accumulated during the trial modification, as the basis for initiating an immediate foreclosure against a homeowner, post-trial modification.

Homeowners who pay their trial modification payments but are not converted should be given an opportunity to pay back the arrears through regular monthly installments rather than a lump sum payment. Furthermore, the borrower should have the choice to have the arrears capitalized into the loan and the term extended so that their participation in HAMP does not result in an increase in monthly payments (if the PSA prevents a term extension, the amortization period should be extended). Finally, many homeowners end up facing foreclosure solely on the basis of the arrears accumulated during a trial modification. Such foreclosures should be prohibited.

**7. Require servicers to provide the homeowner with the relevant written documentation anytime a modification is denied to investor restrictions.**

Servicers are required to provide a HAMP modification whenever the NPV is positive, unless the Pooling and Servicing Agreement with the investor prohibits such a modification and the servicer has sought a change in policy from the investor and the investor has not agreed. When a servicer believes a PSA prevents an NPV-positive modification, the servicer is supposed to contact the trustee and any other parties authorized under the terms of the PSA to attempt to obtain a waiver. However, it appears that many servicers are using "investor turndowns" as a reason not to do a modification in violation of HAMP rules, in most cases because the contract does not actually prohibit the modification and in some instances because the servicer has not requested a change in policy from the investor.

Just last week, recognizing this problem, the Treasury Department changed its policy to require servicers to provide basic information related to investor denials.[69] While this is a small step in the right direction, it is crucial that servicers provide the borrower with this information directly, in hard copy form, as he or she is in the best position to act quickly if there is a problem but may be unable to access online databases. To minimize paperwork burden on servicers, we suggest that the servicer provide the borrower or the borrower's representative a photocopy of the limiting language in the PSA along with information on how to electronic access to a complete and unaltered copy of the PSA, and a copy of all correspondence with the lender and investors attempting to obtain authority to perform a modification,

**8. Share loan-level data with the public to ensure that everyone has access to the most complete source of data on foreclosure prevention publicly available.**

The Treasury Department is collecting a broad range of data from servicers participating in the HAMP program – more data than has ever been collected about the loan modification process by any other public entity. This data can shed great light into how the HAMP program is working: which borrowers are getting modifications and which are not; the geography of modification activity; the types of modifications that are being provided; and the patterns of re-defaults that are occurring. This data is crucial for those working to develop more and better tools to fight foreclosures and prevent a repeat of this crisis.

However, the Treasury Department has severely limited the data it has released. For over a year, it has promised to release the loan-level data to the public, but whenever asked, the promised date of release is pushed back. Treasury should release this data as soon as possible in a raw, disaggregated form so that independent researchers and other interested parties can analyze it themselves. If additional staffing is needed to scrub the data and turn it around quickly, we urge Treasury to assign more people to the task.[70]

Finally, while this data must be purged of private information such as names and social security numbers, some have suggested that race and ethnicity data not be released on a servicer-by-servicer basis. Given the significant racial and ethnic inequities that have plagued the mortgage market, detailed demographic data for each servicer is of vital importance to all stakeholders.

**9. Permit homeowners who experience additional hardships to be eligible for additional HAMP modifications.**

Even after a homeowner is paying the monthly payments due under a HAMP loan modification, life events may still occur that would once again disrupt these payments, such as job loss, disability, or the death of a spouse. These subsequent, unpredictable events, outside the control of the homeowner, should not result in foreclosure if a further loan modification would save investors money and preserve homeownership.

Foreclosing on homes where homeowners have suffered an involuntary drop in income without evaluating the feasibility of a further HAMP modification is punitive to homeowners already suffering a loss and does not serve the interests of investors. Some servicers provide some modifications upon re-default as part of their loss mitigation program; this approach should be standard and should include continued eligibility for HAMP modifications rather than only specific servicer or investor programs.

**10. Mandate an additional 30 days after HAMP denial for the borrower to apply for assistance through a state Hardest Hit Program and then re-evaluate for HAMP if the application is approved.**

Under Supplemental Directive 10-07, servicers may, but do not have to, provide borrowers with an additional 30 days after denial for the borrower to apply for HHF and see if the HHF program will get them to a HAMP-positive result. This additional time period should be mandatory. Allowing servicer discretion will lead to inconsistency in the program operation and denial of borrowers who could qualify for HAMP, and is at odds with HAMP's apparent intention that servicers not be allowed to condition HAMP application on HHF application.

Since borrowers can't know in advance if HHF funding will make the difference between HAMP denial or acceptance and won't know if the servicer will give them a chance to apply for HHF funding if they are denied for HAMP, borrowers will have to apply for HHF funds, even if HAMP alone would do the trick. This will result in the use of HHF funds to subsidize HAMP and diminish the impact of the additional HHF funds.

**11. Clarify existing guidelines to streamline the process and carry out the intention of the program**

These additional issues require some measure of clarification or minor tweaking to prevent abuses and problems:

- **All servicers should accept the standard HAMP application and corrected 4506-T forms.** Borrowers report that servicers reject HAMP applications if borrowers submit a standard application form (RMA) instead of the servicer's form, or return with corrections a 4506-T form completed by the servicer. Servicers need additional guidance that submission of standard tax and HAMP forms by borrowers is adequate for purposes of HAMP review and that servicers may not deny review because a borrower has corrected misinformation on a servicer form.

- **Equity in a home should not preclude a HAMP modification.** Servicers routinely reject borrowers for HAMP who are in default because they have "too much equity," apparently relying on old guidelines to assess the availability of refinancing. Explicit guidance should be provided to servicers to disregard the amount of equity in a home when evaluating a borrower's HAMP eligibility, aside from its role in the NPV test.

- **Non-borrower surviving spouses and those awarded the home in a divorce decree should be eligible for a HAMP modification.** In Sup. Dir. 09-01 and in FAQ 2200, HAMP appears to permit non-borrower surviving spouses or those who receive the property in a divorce decree although they are not borrowers to obtain a loan modification. Servicers, however, continue to insist that an estate be opened before dealing with the surviving spouse and often initiate foreclosure proceedings instead of reviewing the surviving spouse for a HAMP loan modification. Treasury should state directly that non-borrowers permitted under the Garn-St Germain Act to assume the note are to be treated as eligible borrowers for HAMP, provided they meet the other qualifications.

- **Wholly owned subsidiaries should be covered under the servicer contracts.** Many large servicers operate multiple companies and divisions, often with similar names, yet there is no easy way for homeowners to identify if these divisions are participating. For example, the only Wells Fargo entity listed on the "Contact Your Mortgage Servicer" page of the Making Home Affordable website is the national bank, but most mortgage customers of Wells Fargo will deal with Wells Fargo Home Mortgage, Wells Fargo Financial, or America's Servicing. Advocates continue to report confusion as to coverage, with subsidiaries frequently denying that they are covered by a contract signed by the parent.

- **Servicers should not be able to rescind permanent HAMP modifications.** Although HAMP trial modification contracts indicate that a homeowner can obtain a permanent modification by making three trial modification payments, servicers have been withdrawing trial modification offers, and, worse, cancelling existing permanent modifications, citing investor restrictions and other issues that should have been identified prior to these agreements. While servicers and others have sought to describe these cancellations as clerical errors, they are breaches of contract that epitomize the one-sided dynamic of HAMP modifications.

- **Servicers should pre-sign permanent modification documents.** After a borrower successfully completes a trial modification, the servicer is required to send permanent modification papers to the homeowner. Often, these papers are not pre-signed and such finalizing can often take months. Permanent modifications would increase and the timeline would be shortened if servicers were required to send pre-signed permanent modification agreements to the homeowner. Further efficiency would be derived from the establishment of a timeline for the sending and returning of permanent modification documents.

**D. States also should act to prevent servicing abuses and save homes.**

**1. State legislatures should mandate loss mitigation prior to foreclosure.**

States are also in a strong position to prevent unnecessary foreclosures. Although mandatory loss mitigation standards exist in many parts of the market now, lack of enforcement has diminished their impact, and they are not industry-wide. By exercising their control over the foreclosure process, states can require that servicers assess whether foreclosure is in the financial interest of the investor before proceeding to foreclosure. A mandatory loss mitigation standard will function as a low-cost, high-impact foreclosure prevention tool that ensures foreclosure is a last resort.[71]

While states ideally would require servicers to perform a loss mitigation analysis prior to filing for foreclosure, existing laws have incorporated elements of a mandatory loss mitigation standard at other stages of the foreclosure process. Currently, loss mitigation components exist in state foreclosure laws, either implicitly or explicitly, in the following four places: (1) as a pre-condition to foreclosure filing; (2) as part of a foreclosure mediation program; (3) as a pre-condition to foreclosure sale; and (4) as the basis for a challenge post-foreclosure sale.

This range of approaches demonstrates the extent to which a loss mitigation standard can be adapted to any foreclosure process. Because not all foreclosures are preventable, the implementation of this standard will not limit the right of creditors to foreclose on a property where appropriate, but would ensure that the foreclosure sale is a last resort after all other foreclosure prevention strategies have been considered.

States can further promote transparency and accountability by combining a mandatory loss mitigation standard with basic disclosures of the inputs used in the NPV calculation and the results of the calculation, which can be contested by appeal.

To be most effective, a flexible mandatory loss mitigation standard should be combined with:

- a requirement that the foreclosing party provide homeowners with a loss mitigation application in tandem with any pre-foreclosure notice or pre-foreclosure communication;

- a requirement that the foreclosing party submit an affidavit disclosing the specific basis for the denial of a loan modification, including the inputs and outputs of any loss mitigation calculations;

- a defense to foreclosure (or equivalent right in non-judicial foreclosure states) based on failure of the foreclosing party to engage in a good faith review of foreclosure alternatives; and

- public enforcement mechanisms to safeguard against systemic abuses.

- using existing or planned mediation programs as an appeal process when an adverse loss mitigation determination is made.[72]

Finally, state authority to regulate and license mortgage servicers provides yet another avenue through which States can promote servicer accountability and incorporate mandatory loss mitigation. For example, New York recently enacted a strong set of rules that will go a long way toward ending predatory servicing practices and ensuring that homeowners do not lose their homes due to servicer failures.[73] These rules are easily replicable and provide a very useful set of tools for enforcement authorities and advocates.

**2. States should exercise their supervisory and enforcement authority over servicers doing business in their jurisdiction.**

Where state banking agencies have examination and enforcement authority over servicers operating in their jurisdiction, they, too, should focus on the legality, propriety, and accuracy of accounting, inappropriate or unnecessary fees and charges, failure to comply with loss mitigation requirements, and other problems identified in this testimony.

The recently announced investigation by the state attorneys general is one of the most promising developments to date in the fight against foreclosures. We recommend that in addition to any monetary damages, states seek injunctive relief to help promote sustainable loan modifications and eliminate shoddy and illegal business and legal practices.

**Conclusion**

Today's foreclosure crisis is the worst housing downturn since the Great Depression. The stakes are high. Not only have millions of families lost their homes, but the crisis is responsible for close to two trillion dollars in additional lost wealth, cuts in municipal services, shortages of affordable housing, and reduction of homeowner disposable income. As foreclosures mount, these related costs will only grow worse.

Even under a best-case scenario, the current crisis will continue and fester if interventions remain on the current narrow course. Unfortunately, there is no "silver bullet" strategy to fix every mortgage or repair every foreclosure-ravaged neighborhood. To make a real difference in preventing foreclosures and reducing associated losses, we need a multi-pronged strategy that strengthens the way current foreclosure prevention programs are implemented and also invests in new approaches.

As policymakers take actions to address the immediate crisis, it is our hope that they also will be mindful of policy failures that enabled the situation. Economic cycles and housing bubbles may always be with us, but the experience of recent years vividly shows the value of sensible lending rules and basic consumer protections, even during economic booms, to prevent another disaster in the future.

We appreciate the chance to testify today and look forward to continuing to work with Congress on these crucial issues.

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[1] Laurie Goodman, Roger Ashworth, Brian Landy, and Lidan Yang, "The Housing Crisis—Sizing the Problem, Proposing Solutions," Amherst Mortgage Insight (Oct. 1, 2010) [hereinafter "Amherst Study," on file with CRL.

[2] Debbie Gruenstein Bocian, Wei Li and Keith S. Ernst, *Foreclosures by Race and Ethnicity: The Demographics of a Crisis,* Center for Responsible Lending (June 18, 2010).

[3] State Foreclosure Prevention Working Group, "Redefault Rates Improve for Recent Loan Modifications" (August 2010), p.1, *available at* http://www.csbs.org/regulatory/Documents/SFPWG/DataReportAug2010.pdf.

[4] Corbett B. Daly and Elinor Comlay, "States hit banks with mortgage probe," Reuters (Oct. 13, 2010) *available at* http://www.reuters.com/article/idUSTRE69B4UY20101013 (in explaining that the robosigning was just a technicality, Jamie Dimon said, "We're not evicting people who deserve to stay in their home.").

[5] *See, e.g.,* James Eli Shiffer, "Help Retracted by Bank Error," StarTribune.com (Nov. 15, 2010), *available at* http://www.startribune.com/local/west/107775738.html (a permanent loan modification revoked; borrower says he never missed a payment); Aldo Svaldi , " Foreclosure paperwork miscues piling up, The Denver Post (Nov. 14, 2010), *available at* http://www.denverpost.com/business/ci_16601567 (describing homeowners trying to pay off their mortgages but unable to, as well as other problems); J. Scott Trubey, "Foreclosure Came Out of Blue for Two Families," The Atlanta Journal-Constitution, (Oct. 28, 2010), *available at* http://www.ajc.com/business/foreclosures-came-out-of-699191.html (in addition to describing specific cases, article notes that Sen. Saxby Chambliss said his office has dealt with hundreds of constituents alleging problems with their lenders, the modification process and foreclosures). *See also* Special Inspector General of the Troubled Asset Relief Program, Report to Congress October 2010 , *available at* http://www.sigtarp.gov/reports/congress/2010/October2010_Quarterly_Report_to_Congress.pdf.

[6] MBA National Delinquency Survey, August 2010 [hereinafter "MBA National Delinquency Survey"]. The combined percentage of loans in foreclosure or at least one payment past due was 13.7 percent on a non-seasonally adjusted basis.

[7] First American Core Logic Negative Equity Report Q22010, *available at* http://www.corelogic.com/uploadedFiles/Pages/About_Us/ResearchTrends/CL_Q2_2010_Negative_Equity_FINAL.pdf.

[8] Rod Dubitsky, Larry Yang, Stevan Stevanovic and Thomas Suehr, *Foreclosure Update: over 8 million foreclosures expected,* Credit Suisse (Dec. 4, 2008) (projecting 10 million foreclosures by 2012 depending on current unemployment rates); Jan Hatzius and Michael A. Marschoun, *Home Prices and Credit Losses:*

*Projections and Policy Options*, Goldman Sachs Global Economics Paper (Jan. 13, 2009) (projecting 13 million foreclosures by 2014) at 16.

[9] *Supra* note 2.

[10] For methodology, *see* Center for Responsible Lending, "Soaring Spillover: Accelerating Foreclosures to Cost Neighbors $502 Billion in 2009 Alone; 69.5 Million Homes Lose $7,200 on Average; Over Next Four Years, 91.5 Million Families to Lose $1.9 Trillion in Home Value; $20,300 on Average" (May 2009), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/soaring-spillover-3-09.pdf.

[11] Center for Responsible Lending, *Continued Decay and Shaky Repairs: The State of Subprime Loans Today* (Jan. 8, 2009), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/continued_decay_and_shaky_repairs.pdf.

[12] G. Thomas Kingsley, Robin Smith, & David Price, *The Impact of Foreclosures on Families and Communities*, The Urban Institute (May 2009), at 21, Fig. 3.

[13] D. Pelletiere, "Renters in Foreclosure: Defining the Problem, Identifying Solutions," National Low-Income Housing Coalition (Jan. 2010), *available at* http://dsl-router.nlihc.org/doc/renters-in-foreclosure.pdf.

[14] The "Helping Families Save Their Home Act of 2000," signed into law by President Obama in May 2009, provided that month-to-month tenants must receive 90 days' notice before having to move out and that tenants with leases may stay until the end of their lease (unless the owner plans to occupy the property, in which case tenants still must receive 90 days notice).

[15] Also, many tenants are not aware of their right to stay in their homes, and when they receive a notice from a bank lawyer naming their landlord and seeking eviction, they leave regardless of their legal rights. *See, e.g.*, Testimony of Deborah Cuevas Hill, The Legal Aid Society of the District of Columbia, before the Committee on Public Services and Consumer Affairs, Council of the District of Columbia (May 28, 2009), *available at* http://www.legalaiddc.org/issues/documents/TestimonyreTOPALegilsation.pdf.

[16] "Meeting Multifamily Finance Housing Needs During and After the Crisis: A Policy Brief," Joint Center for Housing Studies, Harvard University (Jan. 2009), *available at* http://www.jchs.harvard.edu/publications/finance/multifamily_housing_finance_needs.pdf.

[17] *Id.*

[18] It is popular, although incorrect, to blame the Community Reinvestment Act (CRA) and Fannie Mae and Freddie Mac (the GSEs) for the foreclosure crisis. For a complete discussion of why CRA and the GSEs did not cause the crisis, *see* Testimony of Eric Stein, Center for Responsible Lending, before the Senate Committee on Banking (Oct. 16, 2008), *available at* http://www.responsiblelending.org/mortgage-lending/policy-legislation/congress/senate-testimony-10-16-08-hearing-stein-final.pdf.

[19] These were loans with the following characteristics: debt-to-income ratios lower than 41%; fixed rate or loans with at least a 7 year fixed period; a term of 30 years or less; no balloon payments; no interest-only or negative amortization loans; full income documentation; and either an LTV under 80% or, if LTV above 80%, with mortgage insurance.

[20] Vertical Capital Solutions, Historical Performance of Qualified vs. Non-Qualified Mortgage Loans (February 2010) (on file with CRL).

[21] Rick Brooks and Ruth Simon, *Subprime Debacle Traps Even Very Credit-Worthy: As Housing Boomed, Industry Pushed Loans To a Broader Market*, Wall Street Journal at A1 (Dec. 3, 2007).

[22] Letter from Coalition for Fair & Affordable Lending to Ben S. Bernanke, Sheila C. Bair, John C. Dugan, John M. Reich, JoAnn Johnson, and Neil Milner (Jan. 25, 2007) at 3.

[23] *See e.g.,* Yuliya Demyanyk, "Ten Myths About Subprime Mortgages," Economic Commentary, Federal Reserve Bank of Cleveland (May 2009) *available at* http://www.clevelandfed.org/research/commentary/2009/0509.pdf; Karen Weaver, "The Sub-Prime Mortgage Crisis: A Synopsis," Deutsch Bank (2008) *available at* http://www.globalsecuritisation.com/08_GBP/GBP_GSSF08_022_031_DB_US_SubPrm.pdf (concluding that subprime mortgages "could only perform in an environment of continued easy credit and rising home prices).

[24] Lei Ding, Roberto G. Quercia, Janneke Ratcliff, and Wei Li, "Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Propensity Score Models," Center for Community Capital, University of North Carolina at Chapel Hill (Sept. 13, 2008), *available at* http://www.ccc.unc.edu/abstracts/091308_Risky.php.

[25] Center for Responsible Lending, *Steered Wrong: Brokers, Borrowers and Subprime Loans* (April 8, 2008), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/steered-wrong-brokers-borrowers-and-subprime-loans.pdf.

[26] *Id.*

[27] R.B. Avery, G.B. Canner, and R.E. Cook, Summer 2005. "New Information Reported under HMDA and Its Application in Fair Lending Enforcement," Federal Reserve Bulletin (available at http://www.federalreserve.gov/pubs/bulletin/2005/summer05_hmda.pdf); R.B. Avery, K.P. Brevoort, and G.B. Canner, September 2006. "Higher-Priced Home Lending and the 2005 HMDA Data," Federal Reserve Bulletin (available at http://www.federalreserve.gov/pubs/bulletin/2006/hmda/bull06hmda.pdf); R.B. Avery, K.P. Brevoort, and G.B. Canner, December 2007. "The 2006 HMDA Data" Federal Reserve Bulletin (available at http://www.federalreserve.gov/pubs/bulletin/2007/pdf/hmda06final.pdf); R.B. Avery, K.P. Brevoort, G.B. Canner, December 2008. "The 2007 HMDA Data", Federal Reserve Bulletin (available at http://www.federalreserve.gov/pubs/bulletin/2008/pdf/hmda07final.pdf); R.B. Avery, K.P. Brevoort, G.B. Canner, September 2009, "The 2008 HMDA Data", forthcoming in Federal Reserve Bulletin (available at http://www.federalreserve.gov/pubs/bulletin/2009/pdf/hmda08draft2.pdf). *See also* Debbie Gruenstein Bocian, Keith Ernst and Wei Lee, "Race, Ethnicity and Subprime Loan Pricing." Journal of Economics and Business, Vol. 60, Issues 1-2, January-February 2008, at 110-124; Debbie Gruenstein Bocian and Richard Zhai, "Borrowers in High Minority Areas More Likely to Receive Prepayment Penalties on Subprime Loans,"January 2005, available at http://www.responsiblelending.org/mediacenter/press-releases/archives/rr004-PPP_Minority_Neighborhoods-0105.pdf

[28] *Supra* note 2, at 3.

[29] Debbie Gruenstein Bocian, Peter Smith, Ginna Green and Paul Leonard, Center for Responsible Lending, *Dreams Deferred: Impacts and Characteristics of the California Foreclosure Crisis* (Aug. 2010), *available at* http://www.responsiblelending.org/california/ca-mortgage/research-analysis/dreams-deferred-CA-foreclosure-report-August-2010.pdf.

[30] According to the 2007 Survey of Consumer Finance, the median net worth for white, non-Hispanic families in 2007 was $171,200, compared to $28,300 for families of color. *See* Table 4 of the Survey of Consumer Finance (Tables based on Internal Data, Estimates in Nominal Dollars), *available at* http://www.federalreserve.gov/PUBS/oss/oss2/2007/scf2007home.html.

[31] Similarly, the "cure" rate – the rate at which homeowners who are behind on their mortgages catch up rather than default – has plummeted to an astonishing 6.6 percent. *See* Fitch Ratings, Delinquency Cure Rates Worsening for U.S. Prime RMBS (Aug. 24, 2009).

[32] Laurie Goodman, Roger Ashworth, Brian Landy, Ke Yin, *Negative Equity Trumps Unemployment in Predicting Defaults*, Amherst Mortgage Insight, Amherst Securities Group (Nov. 23, 2009).

[33] Based on MBA Delinquency Survey for 2010 Q2, adjusted to reflect MBA's estimated 88% market coverage.

[34] See Hope Now August Data Report, *available at* http://www.hopenow.com/industry-data.php.

[35] *Supra* note 3.

[36] *See e.g. In re Ocwen Loan Servicing, LLC Mortg. Servicing Litigation,* 491 F.3d 638 (7th Cir. 2007) (allegations by a class of homeowners that Ocwen systematically charged late fees for payments that were sent on time); *Federal Trade Commission (FTC) Settlement* (2003) resulted in $40 million for consumers harmed by illegal loan servicing practices, *available at* http://www.ftc.gov/fairbanks (FTC alleged, among other things, that Fairbanks illegally charged homeowners for "forced placed insurance" and violated the Fair Debt Collection Practices Act); and *FTC Settlement with Countrywide, available at* http://www.ftc.gov/countrywide (Countrywide agreed to pay $108 million dollars to homeowners in response to the FTC's allegations that Countrywide charged illegal fees to homeowners during Chapter 13 bankruptcy proceedings).

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

[38] The Center for Responsible Lending is serving as co-counsel in several cases relating to these issues, including a Maine class action filed against GMAC Mortgage, *Archibald et al v. GMAC Mortgage, LLC* (Civil Action, Docket CV-2010-494, Cumberland County Superior Court).

[39] Testimony of Adam Levitan before the Senate Banking Committee (Nov. 16, 2010), *available at* http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Testimony&Hearing_ID=df8cb685-c1bf-4eea-941d-cf9d5173873a&Witness_ID=2ada1da6-e7cc-4eca-99a4-03584d3748af

[40] As Lewis Ranieri, founder of Hyperion Equity Funds and generally considered "the father of the securitized mortgage market," has recently noted, such relief is the only way to break through the problem posed by second mortgages. Lewis S. Ranieri, "Revolution in Mortgage Finance," the 9th annual John T. Dunlop Lecture at Harvard Graduate School of Design, Oct. 1, 2008, *available at* http://www.jchs.harvard.edu/events/dunlop_lecture_ranieri_2008.mov (last visited Feb. 24, 2010).

[41] Mark Zandi, "Homeownership Vesting Plan," Moody's Economy.com (Dec. 2008), *available at* http://www.dismal.com/mark-zandi/documents/Homeownership_Vesting_Plan.pdf.

[42] Blackrock, the world's largest asset manager, supports using bankruptcy courts to address the need for principal reduction. Bloomberg News, *BlackRock Cramdown Plan,* American Banker (Jan. 22, 2010), *available at* http://www.americanbanker.com/syndication/blackrock-cramdown-plan-1006339-1.html. In April 2010, Bank of America joined Citi in support of this measure as well, so two of the four largest banks now support it. Barbara Desoer, President, Bank of America Home Loans, Hearing Before the Committee

on Financial Services, U.S. House of Representatives, 111[th] Congress, Second Session, April 13, 2010, transcript *available at* http://financialservices.house.gov/Media/file/hearings/111/Printed%20Hearings/111-120.pdf. Citi reaffirmed its support at this same hearing.

[43] Thomas J. Fitzpatrick IV and James B. Thomson, "Stripdowns and Bankruptcy: Lessons from Agricultural Bankruptcy Reform" (8/3/10), *available at* http://www.clevelandfed.org/research/commentary/2010/2010-9.cfm.

[44] In the Senate Senator Jack Reed also introduced legislation that would mandate loss mitigation (S. 1431).

[45] With a well developed system for making, tracking, and evaluating grants for foreclosure legal assistance, IFLA would be well positioned to assist HUD in administering this funding. IFLA is funded through the Center for Responsible Lending and administered by the National Association of Consumer Attorneys.

[46] Shockingly, the Treasury Department has concluded that HHF funds can be used for housing counselors but not for attorneys. While an interpretation of EESA that denies its use for either purpose may be colorable, there is no credible reason for funding one but not the other.

[47] National Taxpayer Advocate, *2008 Annual Report to Congress*, at 341, 391-96.

[48] The legislation defined "qualified mortgage debt" to include only that debt that was used to purchase a home or make major home improvements. In calculating the tax, any unqualified debt is first subtracted in its entirety from the amount of forgiven debt (not on a pro rata basis). In many cases, the amount of unqualified debt will equal or exceed the amount of debt forgiven, leaving the homeowner to pay tax on the entire forgiven debt – and even in those cases where the amount forgiven exceeds the amount of unqualified debt, the homeowner will still owe tax.

[49] To take advantage of the mortgage debt exclusion, a homeowner now has to file a long-form 1040 (not a 1040EZ) along with a Form 982. Unfortunately, most lower and middle income taxpayers are not accustomed to using these forms, and taxpayers filing long-form 1040s are not eligible to use the various tax clinics offered by the IRS and others for lower-income taxpayers.

[50] *Supra* Note 44 at 394.

[51] Pub. L. No. 111-203, Title X, §§ 1025(e); 1029A. Six of the top ten servicers, as ranked by Mortgage Servicing News, appear to be subject to the OCC's primary supervision.

[52] NY and NC in particular.

[53] HAMP Servicer Performance Report Through September 30, 2010, *available at* http://www.financialstability.gov/docs/SeptemberMHAPublic2010AugustMHAPublic2010.pdf. Although at one point more than a million homeowners had a trial modification under HAMP, the number of homeowners who have fallen out of trial mods (nearly 700,000) now far exceeds the number who have permanent modifications.

[54] There has been some back and forth among Treasury, SIGTARP, and Congress concerning the numerical goals of HAMP, and the current Treasury assertion is that they promised only to "offer assistance" to that many homeowners. While it is clear that language suggests that they do not anticipate 3-4 million borrowers actually obtaining a HAMP mod, it is not clear exactly what it does suggest.

[55] The HAMP report itself contains a chart indicating that as of August 31, only 1.3 million borrowers are even eligible for HAMP under its current guidelines and that number is only likely to decline as we see continued high unemployment. http://www.financialstability.gov/docs/AugustMHAPublic2010.pdf

[56] There were 468,058 permanent HAMP modifications and 3,213,594 proprietary modifications, although it is not clear whether these proprietary modifications were temporary or permanent. See Hope Now August 2010 Data Report, available at http://www.hopenow.com/industry-data/HOPE%20NOW%20Data%20Report%20(August)%2010-05-2010%20v2b.pdf.

[57] According to attorneys who are part of the Institute for Foreclosure Legal Assistance network, servicers often promise borrowers a speedier resolution if they choose a proprietary modification.

[58] The Office of the Homeowner Advocate is contained in S. 3793, the Job Creation and Tax Cuts Act of 2010, introduced by Senator Max Baucus (D-MT); "Franken Homeowner Advocate Amendment Passes" (June 15, 2010), *available at* http://senatus.wordpress.com/2010/06/15/franken-homeowner-advocate-amendment-passes/

[59] One Pennsylvania bankruptcy judge has recently provided troubling details of how "communications" between servicers and their outside law firms take place almost entirely through automated systems without any human interaction. *In re Taylor*, 407 B.R. 618 (E.D. Pa. 2009). That judge concluded, "The thoughtless mechanical employment of computer-driven models and communications to inexpensively traverse the path to foreclosure offends the integrity of our American bankruptcy system."

[60] As of April 2010, all applications must now be fully documented.

[61] First American Core Logic, *supra* note 8.

[62] "Factors Affecting the Implementation of the Home Affordable Modification Program", SIGTARP (March 25, 2010), *available at* http://www.sigtarp.gov/reports/audit/2010/Factors_Affecting_Implementation_of_the_Home_Affordable_Modification_Program.pdf

[63] Although many decry the phenomenon of "walkaways," when people voluntarily default on their mortgages, there are actually far fewer such walkaways than economic theory might predict. *See, e.g.*, Roger Lowenstein, *Walk Away from your Mortgage!*, New York Times (Jan. 10, 2010) (noting that it would be economically rational for more people to walk away from their mortgages). However, it is clear that at some level, the disincentive of being underwater will have an impact on the homeowner's success in continuing with the mortgage.

[64] Andrew Haughwout, Ebiere Okah, and Joseph Tracy, *Second Chances: Subprime Mortgage Modification and Re-Default*, Federal Reserve Bank of New York Staff Report (Dec. 2009).

[65] *See, e.g.*, Amherst Study *supra* note 1; Shawn Tully, *Lewie Ranieri Wants to Fix the Mortgage Mess*, Fortune Magazine (Dec. 9, 2009); "Analysis of Mortgage Servicing Performance, Data Report No. 4, Jan. 2010, State Foreclosure Prevention Working Group, at 3.

[66] Most Pooling and Servicing Agreements require the servicer to act in the best interest of the investors as a whole, but those obligations have been honored mainly in the breach.

[67] SIGTARP, *supra* note 3.

[68] http://www.businessinsider.com/average-duration-of-unemployment-in-july-2010-8.

[69] HAMP Supplemental Directive 10-15, *available at* https://www.hmpadmin.com/portal/programs/docs/hamp_servicer/sd1015.pdf.

[70] It should be noted that other government agencies and certain outside researchers appear to have access to some or all of the data, suggesting that it is time to make it available more widely.

[71] U.S. Department of Housing and Urban Development, Mortgagee Letter 2010-04, Loss Mitigation for Imminent Default (January 22, 2010), *available at* http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/10-04ml.pdf (Loss Mitigation is critical to both borrowers and FHA because it works to fulfill the goal of helping borrowers retain homeownership while protecting the FHA Insurance Fund from unnecessary losses. By establishing early contact with the borrower to discuss the reason for the default and the available reinstatement options, the servicer increases the likelihood that the default will be cured and the horrower will be able to retain homeownership.)

[72] *E.g.,* Maryland HB 472 (2010), *available at* http://mlis.state.md.us/2010rs/bills/hb/hb0472f.pdf (Maryland homeowners deemed ineligible for relief from their lender then have the option to participate in the court-administered foreclosure mediation program.).

[73] *See, e.g.,* NYS Banking Department, Part 419 of the Superintendent's Regulations, at 419.11 (effective October 1, 2010), *available at* http://www.banking.state.ny.us/legal/adptregu.htm (Servicers shall make reasonable and good faith efforts consistent with usual and customary industry standards and paragraph (b) of this section to engage in appropriate loss mitigation options, including loan modifications, to avoid foreclosure.).

**Testimony of**

**Alan Jones**
**Operations Manager**
**Wells Fargo Home Mortgage Servicing**

**Before the**

**Subcommittee on Housing and Community Opportunity**
**House Financial Services Committee**
**U.S. House of Representatives**

**November 18, 2010**

Chairman Waters, Ranking Member Capito and Members of the Subcommittee, I'm Alan Jones and I manage operations for Wells Fargo Home Mortgage Servicing. I appreciate the opportunity to appear before you today to discuss Wells Fargo's efforts to respond to the unprecedented housing crisis and our work to keep American families in their homes.

As a company, Wells Fargo has followed three fundamental tenets:

> **First**, we view foreclosure as a measure of last resort. In unfortunate cases where a customer simply cannot afford the property, even with a modification, we actively look at other remedies – such as short sales – to prevent foreclosure and protect the surrounding community.
>
> **Second**, we hold ourselves accountable for the quality of our foreclosure data and we work to ensure our borrowers are protected from wrongful foreclosures.
>
> And **third**, we understand the necessity of having procedures that ensure our documents comply with industry regulations, as well as federal and state laws.

As our country's economy has continued to present new challenges, our goal is and always has been to keep as many customers in their homes as possible. From January 2009 through September 2010, we provided more than 2.45 million customers with mortgage payment relief through refinances and modifications. This included extending more than $3.5 billion in principal reductions to borrowers.

As of the third quarter of 2010, more than 92 percent of our entire servicing portfolio has remained current on their home payments. And, over the last twelve months, less than 2 percent of our owner-occupied servicing portfolio has gone to foreclosure sale. These statistics have remained, over time, the best among our peers and reflect a combination of sound underwriting, as well as the home payment relief efforts I previously mentioned.

We believe, as we have from the beginning of this crisis, that it is in our customers' and the country's best interests to assist customers who can afford their homes – with some help – to remain in them. And, it is our goal to exhaust all options before moving a home to foreclosure sale.

To achieve this, we have invested heavily in hiring and training more than 10,600 additional home preservation staff since the beginning of 2009 – for a current total of more than 16,000 people. And, we expect all of our team members to follow our policies and procedures 100 percent of the time.

- First, using automation, we create an electronic "system of record" for each mortgage customer we service. This information – which you could think of as a digital bank statement, of sorts – includes pertinent customer data such as the customer's name, the property address, the number and timing of payments made, as well as notes about the actions we have taken to jointly explore home retention options.
- We attempt to contact customers, on average, more than 75 times by phone and nearly 50 times by letter during the period of first delinquency to foreclosure sale. When customers choose to work with us, we prevent foreclosures for 7 of every 10 who are 60 days or more past due. The home retention process can take a period of weeks or months, depending on the customer's engagement, circumstances and the complexity of his or her financial challenges. For example, some customers enter bankruptcy which can considerably delay the process while the courts adjudicate the merits of the bankruptcy petition.
- Investor requirements often direct the timing for initiating foreclosure proceedings at a certain point in the loan delinquency. These proceedings sometimes begin while we are working with a customer on a mortgage modification or other foreclosure prevention option. Generally, we continue to work with customers on options – to do everything possible to prevent foreclosure – up to the point of the foreclosure sale date.
- Unfortunately, the hard reality remains that some customers simply are in homes they cannot afford – even with substantially reduced payments. In the month of September, Wells Fargo's customers who completed foreclosure were, on average, 16 payments behind on their mortgage loans and were facing financial circumstances related to debt and life events that made sustaining their mortgage contracts impossible.

  When there is no reasonable alternative, we believe it is best to transition people to affordable housing arrangements. And for the 25 percent of properties already vacant in the late stages of foreclosure, we repair and/or sell these homes to new owners to alleviate any further burden on the housing market, allowing whole neighborhoods and cities to revitalize.
- Wells Fargo has a rigorous system designed to ensure loan data quality throughout the

foreclosure process. As mentioned before, we maintain an electronic system of record that houses data used by Wells Fargo employees and outside foreclosure attorneys. In addition, we have instituted a series of controls to lessen the chances of error. As just one example, on a daily basis we pull a sample of the data we send electronically to external foreclosure lawyers, and do a manual check to ensure that the data provided to these lawyers – which they pass on to the judges in judicial states – is accurate.

- We continually work on improvements to our systems to reduce the likelihood of errors, and address errors when found. For example, we identified instances where we did not adhere to a final step relating to the execution of foreclosure affidavits, including a final review of the affidavit, as well as some aspects of the notarization process. While we do not believe any foreclosure affidavit signing or notary issues resulted in foreclosures that should not otherwise have occurred, we voluntarily opted to provide an additional level of assurance by electing to execute supplemental foreclosure affidavits for foreclosures pending before the courts in the judicial states.

- Finally, we retain and rely on the guidance provided by outside foreclosure attorneys – who are licensed by each respective state – to ensure we fully comply with the local rules, regulations and requirements which often differ by county within a state.

The complexities inherent to the home preservation and foreclosure processes can be difficult for customers to fully understand. To improve communication, this year we introduced a 1:1 customer service model to enable at-risk customers to work with one person from beginning to end on their home preservation options. While that effort has been largely successful, there are areas of improvement on which we continue to work.

In addition, we continue to expand the number of home preservation events we host in cities experiencing challenges with foreclosures. To date, we have hosted large-scale events in 15 cities at which we have met face-to-face with more than 15,000 customers in need. And through the 27 home preservation centers we opened, we have met face-to-face with an additional 25,000 customers.

| Home Preservation Event Locations | Event Dates | Customers Invited |
|---|---|---|
| Phoenix, AZ | 09/08-10/09 | 7,574 |
| Atlanta, GA | 10/26-28/09 | 12,698 |
| Chicago, IL | 12/01-03/09 | 16,354 |
| Baltimore, MD | 01/11-13/10 | 9,648 |
| St Paul, MN | 02/17-18/10 | 4,328 |
| Los Angeles, CA | 03/21-23/10 | 16,473 |
| Oakland, CA | 04/27-29/10 | 14,144 |
| Miami, FL | 05/21-23/10 | 18,182 |
| Minneapolis, MN | 06/05-06/10 | 3,731 |
| Cleveland, OH | 06/17-18/10 | 6,955 |
| Las Vegas, NV | 07/09-11/10 | 5,241 |
| Memphis, TN | 08/07-08/10 | 12,249 |
| Philadelphia, PA | 09/11-12/10 | 14,151 |
| Tampa, FL | 10/08-10/10 | 16,540 |
| Houston, TX | 11/9-10/10 | 6,096 |

**Home Preservation Center Locations**

**AZ:** Peoria, Phoenix

**CA:** Antioch, Bakersfield, Campbell, Clovis, La Puente, Lathrop, Long Beach, Novato, Oceanside, Riverside, Sacramento, San Diego, San Fernando, San Ramon, Santa Ana

**FL:** Boynton Beach, Jacksonville (2), Miramar, Pensacola, Sanford

**GA:** East Point, Suwanee

**NV**: Las Vegas

**OH**: North Olmsted

We also recently announced a joint effort with the Attorneys General in eight states to further help at-risk Wachovia Pick-a-Payment customers. Our new program enables eligible customers to earn principal forgiveness by making their reduced mortgage payments on time.

In conclusion, we remain fully committed to doing what we can to help stabilize the housing industry for the benefit of homeowners, individual communities and the overall general economy. We continue to work hard at helping people to stay in their homes, whenever realistically possible. And, as a standard business practice, we constantly review our policies and procedures to improve the quality of service we give to customers who engage with us in finding a way for them to remain in their homes. Thank you for your time, and I look forward to your questions.

## APPENDIX I

*October 25, 2010 – Modification Report News Release*

**Wells Fargo Reports Modification Activity through September 2010**

*556,868 active trial and completed modifications in place*

DES MOINES, Iowa – Wells Fargo & Co. (NYSE: WFC) said today that of modifications started since the beginning of 2009, the company had 556,868 active trial and completed modifications in place as of Sept. 30, 2010. Included in that total were 495,026 of its own modifications and 61,842 modifications through the federal government's *Home Affordable Modification Program* (HAMP).

In the second quarter of 2010, about 92 percent of Wells Fargo's mortgage customers remained current on their loan payments, according to the Sept. 10 edition of *Inside Mortgage Finance,* and the company's delinquency and foreclosure rates were less than three-fourths that of the industry. As a result, fewer than 2 percent of the loans secured by owner-occupied homes and serviced by Wells Fargo proceeded to foreclosure sale in the last 12 months.

**About Wells Fargo Home Mortgage**
Wells Fargo Home Mortgage is the nation's leading mortgage lender and services one of every six mortgage loans in the nation. A division of Wells Fargo Bank, N.A., it has a national presence in mortgage and banking stores, and also serves the home financing needs of customers nationwide through its call centers, Internet presence and third-party production channels.

## APPENDIX II

### *Explanation of Chain of Title and Assignment*

Some have questioned the procedures the mortgage industry has traditionally used to transfer ownership of a home loan from the originator to another entity, for example, a securitization trust. These concerns primarily stem from procedural issues related to the specific steps required to document ownership of the mortgage as part of the foreclosure process.

These foreclosure-related steps, governed by state law, are not the same as those required to transfer actual ownership of the loan. This has led to confusion regarding the investor's right to recover the collateral following a borrower's default.

A review of the title chain and assignment process helps shed some light on the major issues that have been raised about this topic.

#### Loan Origination and Closing

At loan closing, a borrower signs both a "note" and a "mortgage" or "deed of trust" (depending on the state).

- The note represents the borrower's promise to repay the debt.
- The mortgage or deed of trust represents the borrower's pledge of property to secure the payment of the note. It is executed according to the requirements of laws in the state in which the property is located, and filed with the local Recorder of Deeds to establish its priority as related to other liens.

The only time the note holder needs to exercise its rights to the collateral represented by the mortgage or deed of trust, is when the borrower defaults on the note.

#### Transfers of Ownership Rights

Procedures used to transfer the ownership rights embedded in a mortgage loan are well established.

- Transfers of the note are governed by contract law and the Uniform Commercial Code.
- Assignments of the accompanying mortgage or deed of trust are covered by state real property laws.

Generally when a loan is sold:

- The original note is "endorsed" by the seller and physically transferred to the purchaser. If the loan is sold a second time, the note is again endorsed by the entity selling the note and physically delivered to the purchaser – in this case, the custodian of the Trust which holds the note on behalf of the investor. For operational purposes, notes are typically endorsed "in blank," that is, without identifying the purchaser's name, thus possession of the note is sufficient to establish ownership.

- Transfers of the security interest (mortgage or deed of trust) generally follow the note. When a loan is sold to another lender, the original mortgage is "assigned" to the purchaser and recorded in the purchaser's name. However, if the servicing remains with the seller – which is typical of most securitizations – the mortgage usually continues to be recorded under the servicer's name. In these instances, the seller prepares a "recordable assignment in blank" and delivers it to the Trust. In general, this assignment will only be recorded if the loan goes into foreclosure, or if it is deemed necessary by the trustee.

There are numerous reasons why the *recorded* lien typically remains with the mortgage servicer.

- Most mortgage loans pay back in full. Keeping the mortgage in the servicer's name saves the time and expenses that would otherwise be associated with assigning it to the investor, and then re-assigning it back to the servicer so that the servicer can execute the release of the lien.

- Maintaining the servicer as the party of record also enables the servicer to monitor any additional liens or encumbrances that may be placed on the property, since notification of such actions are sent to the recorded lien holder.

In some instances, the mortgage may be assigned to Mortgage Electronic Registration System (MERS) at origination or upon subsequent sale. Registration with MERS, which becomes the nominee for the beneficial owner of the loan, serves as a central system to track changes in ownership and servicing of the loan. While Wells Fargo no longer uses MERS in its retail business, some of the mortgages contained in our book may have liens that are registered under the name of MERS. Wells Fargo takes the added precautionary step of "deregistering" loans that are registered under MERS at the point foreclosure proceedings begin.

**Loan Terminated Through Pay Off or Default**

***Customer Pays Off Loan***
If a mortgage pays off in full, the mortgage servicer obtains the loan file from the document custodian, which includes the original note or a copy thereof. The note is then stamped "paid in full" and

returned to the borrower for record keeping. The servicer also prepares a formal release of the lien, demonstrating that the note is satisfied and that there is no longer a lien on the property.

***Customer Defaults***

If a borrower defaults, the mortgage servicer requests the loan file from the document custodian and reviews the original note and copies of assignments, and matches the assignee of record with the holder of the note. Any disparity is not a basis to halt a foreclosure, since possession of the note generally demonstrates ownership. The holder of the note is deemed the owner of the mortgage loan with standing and right to foreclose.

Once the mortgage loan servicer receives the file from the document custodian, the file is provided to the foreclosure attorney. After reviewing the loan file, the foreclosure attorney files the appropriate complaint or notice of default. A judgment to foreclose or a foreclosure sale date is established. In most cases, the mortgage loan servicer completes the foreclosure.

Upon the foreclosure sale, a Court or Sheriff's Deed is obtained and then recorded in the mortgage loan servicer's name, assuming the servicer was the high bidder at the foreclosure sale. Once such a foreclosure sale has occurred, the mortgage loan servicer transfers the property to the owner of the loan, or markets the property for resale on their behalf. When the property is sold, the mortgage servicer returns the proceeds of the collateral to the investor.

**APPENDIX III**

### Wells Fargo Home Mortgage Foreclosure Affidavit Review

*The steps below describe what Wells Fargo Home Mortgage expects its team members to follow in processing foreclosure affidavits. Wells Fargo Home Mortgage manages 81 percent of Wells Fargo's foreclosures. The company's other home lending businesses may vary slightly.*

- When a loan is referred to outside foreclosure counsel, the referral package (electronically transmitted from our automated system of record) contains information about the borrower and the appropriate foreclosing party. This information includes, for example, the number of payments the customer has missed and the actions we have taken to contact and work with the customer on home retention options.
- The outside foreclosure attorney reviews the chain of title to ensure that the foreclosing party is indeed authorized to foreclosure and/or will make corrections.
- At the appropriate point of the judicial foreclosure process, our foreclosure attorney submits to Wells Fargo Home Mortgage (WFHM) a request for mortgage loan information to produce judgment figures.
- WFHM receives the request and runs the foreclosure affidavit software program to collect the initial figures for the affidavit. The foreclosure affidavit program automatically sends the loan mortgage debt figures to the attorney via a secured communication tool (Vendorscape) and uploads the same loan mortgage debt figures to our foreclosure system of record (MSP).
- The outside foreclosure attorney receives, verifies, and adjusts (per the respective state rules) the judgment figures, and creates the judgment affidavit for submission to WFHM for verification and execution. Where applicable in certain states the attorney will submit a separate affidavit for their fees and costs.
- The WFHM foreclosure affidavit signer reviews the data on the affidavit and compares it to the data contained within the system of record.
- The affidavit is executed and properly notarized.
- The completed affidavit is returned to the requesting attorney via overnight mail.
- WFHM conducts a daily review of 35 randomly selected mortgage loans to ensure the foreclosure affidavit program is calculating the figures correctly, uploading to the system of record correctly, and sending the figures to the attorney properly.

*GEORGETOWN UNIVERSITY LAW CENTER*

***Adam J. Levitin***
*Associate Professor of Law*

**Written Testimony of**

**Adam J. Levitin**
**Associate Professor of Law**
**Georgetown University Law Center**

Before the
House Financial Services Committee
Subcommittee on Housing and Community Opportunity

"Robo-Singing, Chain of Title, Loss Mitigation, and Other Issues in Mortgage Servicing"

November 18, 2010
10:00 am

**Witness Background Statement**

**Adam J. Levitin** in an Associate Professor of Law at the Georgetown University Law Center, in Washington, D.C., and Robert Zinman Scholar in Residence at the American Bankruptcy Institute. He also serves as Special Counsel to the Congressional Oversight Panel and has been the Robert Zinman Scholar in Residence at the American Bankruptcy Institute.

Before joining the Georgetown faculty, Professor Levitin practiced in the Business Finance & Restructuring Department of Weil, Gotshal & Manges, LLP in New York, and served as law clerk to the Honorable Jane R. Roth on the United States Court of Appeals for the Third Circuit.

Professor Levitin holds a J.D. from Harvard Law School, an M.Phil and an A.M. from Columbia University, and an A.B. from Harvard College.

Professor Levitin has not received any Federal grants nor has he received any compensation in connection with his testimony. The views expressed in Professor Levitin's testimony are his own and do not represent the positions of the Congressional Oversight Panel.

## EXECUTIVE SUMMARY

The US is now in its forth year of a mortgage crisis in which over 3 million families have lost their homes and another 2.5 million are currently scheduled to lose theirs. Repeated government loan modification or refinancing initiatives have failed miserably. To this sad state of affairs, there now come a variety of additional problems: faulty foreclosures due to irregularities ranging from procedural defects (including, but not limited to robosigning) to outright counterfeiting of documents; predatory servicing practices that precipitate borrower defaults and then overcharge for foreclosure services that are ultimately paid for by investors; and questions about the validity of transfers in private-label mortgage securitizations. While the extent of these problems is unknown at present, the evidence is mounting that they are not limited to one-off cases, but that there may be pervasive defects throughout the mortgage servicing and securitization processes.

The servicing problems stem from servicers' failed business model. Servicers are primarily in the transaction processing business and are failing miserably at trying to adapt themselves to the loan modification business. Servicers' business model also encourages them to cut costs wherever possible, even if this involves cutting corners on legal requirements, and to lard on junk fees and in-sourced expenses at inflated prices. The financial incentives of mortgage servicers also encourage them to foreclose, rather than modify loans in many cases, even when modification would maximize the net present value of the loan for investors.

The chain of title problems are highly technical, but they pose a potential systemic risk to the US economy. If mortgages were not properly transferred in the securitization process, then mortgage-backed securities would in fact not be backed by any mortgages whatsoever. The chain of title concerns stem from transactions that make assumptions about the resolution of unsettled law. If those legal issues are resolved differently, then there would be a failure of the transfer of mortgages into securitization trusts, which would cloud title to nearly every property in the United States and would create contract rescission/putback liabilities in the trillions of dollars, greatly exceeding the capital of the US's major financial institutions.

These problems are very serious. At best they present problems of fraud on the court, clouded title to properties coming out of foreclosure, and delay in foreclosures that will increase the shadow housing inventory and drive down home prices. At worst, they represent a systemic risk that would bring the US financial system back to the dark days of the fall of 2008.

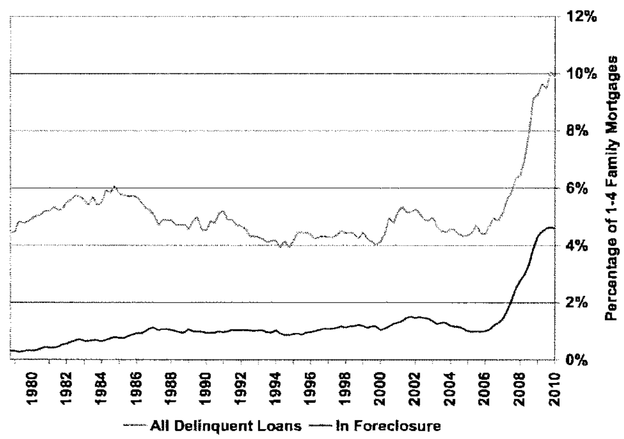
Congress would do well to ensure that federal regulators are undertaking a thorough investigation of foreclosure problems and to consider the possibilities for a global settlement of foreclosure problems, loan modifications, and the housing debt overhang on consumers and financial institutions that stagnate the economy and pose potential systemic risk.

Madam Chairwoman, Members of the Committee:

Good morning. My name is Adam Levitin. I am an Associate Professor of Law at the Georgetown University Law Center in Washington, D.C., where I teach courses in bankruptcy, commercial law, contracts, and structured finance. I also serve as Special Counsel to the Congressional Oversight Panel for the Troubled Asset Relief Program. The views I express today are my own, however.

We are now well into the fourth year of the foreclosure crisis, and there is no end in sight. Since mid-2007 around eight million homes entered foreclosure,[1] and over three million borrowers lost their homes in foreclosure.[2] As of June 30, 2010, the Mortgage Bankers Association reported that 4.57% of 1-4 family residential mortgage loans (roughly 2.5 million loans) were currently in the foreclosure, process a rate more than quadruple historical averages. (See Figure 1.) Additionally, 9.85% of mortgages (roughly 5 million loans) were at least a month delinquent.[3]

**Chart 1: Percentage of 1-4 Family Residential Mortgages in Foreclosure[4]**




Private lenders, industry associations, and two successive administrations have made a variety of efforts to mitigate the crisis and encourage loan modifications and refinancings. A series of much hyped initiatives, such as the FHASecure refinancing program and the Hope4Homeowners have all met what can charitably be described as limited success. FHASecure, predicted to help 240,000 homeowners,[5] assisted only a few thousand borrowers

[1] HOPE Now Data Reports.
[2] *Id.*
[3] Mortgage Bankers Association, National Delinquency Survey.
[4] Mortgage Bankers Association, National Delinquency Surveys.
[5] *See, e.g.*, Press Release, US Dep't of Housing and Urban Development, Bush Administration to Help Nearly One-Quarter of a Million Homeowners Refinance, Keep Their Homes; FHA to implement new "FHASecure" refinancing product (Aug. 31, 2007), *available at* http://www.hud.gov/news/release.cfm?content=pr07-123.cfm; Press Release, US Dep't of Housing and Urban Development, FHA Helps 400,000 Families Find Mortgage Relief; Refinancing on pace to help half-million homeowners by year's end (Oct. 24, 2008), *available at* http://www.hud.gov/news/release.cfm?content=pr08- 167.cfm.

before it wound down,[6] while Hope4 Homeowners, originally predicted to help 400,000 homeowners,[7] had closed only 130 refinancings as of September 30, 2010.[8] The Home Affordable Modification (HAMP) has also failed, producing 495,898 permanent modifications through September 2010. This number is likely to be a high water mark for HAMP, as new permanent modifications are decreasing rapidly while defaults on permanent modifications rise; if current trends continue, by year's end the number of active permanent HAMP modifications will actually decline.

A number of events over the past several months have roiled the mortgage world, raising questions about:

**(1)** Whether there is widespread fraud in the foreclosure process;

**(2)** Securitization chain of title, namely whether the transfer of mortgages in the securitization process was defective, rendering mortgage-backed securities into *non*-mortgage-backed securities;

**(3)** Whether the use of the Mortgage Electronic Registration System (MERS) creates legal defects in either the secured status of a mortgage loan or in mortgage assignments;

**(4)** Whether mortgage servicers' have defaulted on their servicing contracts by charging predatory fees to borrowers that are ultimately paid by investors;

**(5)** Whether investors will be able to "putback" to banks securitized mortgages on the basis of breaches of representations and warranties about the quality of the mortgages.

These issues are seemingly disparate and unconnected, other than that they all involve mortgages. They are, however, connected by two common threads: the necessity of proving standing in order to maintain a foreclosure action and the severe conflicts of interests between mortgage servicers and MBS investors.

It is axiomatic that in order to bring a suit, like a foreclosure action, the plaintiff must have legal standing, meaning it must have a direct interest in the outcome of the litigation. In the case of a mortgage foreclosure, only the mortgagee has such an interest and thus standing. Many of the issues relating to foreclosure fraud by mortgage servicers, ranging from more minor procedural defects up to outright counterfeiting relate to the need to show standing. Thus problems like false affidavits of indebtedness, false lost note affidavits, and false lost summons affidavits, as well as backdated mortgage assignments, and wholly counterfeited notes, mortgages, and assignments all relate to the evidentiary need to show that the entity bringing the foreclosure action has standing to foreclose.

Concerns about securitization chain of title also go to the standing question; if the mortgages were not properly transferred in the securitization process (including through the use of MERS to record the mortgages), then the party bringing the foreclosure does not in fact own the mortgage and therefore lacks standing to foreclose. If the mortgage was not properly transferred, there are profound implications too for investors, as the mortgage-backed securities they believed they had purchased would, in fact be non-mortgage-backed securities, which

[6] Michael Corkery, *Mortgage 'Cram-Downs' Loom as Foreclosures Mount*, WALL ST. J.,, Dec. 31, 2008.
[7] Dina ElBoghdady, *HUD Chief Calls Aid on Mortgages a Failure*, WASH. POST. Dec. 17, 2008, at A1.
[8] *See* FHA Single Family Outlook, Sept. 2010, *at* http://www.hud.gov/offices/hsg/rmra/oe/rpts/ooe/olcurr.xls - 2010-11-02, Row 263 (note that FHA fiscal years begin in October, so that Fiscal Year 2009 began in October 2008).

would almost assuredly lead investors to demand that their investment contracts be rescinded, thereby exacerbating the scale of mortgage putback claims.

Putback claims underscore the myriad conflicts of interest between mortgage servicers and investors. Mortgage servicers are responsible for prosecuting on behalf of MBS investors, violations of representations and warranties in securitization deals. Mortgage servicers are loathe to bring such actions, however, not least because they would often be bringing them against their own affiliates. Servicers' failure to honor their contractual duty to protect investors' interest is but one of numerous problems with servicer conflicts of interest, including the levying of junk fees in foreclosures that are ultimately paid by investors and servicing first lien loans while directly owning junior liens.

Many of the problems in the mortgage securitization market (and thus this testimony) are highly technical, but they are extremely serious.[9] At best they present problems of fraud on the court and questionable title to property. At worst, they represent a systemic risk of liabilities in the trillions of dollars, greatly exceeding the capital of the US's major financial institutions. While understanding the securitization market's problems involves following a good deal of technical issues, it is critical to understand from the get-go that securitization is all about technicalities.

Securitization is the legal apotheosis of form over substance, and if securitization is to work it must adhere to its proper, prescribed form punctiliously. The rules of the game with securitization, as with real property law and secured credit are, and always have been, that dotting "i's" and crossing "t's" matter, in part to ensure the fairness of the system and avoid confusions about conflicting claims to property. Close enough doesn't do it in securitization; if you don't do it right, you cannot ensure that securitized assets are bankruptcy remote and thus you cannot get the ratings and opinion letters necessary for securitization to work. Thus, it is important not to dismiss securitization problems as merely "technical;" these issues are no more technicalities than the borrower's signature on a mortgage. Cutting corners may improve securitization's economic efficiency, but it undermines its legal viability.

Finally, as an initial matter, let me also emphasize that the problems in the securitization world do not affect the whether homeowners owe valid debts or have defaulted on those debts. Those are separate issues about which there is no general controversy, even if debts are disputed in individual cases.[10]

This written testimony proceeds as follows: Part I presents an overview of the structure of the mortgage market, the role of mortgage servicers, the mortgage contract and foreclosure process. Part II presents the procedural problems and fraud issues that have emerged in the mortgage market relating to foreclosures. Part III addresses chain of title issues. Part IV considers the argument that the problems in foreclosures are mere technicalities being used by deadbeats to delay foreclosure. Part V concludes.

[9] I emphasize, however, that this testimony does not purport to be a complete and exhaustive treatment of the issues involved and that many of the legal issues discussed are not settled law, which is itself part of the problem; trillions of dollars of mortgage securitization transactions have been done without a certain legal basis.

[10] A notable exception, however, is for cases where the default is caused by a servicer improperly force-placing insurance or misapplying a payment, resulting in an inflated loan balance that triggers a homeowner default.

## I. Background on Securitization, Servicing, and the Foreclosure Process

### A. *Mortgage Securitization*

Most residential mortgages in the United States are financed through securitization. Securitization is a financing method involving the issuance of securities against a dedicated cashflow stream, such as mortgage payments, that are isolated from other creditors' claims. Securitization links consumer borrowers with capital market financing, potentially lowering the cost of mortgage capital. It also allows financing institutions to avoid the credit risk, interest rate risk, and liquidity risk associated with holding the mortgages on their own books.

Currently, about 60% of all outstanding residential mortgages by dollar amount are securitized.[11] The share of securitized mortgages by number of mortgages outstanding is much higher because the securitization rate is lower for larger "jumbo" mortgages.[12] Credit Suisse estimates that 75% of outstanding first-lien residential mortgages are securitized.[13] In recent years, over 90% of mortgages originated have been securitized.[14] Most second-lien loans, however, are not securitized.[15]

Although mortgage securitization transactions are extremely complex and vary somewhat depending on the type of entity undertaking the securitization, the core of the transaction is relatively simple.[16]

First, a financial institution (the "sponsor" or "seller") assembles a pool of mortgage loans. The loans were either made ("originated") by an affiliate of the financial institution or purchased from unaffiliated third-party originators. Second, the pool of loans is sold by the sponsor to a special-purpose subsidiary (the "depositor") that has no other assets or liabilities. This is done to segregate the loans from the sponsor's assets and liabilities.[17] Third, the depositor sells the loans to a passive, specially created, single-purpose vehicle (SPV), typically a trust in the case of residential mortgages.[18] The SPV issues certificated securities to raise the funds to pay the depositor for the loans. Most of the securities are debt securities—bonds—but there will also be a security representing the rights to the residual value of the trust or the "equity."

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[11] Inside Mortgage Finance, 2010 Mortgage Market Statistical Annual.

[12] *Id.*

[13] Ivy L. Zelman et al., *Mortgage Liquidity du Jour: Underestimated No More* 28 exhibit 21 (Credit Suisse, Equity Research Report, Mar. 12, 2007).

[14] Inside Mortgage Finance, 2010 Mortgage Market Statistical Annual.

[15] Inside Mortgage Finance, 2010 Mortgage Market Statistical Annual. From 2001-2007, only 14% of second lien mortgages originated were securitized. *Id.* Second lien mortgages create a conflict of interest beyond the scope of this paper. In many cases, second lien loans are owned by financial institutions that are servicing (but do not own) the first lien loan. *See* Hearing Before the House Financial Services Committee, Apr. 13, 2009 "Second Liens and Other Barriers to Principal Reduction as an Effective Foreclosure Mitigation Program" (testimony of Barbara DeSoer, President, Bank of America Home Loans) at 6 (noting that Bank of America owns the second lien mortgage on 15% of the first lien mortgages it services); Hearing Before the House Financial Services Committee, Apr. 13, 2009 "Second Liens and Other Barriers to Principal Reduction as an Effective Foreclosure Mitigation Program" (testimony of David Lowman, CEO for Home Lending, JPMorgan Chase) at 5 (noting that Chase owns the second lien mortgage on around 10% of the first lien mortgages it services). The ownership of the second while servicing the first creates a direct financial conflict between the servicer qua servicer and the servicer qua owner of the second lien mortgage, as the servicer has an incentive to modify the first lien mortgage in order to free up borrower cashflow for payments on the second lien mortgage.

[16] The structure illustrated is for private-label mortgage-backed securities. Ginnie Mae and GSE securitizations are structured somewhat differently. The private-label structure can, of course, be used to securitize any asset, from oil tankers to credit card debt to song catalogues, not just mortgages.

[17] This intermediate entity is not essential to securitization, but since 2002, Statement of Financial Accountings Standards 140 has required this additional step for off-balance-sheet treatment because of the remote possibility that if the originator went bankrupt or into receivership, the securitization would be treated as a secured loan, rather than a sale, and the originator would exercise its equitable right of redemption and reclaim the securitized assets. Deloitte & Touche, *Learning the Norwalk Two-Step*, HEADS UP, Apr. 25, 2001, at 1.

[18] The trustee will then typically convey the mortgage notes and security instruments to a "master document custodian," who manages the loan documentation, while the servicer handles the collection of the loans.

The securities can be sold directly to investors by the SPV or, as is more common, they are issued directly to the depositor as payment for the loans. The depositor then resells the securities, usually through an underwriting affiliate that then places them on the market. (See Figure 2, below.) The depositor uses the proceeds of the securities sale (to the underwriter or the market) to pay the sponsor for the loans. Because the certificated securities are collateralized by the residential mortgage loans owned by the trust, they are called residential mortgage-backed securities (RMBS).

A variety of reasons—credit risk (bankruptcy remoteness), off-balance sheet accounting treatment, and pass-through tax status (typically as a REMIC[19] or grantor trust)—mandate that the SPV be passive; it is little more than a shell to hold the loans and put them beyond the reach of the creditors of the financial institution.[20] Loans, however, need to be managed. Bills must be sent out and payments collected. Thus, a third-party must be brought in to manage the loans.[21] This third party is the servicer. The servicer is supposed to manage the loans for the benefit of the RMBS holders.

Every loan, irrespective of whether it is securitized, has a servicer. Sometimes that servicer is a first-party servicer, such as when a portfolio lender services its own loans. Other times it is a third-party servicer that services loans it does not own. All securitizations involve third-party servicers, but many portfolio loans also have third-party servicers, particularly if they go into default. Third-party servicing contracts for portfolio loans are not publicly available, making it hard to say much about them, including the precise nature of servicing compensation arrangements in these cases or the degree of oversight portfolio lenders exercise over their third-party servicers. Thus, it cannot always be assumed that if a loan is not securitized it is being serviced by the financial institution that owns the loan, but if the loan is securitized, it has third-party servicing.

Securitization divides the beneficial ownership of the mortgage loan from legal title to the loan and from the management of the loans. The SPV (or more precisely its trustee) holds legal title to the loans, and the trust is the nominal beneficial owner of the loans. The RMBS investors are formally creditors of the trust, not owners of the loans held by the trust.

The economic reality, however, is that the investors are the true beneficial owners. The trust is just a pass-through holding entity, rather than an operating company. Moreover, while the trustee has nominal title to the loans for the trust, it is the third-party servicer that typically exercises legal title in the name of the trustee. The economic realities of securitization do not track with its legal formalities; securitization is the apotheosis of legal form over substance, but punctilious respect for formalities is critical for securitization to work.

Mortgage servicers provide the critical link between mortgage borrowers and the SPV and RMBS investors, and servicing arrangements are an indispensable part of securitization.[22] Mortgage servicing has become particularly important with the growth of the securitization market.

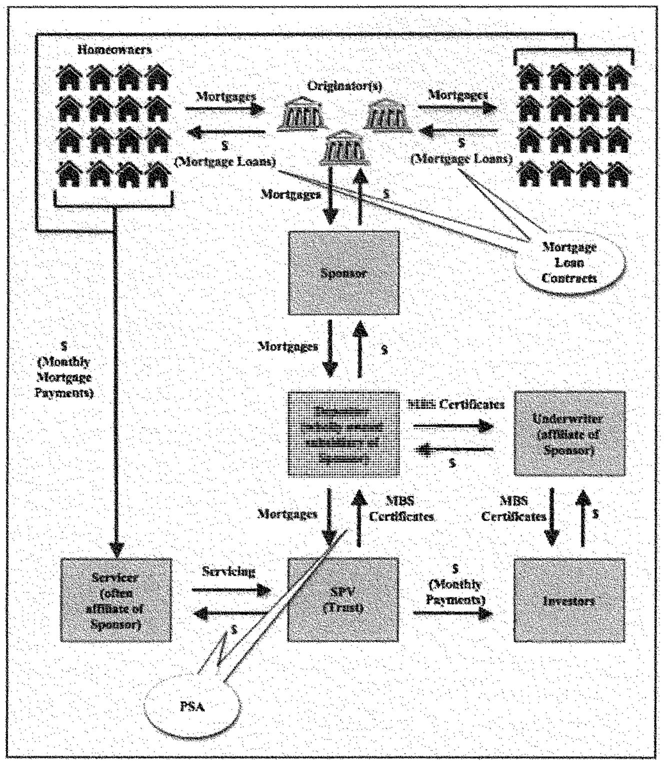
[19] A REMIC is a real estate mortgage investment conduit, as defined under I.R.C. §§ 860A-860G.

[20] *See* Anna Gelpern & Adam J. Levitin, *Rewriting Frankenstein Contracts: Workout Prohibitions in Residential Mortgage Backed Securities*, 82 S. CAL. L. REV. 1075, 1093-98. (2009).

[21] *See* Kurt Eggert, *Limiting Abuse and Opportunism by Mortgage Servicers*, 15 HOUSING POL'Y DEBATE 753, 754 (2004).

[22] The servicing of nonsecuritized loans may also be outsourced. There is little information about this market because it does not involve publicly available contracts and does not show up in standard data.

**Figure 2. Private-Label Mortgage Securitization Structure**[23]




### *B. The Mortgage Servicing Business*[24]

The nature of the servicing business in general militates toward economies of scale and automation. Servicing combines three distinct lines of business: transaction processing, default management, and loss mitigation. Transaction processing is a highly automatable business, characterized by large economies of scale. Default management involves collections and activities related to taking defaulted loans through foreclosure. Like transaction processing,

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[23] *See* ACE Sec. Corp. Home Equity Loan Trust, Series 2006-NC3, Prospectus Supplement (Form 424B5) S-11 (Nov. 21, 2006), *available at* http://www.sec.gov/Archives/edgar/data/1380884/000114420406049985/v058926_424b5.htm.

[24] This section of my testimony comes from Adam J. Levitin & Larry Cordell, *What RMBS Servicing Can Learn from CMBS Servicing*, working paper, November 2010.

default management can be automated,[25] as it does not require any negotiation with the homeowner, insurers, or junior lienholders.[26]

Loss mitigation is considered an *alternative to foreclosure*, and includes activities such as repayment plans, loan modifications, short sales and deeds in lieu of foreclosure. Loss mitigation is always a negotiated process and is therefore labor-intensive and expensive. Not only must the homeowner be agreeable to any loss mitigation solution, but so too must mortgage insurers and junior lienholders if they are parties on the loan. Because each negotiation is separate and requires a trained employee, there are very few opportunities for automation or economies of scale. Labor expenses are also considered overhead, which are all non-reimbursable expenses to servicers. And, to the extent that loss mitigation is in the form of a loan modification, redefault and self-cure risk always lurk in the background. Moreover, loss mitigation must generally be conducted in addition to default management; the servicer must proceed with foreclosure even if attempting to find an alternative, so the cost of loss mitigation is additive. Yet, while taking a loan through foreclosure is likely to involve lower costs than pursuing loss mitigation, it may not ultimately maximize value for RMBS investors because loss severities in foreclosure can easily surpass those on a re-performing restructured loan.

The balance between these different parts of a servicer's business changes over the course of the housing cycle. When the housing market is strong, the transaction processing dominates the servicing business, but when the housing market is weak, default management and loss mitigation become more important.

The very short weighted average life (WAL) of RMBS trusts combined with very low defaults in most economic environments encouraged servicers to place disproportionate weight on performing loan servicing, which historically has been characterized by small servicing fees and enormous economies of scale. Thus, on a typical loan balance of $200,000 today, a servicer might earn between $500 and $1,000 per year.[27] Given the low-level of annual income per loan, the short WAL of each loan, and low default rates in most economic environments before 2006, servicers had few incentives to devote resources to loss mitigation, but large incentives to invest in performing loan automation to capture the large economies of scale. This left servicers wholly unprepared for the elevated level of defaults that began in 2007.

### *C. RMBS Servicer Compensation*

RMBS servicers' duties and compensation are set forth in a document called a "Pooling and Servicing" agreement (PSA) also governs the rights of the RMBS certificate holders. RMBS servicers are compensated in four ways. First, they receive a "servicing fee," which is a flat fee of 25—50 basis points (bps) and is a first priority payment in the RMBS trust.[28] This is by far the greatest portion of servicer income. This fee is paid out proportionately across all loans regardless of servicer costs through the economic cycle.

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[25] *See In re Taylor*, 407 B.R. 618 (Bankr. E.D. Pa. 2009), *rev'd* 2010 WL 624909 (E.D. Pa. 2010).

[26] Arguably servicers have a fourth line of business—the management of real estate owned (REO). REO are foreclosed properties that were not purchased by third-parties at the foreclosure sale. REO management involves caring for and marketing the REO. It does not require negotiations with the homeowner (who is evicted) or junior lienholders (whose liens are generally extinguished by the foreclosure).

[27] Servicing fees are generally 25—50 bps, which translates into $500--$1000 per year in servicing fees.

[28] Generally the servicing fee is 25 bps for conventional fixed rate mortgages, 37.5 bps for conventional ARM loans, 44 bps for government loans and 50 bps for subprime.

Second, servicers earn "float" income. Servicers generally collect mortgage payments at the beginning of the month, but are not required to remit the payments to the trust until the 25th of the month. In the interim, servicers invest the funds they have collected from the mortgagors, and they retain all investment income. Servicers can also obtain float income from escrow balances collected monthly from borrowers to pay taxes and insurance during the course of the year.

Third, servicers are generally permitted to retain all ancillary fees they can collect from mortgagors. This includes things like late fees and fees for balance checks or telephone payments. It also includes fees for expenses involved in handling defaulted mortgages, such as inspecting the property. Finally, servicers can hold securities themselves directly as investors, and often hold the junior-most, residual tranche in the securitization.

Servicers face several costs. In addition to the operational expenses of sending out billing statements, processing payments, maintaining account balances and histories, and restructuring or liquidating defaulted loans, private label RMBS servicers face the expense of "servicing advances."[29] When a loan defaults, the servicer is responsible for advancing the missed payments of principal and interest to the trust as well as paying taxes and insurance on the property. They continue to pay clear through liquidation of the property, unless these advances are not deemed recoverable.

The servicer is able to recover advances it has made either from liquidation proceeds or from collections on other loans in the pool, but the RMBS servicer does not receive interest on its advances. Therefore, advances can be quite costly to servicers in terms of the time value of money and can also place major strains on servicers' liquidity, as the obligation to make advances continues until the loan is liquidated or the servicer believes that it is unlikely to be able to recover the advances. In some cases, servicers have to advance years' worth of mortgage payments to the trust.

While RMBS servicers do not receive interest on servicing advances, they are compensated for their "out-of-pocket" expenses. This includes any expenses spent on preserving the collateral property, including force-placed insurance, legal fees, and other foreclosure-related expenses. Large servicers frequently "in-source" default management expenses to their affiliates.

### *D. Monitoring of RMBS Servicers*

RMBS servicing arrangements present a classic principal-agent problem wherein the agent's incentives are not aligned with the principal and the principal has limited ability to monitor or discipline the agent.

#### *1. Investors*

Investors are poorly situated to monitor servicer behavior because they do not have direct dealings with the servicer. RMBS investors lack information about servicer loss mitigation

[29] In Agency securities, servicers generally stop advancing after borrowers owe their fifth payment, at 120 days past due. For GSE loans, they are then removed from the securities and taken on balance sheet. Servicer advances for the four payments are typically not reimbursed until termination.

activity. Investors do not have access to detailed servicer expense reports or the ability to examine loss mitigation decisions. Investors are able to see only the ultimate outcome. This means that investors are limited in their ability to evaluate servicers' performance on an ongoing basis. And even if investors were able to detect unfaithful agents, they have little ability to discipline them short of litigation.

*2. Trustees*

RMBS feature a trustee, but the name is deceptive. The trustee is not a common law trustee with general fiduciary duties. Instead, it is a limited purpose corporate trustee whose duties depend on whether there has been a default as defined UN the PSA. A failure to pay all tranches their regularly scheduled principal and interest payments is *not* an event of default. Instead, default relates to the financial condition of the servicer, whether the servicer has made required advances to the trust, whether the servicer has submitted its monthly report, and whether the servicer has failed to meet any of its covenants under the PSA.

Generally, before there is an event of default, the trustee has a few specifically assigned ministerial duties and no others.[30] These duties are typically transmitting funds from the trust to the RMBS investors and providing investors performance statements based on figures provided by the servicer. The trustee's pre-default duties do *not* include active monitoring of the servicer.

Trustees are generally entitled to rely on servicers' data reporting, and have little obligation to analyze it.[31] Indeed, as Moody's has noted, trustees lack the ability to verify most data reported by servicers; at best they can ensure that the reported data complies with any applicable covenant ratios:

> The trustee is not in a position to verify certain of the numbers reported by the servicer. For example, the amount of delinquent receivables and the amount of receivables charged off in a given month are figures that are taken from the servicer's own computer systems. While these numbers could be verified by an auditor, they are not verifiable by the trustee.[32]

Likewise, as attorney Susan Macaulay has observed, "In most cases, even if the servicer reports are incorrect, or even fraudulent, absent manifest error, the trustee simply has no way of knowing that there is a problem, and must allocate the funds into the appropriate accounts, and make the mandated distributions, in accordance with the servicer reports."[33]

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[30] *See, e.g.*, Wells Fargo Mortgage Backed Securities 2006-AR10 Trust § 8.01 ("Prior to the occurrence of an Event of Default of which a Responsible Officer of the Trustee shall have actual knowledge and after the curing of all such Events of Default which may have occurred, the duties and obligations of the Trustee shall be determined solely by the express provisions of this Agreement, the Trustee shall not be liable except for the performance of such duties and obligations as are specifically set forth in this Agreement, no implied covenants or obligations shall be read into this Agreement against the Trustee and, in the absence of bad faith on the part of the Trustee, the Trustee may conclusively rely, as to the truth of the statements and the correctness of the opinions expressed therein, upon any certificates or opinions furnished to the Trustee, and conforming to the requirements of this Agreement."). *See also* Moody's Investor Service, Structured Finance Ratings Methodology: Moody's Re-examines Trustees' Role in ABS and RMBS, Feb. 4, 2003, at 4. (noting "Some trustees have argued that their responsibilities are limited to strictly administrative functions as detailed in the transaction documents and that they have no "fiduciary" duty prior to an event nf default.").

[31] MBIA Ins. Corp. v. Royal Indem. Co., 519 F. Supp. 2d 455 (2007), *aff'd* 321 Fed. Appx. 146 (3d Cir. 2009) ("Royal argues that Wells Fargo [the trustee] had the contractual obligation to analyze data using certain financial accounting principles and to detect any anomalies that analysis might have uncovered. As Royal suggests, this analysis may not have been very labor-intensive. Yet, the contract did not call for any analysis at all. It simply required Wells Fargo to perform rote comparisons between that data and data contained in various other sources, and to report any numerical inconsistencies. Wells Fargo did just that.").

[32] Moody's Investor Service, *supra* note 30, at 4.

[33] Susan J. Macaulay, *US: The Role of the Securitisation Trustee*, GLOBAL SECURITISATION AND STRUCTURED FINANCE 2004. Macaulay further notes that:

Similarly, trustees usually wait for servicers to notify them of defaults,[34] and Moody's has noted that trustees are often unresponsive to information from third parties indicating that an unreported default might have occurred.[35] Thus, trustees enforce servicer representations and warranties largely on the honor system of servicer self-reporting.

For private-label securities, trustees also lack the incentive to engage in more vigorous monitoring of servicer loss mitigation decisions. The trustee does not get paid more for more vigorous monitoring. The trustee generally has little ability to discipline the servicer except for litigation. Private-label RMBS trustees have almost no ability to fire or discipline a servicer. Servicers can only be dismissed for specified acts, and these acts are typically limited to the servicer's insolvency or failure to remit funds to the trust. Occasionally servicers may be dismissed if default levels exceed particular thresholds.

Trustees also have no interest in seeing a servicer dismissed because they often are required to step in as back-up servicer.[36] In the event of a servicer default, the trustee takes over as servicer (which includes the option of subcontracting the duties), and assumes the duty of making servicing advances to the trust. The back-up servicer role is essentially an insurance policy for investors, and activation of that role is equivalent to payment on a claim; a trustee that has to act as a back-up servicer is likely to lose money in the process, especially when some of the trustees do not themselves own servicing operations.

Trustees also often have close relationships with particular servicers. For example, Professor Tara Twomey and I have shown that Bank of America/Countrywide accounts for nearly two-thirds of Deutsche Bank's RMBS trustee business.[37] In such circumstances, trustees are unlikely to engage in meaningful monitoring and disciplining of servicers.[38] Amherst Securities points out that early payment default provisions are not effectively enforced by trustees, to the point where in cases where borrowers did not make a single payment on the mortgage, only 37 percent were purchased out of the trust, much smaller amounts for loans making only one to six payments.[39] Thus, for private-label RMBS, there is virtually no supervision of servicers.[40]

GSE and Ginnie Mae securitization have greater oversight of servicers. The GSEs serve as master servicers on most of their RMBS; they therefore have a greater ability to monitor servicer compliance. The GSEs require servicers to foreclose according to detailed timelines, and

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It is almost always an event of default under the indenture if the trustee does not receive a servicer report within a specified period of time, and the trustee must typically report such a failure to the investors, any credit enhancement provider, the rating agencies and others. However, the trustee generally has no duties beyond that with respect to the contents of the report, although under the TIA, the trustee must review any reports furnished to it to determine whether there is any violation of the terms of the indenture. Presumably this would include verifying that any ratios represented in any reports conform to financial covenants contained in the indenture, etc. It would not however, require the trustee to go beyond the face of the report, i.e. to conduct further investigation to determine whether the data underlying the information on the reports presented to it were, in fact, true. Virtually all indentures, whether or not governed by the TIA, explicitly permit the trustee to rely on statements made to the trustee in officers' certificates, opinions of counsel and documents delivered to the trustee in the manner specified within the indenture.

*Id.*

[34] Moody's Investor Service, *supra* note 30, at 4.

[35] *Id.*

[36] Eric Gross, *Portfolio Management: The Evolution of Backup Servicing*, Portfolio Financial Servicing Company (PFSC) (July 11, 2002) *at* http://www.securitization.net/knowledge/article.asp?id=147&aid=2047.

[37] Adam J. Levitin & Tara Twomey, *Mortgage* Servicing, 28 YALE J. ON REG. (forthcoming 2011).

[38] *See* Ellington Credit Fund, Ltd. v. Select Portfolio, Inc., No. 1:07-cv-00421-LY, W.D. Tex., Plaintiffs' First Amended Complaint, July 10, 2007 (RMBS residual tranche holder alleging that trustee was aware that servicer was in violation of PSA and failed to act).

[39] *See* Amherst Mortgage Insight, "The Elephant in the Room—Conflicts of Interest in Residential Mortgage Securitizations", 15, May 20, 2010.

[40] For MBS with separate master and primary servicers, the master servicer may monitor the primary servicer(s), but often the master and primary servicers are the same entity.

servicers that fail to comply face monetary penalties. Recognizing the benefits inherent in effective loss mitigation, Fannie Mae places staff directly in all of the largest servicer shops to work alongside loss mitigation staff at their servicers.[41] Freddie Mac constructed servicer performance profiles to directly monitor servicers, sharing results directly with servicers and rating agencies. Since each GSE insures against credit losses on the loans, their ongoing monitoring provides consistent rules and a single point of contact to approve workout packages and grant exceptions, something absent in private label RMBS.

*3. Ratings and Reputation*

Like any repeat transaction business, servicers are concerned about their reputations. But reputational sanctions have only very weak discipline on servicer behavior.

While Regulation AB requires servicers to disclose information about their experience and practices,[42] they are not required to disclose information about performance of past pools they have serviced. In any event, reputational sanctions are ineffective because loss severities are more likely to be attributed to underwriting quality than to servicing decisions.

Rating agencies also produce servicer ratings, but these ratings are a compilation of the evaluation of servicers on a multitude of characteristics. Rating agencies have been known to incorporate features of Freddie Mac's servicer performance profiles in their servicer assessments and to incorporate loss mitigation performance into their ratings. But details of their methodology used to measure these assessments are not disclosed. They give no indication of whether a servicer is likely to make loss mitigation decisions based solely on the interests of the securitization trust. Ratings are also combined with other criteria, such as the servicer's own financial strength and operational capacity. In other words, servicer ratings go to the question of whether a servicer will have to be replaced because it is insolvent or lacks the ability to service the loans, with much less weight given to whether the servicer acts in the investors' interests.

*C. THE MORTGAGE CONTRACT AND FORECLOSURE PROCESS*

The mortgage contract consists of two documents, a promissory note (the "note" or the "mortgage loan") and a security instrument (the "mortgage" or the "deed of trust").[43] The note is the IOU that contains the borrower's promise to repay the money loaned. If the note is a negotiable instrument, meaning that it complies with the requirements for negotiability in Article 3 of the Uniform Commercial Code,[44] then the *original physical note* is itself the right to payment.[45]

The mortgage is the document that connects the IOU with the house. The mortgage gives the lender a contingent right to the house; it provides that *if* the borrower does not pay according to the terms of the note, then the lender can foreclose and have the property sold *according to the*

[41] PMI insurers have recently started to embed staff in servicer shops to monitor loss mitigation efforts. Harry Terris & Kate Berry, *In the Trenches*, AM. BANKER, Aug. 27, 2009.

[42] 17 C.F.R. § 229.1108.

[43] The note and the mortgage can be combined in a single document, but that is not common practice, both because the mortgage can be granted subsequent to the creation of the debt and because of borrower privacy concerns about the terms of the note, which would become public if the note and mortgage were combined and recorded in local property records.

[44] *See* UCC 3-104.

[45] UCC 3-203, Cmt. 1 ("An instrument is a reified right to payment. The right is represented by the instrument itself.").

*terms of the mortgage and applicable state and federal law.* The applicable law governing foreclosures is state law.[46]

State real estate law, including foreclosure law, is non-uniform, making it difficult to state what the law is as a generic matter; there is always the possibility that some jurisdictions may deviate from the majority rule. That said, no state requires a borrower's note to be recorded in local land records for the note to be valid, and, as a general matter, state law does not require the mortgage to be recorded either in order for the mortgage to be enforceable against the borrower. Recording of the mortgage is necessary, however, to establish the mortgage's priority relative to the claims of other parties, including other mortgagees, judgment lien creditors and tax and workmen's' liens against the property. The basic rule of priority is first in time, first in right; the first mortgage to be recorded has senior priority. An unrecorded mortgage will thus, generally have junior priority to a subsequently issued, but recorded mortgage. The difference between enforceability and priority is an important one, discussed in more detail below, in the section of this testimony dealing with MERS.

State law on foreclosures is also non-uniform. Roughly, however, states can be divided into two groups: those where foreclosure actions are conducted through the courts ("judicial foreclosure") and those where foreclosure actions are conducted by private sales ("nonjudicial foreclosure"). This division maps, imperfectly, with whether the preferred security instrument is a mortgage or a deed of trust.[47]

Mortgage loans cost more in states that have judicial foreclosure; what this means is that borrowers in judicial foreclosure states are paying more for additional procedural rights and legal protections; those procedural rights are part of the mortgage contract; failure to honor them is a breach of the mortgage contract. Note, that a default on the mortgage note is not a breach of the contract per se; instead it merely triggers the lender's right to foreclose per the applicable procedure.

In a typical judicial foreclosure proceeding, the homeowner receives a notice of default and if that default is not cured within the required period, the mortgagee then files a foreclosure action in court. The action is commenced by the filing of a written complaint that sets forth the mortgagee's allegations that the homeowner owes a debt that is secured by a mortgage and that the homeowner has defaulted on the debt. Rules of civil procedure generally require that legal actions based upon a writing include a copy of the writing as an attachment to the complaint, although there is sometimes an exception for writings that are available in the public records. While the mortgage is generally filed in the public records, assignments of the mortgage are often not (an issue complicated by MERS, discussed below), and the note is almost never a matter of public record.

It is important to understand that most judicial foreclosures do not function like the sort of judicial proceeding that is dramatized on television, in which all parties to the case appear in court, represented by attorneys and judgment only follows a lengthy trial. Instead, the norm in foreclosure cases is a default judgment. Most borrowers do not appear in court or contest their

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[46] There is a federal foreclosure statute that can be utilized by the federal government. *See* 12 U.S.C. §§ 3701-3713 (multi-family property foreclosures); §§3751-3768 (single-family property foreclosures).

[47] Mortgages sometimes also include a power of sale, permitting nonjudicial foreclosure. In a deed of trust, the deed to the property is transferred in trust for the noteholder to a deed of trust trustee, often a local attorney. The note remains the property of the lender (the deed of trust beneficiary). When there is a default on the note, the lender notifies the deed of trust trustee and the lender or its agent is typically appointed as substitute deed of trust trustee to run the foreclosure sale.

foreclosures, and not all of those who do are represented by competent counsel, not least because of the difficulties in paying for counsel. Most borrowers that the borrower does not contest the foreclosure or appear in court. In most cases, only the lender's attorney appears, and judges routinely dispatch dozens or hundreds of foreclosure cases in a sitting. Homeowners in foreclosure actions are among the most vulnerable of defendants, the least able to insist up on and vindicate their rights, and accordingly the ones most susceptible to abuse of legal process.

## II. PROCEDURAL PROBLEMS AND FRAUD

The first type of problems in the mortgage market are what might generously be termed "procedural defects" or "procedural irregularities." There are numerous such problems that have come to light in foreclosure cases. The extent and distribution of these irregularities is not yet known. No one has compiled a complete typology of procedural defects in foreclosures; there are, to use Donald Rumsfeld's phrase, certainly "known unknowns" and well as "unknown unknowns."

### *A. AFFIDAVITS FILED WITHOUT PERSONAL KNOWLEDGE (ROBOSIGNING)*

Affidavits need to be based on personal knowledge to have any evidentiary effect; absent personal knowledge an affidavit is hearsay and therefore generally inadmissible as evidence. Accordingly, affidavits attest to personal knowledge of the facts alleged therein.

The most common type of affidavit is an attestation about the existence and status of the loan, namely that the homeowner owes a debt, how much is currently owed, and that the homeowner has defaulted on the loan. (Other types of affidavits are discussed in sections II.B. and II.C., *infra*). Such an affidavit is typically sworn out by an employee of a servicer (or sometimes by a law firm working for a servicer). Personal knowledge for such an affidavit would involve, at the very least, examining the payment history for a loan in the servicer's computer system and checking it against the facts alleged in a complaint.

The problem with affidavits filed in many foreclosure cases is that the affiant lacks any personal knowledge of the facts alleged whatsoever. Many servicers, including Bank of America, Citibank, JPMorgan Chase, Wells Fargo, and GMAC, employ professional affiants, some of whom appear to have no other duties than to sign affidavits. These employees cannot possibly have personal knowledge of the facts in their affidavits. One GMAC employee, Jeffrey Stephan, stated in a deposition that he signed perhaps 10,000 affidavits in a month, or approximately 1 a minute for a 40-hour work week.[48] For a servicer's employee to ascertain payment histories in a high volume of individual cases is simply impossible.

When a servicer files an affidavit that claims to be based on personal knowledge, but is not in fact based on personal knowledge, the servicer is committing a fraud on the court, and quite possibly perjury. The existence of foreclosures based on fraudulent pleadings raises the

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[48] *See* Deposition of Jeffrey Stephan, GMAC Mortgage LLC v. Ann M. Neu a/k/a Ann Michelle Perez, No. 50 2008 CA 040805XXXX MB, (15th Judicial Circuit, Florida, Dec. 10, 2009) at 7, *available at* http://api.ning.com/files/s4SMwIZXvPu4A7kq7XQUsGW9xEcYtqNMPCm0a2hISJu88PoY6ZNqanX7XK41Fvf9gV8JIHDmc7KcFO2cvHqSEMcpIJ8vwnDT/091210gmacmortgagevsannmneu1.pdf (stating that Jeffrey Stephan, a GMAC employee, signed approximately 10,000 affidavits a month for foreclosure cases).

question of the validity of foreclosure judgments and therefore title on properties, particularly if they are still in real estate owned (REO).

### *B. Lost Note Affidavits for Notes that Are Not Lost*

The plaintiff in a foreclosure action is generally required to produce the note as evidence that it has standing to foreclose. Moreover, under the Uniform Commercial Code, if the note is a negotiable instrument, only a holder of the note (or a subrogee)—that is a party in possession of the note— may enforce the note, as the note is the reified right to payment.[49]

There is an exception, however, for lost, destroyed, or stolen notes, which permits a party that has lost possession of a note to enforce it.[50] If a plaintiff seeks to enforce a lost note, it is necessary "to prove the terms of the instrument" as well as the "right to enforce the instrument."[51] This proof is typically offered in the form of a lost note affidavit that attests to the prior existence of the note, the terms of the note, and that the note has been lost.

It appears that a surprisingly large number of lost note affidavits are filed in foreclosure cases. In Broward County, Florida alone, over 2000 such affidavits were filed in 2008-2009.[52] Relative to the national population, that translates to roughly 116,000 lost note affidavits nationally over the same period.[53]

There are two problems with the filing of many lost note affidavits. First, is a lack of personal knowledge. Mortgage servicers are rarely in possession of the original note. Instead, the original note is maintained in the fireproof vault of the securitization trustee's document custodian. This means that the servicer lacks personal knowledge about whether a note has or has not been lost.[54] Merely reporting a communication from the document custodian would be hearsay and likely inadmissible as evidence.

The second problem is that the original note is frequently not in fact lost. Instead, it is in the document custodian's vault. Servicers do not want to pay the document custodian a fee (of perhaps $30) to release the original mortgage, and servicers are also wary of entrusting the original note to the law firms they hire. Substitution of counsel is not infrequent on defaulted mortgages, and servicers are worried that the original note will get lost in the paperwork shuffle if there is a change in counsel. When pressed, however, servicers will often produce the original note, months after filing lost note affidavits. The Uniform Commercial Code (UCC) requires that a party seeking to enforce a note be a holder (or subrogee to a holder) or produce evidence that a note has been lost, destroyed, or stolen; the UCC never contemplates an "inconvenience affidavit" that states that it is too much trouble for a servicer to bother obtaining the original note. But that is precisely what many lost note affidavits are effectively claiming.

Thus, many lost note affidavits are doubly defective: they are sworn out by a party that does not and cannot have personal knowledge of the alleged facts and the facts being alleged are

[49] UCC 3-301; 1-201(b)(21) (defining "holder").

[50] UCC 3-309. Note that UCC 3-309 was amended in the 2001 revision of Article 3. The revision made it easier to enforce a lost note. Not every state has adopted the 2001 revisions. Therefore, UCC 3-309 is non-uniform law.

[51] UCC 3-309(b).

[52] Gretchen Morgenson & Andrew Martin, *Battle Lines Forming in Clash Over Foreclosures*, N.Y. TIMES, Oct. 20, 2010, at A1.

[53] According to the US Census Bureau, Broward County's population is approximately 1.76 million, making it .57% of the total US population of 307 million. Broward does have a significantly higher than average foreclosure rate, roughly 12% over the past two years, according to Core Logic Loan Performance data, making it approximately 3 times the national average.

[54] The 2001 version of UCC 3-309 permits not only a party that has lost a note but a buyer from such a party to enforce a lost note.

often false as the note is not in fact lost, but the servicer simply does not want to bother obtaining it.

### *C. Junk Fees*

The costs of foreclosure actions are initially incurred by servicers, but servicers recover these fees off the top from foreclosure sale proceeds before MBS investors are paid. This reimbursement structure limits servicers' incentive to rein in costs and actually incentives them to pad the costs of foreclosure. This is done in two ways. First, servicers charge so-called "junk fees" either for unnecessary work or for work that was simply never done. Thus, Professor Kurt Eggert has noted a variety of abusive servicing practices, including "improper foreclosures or attempted foreclosures; imposition of improper fees, especially late fees; forced-placed insurance that is not required or called for; and misuse of escrow funds."[55] Servicers' ability to retain foreclosure-related fees has even led them to attempt to foreclose on properties when the homeowners are current on the mortgage or without attempting any sort of repayment plan.[56] Consistently, Professor Katherine Porter has documented that when mortgage creditors file claims in bankruptcy, they generally list amounts owed that are much higher than those scheduled by debtors.[57]

There is also growing evidence of servicers requesting payment for services not performed or for which there was no contractual right to payment. For example, in one particularly egregious case from 2008, Wells Fargo filed a claim in the borrower's bankruptcy case that included the costs of two brokers' price opinions allegedly obtained in September 2005, on a property in Jefferson Parish, Louisiana when the entire Parish was under an evacuation order due to Hurricane Katrina.[58]

Similarly, there is a frequent problem of so-called "sewer summons" issued (or actually not issued) to homeowners in foreclosures. Among the costs of foreclosure actions is serving notice of the foreclosure (a court summons) on the homeowner. There is disturbing evidence that homeowners are being charged for summons that were never issued. These non-delivered summons are known as "sewer summons" after their actual delivery destination.

One way in which these non-existent summons are documented is through the filing of "affidavits of lost summons" by process servers working for the foreclosure attorneys hired by mortgage servicers. A recent article reports that in Duval County, Florida (Jacksonville) the number of affidavits of lost summons has ballooned from 1,031 from 2000-2006 to over 4,000 in the last two years, a suspiciously large increase that corresponds with a sharp uptick in foreclosures.[59]

Because of concerns about illegal fees, the United States Trustee's Office has undertaken several investigations of servicers' false claims in bankruptcy[60] and brought suit against

[55] Kurt Eggert, *Comment on Michael A. Stegman et al.'s "Preventive Servicing Is Good for Business and Affordable Homeownership Policy": What Prevents Loan Modifications?*, 18 HOUSING POL'Y DEBATE 279 (2007).

[56] Eggert, *Limiting Abuse*, *supra* note 21, at 757.

[57] Katherine M. Porter, *Mortgage Misbehavior*, 87 TEX. L. REV. 121, 162 (2008).

[58] *In re* Stewart, 391 B.R. 327, 355 (Bankr. E.D. La. 2008).

[59] Matt Taibi, *Courts Helping Banks Screw Over Homeowners*, ROLLING STONE, Nov. 25, 2010, *at* http://www.rollingstone.com/politics/news/17390/232611?RS_show_page=7.

[60] Ashby Jones, *U.S. Trustee Program Playing Tough With Countrywide, Others*, LAW BLOG (Dec. 3, 2007, 10:01 AM), *at* http://blogs.wsj.com/law/2007/12/03/us-trustee-program-playing-tough-with-countrywide-others.

Countrywide,[61] while the Texas Attorney General has sued American Home Mortgage Servicing for illegal debt collection practices.[62]

The other way in which servicers pad the costs of foreclosure is by in-sourcing their expenses to affiliates at above-market rates. For example, Countrywide, the largest RMBS servicer, force places insurance on defaulted properties with its captive insurance affiliate Balboa.[63] Countrywide has been accused of deliberately extending the time to foreclosure in order to increase the insurance premiums paid to its affiliate, all of which are reimbursable by the trust, before the RMBS investors' claims are paid.[64] Similarly, Countrywide in-sources trustee services in deed of trust foreclosures to its subsidiary Recon Trust.[65]

Thus, in Countrywide's' 2007 third quarter earnings call, Countrywide's President David Sambol emphasized that increased revenue from in-sourced default management functions could offset losses from mortgage defaults.

> Now, we are frequently asked what the impact on our servicing costs and earnings will be from increased delinquencies and loss mitigation efforts, and what happens to costs. And what we point out is, as I will now, is that *increased operating expenses in times like this tend to be fully offset by increases in ancillary income in our servicing operation, greater fee income from items like late charges, and importantly from in-sourced vendor functions* that represent part of our diversification strategy, a counter-cyclical diversification strategy such as our businesses involved in foreclosure trustee and default title services and property inspection services.[66]

In June, 2010, Countrywide settled with the FTC for $108 million on charges that it overcharged delinquent homeowners for default management services. According to the FTC,

> Countrywide ordered property inspections, lawn mowing, and other services meant to protect the lender's interest in the property… But rather than simply hire third-party vendors to perform the services, Countrywide created subsidiaries to hire the vendors. The subsidiaries marked up the price of the services charged by the vendors – often by 100% or more – and Countrywide then charged the homeowners the marked-up fees.[67]

Among the accusations brought against Countrywide in a recent investor notice of default filed by the Federal Reserve Bank of New York along with BlackRock and PIMCO, is that Countrywide has heen padding expenses via in-sourcing on the 115 trusts covered by the letter.[68]

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[61] Complaint, Walton v. Countrywide Home Loans, Inc. (*In re* Atchely), No. 05-79232 (Bankr. N.D. Ga. filed Feb. 28, 2008).

[62] Complaint, State v. Am. Home Mtg. Servicing, Inc., No. 2010-3307 (Tex. Dist. Ct. 448th Jud. Dist. filed Aug. 30, 2010).

[63] Amherst Mortgage Insight, 2010, "The Elephant in the Room—Conflicts of Interest in Residential Mortgage Securitizations," 23, May 20, 2010.

[64] *Id.*

[65] Center for Responsible Lending, *Unfair and Unsafe: How Countrywide's irresponsible practices have harmed borrowers and shareholders*, CRL Issue Paper, Feb. 7, 2008, at 6-7.

[66] Transcript, "Countrywide Financial Corporation Q3 2007 Earnings Call," Oct. 26, 2007 (emphasis added) (also mentioning "Our vertical diversification businesses, some of which I mentioned, are counter-cyclical to credit cycles, like the lender-placed property business in Balboa and like the in-source vendor businesses in our loan administration unit.").

[67] FTC, Press Release, June 7, 2010, *Countrywide Will Pay $108 Million for Overcharging Struggling Homeowners; Loan Servicer Inflated Fees, Mishandled Loans of Borrowers in Bankruptcy.*

[68] Kathy D. Patrick, Letter to Countrywide Home Loan Servicing LP and the Bank of New York, dated Oct. 18, 2010, *available at* http://www.scribd.com/Bondholders-Letter-to-BofA-Over-Countrywide-Loans-inc-NY-Fed/d/39686107.

Countrywide is hardly the only servicer accused of acting in its interests at the expense of investors. Carrington, another major servicer, also owns the residual tranche on many of the deals it services. Amherst Mortgage Securities has shown that Carrington has been much slower than other servicers to liquidate defaulted loans.[69] Delay benefits Carrington both as a servicer and as the residual tranche investor. As a servicer, delay helps Carrington by increasing the number of monthly late fees that it can levy on the loans. These late fees are paid from liquidation proceeds before any of the MBS investors.

As an investor in the residual tranche, Carrington has also been accused of engaging in excessive modifications to both capture late fees and to keep up the excess spread in the deals, as it is paid directly to the residual holders.[70] When loans were mass modified, Carrington benefited as the servicer by capitalizing late fees and advances into the principal balance of the modified loans, which increased the balance on which the servicing fee was calculated. Carrington also benefited as the residual holder by keeping up excess spread in the deals and delaying delinquency deal triggers that restrict payments to residual holders when delinquencies exceed specified levels. Assuming that the residual tranche would be out of the money upon a timely foreclosure, delay means that Carrington, as the residual holder, receives many more months of additional payments on the MBS it holds than it otherwise would.[71]

It is important to emphasize that junk fees on homeowners ultimately come out of the pocket of MBS investors. If the homeowner lacks sufficient equity in the property to cover the amount owed on the loan, including junk fees, then there is a deficiency from the foreclosure sale. As many mortgages are legally or functionally non-recourse, this means that the deficiency cannot be collected from the homeowner's other assets. Mortgage servicers recover their expenses off the top in foreclosure sales, before MBS investors are paid. Therefore, when a servicer lards on illegal fees in a foreclosure, it is stealing from investors such as pension plans and the US government.

### *D. Complaints that Fail to Include the Note*

Rule of civil procedure generally require that a compliant based on a writing include, as an attachment, a copy of a writing. In a foreclosure action, this means that both the note and the mortgage and any assignments of either must be attached. Beyond the rules of civil procedure requirement, these documents are also necessary as an evidentiary matter to establish that the plaintiff has standing to bring the foreclosure. Some states have exceptions for public records, which may be incorporated by reference, but it is not always clear whether this exception applies in foreclosure actions. If it does, then only the note, which is not a public record, would need to be attached.

[69] Amherst Mortgage Insight, 2010, "The Elephant in the Room—Conflicts of Interest in Residential Mortgage Securitizations", pp. 22-24, May 20, 2010.

[70] See Amherst Mortgage Insight, "Why Investors Should Oppose Servicer Safe Harbors", April 28, 2009. Excess spread is the difference between the income of the SPV in a given period and its payment obligations on the MBS in that period, essentially the SPV's periodic profit. Excess spread is accumulated to supplement future shortfalls in the SPV's cashflow, but is either periodically released to the residual tranche holder. Generally, as a further protection for senior MBS holders, excess spread cannot be released if certain triggers occur, like a decline in the amount of excess spread trapped in a period beneath a particular threshold.

[71] Carrington would still have to make servicing advances on any delinquent loans if it stretched out the time before foreclosure, but these advances would be reimbursable, and the reimbursement would come from senior MBS holders, rather than from Carrington, if it were out of the money in the residual.

Many foreclosure complaints are facially defective and should be dismissed because they fail to attach the note. I have recently examined a small sample of foreclosure cases filed in Allegheny County, Pennsylvania (Pittsburgh and environs) in May 2010. In over 60% of those foreclosure filings, the complaint failed to include a copy of the note. Failure to attach the note appears to be routine practice for some of the foreclosure mill law firms, including two that handle all of Bank of America's foreclosures.

I would urge the Committee to ask Bank of America whether this was an issue it examined in its internal review of its foreclosure practices.

### *E. Counterfeit and Altered Documents and Notary Fraud*

Perhaps the most disturbing problem that has appeared in foreclosure cases is evidence of counterfeit or altered documents and false notarizations. To give some examples, there are cases in which multiple copies of the "true original note" are filed in the same case, with variations in the "true original note;"[72] signatures on note allonges that have clearly been affixed to documents via Photoshop;[73] "blue ink" notarizations that appear in blank ink; counterfeit notary seals;[74] backdated notarizations of documents issued before the notary had his or her commission;[75] and assignments that include the words "bogus assignee for intervening asmts, whose address is XXXXXXXXXXXXXXXXX."[76]

Most worrisome is evidence that these frauds might not be one-off problems, but an integral part of the foreclosure business. A price sheet from a company called DocEx that was affiliated with LPS, one of the largest servicer support firms, lists prices for various services including the "creation" of notes and mortgages. While I cannot confirm the authenticity of this price sheet or date it, it suggests that document counterfeiting is hardly exceptional in foreclosure cases.

While the fraud in these cases is not always by servicers themselves, but sometimes by servicer support firms or attorneys, its existence should raise serious concerns about the integrity of the foreclosure process. I would urge the Committee to ask the servicer witnesses what steps they have taken to ascertain that they do not have such problems with loans in their servicing portfolios.

### *G. The Extent of the Problem*

The critical question for gauging the risk presented by procedural defects is the extent of the defects. While Federal Reserve Chairman Bernanke has announced that federal bank regulators are looking into the issue and will issue a report this month, I do not believe that it is

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Brief of Antonio Ibanez, Defendant-Appellee, US Bank Nat'l Assn, as Trustee for the Structured Asset Securities Corporation Mortgage Pass-Through Certificates, Series 2006-Z v. Ibanez; Wells Fargo Bank, N.A. as Trustee for ABFC 2005-Opt 1 Trust, ABFC Asset Backed Certificates Series 2005-OPT 1, No 10694, (Mass. Sept. 20, 2010), at 10 (detailing 3 different "certified true copies" of a note allonge and of an assignment of a mortgage); http://4closurefraud.org/2010/04/27/foreclosure-fraud-of-the-week-two-original-wet-ink-notes-submitted-in-the-same-case-by-the-florida-default-law-group-and-jpmorgan-chase/ (detailing a foreclosure file with two different "original" wet ink notes for the same loan).

[73] http://4closurefraud.org/2010/04/08/foreclosure-fraud-of-the-week-poor-photoshop-skills/.

[74] *See* WSTB.com, *at* http://www.wsbtv.com/video/25764145/index.html.

[75] Deposition of Cheryl Samons, Deutsche Bank Nat'l Trust Co., as Trustee for Morgan Stanley ABS Capital I Inc. Trust 2006-HE4 v. Pierre, No. 50-2008-CA-028558-XXXX-MB (15th Judicial Circuit, Florida, May 20, 2009, *available at* http://mattweidnerlaw.com/blog/wp-content/uploads/2010/03/depositionsammons.pdf.

[76] http://www.nassauclerk.com/clerk/publicrecords/oncoreweb/showdetails.aspx?id=809395&m=0&pi=0&ref=search.

within the ability of federal bank regulators to gauge the extent of procedural defects in foreclosure cases. To do so would require, at the very least, an extensive sampling of actual foreclosure filings and their examination by appropriately trained personnel. I am unaware of federal bank regulators undertaking an examination of actual foreclosure filings, much less having a sufficient cadre of appropriately trained personnel. Bank examiners lack the experience or training to evaluate legal documents like foreclosure filings. Therefore, any statement put forth by federal regulators on the scope of procedural defects is at best a guess and at worse a parroting of the "nothing to see here folks" line that has come from mortgage servicers.

I would urge the Committee to inquire with federal regulators as to exactly what steps they are taking to examine foreclosure irregularities and how they can be sure that those steps will uncover the extent of the problem. Similarly, I would urge the Committee to ask the servicer witnesses what specific irregularities they examined during their self-imposed moratoria and by what process. It defies credulity that a thorough investigation of all the potential problems in foreclosure paperwork could be completed in a month or two, much less by servicers that have taken so long to do a small number of loan modifications.

## III. CHAIN OF TITLE PROBLEMS

A second problem and potentially more serious problem relating to standing to foreclose is the issue of chain of title in mortgage securitizations.[77] As explained above, securitization involves a series of transfers of both the note and the mortgage from originator to sponsor to depositor to trust. This particular chain of transfers is necessary to ensure that the loans are "bankruptcy remote" once they have been placed in the trust, meaning that if any of the upstream transferors were to file for bankruptcy, the bankruptcy estate could not lay claim to the loans in the trust by arguing that the transaction was not a true sale, but actually a secured loan.[78] Bankruptcy remoteness is an essential component of private-label mortgage securitization deals, as investors want to assume the credit risk solely of the mortgages, not of the mortgages' originators or securitization sponsors. Absent bankruptcy remoteness, the economics of mortgage securitization do not work in most cases.

Recently, arguments have been raised in foreclosure litigation about whether the notes and mortgages were in fact properly transferred to the securitization trusts. This is a critical issue because the trust has standing to foreclose if, and only if it is the mortgagee. If the notes and mortgages were not transferred to the trust, then the trust lacks standing to foreclose. There are several different theories about the defects in the transfer process; I do not attempt to do justice to any of them in this testimony.

[77] Chain of title problems appear to be primarily a problem for private-label securitization, not for agency securitization because even if title were not properly transferred for Agency securities, it would have little consequence. Investors would not have incurred a loss as the result of an ineffective transfer, as their MBS are guaranteed by the GSEs or Ginnie Mae, and when a loan in an Agency pool defaults, it is removed from the pool and the owned by the GSE or Ginnie Mae, which is then has standing to foreclose.

[78] Bankruptcy remote has a second meaning, namely that the trust cannot or will not file of bankruptcy. This testimony uses bankruptcy remote solely in the sense of whether the trust's assets could be clawed back into a bankruptcy estate via an equity of redemption. The Uniform Commercial Code permits a debtor to redeem collateral at face value of the debt owed. If a pool of loans bore a now-above-market interest rate, the pool's value could be above the face value of the debt owed, making redemption economically attractive.

It can be very difficult to distinguish true sales from secured loans. For example, a sale and repurchase agreement (a repo) is economically identical to a secured loan from the repo buyer to the repo seller, secured by the assets being sold.

While the chain of title issue has arisen first in foreclosure defense cases, it also has profound implications for MBS investors. If the notes and mortgages were not properly transferred to the trusts, then the mortgage-backed securities that the investors' purchased were in fact *non-mortgage-backed securities*. In such a case, investors would have a claim for the rescission of the MBS,[79] meaning that the securitization would be unwound, with investors receiving back their original payments at par (possibly with interest at the judgment rate). Rescission would mean that the securitization sponsor would have the notes and mortgages on its books, meaning that the losses on the loans would be the securitization sponsor's, not the MBS investors, and that the securitization sponsor would have to have risk-weighted capital for the mortgages. If this problem exists on a wide-scale, there is not the capital in the financial system to pay for the rescission claims; the rescission claims would be in the trillions of dollars, making the major banking institutions in the United States would be insolvent.

The key questions for evaluating chain of title are what method of transferring notes and mortgages is actually supposed to be used in securitization and whether that method is legally sufficient both as a generic matter and as applied in securitization deals. There is a surprising lack of consensus on both counts. Scholars and attorneys cannot agree either on what methods would work generically, much less determine which were used in securitization transactions. This means there is a great deal of legal uncertainty over these issues. Even among banks' attorneys, different arguments appear in different litigation. For example, one possible method of transfer—a sale under Article 9 of the Uniform Commercial Code—has never, to my knowledge, been made by banks' attorneys in foreclosure litigation when chain of title has been questioned, even though it is one of the two methods that a recent American Securitization Forum (ASF) white paper argues is proper.[80] Even among the banks' lawyers, then, there is lack of consensus on what law governs transfers.

The following section outlines the potential methods of transfer and some of the issues that arise regarding specific methods. It is critical to emphasize that the law is not settled on most of the issues regarding securitization transfers; instead, these issues are just starting to be litigated.

### *A. Transfers of Notes Generally*

As a generic matter, a note can be transferred in one of four methods:

(1) The note can be sold via a contract of sale, which would be governed by the common law of contracts.

(2) If the note is a negotiable instrument,[81] it could be negotiated, meaning that it would be transferred via endorsement and delivery, with the process governed by Article 3 of the Uniform Commercial Code (UCC).[82] The endorsement can either be a specific

[79] This claim would not be a putback claim necessarily, but could be brought as a general contract claim. It could not be brought as a securities law claim under section 11 of the Securities Act of 1933 because the statute of limitations for rescission has expired on all PLS.

[80] American Securitization Forum, *Transfer and Assignment of Residential Mortgage Loans in the Secondary Mortgage Market*, ASF White Paper Series, Nov. 16, 2010, *at* http://www.americansecuritization.com/uploadedFiles/ASF_White_Paper_11_16_10.pdf. The ASF white paper notes that it has been reviewed and approved by 13 major (but unnamed) law firms. The ASF white paper does not report whether any of these firms have outstanding opinion letter liability on securitization transactions.

[81] It is not clear whether mortgage notes are necessarily negotiable instruments.

[82] The note endorsement process works just like endorsements on checks and is governed by the same law.

endorsement to a named endorsee or an endorsement in blank that converts the note into bearer paper.

(3) The note could be converted into an electronic note and transferred according to the provisions of the federal E-SIGN Act.[83]

(4) The note could be sold pursuant to UCC Article 9, if it was sold after 2001.[84] In 49 states (South Carolina being the exception), Article 9 provides a method for selling a promissory note, which requires that there be an authenticated (signed) agreement, value given, and that the seller have rights in the property being transferred.[85] This process is very similar to a common law sale.

### *B. TRANSFERS OF MORTGAGES GENERALLY*

There is general agreement that as a generic method, any of these methods of transfer would work to effectuate a transfer of the note. No method is mandatory. Whether or not the chosen process was observed in practice, is another matter, however.[86] Concerns about non-compliance is discussed below.

There are also several conceivable ways to transfer mortgages, but there are serious doubts about the validity of some of the methods:

(1) The mortgage could be assigned through the traditional common law process, which would require a document of assignment. There is general consensus that this process works.

(2) The mortgage could be negotiated. This method of transfer is of questionable effectiveness. A mortgage is not a negotiable instrument, and concepts of negotiability do not fit well with mortgages. For example, if a mortgage were negotiated in blank, it should become a "bearer mortgage," but this concept is utterly foreign to the law, not least as the thief of a bearer mortgage would have the ability to enforce the mortgage (absent equitable considerations). Similarly, with a bearer mortgage, a homeowner could never figure out who would be required to grant a release of the mortgage upon payoff. And, in many states (so-called title theory states), a mortgage is considered actual ownership of real property, and real property must have a definite owner (not least for taxation purposes).

(3) The mortgage could "follow the note" per common law. While there is a good deal of case law using this mellifluous phrase, common law is not wholly settled on the principle,

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[83] 15 U.S.C. § 7021. E-SIGN imposes a number of requirements on electronic note transfers and also requires consent of the issuer (maker) of the note.

[84] The revisions of UCC Articles 1 and 9 went into effect nationally in 2001.

[85] UCC 9-203. The language of Article 9 is abstruse, but UCC Revised Article 1 defines "security interest" to include the interest of a buyer of a promissory note. UCC 1-201(b)(35). Article 9's definition of "debtor" includes a seller of a promissory note, UCC 9-102(a)(28)(B ), and "secured party" includes a buyer of a promissory note, UCC 9-102(a)(72)(D). Therefore UCC 9-203, which would initially appear to address the attachment (enforceability) of a security interest also covers the sale of a promissory note. South Carolina has not adopted the revised Article 1 definition of security interest necessary to make Article 9 apply to sales of promissory notes.

[86] Note that common law sales and Article 9 sales do not affect the enforceability of the note against the obligor on the note. UCC 9-308, Cmt.6, Ex. 3 ("Under this Article, attachment and perfection of a security interest in a secured right to payment do not of themselves affect the obligation to pay. For example, if the obligation is evidenced by a negotiable note, then Article 3 dictates the person to whom the maker must pay to discharge the note and any lien security it."). UCC Article 3 negotiation and E-SIGN do affect enforceability as they enable a buyer for value in good faith to be a holder in due course and thereby cut off some of the obligor's defenses that could be raised against the seller. UCC 3-305, 3-306; 15 U.S.C. § 7021(d).

and its meaning is not entirely clear (e.g., does it mean that a transfer of the note effectuates a transfer of the mortgage or that the mortgage and the note cannot be separated and both must be transferred—by their own processes— in order for either transfer to work). There are also several instances where the mortgage clearly does not follow the note. For example, the basic concept of a deed of trust is that the security instrument and the note are separated; the deed of trust trustee holds the security, while the beneficiary holds the note. Likewise, the mortgage follows the note concept would imply that the theft of a note also constitutes theft of a mortgage, thereby giving to a thief more than the thief was able to actually steal. Another situation would be where a mortgage is given to a guarantor of a debt. The mortgage would not follow the debt, but would (at best) follow the guarantee. And finally, the use of MERS, a recording utility, as original mortgage (a/k/a MOM) splits the note and the mortgage. MERS has no claim to the note, but MERS is the mortgagee. If taken seriously, MOM means that the mortgage does not follow the note. While MERS might claim that MOM just means that the beneficial interest in the mortgage follows the note, a transfer of the legal title would violate a bankruptcy stay and would constitute a voidable preferenee if done before bankruptcy.

(4) the mortgage could "follow the note" if it is an Article 9 transfer.[87] There is consensus that this process would work *if* Article 9 governs the transfer of the note.

### *C. Transfers in Residential Mortgage Securitization Transactions*

All the methods described above for transferring notes and mortgages are simply generic methods. There may be additional requirements for a valid transfer, either as a function of trust law or as agreed upon by the parties themselves by contract. Notably, the American Securitization Forum's white paper considers neither of these possibilities.[88]

#### *1. Trust Law*

Trust law creates additional requirements for transfers. RMBS typically involve a transfer of the assets to a New York common law trust. Transfers to New York common law trusts are governed by the common law of gifts. In New York, such a transfer requires actual delivery of the transferred assets in a manner such that no one else could possibly claim ownership.[89] This is done to avoid fraudulent transfer concerns. For a transfer to a New York common law trust, the mere recital of a transfer, is insufficient to effectuate a transfer;[90] there must be delivery in as perfect a manner as possible.[91] Similarly, an endorsement in blank might not be sufficient to effectuate a transfer *to a trust* because endorsement in blank turns a note into bearer paper to which others could easily lay claim.

[87] UCC 9-203(g). If the transfer is not an Article 9 transfer, then the Article 9 provision providing that the mortgage follows the note would not apply.

[88] *See supra*, note 80.

[89] *See* Vincent v. Putnam, 248 N.Y. 76, 83 (N.Y. 1928) ("The delivery must be such as to vest the donee with the control and dominion over the property and to absolutely divest the donor of his dominion and control, and the delivery must be made with the intent to vest the title of the property in the donee....Equity will not help out an incomplete delivery.").

[90] *Id.* at 84 ("Mere words never constitute a delivery.").

[91] *In re* Van Alstyne, 207 N.Y. 298, 309 (N.Y. 1913).

### *2. Private Contract*

The UCC is simply a set of default rules.[92] Parties are free to contract around it, and need not do so explicitly.[93] Parties can thus impose by contract additional requirements for transfers to those in Articles 3 and 9 or, alternatively, ease the requirements. PSAs appear to be precisely this type of variation by agreement from the UCC. If so, then they would govern the transfers as a simple matter of contract law. Deviation from the PSA requirements would be allowed, but only by the extent permitted by contract law, and even if there were a deviation that constituted a material breach of the contract, it would not void the transfer on a self-executing basis.

### *3. Private Contract + Trust Law*

Trust law and private contract law combine to make a much more rigid set of transfer requirements that contract law would by itself. New York law provides that a trustee's authority is limited to that provided in the trust documents.[94] New York law also provides that any transfer in contravention of the trust documents is void.[95] Therefore, if the PSA—the trust document—says that the transfer must be done in a certain way and the transfer did not comply, the transfer is void, irrespective of whether it would comply with the Uniform Commercial Code or other law. The trust document creates a higher level of conduct to which the transfer must comply.

PSAs require a specific form of transfer. First, the PSA contains a recital of the transfer.[96] But per New York trust law, that recital alone is insufficient to effectuate a transfer to a common law trust.[97] Second, PSAs contain a provision that calls for delivery to the trustee for every mortgage loan in the deal of

> the original Mortgage Note bearing all intervening endorsements showing a complete chain of endorsement from the originator to the last endorsee, endorsed *"Pay to the order of ____________, without recourse"* and signed (which may be by facsimile signature) in the name of the last endorsee by an authorized officer.[98]

The reason for requiring this complete chain of endorsement from originator up through the Depositor before a final endorsement to the trust is to provide a clear evidentiary basis for all of the transfers in the chain of title in order to remove any doubts about the bankruptcy remoteness of the assets transferred to the trust. Absent a complete chain of endorsements, it

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[92] A few provisions of the UCC are mandatory, but these do not affect the chain of title issue.

[93] UCC 1-203; 1-201(b)(3) (defining "agreement").

[94] 14-140 Warren's Weed New York Real Property § 140.58 ("It is a fundamental principle of trust law that the instrument under which the trustee acts is the charter of his rights. Therefore, in administering the trust, he must act in accordance with its terms. This rule applies to every kind of trustee, regardless of whether the trustee is to hold, invest or pay over income, or to sell or liquidate for the benefit of creditors.").

[95] N.Y. E.P.T. L. § 7.2-4.

[96] Pooling and Servicing Agreement, Securities Asset Backed Receivables LLC Trust 2005-FR3, § 2.01(b), July 1, 2005, *available at* http://www.secinfo.com/dRSm6.z1Fa.d.htm ("The Depositor, concurrently with the execution and delivery hereof, hereby sells, transfers, assigns, sets over and otherwise conveys to the Trustee for the benefit of the Certificateholders, without recourse, all the right, title and interest of the Depositor in and to the [mortgage notes].")

[97] Vincent v. Putnam, 248 N.Y. 76, 84 (N.Y. 1928) ("Mere words never constitute a delivery.").

[98] Pooling and Servicing Agreement, Securities Asset Backed Receivables LLC Trust 2005-FR3, § 2.01(b), July 1, 2005, *available at* http://www.secinfo.com/dRSm6.z1Fa.d.htm. Deal language may vary, and some PSAs merely require endorsement in blank, not the chain of endorsements on the note. *See, e.g.*, Pooling and Servicing Agreement, Asset Backed Finance Corp. 2006-OPT- 1 Trust, July 1, 2006, *available at* http://www.secinfo.com/dRSm6.v2K1.c.htm#8mq6 (requiring delivery to the trustee of "the original Mortgage Note, endorsed in blank or with respect to any lost Mortgage Note, an original Lost Note Affidavit, together with a copy of the related Mortgage Note" but not of intervening endorsements.).

could be argued that the trust assets were transferred directly from the originator to the trust, raising the concern that if the originator filed for bankruptcy, the trust assets could be pulled back into the originator's bankruptcy estate.

### *D. Compliance*

Regardless of the legal method that applies for transferring notes and mortgages, there is a question of whether there was compliance with that method in actual securitization deals. The American Securitization Forum white paper says nothing on this count, nor can it; evaluating compliance would involve examining actual loan files. This is something that federal bank regulators should be doing, and I would urge the Committee to underscore that point in conversations with the regulators.

There are, of course, a multitude of potential non-compliance problems, including the premature shredding of notes[99] or the signing of assignments by purported agents of now-defunct companies. The scope of these problems is unclear; they may plague individual deals or just individual loans within those deals. On the other hand, if the PSAs set forth the transfer requirements, there may well be widespread non-compliance with the endorsement requirements of the PSAs. Most notes contain only a single endorsement in blank, not "all intervening endorsements showing a complete chain of endorsement from the originator to the last endorsee" before a final endorsement in blank. This would appear to mean that such transfers are void under New York law and that the mortgages were never actually transferred to the trusts issuing the MBS and this could not be corrected because of various timeliness requirements in PSAs.

It bears emphasis that the validity of transfers to the trusts is an unsettled legal issue. It is not as clear as either the American Securitization Forum or any law firm with outstanding securitization opinion letter liability would have one believe. There are questions both about what law actually governs the transfers and about whether there was compliance with the law. If there is a widespread chain of title problem, however, it would create a systemic crisis, as title on most properties in the US would be clouded and the contract rescission/putback liability because of the failed transfers would greatly surpass the market capitalization of the country's major banks.

## IV. Yes, But Who Cares? These Are All Deadbeats

### *A. Does Banks' Convenience Trump Rule of Law?*

A common response from banks about the problems in the securitization and foreclosure process is that it doesn't matter as the borrower still owes on the loan and has defaulted. This "No Harm, No Foul" argument is that homeowners being foreclosed on are all a bunch of deadbeats, so who really cares about due process? As JPMorganChase's CEO Jamie Dimon put it "for the most part by the time you get to the end of the process we're not evicting people who

[99] *See* Florida Bankers' Ass'n Comment to the Florida Supreme Court on the Emergency Rule and Form Proposals of the Supreme Court Task Force on Residential Mortgage Foreclosure Cases, at 4, *at* http://www.scribd.com/doc/38213950/Notes-Are-Destroyed ("The reason 'many firms file lost note counts as a standard alternative pleading in the complaint' is because the physical document was deliberately eliminated to avoid confusion immediately upon its conversion to an electronic file.").

deserve to stay in their house."[100]

Mr. Dimon's logic condones vigilante foreclosures: so long as the debtor is delinquent, it does not matter who evicts him or how. (And it doesn't matter if there are some innocents who lose their homes in wrongful foreclosures as long as "for the most part" the borrowers are in default.) But that is not how the legal system works. A homeowner who defaults on a mortgage doesn't have a right to stay in the home if the proper mortgagee forecloses, but any old stranger cannot take the law into his own hands and kick a family out of its home. That right is reserved solely for the proven mortgagee.

Irrespective of whether a debt is owed, there are rules about who can collect that debt and how. The rules of real estate transfers and foreclosures have some of the oldest pedigrees of any laws. They are the product of centuries of common law wisdom, balancing equities between borrowers and lenders, ensuring procedural fairness and protecting against fraud.

The most basic rule of real estate law is that only the mortgagee may foreclosure. Evidence and process in foreclosures are not mere technicalities nor are they just symbols of rule of law. They are a paid-for part of the bargain between banks and homeowners. Mortgages in states with judicial foreclosures cost more than mortgages in states without judicial oversight of the foreclosure process.[101] This means that homeowners in judicial foreclosure states are buying procedural protection along with their homes, and the banks are being compensated for it with higher interest rates. Banks and homeowners bargained for legal process, and rule of law, which is the bedrock upon which markets are built function, demands that the deal be honored.

Ultimately the "No Harm, No Foul," argument is a claim that rule of law should yield to banks' convenience. To argue that problems in the foreclosure process are irrelevant because the homeowner owes *someone* a debt is to declare that the banks are above the law.

### *B. Are They All Deadbeats?*

Not every homeowner in foreclosure is a deadbeat. There are some homeowners who are in foreclosure while current on their mortgages, others who are in foreclosure after having been told by their servicers that they have received loan modifications, and others who are in foreclosure because of warehouse lending fraud problems whereby their original lender sold their same mortgage multiple times. There are also homeowners who are in foreclosure because of predatory servicing practices such as charges for forced-placed insurance at way-above-market rates and misapplication of payments (such as illegally applying payments first to late fees and then the principal and interest owed so as to make the payment only qualify as a partial payment, thus incurring another late fee). These homeowners are hardly deadbeats; they are in foreclosure not because of their own behavior, but because of their servicer's behavior.

Ultimately, we don't know how many homeowners in foreclosure are truly in default on their mortgages. To actually determine that would require a detailed examination of homeowners' payment history, an examination that would take several hours in most cases, and homeowners currently lack the right to receive servicing statements showing how their payments

[100] Tamara Keith & Renee Montaigne, *Sorting Out the Banks' Foreclosure Mess*, NPR, Oct. 15, 2010.

[101] *See* Karen Pence, *Foreclosing on Opportunity: State Laws and Mortgage Credit*, 88 REV. ECON. & STAT. 177 (2006) (noting that the availability—and hence the cost—of mortgages in states with judicial foreclosure proceedings is greater than in states with non-judicial foreclosures).

are applied. A servicer's assertion that the homeowner is delinquent is not conclusive evidence, especially if the assertion is in a robosigned affidavit. Most homeowners in foreclosure are likely in default, but given that most homeowners lack legal representation, we should be cautious in assuming too much. Sometimes a default judgment is an admission that the plaintiff is correct, and sometimes it is just a sign of lack of resources to litigate.

## V. CONCLUSION

The foreclosure process is beset with problems ranging from procedural defects that can be readily cured to outright fraud to the potential failure of the entire private label mortgage securitization system.

In the best case scenario, the problems in the mortgage market are procedural defects and they will be remedied within reasonably quickly (perhaps taking around a year). Remedying them will extend the time that properties are in foreclosure and increase the shadow housing inventory, thereby driving down home prices. The costs of remedying these procedural defects will also likely be passed along to future mortgage borrowers, thereby frustrating attempts to revive the housing market and the economy through easy monetary policy.

In the worst case scenario, there is systemic risk, as there could be a complete failure of loan transfers in private-label securitization deals in recent years, resulting in trillions of dollars of rescission claims against major financial institutions. This would trigger a wholesale financial crisis.

Perhaps the most important lesson from 2008 is the need to be ahead of the ball of systemic risk. This means (1) ensuring that federal regulators do a serious investigation as discussed in this testimony above and (2) considering the possible legislative response to a crisis. The sensible course of action here is to avoid gambling on unsettled legal issues that could have systemic consequences. Instead, we should recognize that stabilizing the housing market is the key toward economic recovery, and that it is impossible to fix the housing market unless the number of foreclosures is drastically reduced, thereby reducing the excess inventory that drives down housing prices and begets more foreclosures. Unless we fix the housing market, consumer spending will remain depressed, and as long as consumer spending remains depressed, high unemployment will remain and the US economy will continue in a doldrums that it can ill-afford given the impending demographics of retirement.

This suggests that the best course of action is a global settlement on mortgage issues, the key elements of which must be (1) a triage between homeowners who can and cannot pay with principal reduction and meaningful modifications for homeowners with an ability to pay and speedier foreclosures for those who cannot, (2) a quieting of title on securitized properties, and (3) a restructuring of bank balance sheets in accordance with loss recognition.

A critical point in any global settlement, however, must be removing mortgage servicers from the loan modification process. Servicers were historically never in the loan modification business on any scale, and four years of hoping that something would change have demonstrated that servicers never will manage to successfully modify many loans on their own. They lack the capacity, they lack the incentives, and the lack the will.

If we want to see more loan modifications—and I would submit that this is important not just as a type disaster relief for deserving homeowners, but as an indispensable measure for stabilizing the housing market and the economy—then we need to take servicers out of the loan modification process and have modifications done either by a government agency or by the courts or by outcome-neutral third parties.

A global settlement would also be an allocation of the losses from the implosion of the housing bubble. Those losses are not avoidable. The Treasury Department's unspoken hope that the economy will grow its way out of those losses and that they can be recognized against future retained earnings was optimistic to begin with and given the performance of the economy of the past two years, it is Pollyannaism to continue in such a belief. Instead, if the economy is to move forward without losing a decade or more in a long-shot bet on sudden resurrection, we must face the losses from the financial crisis and allocate them sensibly. There are only a limited number of places where we can put those losses: homeowners, banks, MBS investors (including many pension funds), or the government. There are political choices to be made in any allocation, but failure to make an explicit allocation is also a choice—that the losses will be borne by homeowners and MBS investors. We should be cognizant of these choices.

I recognize that for many, the preferred course of action is not to deal with a problem until it materializes and certainly to avoid any loss allocation that might threaten US financial institutions. But if we pursue that route, we may well be confronted with an unmanageable crisis. We cannot rebuild the US housing finance system until we deal with the legacy problems from our old system, and these are problems that are best addressed sooner, before an acute crisis, then when it is too late.

**Testimony of Harold Lewis**
**Managing Director, CitiMortgage**
**Before the Committee on Financial Services**
**Subcommittee on Housing and Community Opportunity**
**November 18, 2010**

Chairwoman Waters, Ranking Member Capito and members of the Committee, my name is Harold Lewis, and I am a Managing Director of CitiMortgage and Head of Citi's Homeowner Assistance Program. Thank you for the opportunity to speak with you today about Citi's efforts to help families stay in their homes and to address the questions you have asked.

As the housing crisis has worsened, we have devoted considerable resources to helping our customers who are facing financial challenges. We have a specially trained and dedicated staff of approximately 5,000 employees, who work with at-risk homeowners to help them find workable solutions to avoid foreclosure. To further these efforts, we partner with community organizations across the country, including Neighborhood Assistance Corporation of America, National Community Reinvestment Coalition, Consumer Credit Counseling Service, Consumer Counseling Resource Center, Consolidated Board of Realtists, National Council of La Raza, NeighborWorks America, East Los Angeles Community Corporation and Los Angeles Family Housing. Since 2007, we have helped more than a million distressed borrowers in their efforts to avoid potential foreclosure.

Our efforts to help borrowers include our participation in the federal Home Affordable Modification Program ("HAMP") and our creation of additional, proprietary Citi modification programs.

We believe that we have been a leader in HAMP modifications. We actively identify eligible borrowers and conduct extensive outreach to contact them and guide them through the process of applying for trial modifications and obtaining permanent modifications. Throughout this process, we offer borrowers the assistance of housing counselors, provide detailed instructions for completing required documents, and follow up with applicants by phone, email, text messages and in-home visits. As of September 30, 2010, 44% of our eligible borrowers have obtained a permanent modification under HAMP.

Borrowers who do not qualify for a HAMP modification may be eligible for one of the proprietary modification and other assistance programs we have developed. These programs include the Citi Homeowners Unemployment Assistance Program, which provides temporarily lowered monthly payments to borrowers who have lost their jobs, and the Citi Supplemental Modification Program, which provides a two-year interest rate reduction for eligible borrowers who successfully complete a three-month trial period.

In addition, for those borrowers who face severe hardship, we have in place short sale and deed in lieu of foreclosure programs, which provide alternatives to foreclosure and allow families to make planned transitions to the next phase in their lives. Through

September of this year alone, our short sales have increased more than six-fold from the number of short sales we completed in 2007. Under our deed in lieu of foreclosure program, a borrower may sign the property deed over to Citi and vacate the property, and may receive a monetary relocation incentive. In a pilot program available in six states, eligible borrowers may stay in their homes for a period of up to six months and will receive a relocation incentive as well as counseling by trained professionals.

Every loan is reviewed for eligibility for the modification and assistance programs described above, and any other applicable programs, before any foreclosure is initiated. Citi is ranked among the top of the U.S. Treasury's rankings for HAMP. In addition, the re-default rate for our customers who obtain modifications is well below the re-default rate of other major lenders. We at Citi are committed to achieving affordability in a responsible manner while helping families stay in their homes, and we support Treasury's programs to help consumers.

All of us at Citi recognize the hardship that can be suffered by a family losing its home. This is why foreclosure is always a last resort for us. In the event that a foreclosure cannot be avoided, however, we have processes in place that are designed to make sure that foreclosures comply with all relevant state and federal laws, and that we do everything we can to make the transition for our customers as smooth as possible.

As I have indicated, as the housing crisis worsened, Citi's main focus has been to work with borrowers to keep them in their homes. Citi has dedicated both staff and resources to this worthy goal and as a result, during the period January 1, 2007 through September 30, 2010, Citi has helped more than one million homeowners in their efforts to avoid potential foreclosure. That has always been our first priority.

As we have said, Citi also has been continuously reviewing its foreclosure processes with respect to its U.S. mortgage portfolios. We first focused on our existing foreclosure processes, which we strengthened over time, and determined that the integrity of our current process is sound and that there are no systemic issues. We have subsequently focused on ensuring that pending foreclosures, regardless of when they were initiated, as well as cases that were being handled by the Stern law firm, also meet our current standards.

Taking each of these actions in turn:

Beginning in the fall of 2009, Citi took a series of steps to strengthen its practices and add additional resources to ensure foreclosures were being processed correctly. As part of these improvements, Citi centralized its foreclosure operations into one unit, added staff and enhanced training for greater efficiency and control. Citi limited the volume of documents that staff processes and requires annual certification of its employees' understanding of the proper procedures. Also, managers were made accountable for regularly reviewing files to make certain that employees comply with the procedures. These improvements were fully implemented at our St. Louis processing center in February of 2010.

Under Citi's existing procedures, affidavits are prepared by outside counsel to ensure compliance with each state's foreclosure laws, and each package is reviewed by a Citi employee who now verifies the information and signs the foreclosure affidavit in the presence of a notary. In a limited number of cases earlier this year, affidavits may have been executed by outside counsel under now-revoked powers of attorney. When errors are found, the documents are returned to the attorney, who revises the package and resubmits the documents for review. Foreclosures are monitored to make certain that staffing is adequate to review the affidavits properly. As noted previously, the changes and safeguards implemented this year give Citi confidence that there are no systemic issues in its existing foreclosure processes. To date, Citi's review of foreclosure affidavits has not identified cases where Citi foreclosed on a property in error.

As an additional quality control measure, Citi is currently reviewing approximately 10,000 affidavits that were executed in pending judicial foreclosures initiated prior to February 2010 to assure that these affidavits are substantively correct and properly executed. Citi expects that affidavits executed prior to the fall of 2009 will need to be re-filed.

Separately, Citi is also reviewing approximately 4,000 pending foreclosure affidavits in judicial states that were executed at our Dallas processing center and may not have been signed in the presence of a notary, to assure that these affidavits are substantively correct and properly executed. Citi expects that it will re-file these affidavits.

Lastly, as previously announced, Citi stopped referring new matters to the Florida law firm David Stern in September of 2010 and has since withdrawn all pending matters from that firm. As an added precaution and quality-control measure, Citi is transferring approximately 8,500 pending foreclosure files from the Stern law firm to new counsel. New affidavits for these cases will be prepared and re-filed by new counsel under Citi's current procedures.

Citi, through the implementation of the procedures and reviews described above, is making every effort to ensure that no foreclosure goes forward based on an inaccurate or defective affidavit. Citi has not suspended its foreclosure process and believes there is no reason to do so.

As Citi CEO Vikram Pandit has said, we owe a debt of gratitude to the American taxpayer for providing Citi with TARP funds. We believe it is our responsibility to help American families in financial distress, and in particular, to help families stay in their homes. We remain committed to helping borrowers facing hardship.

Thank you for the opportunity to address the Committee. I would be happy to answer any questions you might have.

# # #

**Appendix to Testimony of Harold Lewis**
**Before the Committee on Financial Services**
**Subcommittee on Housing and Community Opportunity**
**November 18, 2010**

- **Please describe the process your firm uses when foreclosing on borrowers (give a step-by-step description, including the types of systems used, when contractors might be employed, the number of employees involved, and any other relevant information).**

Every delinquent loan is subject to multiple levels of review by specialized Citi personnel, including reviews for eligibility for HAMP and Citi's proprietary loan modification programs, before the foreclosure process is initiated. We initiate contact with borrowers at the earliest stages of delinquency, offer borrowers the assistance of housing counselors, provide detailed instructions for completing required documents, and follow up with applicants by phone, email, text messages and in-home visits.

All of us at Citi recognize the hardship that can be suffered by a family losing its home. This is why foreclosure is always a last resort for us. In the event that a foreclosure cannot be avoided, however, we have processes in place that are designed to make sure that foreclosures comply with all relevant state and federal laws, and that we do everything we can to make the transition for our customers as smooth as possible.

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Citi, through the implementation of the procedures and reviews described above, is making every effort to ensure that no foreclosure goes forward based on an inaccurate or defective affidavit. Citi has not suspended its foreclosure process and believes there is no reason to do so.

- **In the last two years, in what proportion of foreclosures in judicial foreclosure states did your firm use a lost note affidavit?**

We cannot provide the exact number of instances in which we have used a lost note affidavit; however, we make every effort to ensure that all necessary documentation is present for each foreclosure. In the infrequent event that we use a lost note affidavit, we do so in accordance with Fannie Mae, Freddie Mac, and Ginnie Mae and other investor guidelines as applicable.

- **How does your firm establish if the trustee is in possession of the note?**

  In the event a loan is sold to an investor such as Fannie Mae, Ginnie Mae or in a securitization, the note is transferred to the investor or its custodian. In the infrequent event the note cannot be located, a lost note affidavit, produced in accordance with investor requirements, is delivered to the investor or its custodian. If the seller cannot deliver the note or lost note affidavit, the loan is repurchased from the investor.

- **What internal controls do you have in place to monitor whether the outside law firms you employ follow all relevant laws, regulations and company policies related to foreclosure (including notarization, process service, confirmation of the amount due by the borrower, whether appropriate fees were levied, etc)?**

  Before permitting any law firm to perform foreclosure work for us, we conduct extensive due diligence on the firm, which includes completing a detailed questionnaire and conducting searches for any complaints or lawsuits with the state bar, regulatory agencies and state and federal courts. Law firms are informed of our standards and expectations with respect to affidavits and other filings submitted on our behalf in foreclosure proceedings, the control processes such firms must have in place concerning foreclosure-related documentation, and the escalation of any issues to us. Among other things, each law firm is required, as a condition of its representation of Citi, to follow all local, state and federal laws regarding their legal work on our behalf, and to be familiar with and comply with each specific state's laws and processes regarding foreclosure. We also do periodic on-site legal audits to review selected files, observe default-related processes at the law firm, and review new legal requirements and challenges in the relevant state. If deficiencies are found, appropriate corrective action is required. In addition, if a foreclosure is contested or encounters unexpected issues, the law firm escalates the matter to us, and we may elect to direct the law firm to cease or take certain actions.

- **What is the typical educational level of someone employed by your firm to sign-off on foreclosures (i.e., a "robo-signer")? What is the typical salary of such an employee? What is the typical turnover for such employees? What is the typical daily/weekly/monthly caseload of such an employee?**

  Our foreclosure affidavit group is made up of mid-level employees who are compensated in a range from approximately $25,000 to $44,000. These employees typically have four or more years' default processing experience, and a college degree is not required. We currently have 21 employees in the foreclosure affidavit group, and there has been very little turnover in this group over the last 12 months. On any given day, an employee will review and execute an average of 35 affidavits. In addition, this group has three supervisory employees who are accountable for regularly reviewing files to make certain that employees comply with required procedures.

- **Has your firm ever been fined by any federal regulator, Fannie Mae or Freddie Mac for failure to properly service loans or engage in appropriate loss mitigation?**

  Citi has never been fined by any federal regulator, or Fannie Mae or Freddie Mac, for failure to engage in appropriate loss mitigation or to properly service loans. The U.S. Department of Housing and Urban Development ("HUD") and the various government-sponsored entities ("GSEs"), such as Fannie Mae and Freddie Mac, routinely audit for compliance with all timelines and other guidelines on a loan-by-loan level. Any lack of compliance with such timelines and other guidelines results in an offset to reimbursement, repayment of a reimbursement or a fee paid to HUD, as applicable. These offsets, repayments and fees are on a loan-level basis and are not fines for failure to properly service.

- **Of the borrowers whose trial Home Affordable Modification Program (HAMP) modifications failed to become permanent modifications, what proportion of those borrowers failed to achieve permanent modifications because they did not pay their mortgages during the trial period? What proportion failed to achieve permanent modifications because they failed to submit the appropriate paperwork?**

  We actively identify eligible borrowers and conduct extensive outreach to contact them and guide them through the process of applying for trial modifications and obtaining permanent modifications. Throughout this process, we offer borrowers the assistance of housing counselors, provide detailed instructions for completing required documents, and follow up with applicants by phone, email, text messages and in-home visits.

  Despite these efforts, borrowers who receive a trial modification do not always meet HAMP's requirements for a permanent modification.

  Prior to March 2010, borrowers were permitted to begin a trial period before submitting income documentation. During this period, of those borrowers who did not obtain permanent modification, 50% were borrowers who were ineligible for permanent modification based on the documentation they submitted, 29% did not submit required documentation, and 7% did not make trial modification payments.

  In March 2010, we implemented the U.S. Treasury's change in the way HAMP is offered, requiring borrowers to provide income documentation reflecting eligibility before beginning a trial modification. In the period since March, more than 70% of borrowers who received trial modifications have achieved permanent modifications.

- **How many proprietary short sales has your firm completed since April of 2010? How many short sales has your firm completed under the Home Affordable Foreclosure Alternatives (HAFA) Program since that program launched in April 2010? Why have you completed such fewer foreclosures under the HAFA program than under your proprietary program?**

  From April 1, 2010 to September 30, 2010, we completed over 14,000 short sales through our proprietary programs. We have also implemented the federal Home Affordable Foreclosure Alternatives program ("HAFA") after the GSEs approved it in August 2010. Although we have completed very few short sales under this program in the brief time period since the GSEs approved it, we continue to proactively solicit HAFA-eligible customers per the directive provided by the Making Home Affordable Program.

- **Does/did your firm purchase document reproduction services from the Lender Processing Services subsidiary DocX (services include creating missing or intervening assignments, curing defective assignments, retrieving a UCC package, recreating collateral files, creating allonges, etc.)? If so, which services did your firm purchase? For how many foreclosure cases were these services purchased?**

  Citi has not purchased and does not purchase any document reproduction services from the Lender Processing Services subsidiary DocX.

- **What is your firm's position on providing borrowers with a mandatory right to loss mitigation as provided in H.R. 3451?**

  We agree with the intent of the legislation that all other options should be exhausted before foreclosure occurs. The guiding principle of our loss mitigation process is that foreclosure is always a last resort. However, we believe a range of tools should be available in light of the importance of keeping people in their homes. We would be happy to work with the sponsor of the proposed legislation.

- **What is your firm's position on judicial modification of bankruptcy filers' mortgages (for their primary residences)?**

  In January 2009, Citi CEO Vikram Pandit expressed support for a House Judiciary Committee bill that would have authorized federal bankruptcy courts to reduce the principal amount of bankruptcy filers' mortgages on their primary residences to the fair value of the property under certain circumstances. Citi's position has not changed.

# # #

**TESTIMONY OF**

**REBECCA MAIRONE**

**DEFAULT SERVICING EXECUTIVE**

**BANK OF AMERICA HOME LOANS**

**Before the**

**HOUSE FINANCIAL SERVICES**

**HOUSING AND COMMUNITY OPPORTUNITY SUBCOMMITTEE**

**WASHINGTON, DC**

**NOVEMBER 18, 2010**

**Introduction**

Chairwoman Waters, Ranking Member Capito, and Members of the Committee, thank you for the opportunity to discuss Bank of America's loan modification performance and foreclosure process.

The prolonged economic downturn and sustained high unemployment, coupled with the collapse of the U.S. housing market, have led to challenges that are more profound and complex than anyone anticipated. For a borrower, the prospect of falling behind on mortgage payments due to loss of income would be a wrenching personal situation in normal times. But these are not normal times, and the traditional solutions of the refinance of debt or the sale of a home at sufficient value to repay the debt, do not exist for many, which causes great anxiety and frustration for borrowers under economic stress. We know you are hearing from your constituents, because in many cases your constituents are also our customers.

These customers depend on us – Treasury, GSE's, lenders, and servicers to have a solution for their unprecedented needs. The good news: we have worked together at extraordinary speed to create solutions – like HAMP – and to retool mortgage servicing; adding new people, new processes, and new technology capabilities to meet the ever increasing needs. Unfortunately, those solutions have not met all of the needs nor have they been executed well in some cases.

It's important to note that despite the hardships most Americans are facing, more than 86% of Bank of America customers remain current and are making their mortgage payment each month. Others are unfortunately in distress. Helping these customers remain in their homes where possible is a top priority for Bank of America – as evidenced by our 700,000 completed loan modifications since 2008.

Whether one of our customers has just missed his or her first mortgage payment or is many months delinquent and at the point of foreclosure – Bank of America believes the customer's experience with us, from start to finish, must be consistent, accurate, and understandable. Our customers are entitled to an experience that gives them confidence they are being treated fairly.

We have, however, reached a crossroads between loan modification efforts and the reality of foreclosure. Fortunately, early stage delinquencies are stabilizing. The majority of initial volume and backlog of customers seeking solutions have been evaluated for available programs. We're reaching a peak where some customers will be dealing with the reality that despite the myriad of programs and our best efforts, foreclosure is unavoidable. That has driven an increase in the concerns you and we hear from distressed homeowners, and our increases in staffing and foreclosure alternative programs are directed at moving through this difficult period. We believe that these efforts are working, as every day we reduce the backlog in both modification decisions and customer complaints.

It is our responsibility to be fair, to be responsive and, where a foreclosure is unavoidable, to treat customers with respect as they transition to alternative housing. We, and those who work with us in connection with foreclosure proceedings, also have an obligation to do our best to protect the integrity of those proceedings. When and where that has not happened, we accept responsibility for it, and we deeply regret it. We take seriously our obligation to the customer, the investor, the legal process and the economy.

We also fully understand our obligation to evaluate customers for every way to make their payment more affordable, and we are continually improving our processes for working with customers.

When industry concerns arose with the foreclosure affidavit process, we took the step to stop foreclosure sales nationwide and launch a voluntary review of our foreclosure procedures. Thus far, we have confirmed the basis for our foreclosure decisions has been accurate. At the same time, however, we have not found a perfect process. There are areas where we clearly must improve, and we are committed to making needed changes.

We've also used this opportunity to further evaluate our modification program and identify additional enhancements we can make. We have done this based on feedback from you, our customers, community groups, investors, and from our regulators. We also are committed to a constructive dialogue with State Attorneys General, who have taken a leadership role on these issues.

**Role of the Servicer**

Before I describe the changes we have made in the foreclosure and modification processes, I would like to provide some context regarding the role of mortgage servicers, the complexity of our portfolio and loan modification performance. This context relates directly to the changes we are making.

Traditionally, a mortgage servicer's primary function is to collect loan payments from customers and to distribute payments to the investors who own the loan. Until recent years, foreclosures were ancillary and loan modifications were essentially non-existent. Economic conditions – including the loss of income, inability of many consumers to pay their mortgages or, when in distress, to sell their property – have dramatically increased the volume of modifications and foreclosures, severely straining industry systems and resources designed around much lower volumes of activity.

Moreover, Bank of America is constrained by our duties to investors; of the nearly 14 million loans in our servicing portfolio:

- 23% of the portfolio is owned by Bank of America
- 77% of the portfolio we service for the investors who own the loans – Fannie Mae and Freddie Mac are the investors on 60% of these loans, for example.

Many investors limit Bank of America's discretion to take certain actions. When working with delinquent customers, we aim to achieve an outcome that meets customer and investor interests, consistent with whatever contractual obligations we have to the investor.

Duties to investors add complexities to the execution of modification programs and can result in confusion for customers. For example, Treasury, investors, and other constituencies often change the requirements of their modification programs. HAMP alone has had nearly 100 major program changes in the past 20 months. Fannie and Freddie, as investors, have layered on additional requirements, conditions and restrictions for HAMP processing. When these changes occur, we and other servicers have to change our process, train our staff, and update technology. These changes can also affect what is required of the customer, for example the need for new or different documentation.

***Basic Facts of the Bank of America Portfolio***

With the Countrywide acquisition, Bank of America became the nation's largest mortgage servicer – with a servicing portfolio that more than tripled post-acquisition to nearly 14 million customer loans – 1 in 5 of all U.S. mortgages.

The majority - 86% - of our customers are current and making their mortgage payments on time every month. Fortunately, that number is stabilizing. But the segments of the portfolio that are distressed include large numbers of customers who are seriously delinquent. Nearly 600,000 customers have not made a mortgage payment in more than a year; of these 195,000 have not made a mortgage payment in two years.

**Servicer Implementation of Loan Modification Solutions**

To address these drastic economic and industry changes, Bank of America has had to undertake a massive retooling since our acquisition of Countrywide in 2008 to shift our servicing organization from one that simply services loans, to one that also manages customer requests for aid as the housing downturn and high unemployment persist. We also have built new processes, tools and partnerships with community organizations to reach customers who do not respond to loan modification offers.

We've hired and trained more than 10,000 new employees – and now have a team of more than 26,000 helping customers who are delinquent. To reach customers we've opened bricks and mortar customer assistance centers; gone door to door with modification solicitations, and participated in more than 500 housing rescue fairs across the country.

We have completed more than 614,000 proprietary modifications and 85,000 HAMP modifications. Given the majority of our delinquent borrowers are not eligible for HAMP today, proprietary solutions have been critical to provide meaningful options for those who fall outside the requirements of HAMP. We have completed over 95,000 second lien modifications and were the first servicer to implement the Treasury's second lien program – 2MP.

We have provided innovative solutions to meet evolving customer needs, including the launch of an industry-leading principal reduction program earlier this year. Bank of America is also a leader in the Hardest Hit Fund program development and is working with Treasury, the state Housing Finance Authorities, and others as we attempt to find solutions and design programs including principal reduction in the most severely impacted states.

If all home retention options are exhausted, and there is not a viable alternative to create an affordable payment, we offer short sale and deed-in-lieu solutions that allow customers to avoid foreclosure and ease the transition to alternative housing. Earlier this year, we launched a proprietary cooperative short sale program that proactively solicits customers in late stage delinquency to provide assistance. We are also fully operational with Treasury's Home Affordable Foreclosure Alternatives (HAFA) program, which streamlines the short sale process for borrowers who have been considered for HAMP and offers customers relocation assistance of $3,000. We've completed nearly 70,000 short sales through the first three quarters of this year.

We also provide deed in lieu programs that do provide an increased cash allotment for expenses such as moving and rental security deposits in exchange for the deed to the property in which the customer currently resides.

Our intent is to exhaust all modification, short sale and other disposition options before foreclosure. Despite those efforts, far too many customers have been impacted by an economy that has left them unemployed or severely underemployed to a point that leaves even a modified mortgage payment out of reach.

With that background in mind, I would like to inform you of some key decisions and commitments we have made to address concerns we have heard from our customers, your constituents and other stakeholders:

***Single Point of Contact***
A frequent source of frustration for customers is when they feel they are being passed around the system, seemingly never talking to the same person twice. We are addressing this by redesigning our modification process to offer a single point of contact for every eligible borrower. We are in the midst of implementation and more than 140,000 customers have already been assigned a single case manager to whom they can always turn with questions or concerns that arise throughout the process. We are also in discussions with key stakeholders, like the State Attorneys General, about how this approach can be expanded, and refined, to improve the customer experience and reduce borrower anxiety during the time they are being considered for modifications. We know this goes to the heart of many customer complaints that you have heard.

***Reform of Dual Track System***
Parallel foreclosure and modification processes are required by many investors, and reflect an industry-wide servicing practice. This so-called "dual track" process has been a source of confusion for customers. We want to be a partner with you, State Attorneys General, other servicers, and investors in looking for ways to change industry practice with respect to evaluation of borrowers for modifications after they have been referred to foreclosure to mitigate the very real concerns we have heard about that practice.

***Customer Status Checklist***
Customers are understandably frustrated when they are unsure where they are in the process of modification or foreclosure. To address this and provide greater clarity, we are working to create a Customer Status Checklist, so that customers will have a document in hand to understand their status, the steps they have completed, reasons decisions have been made and what additional steps remain.

***Housing Rescue Fairs and Outreach***
By establishing a presence in the community, we've had greater success reaching customers who have not been responsive to more traditional contact methods. We've deployed Customer Assistance Centers in areas most impacted by the housing downturn. We've also launched mobile home retention teams who travel around the country meeting with customers.

We've had considerable success in working with nonprofit partners such as Neighborhood Assistance Corporation of America (NACA), National Urban League, National Council of La Raza and the National Association of Asian Pacific Americans for Community Development. We established the Alliance for Stabilizing our Communities – the first national multicultural outreach and home retention effort to address foreclosure prevention in diverse communities. Through the Alliance, 34 home rescue fairs have been completed serving more than 9,800 families.

We find that the opportunity for customers to work with a trusted nonprofit and get the chance to meet with their servicer face-to-face can enhance the response rates of borrowers and the chance for a successful modification, and we are committed to increasing the resources committed to face to face contact in 2011 – including doubling our outreach staff.

***Enhanced Transition Services:***
When we cannot change the foreclosure outcome, we can ensure the process is respectful. We have been in extensive conversations with the Neighborhood Preservation Foundation, the *United Way*, other non-profit agencies, and with HUD to determine how we can most effectively engage them to help customers in the transition of households to alternative, more affordable housing. We are working with

these and other community partners to expand support services – relocation assistance, credit counseling, and other aid to help customers and rejuvenate neighborhoods.

***Other Reforms***
Additional reforms and process enhancements may be identified through our constructive and continuing conversations with State Attorney General Miller and the Executive Committee of the National Association of Attorneys General.

**Foreclosure Process**
Our commitment at Bank of America and its subsidiaries is to ensure that no property is taken to foreclosure sale until our customer is given a fair opportunity to be evaluated for a modification to an affordable payment or, if that cannot be done, a short sale or deed in lieu solution. Foreclosure is the option of last resort.

We voluntarily launched a foreclosure hold in October 2008 and have participated in several others -- as new programs were developed and launched, in order to ensure no customer goes to foreclosure who has a reasonable option to stay in their home.

We re-evaluate borrowers for home retention options throughout the foreclosure process and check to determine whether a borrower is being evaluated for a modification all the way up until the day before the foreclosure sale. Subject to investor guidelines and the rules of the applicable court, we defer the sale dates of borrowers who are being evaluated for modifications.

When a customer is referred to foreclosure sale, the process and requirements vary significantly among states. Courts have jurisdiction over foreclosures in 23 states (called judicial states). In both judicial and non-judicial cases, it is our policy to refer a loan to foreclosure only after we have completed a review for modification eligibility, assessment of foreclosure alternatives and compliance with applicable state law requirements. Also included are several checks to ensure the data supporting the foreclosure is both accurate and accurately recorded.

On average, it takes nearly a year from the time a customer receives a foreclosure notice until the actual foreclosure sale is completed; and for customers in judicial states like Florida that timeline can be closer to two years. This is not a process that is rushed and there are multiple checkpoints and controls along the way to prevent wrongful foreclosure – controls that have now been further strengthened.

**Foreclosure Review and Improvements**
After concerns emerged at other lenders regarding the foreclosure affidavit in judicial foreclosure states, Bank of America and its servicing subsidiary initiated a review of our foreclosure procedures. On October 1, we voluntarily suspended foreclosure judgments in the 23 judicial foreclosure states while we completed this review.

One week later, we paused foreclosure sales nationwide as we launched a voluntary review of our foreclosure process in all 50 states. We believe this step was appropriate and responsible in order to give our customers confidence they are being treated fairly in the process. I would like to share some conclusions we've reached following our review, as well as some of our plans to improve our process going forward.

Let me first offer a quick overview of the typical foreclosure process in a judicial foreclosure state. If the internal foreclosure review process concludes all other options are exhausted and that foreclosure is necessary, the loan is referred to our foreclosure operation and to outside foreclosure counsel, who prepare affidavits of indebtedness where required and ultimately handle the local foreclosure process.

The decision to refer a loan to foreclosure is made by Bank of America after a foreclosure review process that is based on an evaluation of our servicing records. This evaluation precedes and is independent from the process used to create and execute affidavits of indebtedness. The foreclosure affidavit is a summary of the basic facts in the foreclosure case (for example, the borrower's name, address and delinquent amount). For all GSE loans, we select the outside counsel from pre-approved lists created by each of Fannie Mae and Freddie Mac.

Once Bank of America receives the affidavit from outside counsel, we conduct a multi-step quality assessment process to verify the key facts underlying the affidavit. After this quality check, the verified affidavits are sent to a bank officer for a notarized signature and then returned to foreclosure counsel for filing.

Even though our review has indicated the basis for our foreclosure decisions has been accurate, we have identified areas for improvement as a result of our intensive review. We are taking the need for improvement very seriously and are implementing changes accordingly. These changes in the foreclosure process include, among other things, a new affidavit form and additional quality control checks.

Every affidavit will be individually reviewed by the signer, properly executed, and promptly notarized. We are carefully restarting the affidavit process with these controls in place. We are working to replace previously filed affidavits in as many as 102,000 pending foreclosure cases that have not yet gone to judgment. Further, with regard to both judicial and non-judicial states, we are implementing new procedures for selecting and monitoring outside counsel.

**Conclusion**

If a Bank of America customer is eligible for a modification, we'll help him or her stay in their home. That is in our interest as a mortgage servicer and as an owner of loans. And, when foreclosure is the necessary outcome, we will pursue it through a respectful process. As the loan servicer, the decision is not always in our hands, but ensuring a process that is fair, accurate and consistent is our accountability.

We have worked for two years since our acquisition of Countrywide to aggressively respond to more than a million customers in distress. We don't claim perfection, but we believe we have led with innovative ideas and continue to put forward solutions that respond to customer needs. That's a responsibility that comes with being America's leading consumer bank – and a responsibility every associate at Bank of America is working diligently to uphold.

Thank you and I look forward to your questions.

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Testimony of

Mr. Thomas Marano
Chief Executive Officer, Mortgage Operations
Ally Financial Inc.

before the

Subcommittee on Housing and Community Opportunity,
Committee on Financial Services, U.S. House of Representatives

November 18, 2010

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Chairwoman Waters, Congresswoman Capito, and members of the subcommittee, I am Tom Marano, the chief executive officer of mortgage operations for Ally Financial. I appreciate the opportunity to appear before you today.

Ally's mortgage business is conducted through GMAC Mortgage. Founded in 1985, GMAC Mortgage is currently the fifth largest residential mortgage servicer in the United States, servicing 2.4 million loans, about 96% of which are owned by others. Since 2008, we have provided more than $176 billion in funding to U.S. homeowners each year, and we provide more than $2 billion each month in short-term credit to mortgage loan originators.

Madam Chairwoman, I want to address specifically the issues that bring us here today. Our company's process for preparing foreclosure affidavits was flawed. There were affidavits signed outside the immediate physical presence of a notary and without direct personal knowledge of the information in the affidavit. These flaws are entirely unacceptable to me. I directed my management team to devote whatever resources are required to correct these flaws and bring integrity back to the foreclosure process.

We understand the pain caused by foreclosures. In foreclosures, everybody loses – the homeowner, the servicer, the investor, and the community. We therefore do everything that we can to avoid foreclosures. When a homeowner faces difficulty in a mortgage, we strive to find a solution that is affordable and sustainable for the borrower, while balancing the contractual rights of the investor on whose behalf we service. Since 2008, GMAC Mortgage has achieved approximately 565,000 workout solutions for customers. In each of the last two years, GMAC Mortgage has successfully instituted more alternatives to foreclosure, such as forbearance, repayment plans, modifications, short sales, and deeds-in-lieu of foreclosure, than we have had foreclosure sales.* Based on our review to date, no loan was foreclosed unless the borrower was in default.

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* Statistics for this year are as of September 30, 2010.

The errors we found in the affidavits of indebtedness should not have occurred. We are investigating and remediating the errors. We reformed our internal foreclosure processes to increase the training that we provide to employees responsible for signing foreclosure documents; we strengthened our internal affidavit signing policies; and we substantially increased the number of employees handling foreclosure documentation. Moreover, in an effort to minimize the risk that even a single foreclosure might go forward inappropriately during our review, we took steps to suspend foreclosure sales in 23 judicial foreclosure states.

We have resumed foreclosure sales only after an individualized review of each case. Our individualized review encompasses all loans in the foreclosure process, as well as loans that have completed the foreclosure process but which GMAC Mortgage could still address if there were deficiencies in the affidavit.

For any case that is still in process and has not yet received a judgment, we are filing a new and properly verified affidavit with the court, as appropriate, and where there was no prior affidavit, we are processing any necessary affidavits under our new procedures.

For any matter that has proceeded to a judgment in favor of foreclosure but the foreclosure sale has not yet been confirmed to have occurred, we are filing a new and proper affidavit with the court, as appropriate. Where the original affidavit was substantively correct, we are generally seeking the court's permission to proceed with the prior judgment. In some jurisdictions, we are filing motions to vacate prior judgments and will refile a subsequent foreclosure proceeding with a new and proper affidavit.

We have taken additional measures in all states to review foreclosure sales. Across the United States, we have implemented a new process that reviews all pending foreclosure sales going forward within seven days of the scheduled sale by an internal quality control team independent of our foreclosure department. We have also engaged national mortgage counsel and PricewaterhouseCoopers to conduct a comprehensive review of our foreclosure policies and procedures across the United States.

Madam Chairwoman, I want to stress that foreclosure is a painful last resort where everyone loses. By the time a loan goes to foreclosure sale, the borrower is, on average, 413 days behind in payments and in many cases taxes and insurance obligations have not been met. GMAC Mortgage strives to find alternate solutions that avoid foreclosure and keep families in their homes, and we are proud of the 565,000 workout solutions we have found for customers since 2008. In addition, our rate of conversion from HAMP-trial to HAMP-permanent loan modifications is 71%. Moreover, for the last eight months, only about 15% of customers in permanent HAMP loan modifications have failed to make their payment six months after the loan modification. This is below the average for the industry. As this subcommittee examines issues related to foreclosures, I urge you to make sure that alternatives to foreclosure are also robust and available.

Attached to my written testimony is a chart that illustrates the foreclosure process and shows GMAC Mortgage's commitment to seeking alternative solutions that preserve homeownership. Throughout the foreclosure process, GMAC Mortgage reaches out to customers about alternatives to foreclosure that may preserve homeownership. Even as the process is ongoing, borrowers are able to remain in the home, on average, about 15 months. At GMAC Mortgage, we believe that foreclosure should only occur after all home preservation efforts have failed.

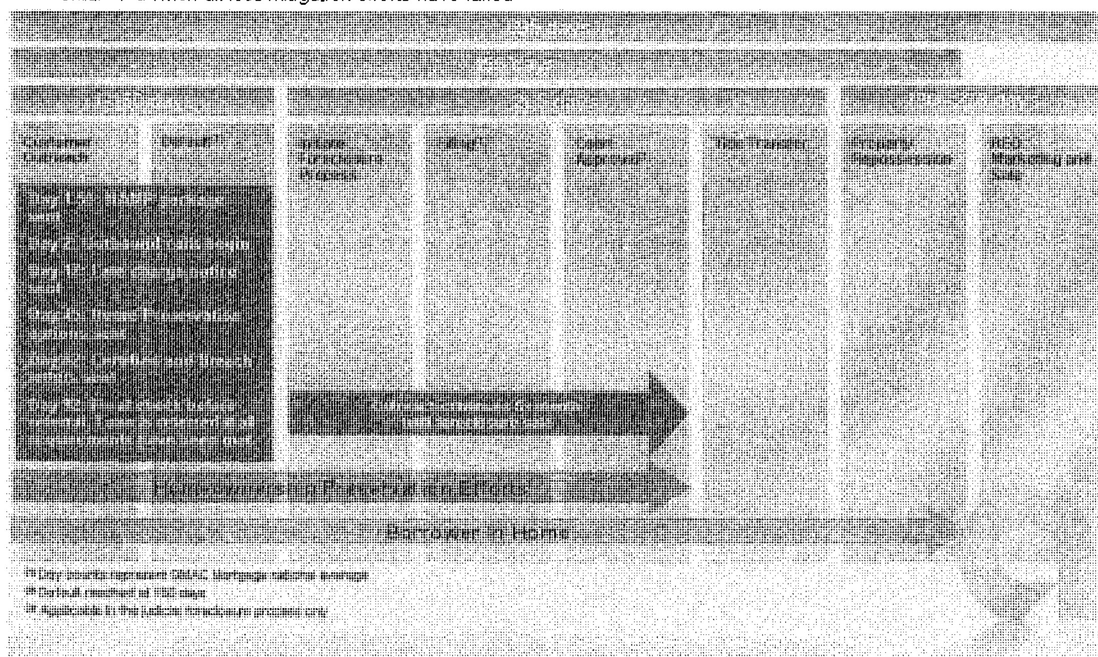
Preserving homeownership is in the best interest of all parties. In addition to the benefits to families, it is beneficial to GMAC Mortgage. We are paid fees and are able to recover advances and expenses more rapidly after a successful modification. In contrast, during a foreclosure, we must make servicing advances until the sale of the property and we lose the servicing fee income. Therefore, it is in our best interest to strive to place the borrower in a loan modification.

Finally, Madam Chairwoman, I have personally been a longstanding advocate of loan modification. I brought that perspective to GMAC Mortgage, and I strive to ensure that no American loses a home without a thorough and complete opportunity to obtain loan modification or an alternative to foreclosure. For example, I often communicate with homeowners directly. From these conversations, it is clear to me that everyone in the industry needs to do more to help homeowners in this difficult environment. As one example, we are working closely with state officials to launch Hardest Hit Fund programs as quickly as possible.

Your letter inviting me to testify contained several specific questions. Attached to my testimony are specific responses to your questions. Thank you for the opportunity to appear before you today, and I would be happy to answer any questions that you may have for me.

# Foreclosure as a Last Resort

- Ally strives to preserve homeownership whenever possible and has completed more than 220,000 HAMP and non-HAMP permanent loan modifications since 2008
- The foreclosure process is a lengthy procedure, which does not get initiated until after many months of delinquency, default and when all loss mitigation efforts have failed



Responses to letter from Rep. Maxine Waters, Chairwoman, Subcommittee on Housing and Community Opportunity, to Thomas Marano (Nov. 10, 2010). Responses are as of November 15, 2010, unless otherwise noted. Although the responses are based on information believed to be reliable, GMAC Mortgage's ("GMACM") review of issues concerning the execution of foreclosure documents is ongoing.

**(1) Please describe the process your firm uses when foreclosing on borrowers (give a step-by-step description, including the types of systems used, when contractors might be employed, the number of employees involved, and any other relevant information).**

GMACM's current foreclosure staff includes 120 full-time employees and 27 contractors. Our staff members rely on a variety of computer systems, including programs called (1) LoanServ, which provides tracking of the mortgage servicing process and all key milestones associated with the process of servicing mortgage loans, and (2) Process Management, which is a communication tool for GMACM and its foreclosure counsel and includes electronic referrals and critical data from LoanServ and all necessary documents for foreclosure referral.

The foreclosure process differs from state to state but can generally be categorized as either judicial or non-judicial.

Non-judicial foreclosures are based on a "power of sale" provision in the security instrument between the lender and the borrower, which authorizes the lender to accelerate the outstanding debt upon default and to sell the property via a third-party trustee. GMACM refers the loan to the appropriate trustee when the loan is 105 days delinquent (for loans serviced for Fannie Mae) and 120 days delinquent (other loans). GMACM's policy is to refer within the investor-required timeframes; however if there is active dialogue with the customer to explore potential workout options, foreclosure referral may be delayed. GMACM refers loans to foreclosure at an average of more than 160 days delinquent. The trustee then provides written notice of acceleration and of a foreclosure sale date to the property owner and all recorded lien-holders. After all notices have been provided, and if the borrower does not pay-off the debt or enter into a loan modification or payment plan with the lender, the property is sold at an auction to the highest bidder. The borrower can often reclaim the property upon payment after sale, but this right varies from state to state. The entire non-judicial process takes an average of 30 to 90 days to complete, depending on the time requirements set forth in the relevant state statute. We note that non-judicial foreclosures generally do not involve affidavits that are filed with a court.

By contrast, a judicial foreclosure is commenced in the appropriate state court like any other lawsuit. GMACM has a network of foreclosure counsel across the country that conduct its judicial foreclosures. Prior to filing the lawsuit, the lender sends a letter, or a series of letters, to the borrower providing notice that the loan is in default and requesting payment of the amount outstanding. If the loan is not brought current, a lawsuit is filed, naming as defendants the borrower and any other person or entity with an interest in the property, and defendants are served a copy of the complaint. Within a specified time period (usually 20 or 30 days) following proper service of the complaint, each defendant must file an answer to the complaint. GMACM employs local foreclosure counsel, typically choosing from the investor's approved list. (Fannie Mae requires servicers to use only Fannie-approved foreclosure counsel.) When the lender files a motion asking the court to enter judgment in its favor, an affidavit of indebtedness may be required. If the motion is denied, the case will be set for trial. After judgment is entered in favor of the lender, the foreclosure sale will be scheduled and the property may be sold to a third party or repurchased by the lender. Many states will provide for judicial confirmation of the sale after the fact to ensure that the sale was handled in an appropriate and commercially reasonable manner. The time frame of this process can vary greatly from state to state or even from court to court within a given state. On average, by the time the property is repossessed, the borrower has been delinquent for 425 days and there have been numerous attempts to cure the default.

In both non-judicial and judicial foreclosures, the borrower typically has the right to reinstate the loan at any time prior to the foreclosure sale. A borrower may also request a modification of the loan pursuant to the Home Affordable Modification Program ("HAMP"), depending on whether the borrower satisfies the income requirements and other guidelines applicable under HAMP. Additionally, many lenders offer traditional loan modification opportunities (i.e., non-HAMP) during the process, up to the point of foreclosure sale. Of the 505,426 loans GMACM has rescheduled since January 2008, 35,925 were through HAMP and 190,476 were through traditional workout plans. The remaining 279,025 were repayment plans arranged with borrowers. (Figures as of September 30, 2010.)

**(2) Please explain the rationale behind the voluntary foreclosure moratorium recently announced by your firm as well as the rationale for the duration of the moratorium.**

On September 17, 2010, GMACM through written communication directed its real estate agents and outsource vendors to suspend evictions and real estate owned foreclosure sales in the 23 states where judicial foreclosures use affidavits such as the affidavits found to be at issue. This action, which was incorrectly reported in the media as a "moratorium" on foreclosures, was taken in an effort to minimize the risk that even a single foreclosure might go forward inappropriately during our review. Since the suspension of foreclosure processing in September, we have resumed each foreclosure sale or eviction only after an individualized review of the case.

**(3) Please explain your firm's plan and timeline to resume foreclosures.**

Since the suspension of foreclosure processing in September, as detailed above, we have resumed each foreclosure sale or eviction only after an individualized review of the case.

**(4) In the last two years, in what proportion of foreclosures in judicial foreclosure states did your firm use a lost note affidavit?**

GMACM does not track the proportion of judicial foreclosures that use a lost note affidavit.

**(5) How does your firm establish if the trustee is in possession of the note?**

A trustee is only used in non-judicial foreclosure states. The trustee would not normally have possession of the note because non-judicial foreclosures are largely governed by the deed of trust, not the note.

**(6) What internal controls do you have in place to monitor whether the outside law firms you employ follow all relevant laws, regulations and company policies related to foreclosure (including notarization, process service, confirmation of the amount due by the borrower, whether appropriate fees were levied, etc.)?**

GMACM is enhancing the internal controls for outside counsel. This enhancement includes an additional due diligence questionnaire, an onsite visit, and a sampling audit. Many of the firms that GMACM engaged were Fannie Mae or Freddie Mac designated firms, and we understand that Fannie Mae and Freddie Mac routinely conduct their own reviews and audits of such firms.

**(7) What is the typical educational level of someone employed by your firm to sign-off on foreclosures (i.e., a "robo-signer")? What is the typical salary of such an employee? What is the typical turnover for such employees? What is the typical daily/weekly/monthly caseload of such an employee?**

More than half of the individuals currently employed by GMACM to execute foreclosure-related documents have completed four years of college; many others have associate's degrees or some level of college education. Typical annual salaries range from $48,000 to $53,000. Those who execute foreclosure-related documents are permanent employees of GMACM and there is no typical level of turnover. Currently, employees who execute foreclosure-related documents review an average of 31 files per day, though they may review more per day at present because of our remediation effort and increased hours of operation for the remediation effort. We currently have an additional 65 full time employees assisting with the remediation effort.

**(8) Has your firm ever been fined by any federal regulator (FHA, FHFA), or been sued by any investor, for failure to properly service loans or engage in appropriate loss mitigation?**

GMACM is aware of *American Residential Equities, LLC v. GMAC Mortgage, LLC*, Southern District of Florida, Miami Division, 1:10-CV-21943-ASG, which was filed in June 2010 and is currently in litigation. GMACM denies the allegations in the case. GMACM is not aware of an instance in which it was fined by a federal regulator for failure to properly service loans or engage in appropriate loss mitigation.

Note: GMACM has operated as a mortgage servicer for more than 25 years, and the question is not limited to a time period. This response is based on a review of readily available records and personal recollections of current GMACM employees.

**(9) Of the borrowers whose trial Home Affordable Modification Program (HAMP) modifications failed to become permanent modifications, what proportion of those borrowers failed to achieve permanent modifications because they did not pay their mortgages during the trial period? What proportion failed to achieve permanent modifications because they failed to submit the appropriate paperwork?**

For loans serviced by GMACM, 19% of borrowers who executed a HAMP trial failed to reach a permanent HAMP modification because the borrower did not make the required payments during the trial period. For the loans serviced by GMACM, 12.8% of the borrowers were not offered a trial payment because the borrowers failed to submit the appropriate paperwork.

**(10) How many proprietary short sales has your firm completed since April of 2010? How many short sales has your firm completed under the Home Affordable Foreclosure Alternatives (HAFA) Program since that program launched in April 2010? Why have you completed fewer foreclosures under the HAFA program than under your proprietary program?**

GMACM has completed 12,322 proprietary short sales since April 2010, and has completed 4 HAFA short sales in that same period. One of the reasons the proprietary program has had a higher success rate than the HAFA program is the requirement that HAFA participants meet all HAMP eligibility requirements, including a maximum debt-to-income ratio and a mortgage of less than $729,000. Also, the HAFA program targets individuals who have first failed to complete the HAMP or proprietary loan modification programs. As such, these individuals are generally more interested in remaining in their homes with a modified payment than in selling their homes. We have found that solicitations under the HAFA program have resulted in a 1% response rate, and follow up discussions with borrowers have indicated a lack of interest in selling their properties. On the other hand, borrowers who participate in the proprietary short sale program have already identified that selling the property would be better for their particular financial situation, and they do not necessarily want to gather all of the documentation required by the HAMP/HAFA programs. In summary, our borrowers appear to find the proprietary short sale program easier to navigate and the proprietary program is demonstrably successful.

**(11) Does/did your firm purchase document reproduction services from the Lender Processing Services Subsidiary DocX (services include creating missing or intervening assignments, curing defective assignments, retrieving a UCC package, recreating collateral files, creating allonges, etc.)? If so, which services did your firm purchase? For how many foreclosure cases were these services purchased?**

To the best of our knowledge, we do not use DocX.

**(12) What is your firm's position on providing borrowers with a mandatory right to loss mitigation (such as the right provided under H.R. 3451)?**

GMAC Mortgage believes it is important to attempt – in every case – to find an affordable and sustainable solution as an alternative to foreclosure. Our experience indicates that alternatives are often available, as indicted by the 565,000 workout options we have achieved since 2008 as alternatives to foreclosures. At the same time, we have found that affordable and sustainable alternatives to foreclosure are not always viable. GMAC Mortgage has not expressed an opinion specifically on pending legislation in this area. GMAC Mortgage would welcome the opportunity to work with the subcommittee and share our experience and findings in home ownership preservation.

**(13) What is your firm's position on judicial modification of bankruptcy filers' mortgages (for their primary residences)?**

GMAC Mortgage prefers to work with borrowers to find affordable and sustainable modifications to loans prior to a bankruptcy filing. Our experience has been that working with a customer on home ownership preservation efforts is a preferable course of action whenever possible.

EMBARGOED FOR RELEASE UNTIL 10:00 AM, NOVEMBER 18, 2010

**Testimony of Stephanie Mudick**
**JPMorgan Chase**
**Committee on Financial Services**
**Subcommittee on Housing and Community Opportunity**
**United States House of Representatives**
**November 18, 2010**

**Introduction**

Chairwoman Waters, Ranking Member Capito, and Members of the Committee, thank you for inviting me to appear before you today. My name is Stephanie Mudick, and I am the head of the Office of Consumer Practices at JPMorgan Chase. I am grateful for the opportunity to discuss Chase's loan servicing business, our wide-ranging efforts to enable borrowers to keep their homes and avoid foreclosure where possible, and the recent issues that have arisen relating to affidavits filed in connection with certain foreclosure proceedings.

JPMorgan Chase is committed to ensuring that all borrowers are treated fairly; that all appropriate measures short of foreclosure are considered; and that, if foreclosure is necessary, the foreclosure process complies with all applicable laws and regulations. As I will discuss in detail later in my testimony, we regret the errors that we have discovered in our processes, and we have worked hard to correct these processes so that we get them right. We take these issues very seriously.

Chase services about nine million mortgages across every state, representing over $1.2 trillion in loans to borrowers. In our role as servicer, we are responsible for administering loans on behalf of the owner of the loan, which sometimes is Chase itself, but more often is someone else – a government-sponsored enterprise (GSE), a government agency (such as the Federal Housing Administration or the Department of Veterans Affairs), a securitization trust, or another private investor.

I will first discuss Chase's extensive efforts to help borrowers avoid foreclosure and then discuss the issues that led to our temporary halt to some foreclosures, as well as Chase's enhanced procedures for the foreclosure process.

The past several years have been very difficult ones for many Americans. We have made extensive efforts during these difficult economic times to help borrowers who have fallen behind on their payments understand all of their options and, where feasible, to work with them in an effort to modify their loans and bring their accounts current so that they can keep their homes.

At the outset, I want to emphasize that Chase strongly prefers to work with borrowers to reach a solution that permits them to keep their homes rather than foreclose on their properties. As we discuss below, solutions may include modification, temporary forbearance, short sales or deeds in lieu of foreclosure. Foreclosures cause significant hardship to borrowers, harm their credit profiles, and depress property values in the communities where they occur. Foreclosures also inevitably result in severe losses for lenders and investors. Therefore, we always consider whether there are viable alternatives to foreclosure before proceeding with a foreclosure.

It is critical to note that the analysis we use in deciding whether to proceed with a modification or foreclosure does not take into account servicer compensation. Furthermore, if it were considered, servicer compensation would tend to favor modification over foreclosure. Indeed, the cost for servicers to take a loan to foreclosure generally is significantly greater than the cost of a modification. With a successful modification, Chase is able to continue to service the loan and earn servicer fees; but when a property is sold as a result of foreclosure, Chase's role as servicer ends and Chase receives no further fees.

Chase has established modification programs that collectively have allowed us to avoid many more foreclosures than we have completed. We established these programs starting in early 2007 in recognition of the difficult economic conditions that resulted in a growing number of our borrowers being unable to make their monthly payments. While we keep striving to do even better, our efforts to date have yielded significant results. Since January 2009, Chase has offered almost one million modifications to struggling borrowers and has completed over 250,000 permanent modifications under the Home Affordable Modification Program (HAMP), Chase's own proprietary modification programs, and modification programs offered by the GSEs and FHA/VA. Combined with other programs designed to avoid foreclosure, we have prevented over 429,000 foreclosures since January 2009. Over that same period, we have completed over 241,000 foreclosures. In other words: during the last two years, Chase has successfully prevented about two foreclosures for each one we have completed.

Sustainable modifications are not always possible; there are some borrowers who simply cannot afford to stay in their homes, notwithstanding the modification programs and other foreclosure prevention alternatives available. There are other borrowers who are not seeking modifications; in the majority of cases that went to foreclosure sale in the last quarter, the properties were vacant or not owner-occupied.

**Our Investment in Foreclosure Prevention**

Our progress in foreclosure prevention derives in part from early and significant investments since late 2008. Currently, Chase employs over 6,000 customer-facing staff whose focus is working with distressed borrowers, and we have more than doubled the number of employees in this area in the last two years. For more than six months, we have assigned each borrower a single point of contact who serves as a consistent touchpoint for the borrower as he/she seeks a loan modification. More than 1,900 dedicated relationship managers serve in this role for our borrowers.

In addition, Chase has made major efforts to reach out personally to borrowers and offer assistance with modifications. Since early 2009, our employees have met with 115,000 struggling borrowers at the 51 Homeownership Centers we have created in 15 states and the District of Columbia. The Chase Homeownership Centers are a notable example of our early efforts to reach borrowers in need. We also have a Homeownership Preservation Office, which maintains relationships with national groups like HOPE NOW and NeighborWorks, as well as with hundreds of local non-profit organizations across the country. Our team works closely with government and community leaders on initiatives that focus on affordable housing, foreclosure prevention and community revitalization. The team also travels across the country and directs national outreach events. Over 3.7 million letters have been sent to borrowers inviting them to attend these events. More than 54,000 borrowers have attended one of the hundreds of events held to date.

We expend great efforts to reach our borrowers and inform them about modification alternatives. In the last two years, Chase has made 341 million outbound calls to borrowers. Chase does not wait for borrowers to contact us; when we believe a borrower may be at risk, we affirmatively reach out to them early to discuss possible modification options. While requirements vary by state, generally our outreach to borrowers includes numerous calls from a customer service representative and letters detailing the nature of the delinquency and possible government and other modification programs. Our borrowers also receive a Chase Homeownership and Outreach letter, including any information about local events that provide in-person help. When a loan becomes more delinquent, a Chase representative may visit the property; and generally at 90 days past due, the borrower receives notification of intent to foreclose. On average, we contact a borrower over 100 times before a foreclosure is completed. In addition, our loan counselors have fielded over 29 million inbound calls from borrowers seeking foreclosure prevention assistance in the last two years and 5 million calls to our dedicated loan modification hotline.

**Loan Modification Programs**

Chase's modification programs are focused on helping borrowers stay in their homes by making their monthly mortgage payments affordable.

***HAMP Modifications***

Chase has supported the Department of Treasury's efforts to increase mortgage modifications industry-wide through HAMP, and Chase was one of the first major servicers to begin implementing the program. Chase mails a HAMP application to every borrower whose loan meets the program's eligibility criteria at both 40 and 70 days delinquency. To date, we have sent HAMP applications to 900,000 borrowers.

Chase makes substantial efforts to help borrowers complete the necessary paperwork, and any decision denying a HAMP application is subject to a rigorous review. Chase also affords borrowers an opportunity to appeal denials of HAMP applications by supplementing the information in their file. When an application is pending, Chase suspends foreclosure sales; and if that application is denied, Chase ordinarily will not proceed with the foreclosure sale for a period of 30 days, provided that an investor does not instruct us to proceed sooner.

If a borrower is eligible for participation in HAMP and is approved for a trial modification, we adjust the mortgage payment to 31% of the borrower's total pretax income, as required by HAMP. To achieve this level, as a first step, the loan's interest rate is reduced to as low as 2%. If this is not sufficient, then the term of the loan is extended to 40 years. Finally, if necessary, a portion of the principal is deferred until the loan is paid off, and no interest is charged on the deferred principal.

The response to HAMP has been substantial. To date, we have offered HAMP trial plans to more than 270,000 borrowers and have over 60,000 borrowers in active permanent HAMP modification plans through October 2010. These modifications have benefitted borrowers by reducing their monthly mortgage payments in most cases. Our borrowers who have taken advantage of HAMP modifications realized an average reduction of 28% in their monthly payment.

***Modifications for Adjustable Rate Mortgages***

Prior to the introduction of HAMP, Chase implemented several of its own proprietary loan modification programs, including several programs for adjustable rate mortgages (ARMs). Chase-owned subprime hybrid ARMs scheduled to reset for the first time are modified to remain at the initial interest rate for the life of the loan. Borrowers qualify for this program if they have a clean payment history on a hybrid ARM with an interest rate that adjusts after the first two or three years. Borrowers do not need to contact Chase to benefit from this program; Chase implements the rate lock automatically, and borrowers are so advised. In cases of hybrid ARM loans that we service but do not own, we use the American Securitization Forum (ASF) Fast Track program to reduce payment shock. Under this program, qualifying borrowers will have their initial ARM rate frozen for five years.

We also have taken action to help borrowers with Chase-owned Pay Option ARMs. Chase did not originate or purchase these loans, but assumed them through the 2008 acquisition of the mortgage assets of Washington Mutual. Chase has developed proactive programs to assist current Pay Option ARM borrowers who may be at higher risk of default due to factors such as credit score, loan-to-value ratio (LTV), and future payment shock. To eliminate any potential payment shock, we offer to modify the loan to a fixed payment, keeping the borrower's monthly payment at its current amount. For the majority of these modifications, the borrower's payment is fixed for the life of the loan. Since 2009, Chase has proactively completed about 22,000 Option ARM modifications on current loans, worth $8 billion in unpaid principal balance.

***Chase Custom Modifications***

Borrowers not eligible for HAMP are reviewed on a case-by-case basis to determine their suitability for an alternative modification. We evaluate these loans by developing an estimated target affordable payment of 31% to 40% of the borrower's gross income. We use the lowest percentage for borrowers with the lowest incomes. Once the target payment is calculated for the borrower, we test each modification option to see if it will get the borrower to an affordable payment. As in the HAMP program, we apply a net present value (NPV) analysis to each option to determine whether the value of the modification exceeds the value expected to be recovered through a foreclosure. Chase recommends a modification when that option produces both an affordable payment and a positive NPV result.

Despite our best efforts, not every loan can be modified, for a variety of reasons. Most of the mortgages we service are serviced on behalf of others; we do not own the loans. We generally owe those third parties, which include the GSEs, a contractual duty to maximize the return on the investment they made. As noted above, the high costs of foreclosure give them (and us) an incentive to consider meaningful payment reduction when necessary to effectively modify the loan, but modifications that do not maximize the return to investors are inconsistent with our duties as servicer. And even aside from our contractual duties, the U.S. mortgage market will never return to health if investors come to believe that the value of the collateral is unreliable.

**Other Loss Mitigation Efforts**

For a variety of reasons, loan modifications are not always a workable solution. Borrowers who cannot afford their homes, even if the payment is substantially reduced, need other solutions. So, in addition to loan modifications, Chase also offers borrowers other options to avoid foreclosure. These include:

- **Short Sales** – For borrowers who do not qualify for loan modification or would qualify, but do not wish to stay in their homes, Chase has a program that makes available a short sale in which Chase agrees to a sale to a third party, arranged by the borrower, at a price below the outstanding amount of indebtedness. Since April 2010, Chase has had a program to proactively contact borrowers who have listed their homes for sale and who would be good candidates for short sales. Chase provides these borrowers with a minimum offer that Chase would accept to approve a short sale. Since 2009, Chase has completed more than 83,000 short sales.

- **Deed in Lieu** – In cases where a short sale is not possible because a sale cannot be arranged within the prescribed period of time, Chase may offer borrowers the option of deeding the property to Chase in full satisfaction of their debt. Since 2009, Chase has completed more than 3,400 deeds-in-lieu.

- In addition to short sales and deeds-in-lieu, since 2009, Chase has implemented over 55,000 forbearance, extension and repayment plans to help with a hardship and avoid foreclosure.

**Foreclosures**

The decision to foreclose is always a difficult one, but there are unfortunately many cases where this alternative is unavoidable. In many cases, borrowers are unemployed or otherwise do not or cannot make any meaningful payment on their mortgages. In the average case where we foreclose, the borrower has not made any payment for 14 months; in Florida, where many of our foreclosures have occurred, the average period without payment prior to foreclosure sale is 22 months. In some cases, the borrower may not have an incentive to pursue a modification; of the properties on which we foreclose, a significant percentage is vacant or not the owner's primary residence, but rather an investment property. In cases where the property is vacant, foreclosure may not only be the right economic decision -- it also transfers the property into a new owner's hands, improving community safety and stabilizing neighboring property values.

We recently announced that we had temporarily suspended foreclosures, foreclosure sales, and evictions in a number of states to allow for a review and enhancement of our procedures. It is important to note at the outset that the issues that have arisen in connection with foreclosure proceedings do not relate to whether foreclosure proceedings were appropriately commenced. We have not found errors in our systems or processes that would have led foreclosure proceedings to be commenced when the borrower was not in default.

Chase has substantial safeguards in place designed to ensure that foreclosures are both a last resort and instituted only in appropriate cases. A loan is referred to foreclosure only after Chase has made substantial attempts to provide the borrower with alternatives to foreclosure. Then, as part of the process that can ultimately lead to referring a loan to foreclosure, Chase policy requires that all delinquent loans be reviewed by its Independent Foreclosure Review team. The Independent Foreclosure Review confirms that the loan is past due and that Chase has complied with its pre-referral policies, including repeated efforts to contact the borrower to discuss alternatives. Under Chase's policies, only *after* the Independent Foreclosure Review is complete can a loan be referred for foreclosure proceedings. The Independent Foreclosure Review is repeated two to three weeks prior to any scheduled sale, and a final check also is performed 72 hours prior to the sale. If any of these subsequent reviews suggests that a loan should not have been referred to foreclosure, we do not proceed with the sale. Under our policies, if a loan modification process has begun after the commencement of a foreclosure, we do not engage in a foreclosure sale if the modification succeeds or until the modification process fails. That is not to say we are perfect – we service millions of loans, and we sometimes do make mistakes. But when we find an error, we fix it.

**The Nature of the Affidavit Issues**

Chase's recent temporary suspension of foreclosure operations in a number of states arose out of concerns about affidavits prepared by local foreclosure counsel, signed by Chase employees, and filed in certain mortgage foreclosure proceedings. Specifically, employees in our foreclosure operations area may have signed affidavits on the basis of file reviews and verifications performed by other Chase personnel, not by the affiants themselves. In addition, we discovered other related issues in connection with some of these affidavits, including instances in which notarized affidavits may not have been signed and affirmed in the physical presence of the notary. Nevertheless, the facts set forth in the affidavits with respect to the borrowers' indebtedness and the amount of the debt – the core facts justifying foreclosure – were verified prior to the execution of the affidavits by Chase employees consulting the company's books and records, which are themselves subject to extensive internal and external controls. Therefore, we believe the underlying information about default and indebtedness was materially accurate and the issues described above did not result in unwarranted foreclosures.

We take these issues very seriously. Our process was not what it should have been; quite simply, it did not live up to our standards. To begin to address these issues, we temporarily halted foreclosure and related proceedings in certain states because our procedures may not have complied with personal knowledge and notarization requirements. In late September, Chase temporarily halted all foreclosure proceedings and property sales in the 23 states where foreclosure primarily occurs through a judicial process and where affidavits are generally filed as part of the process. Shortly thereafter, Chase also temporarily halted foreclosure proceedings in certain states where foreclosure primarily occurs through a non-judicial process in order to assess whether similar documentation issues might exist in those jurisdictions. As an additional safeguard, Chase also temporarily halted evictions in the states in which it suspended foreclosures, as well as in other states where Chase-signed affidavits might be used as part of the eviction process.

While these proceedings have been halted, Chase has thoroughly reviewed its foreclosure procedures and enhanced them to resolve these issues. Briefly, the remedial actions undertaken by Chase include:

- A complete review of our document execution policies and procedures;
- The creation of model affidavits that will comply with all local law requirements and be used in every case, and that will limit factual assertions to those within the personal knowledge of the signer and eliminate any legal conclusions that are outside the signer's personal knowledge;
- Implementation of enhanced procedures designed to ensure that the employees who execute affidavits personally verify their contents and that the affidavits are executed only in the physical presence of a licensed notary;
- Extensive training for all personnel who will have responsibility for document execution going forward and certification of those personnel by outside counsel;
- Implementation of a rigorous quality control double-check review of affidavits completed by Chase employees; and
- Review and verification of our revised procedures by outside experts.

In addition to enhancing procedures for future foreclosure filings, Chase also is working to remedy any issues with affidavits on file in pending proceedings. Although Chase's approach will vary based on the procedures in individual states, in cases in which judgment has not yet been entered, Chase plans to re-verify the material information in filed affidavits and file replacement affidavits prepared under the new enhanced procedures to eliminate any possible defects in these affidavits. Chase is taking other appropriate measures in connection with foreclosure matters in which judgment has been entered but a sale has not yet occurred.

We have worked hard over the past month and a half to review and strengthen our procedures to remediate the affidavit issues we found. We are committed to addressing these issues as thoroughly and quickly as possible.

# # #

I hope that my testimony has explained our processes for dealing with cases of borrower default, as well as the issues surrounding the documentation filed in Chase's foreclosure proceedings and the steps we have taken to address them. Foreclosure is a last resort for Chase, but when we do foreclose, we are committed to making sure that we do so in compliance with applicable law and with respect for the borrower. I would be happy to answer questions from the Committee.

**Statement of Anthony B. Sanders**
**Subcommittee on Housing and Community Opportunity**
**U.S. House of Representatives**
**November 18, 2010**

Chairman Waters, Ranking Member Capito, Members of the Committee, thank you for the opportunity to testify before you today.

The U.S. mortgage market grew at a phenomenal pace from 1998 through 2009 with the GSEs (Fannie Mae, Freddie Mac) and Federal Home Loan Banks alone accounting for $5 trillion in debt to fund mortgage growth (see Figure 1). As we sit here today, there are over 42 million mortgages outstanding in the U.S. Of the over 42 million mortgages, approximately 60% were securitized (or assigned to another party).[1]

Loan assignments have occurred in the United States since before the Great Depression. Yet only recently have Congress and the Administration taken notice of loan assignments. What is particularly interesting is that despite the myriad of Federal housing agencies, pseudo-agencies and financial system regulators that have been in existence since the Great Depression, the Federal government has ignored the fundamental problem with loan assignment regarding the location of the title or other document defects pertaining to foreclosure.

**Economic Harm to Borrowers**

What is the economic harm to borrowers of alleged document defects pertaining to foreclosure? The answer is none. First, the loans are in default. Second, the average length of time to foreclosure and liquidation is over 17 months. If each borrower is living in the dwelling and not paying interest (say $1,000 per month), that translates to $17,000 in lost earnings to the lenders/investors.[2] Suppose that 3,000,000 borrowers are in the foreclosure process; that translates into a potential loss of $51 billion to lender/investors over and above the loss incurred by lenders/investors.[3] Thus, the $51-102 billion cost to lenders/investors is the cost of delaying foreclosure.[4] "Insofar as the foreclosure process often takes 17 months, lenders/investors are not receiving any payment for interest or principal and are incurring transaction costs. In the meantime, the borrowers are not making any payments on a house in which they are still living -- effectively receiving over a year of housing rent-free."[5]

In the case of loan default, the lender has the right to take the asset and sell it in order to recoup the amount owed, if possible. Document defects pertaining to foreclosure, if material, can slow down the foreclosure process. Therefore, lenders/investors have the economic incentive to clear up any material document defects pertaining to foreclosure as soon as reasonably possible.

[1] As of 2009, 85.6% of mortgages were securitized (see Table 1).
[2] If we assume a $150,000 loan at 7% over 30 years, the payment would be approximately $1,000. If we double the loan amount to $300,000, the payment would rise to just under $2,000 per month.
[3] If the average loan size is $300,000, the loss to lenders/services rises to $102 billion.
[4] Additional costs facing lenders/investors beyond the point of loan default is the decline in the value of the collateral.
[5] Of course, not all borrowers that defaulted on their loans are still living in the same dwelling.

**Robo-Signing and Economic Harm**

Once again, the critical point is that borrowers have defaulted on their loans and the lenders/servicers are trying to foreclose on the dwelling to recoup the amount owed. The acid test for robo-signing, the allegation that some documents were not read, is whether the borrower was materially and adversely affected. Only if it can be shown that borrowers were inappropriately identified as having defaulted on their loan and subsequently foreclosed upon is there a material problem. Otherwise, the borrowers have not been harmed.

**Creating Economic Harm through Moratoriums**

Any proposed moratorium on foreclosures, whether at the Federal or State levels, represents a danger to the stability of the housing market. Government intervention in the housing market (such as HAMP and the tax credit) has failed to slow or merely delayed defaults. The housing market needs to heal and it can only do so if defaulted loans can be brought to market through foreclosure. Preventing foreclosures extends losses to lenders/investors and allows non-paying households to continue staying in the dwelling. In addition, there are sales of foreclosed properties that will be delayed if a moratorium is undertaken.

**The Creation of MERS**

MRES (Mortgage Electronic Registration Systems was created to deal with the flood of paperwork related to mortgage securitization. MERS focused on eliminating mortgage loan assignments by providing an electronic registry to track the many transfers that occur in the mortgage market. Even if MERS was a perfect solution to the registration of mortgages, since financial institutions and the GSEs are owners of MERS, it would seem reasonable to have assumed that each of the regulatory bodies for the thrifts, banks and GSEs would have thoroughly investigated the practices and procedures of MERS. If they had investigated MERS, they could have discovered potential problems with the MERS.

**Where Were the Regulators?**

If material document defects were pervasive in the economy, why weren't our regulatory agencies on top of the problem and seeking solutions? It is notable that the leading thrifts that securitized loans were Countrywide, Indymac and WAMU, all supervised by the Office of Thrift Supervision (OTS) which was the regulatory body for the thrift industry. As defaults and foreclosures mounted, the OTS should have been painfully aware that a problem with foreclosure could arise if the title and accurate supporting loan documentation could not be produced. It should be determined if the OTS was aware of the problem and considered it to be trivial, if they were aware of the problem and chose to do nothing or they were unaware of the potential problem.

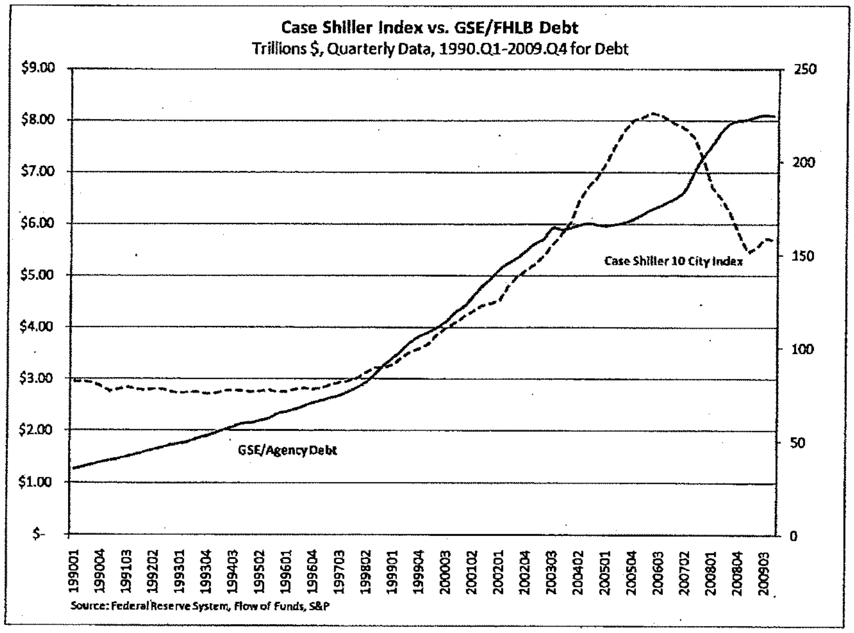
Of course, the same questions should be asked to the Federal Deposit Insurance Corporation (FDIC) that regulates the state-chartered banks, the Office of the Comptroller of the Currency that regulates the nationally-chartered banks and the Federal Reserve that regulates state-chartered member banks. And then there are state bank and thrift regulators. With so much regulatory power were the FDIC, OCC and Fed not investigating the potential foreclosure document issue and taking corrective action if it was material?

**Proposed Solutions**

1. All relevant loan documents should be immediately scanned and a digital file created. This file (which we call a "Securitization Packet") would travel with the loan when it is sold. This

digitized file should be kept at either the Federal Reserve or a private market enterprise (with regulatory oversight).

2. The regulatory bodies (whether it is the Federal Reserve, the FDIC or OCC) should develop requirements for the assignment of loans requiring notification of what entity has purchased the loan and the new servicer, if applicable. That is, the regulatory bodies can either set standards or work with the industry on setting standards.


Case Shiller Index vs. GSE/FHLB Debt
Trillions $, Quarterly Data, 1990.Q1-2009.Q4 for Debt
$9.00
$8.00
$7.00
$6.00
$5.00
$4.00
$3.00
$2.00
$1.00
$-
250
200
150
100
50
0
Case Shiller 10 City Index
GSE/Agency Debt
199001
199004
199103
199202
199301
199304
199403
199502
199601
199604
199703
199802
199901
199904
200003
200102
200201
200204
200303
200402
200501
200504
200603
200702
200801
200804
200903
Source: Federal Reserve System, Flow of Funds, S&P

**Securitization Rates for Home Mortgages**
*(Dollars in Billions)*

| | Total | Conforming | Prime jumbo | Sub/Alt A | FHA/VA | Seconds |
|---|---|---|---|---|---|---|
| 2001 Securitization rate | 60.7% | 72.3% | 32.0% | 45.8% | 98.7% | 13.5% |
| MBS issuance | $1,344.7 | $914.9 | $142.2 | $98.4 | $172.7 | $16.5 |
| Estimated originations | $2,215.0 | $1,265.0 | $445.0 | $215.0 | $175.0 | $115.0 |
| 2002 Securitization rate | 63.0% | 74.5% | 30.0% | 66.0% | 97.8% | 15.0% |
| MBS issuance | $1,817.4 | $1,270.4 | $171.6 | $176.1 | $172.2 | $24.8 |
| Estimated originations | $2,885.0 | $1,706.0 | $571.0 | $267.0 | $176.0 | $165.0 |
| 2003 Securitization rate | 67.5% | 77.7% | 38.5% | 68.1% | 99.3% | 9.3% |
| MBS issuance | $2,662.4 | $1,912.4 | $237.5 | $269.1 | $218.5 | $20.4 |
| Estimated originations | $3,945.0 | $2,460.0 | $650.0 | $395.0 | $220.0 | $220.0 |
| 2004 Securitization rate | 62.6% | 73.7% | 45.3% | 72.9% | 95.8% | 13.8% |
| MBS issuance | $1,826.8 | $892.3 | $233.4 | $521.1 | $126.4 | $49.1 |
| Estimated originations | $2,920.0 | $1,210.0 | $515.0 | $715.0 | $132.0 | $355.0 |
| 2005 Securitization rate | 67.7% | 80.5% | 49.2% | 79.3% | 99.5% | 16.6% |
| MBS issuance | $2,111.8 | $879.1 | $280.7 | $797.4 | $85.6 | $60.7 |
| Estimated originations | $3,120.0 | $1,092.0 | $570.0 | $1,005.0 | $86.0 | $365.0 |
| 2006 Securitization rate | 67.6% | 82.5% | 45.6% | 81.4% | 100.2% | 17.3% |
| MBS issuance | $2,018.0 | $816.9 | $219.0 | $814.3 | $83.2 | $74.2 |
| Estimated originations | $2,980.0 | $990.0 | $480.0 | $1,000.0 | $83.0 | $430.0 |
| 2007 Securitization rate | 74.2% | 91.4% | 51.3% | 92.6% | 97.7% | 9.3% |
| MBS issuance | $1,804.2 | $1,062.0 | $178.1 | $432.5 | $98.6 | $32.9 |
| Estimated originations | $2,430.0 | $1,162.0 | $347.0 | $468.0 | $101.0 | $355.0 |
| 2008 Securitization rate | 78.5% | 97.8% | 6.8% | 2.9% | 92.8% | 0.0% |
| MBS issuance | $1,177.3 | $899.8 | $6.6 | $1.9 | $269.0 | $0.0 |
| Estimated originations | $1,500.0 | $920.0 | $97.0 | $64.0 | $290.0 | $114.0 |
| 2009 Securitization rate | 85.6% | 93.4% | 0.0% | 0.0% | 98.9% | 0.0% |
| MBS issuance | $1,553.0 | $1,106.6 | $0.0 | $0.0 | $446.2 | $0.0 |
| Estimated originations | $1,816.0 | $1,185.0 | $92.0 | $10.0 | $451.0 | $77.0 |

*Notes: Total MBS excludes re-securitizations, scratch-and-dent MBS and deals backed by seasoned loans. Conforming includes conventional conforming mortgages and Fannie/Freddie MBS excluding pools with average loan age over 3 months. Seconds include home-equity lines of credit and closed-end seconds; some second mortgages are also securitized in subprime and other MBS products.*

*Source: Inside MBS & ABS*

**Written Testimony of David H. Stevens**
**Assistant Secretary of Housing – Federal Housing Administration Commissioner**
**U.S. Department of Housing and Urban Development**

**"Robo-Signing, Chain of Title, Loss Mitigation and Other Issues in Mortgage Servicing"**

**Hearing before the House Financial Services Committee**
**Subcommittee on Housing and Community Opportunity**
**Thursday, November 18, 2010**

Chairwoman Waters, Ranking Member Capito and Members of the Subcommittee, thank you for the opportunity to testify before you today on behalf of the Department of Housing and Urban Development and the Federal Housing Administration regarding foreclosure processing concerns that have been raised about certain loan servicers – specifically, about what HUD is doing to enforce the law and to describe FHA's four-month review of firms servicing FHA mortgages.

Madam Chairwoman, since taking office 21 months ago, helping families and our economy recover from the worst economic crisis in 80 years has been the Obama Administration's top priority. As part of that effort, we have taken a comprehensive approach to addressing the housing crisis.

Since April 2009, more than 3.52 million families have received restructured mortgages with more affordable monthly payments. And while we still have a long way to go, we are seeing some positive signs – some indices suggest a stabilization of home prices after their 30 month slide, and foreclosure starts are actually down compared to this time last year.

With this Subcommittee's help, we passed the Dodd-Frank Wall Street Reform bill, which addresses many of the systemic issues in the financial system that led to our recent struggles, and lays a solid foundation for building a healthier housing finance system. Dodd-Frank will also put an end to hidden fees, deceptive mortgages and other practices that tilted the table against ordinary people. And perhaps most important of all, it created a Consumer Financial Protection Bureau that will help protect consumers against precisely the kinds of negligence and abuse we're now finding in the foreclosure processes of some servicers.

***Administration Efforts Around Foreclosure Processing***

Of course, as I mentioned, the job is far from over. Recent reports of faulty documentation and fraudulent affidavits in the foreclosure process remind us that we continue to pay a very steep price for nearly a decade of abuses and bad behavior

As Secretary Donovan has said, the notion that many of the very same institutions that helped cause this housing crisis may well be making it worse is not only frustrating – it's shameful.

As such, the Administration is focused on three primary goals in addressing foreclosure issues.

First, we are holding lenders and servicers accountable. Mortgage servicers expect that homeowners will meet their mortgage obligations – and American homeowners should expect the same of the servicers. We take very seriously the charge that servicers must meet that expectation.

Second, we are helping struggling borrowers into sustainable housing situations through modification programs for borrowers who are facing financial hardship or have lost their jobs, refinancing programs for underwater homeowners, and incentives to promote alternatives to foreclosure such as short sales and deeds-in-lieu of foreclosure.

Third, we are working to resolve the significant uncertainty that this controversy has raised for borrowers and the housing market. With 1 out of every 4 homes sold in recent months a foreclosure sale—and with vacant and abandoned homes more than three times as destructive to neighboring property values as occupied homes at the beginning of the foreclosure process—those falling behind on their mortgage payments are not the only families at risk from this situation. Homeowners around the country who have watched their home values plummet over the last few years through no fault of their own are also put at risk.

To support the goals of accountability, stability, and clarity in the housing market, HUD is working with other federal agencies and regulators to fully investigate the issues that recent foreclosure revelations have raised, including working with the Financial Fraud Enforcement Task Force, the Office of the Comptroller of the Currency, the Federal Housing Finance Agency, and the Federal Reserve Bank. Indeed, Secretaries Donovan and Geithner were joined at HUD in October by representatives from 10 different federal and regulatory agencies where we discussed how we could best coordinate our investigations and jointly ensure that action is taken.

Following that meeting, we together sent a clear message:

Where any homeowner has been defrauded or denied the protections and rights owed them under law, those protections and rights should be enforced. And problematic practices should be fixed quickly so that these issues do not recur.

Madam Chairwoman, with the remainder of my testimony, I want to tell you in more detail how HUD and the FHA are responding to these challenges – specifically, the steps we took at FHA when we took office to protect responsible borrowers and the other ways HUD enforces the law to protect consumers.

***FHA Loss Mitigation Protocols and Review***

As you know, Madam Chairwoman, FHA requires the servicers it approves to actively engage struggling homeowners to prevent avoidable foreclosures. We do this to ensure that help is being provided before homeowners get into trouble, not just after the fact, by which time it's much less likely that families will be able to stay in their home.

*FHA's Loss Mitigation Program*

FHA's loss mitigation program, which has helped protect more than half a million borrowers during this crisis, includes numerous strategies to make sure that mortgagees take the right steps to minimize the risk that a troubled borrowers goes into foreclosure. Participation in the loss mitigation program is mandatory for FHA lenders. FHA lenders are required to:

- Consider all reasonable means to address delinquency at the earliest possible moment;
- Inform borrowers of available loss mitigation options and the availability of housing counseling within the second month of delinquency;
- Evaluate each delinquent loan no later than the 90th day of delinquency to determine which loss mitigation option is appropriate;
- Utilize loss mitigation whenever feasible to avoid foreclosure;
- Re-evaluate each loan monthly until reinstatement or foreclosure;
- Report loss mitigation actions through the single family default monitoring system (SFDMS);
- Retain a complete audit trail confirming compliance with all loss mitigation requirements.

Several comprehensive reinstatement options are available to promote retention of home ownership, with an additional two disposition options available to assist borrowers who are in default and need to transition to lower cost housing. FHA enforces its loss mitigation protocols by performing servicer compliance reviews. Where FHA finds that servicers have not complied with FHA's loss mitigation requirements, FHA seeks indemnifications against future insurance claim losses and/or may refer servicers to the Mortgagee Review Board for egregious violations.

With these rules, FHA has helped more than half a million homeowners during this crisis through some 760,000 loss mitigation actions – which has protected the taxpayer and FHA capital reserves by reducing the number of defaults in FHA's portfolio.

*Monitoring and Servicer Performance*

While much of the recent media attention has focused on affidavits and other steps near the end of the foreclosure process, at the FHA, we were focused well before the recent revelations on the mortgage servicing process as a whole.

At the time I took office at FHA, we found that significant reviews of servicer performance were not being done and had never been done, certainly not at the level of detail required. Thus, in November, 2009 we began implementing very specific monitoring around servicer performance – particularly whether servicers were helping to prevent foreclosures by helping responsible homeowners restructure their mortgages.

Specifically, we initiated more robust servicer loss mitigation comparison reporting, which spanned the vast majority of the FHA portfolio. This new, more detailed reporting system enabled FHA to provide peer group comparisons of servicers in their utilization of loss mitigation options available to borrowers, which allowed us to identify which tools servicers were using, how frequently and how consistently.

Initial findings showed significant variations in the performance of different servicers, triggering a more in-depth look at firms servicing FHA mortgages.

*FHA's Four-Month Review Of Firms Servicing FHA-Insured Mortgages*

In May, FHA launched an in-depth review of several of its largest servicers, looking in particular at whether their foreclosure prevention efforts fully comply with the FHA's rules and regulations.

FHA reviewed the operations of the five largest servicers of FHA-insured loans, whose aggregate portfolios account for over 70% of HUD's single family insured servicing portfolio, to monitor their compliance with FHA requirements.

The early returns suggest that some servicers may be falling short – that in varying degrees many of the servicers under review may not have met HUD's expectations in assisting borrowers through the loss mitigation process. Field analyst reviews suggest that some servicers may lack knowledge of the FHA loss mitigation process, the technology necessary to expedite loss mitigation processing requests, and a sufficient number of experienced staff necessary to clear loan modification request backlogs.

FHA is ensuring these servicers address the issues of concern identified through its reviews. This includes extensive consultation with servicers' senior management and assigned work groups, customized training and planning assistance, and ongoing evaluations of servicers' progress in correcting deficiencies and improving compliance.

*Penalties and Claim Reimbursements Imposed by FHA on Servicers*

Should it become clear that these early indications are in fact part of a much broader problem of unacceptable behavior on the part of certain servicers, our response will be very firm where it is appropriate. Servicers that are not meeting FHA's standards will face the full strength of our enforcement authority, including the levying of fines, sanctions, and if necessary, stripping institutions of their FHA approval. Prior to the start of FHA's current servicer review process, which began in May 2010, an evaluation of the practices of one servicer yielded over $700,000 in administrative fees .

This is part of a broader commitment to lender enforcement. Indeed, since I began serving as Commissioner, FHA has suspended a number of well-known lenders, withdrawn approval for over 1,500 others and imposed over $4.27 million in civil money penalties and administrative payments to non-compliant lenders.

In all of these actions, we are sending a very clear message: that if you don't operate ethically and transparently, we won't do business with you. And we will not hesitate to act.

It is worth noting that at FHA, the violations we have seen are not industry-wide. While the review I discussed above shows that certain companies do not appear to be following the rules, others are. Given the recent reports of more widespread problems in how servicers have been handling the foreclosure process, we have broadened our reviews to cover that process more comprehensively, in order to obtain a clearer picture of the extent of the problems.

Those who are breaking the law will be held accountable.

But Madam Chairwoman, I would also add that where problems have not been found, we should not be leaving families in limbo indefinitely. Getting to the bottom of these problems and providing struggling homeowners and homebuyers alike with the assistance and certainty they need is essential to economic recovery.

***HUD's Broader Enforcement Role***

The review at FHA represents only one part of the aggressive, comprehensive approach that FHA and HUD have taken to protect homeowners and borrowers in these difficult times and to help our housing market recover – including how we have responded to foreclosure processing revelations.

*FHA's Enforcement Role*

Perhaps the most significant way we protect consumers is through FHA enforcement on lenders in its portfolio. As this Subcommittee well knows, we are in the process of implementing the most sweeping reforms to FHA credit policy, risk management, lender enforcement, and consumer protections in the agency's history. And as I mentioned above, we have suspended and withdrawn approval for over 1,500 lenders.

We appreciate again the support the full Committee showed for giving FHA the authority to increase its premiums – and for supporting broader FHA Reform legislation that would provide additional tools to hold lenders accountable. And I urge Congress to enact the key enforcement elements of that legislation before the end of the year.

*HUD's Process for Addressing Consumer Complaints*

For FHA-insured borrowers, consumer complaints come into our National Servicing Center. Servicers are closely monitored on the number and type of customer complaints that are elevated to the National Servicing Center call center. Servicers with excessive complaints are required to implement a rapid response escalation process within their own organization to address borrowers needing immediate assistance. This process must include written procedures, turnaround time standards, and the documentation of quality control metrics.

*Roles in Monitoring/Regulating the Current Problems*

Typically our lender reviews are for compliance with loss mitigation and foreclosure requirements. Put simply, servicers of FHA-insured loans must comply with FHA's foreclosure guidelines. FHA requires that servicers only foreclose after all loss mitigation options have been considered. If a servicer determines that its only option is to foreclose, FHA regulates that process to ensure the servicer forecloses in a manner that is fair to all parties involved. FHA monitors servicers by reviewing a sample of their executed foreclosures and examining the procedures and processes they have in place to govern their foreclosure operations.

We are in the process of expanding our lender review to look into specific compliance with foreclosure process. In order to fully evaluate servicers' complete affidavit process, including detection of robo-signing, a foreclosure review questionnaire has been issued to large servicers of FHA-insured loans to obtain detailed information regarding their foreclosure processes generally, as well as their payment processing, document handling, and title clearance operations. On-site servicer inspections will then take place the first 2 weeks of December 2010 to follow up on information received via the questionnaires. HUD analysts will use the information provided in the questionnaires and reviews to investigate the means by which servicers track affidavits, security instruments and promissory notes, whether servicers verify the validity of these documents and what controls they have in place to identify failures in the process.

*RESPA and SAFE*

HUD protects consumers through additional efforts as well. Through oversight of state compliance with the Secure and Fair Enforcement (SAFE) Mortgage Licensing Act, HUD is working with states to identify, track, and bar fraudulent loan officers and improve the quality of loan officers through licensing. The SAFE Act directs States to adopt minimum uniform standards for the licensing and registration of residential mortgage loan originators and to participate in a nationwide mortgage licensing system and registry database of residential mortgage loan originators. It sets forth a nationwide minimum standard for the licensing and registration of state-licensed mortgage loan originators.

Through the Real Estate Settlement and Procedures Act (RESPA), HUD enforces requirements on the front end to provide more disclosure in the process from lenders when purchasing a home.

RESPA Specialists investigate every complaint of loan servicer RESPA violations. Complaints are received from consumers by mail, phone calls and e-mail. Phone calls are assigned to Specialists on a rotating basis and must be answered within 2 business days of assignment. E-mails are also assigned to Specialists on a rotating basis and must be answered on the day of assignment. Case files are opened for each complaint received by mail and for each phone call and e-mail that cannot be immediately handled with a response to the complainant.

*Enforcement Processes under Section 6 of RESPA*

Section 6 of RESPA covers loan servicing and escrow account administration. After a Specialist is assigned a case, he or she will contact the complainant for additional information. In many cases, all the consumer needs is information on filing a complaint with the loan servicer. The consumer is given information on how to file a Qualified Written Request or QWR. Under RESPA, the loan servicer must acknowledge the complaint within 20 days and provide a response within 60 days. If the loan servicer fails to comply with the statute or the actions of the servicer has put the consumer's property in immediate jeopardy, the Specialist contacts the servicer to discuss the consumer's problems and complaints.

The Specialist acts as an intermediary between the consumer and the settlement service provider and shepherds the case until the matter is resolved. If necessary, a closing letter is sent to the consumer and the settlement service provider setting forth the terms of the resolution in order to insure that the resolution is carried out.

Section 6 of RESPA, in subsection (f), provides that an individual may seek damages and costs against anyone who fails to comply with any provision of the section. It also allows for a class action to redress violations. It does not specifically authorize an enforcement action by HUD or by any other federal or State government entity. However, section 16 of RESPA provides jurisdiction of the courts and a statute of limitations for any government action pursuant to the provisions of sections 6, 8, or 9 of RESPA. Generally, the RESPA Office relies upon negotiating with the target loan servicer to insure voluntary compliance with the requirements of section 6.

*Enforcement Processes under Section 10 of RESPA*

Section 10 of RESPA restricts the amount of money a loan servicer can require in an escrow account. The process for handling cases involving violations of Section 10 is more complex. After the file is opened and assigned, the Specialist contacts the complainant for additional information. If it is determined that the business practices of a settlement service provider should be investigated, the Specialist determines how the investigation should proceed. The Specialist can send an information and document request under the investigative authority given to the Secretary.

If it is determined that an on-site investigation of the target would yield more information, the case can be referred to the RESPA Office's investigation consultants who will conduct an investigation under the Specialist's directions.

If the violation is minor, no consumer has been harmed, and the violation is the result of the settlement service provider's failure to understand the constraints placed on his/her actions by RESPA, a warning letter may be sent to the target outlining the violation and asking for a signed affidavit stating that the business practice in question has ceased. The target is told that if the violation continues or occurs again, the RESPA Office will open up a full-scale investigation.

At any time, the Specialist may determine that the facts of a case, a high-profile target, or the hiring of legal counsel by the target warrants the case being referred to the Office of General Counsel (OGC). The assigned attorney will assist the Specialist in determining how to proceed with the case, and in handling settlement negotiations and drafting settlement documents. If the target has failed to respond to the information and document request, OGC will issue a subpoena.

In the case of failure of a lender or escrow servicer to submit an escrow statement to the borrower as required by section 10(c), the Secretary shall assess against that party a civil penalty of $50 for each such failure. The total amount imposed on a lender or escrow servicer for all such failures during any 12-month period shall not exceed $100,000. If the failure is the result of an intentional disregard of the requirement to submit a statement, then the penalty imposed shall be $100 per failure, and the $100,000 limitation shall not apply.

If the target is regulated by another state or federal agency, the specialist will contact that agency to discuss the possibility of a joint investigation. The RESPA Office has developed excellent working relationships with several agencies in conducting joint investigations.

*Consumer Redress*

Although the RESPA Office cannot take action on behalf of an individual consumer, if a Specialist discovers during the course of an investigation that consumers have been financially damaged by the business practices of the target, the Specialist will generally require as a part of any settlement, that restitution be made to the consumers in addition to any penalties agreed to in the settlement.

If OGC and the Specialist determine that a settlement cannot be reached with the target or if the violations warrant taking legal action, the case may be referred to the Justice Department for consideration and action.

For FY 2010 there were 40 cases resolved as Consumer Redress; the total Settlement Amount was more than $392,000. This represents 23% of the Consumer Redress cases since the RESPA Office started keeping records in 2006.

According to the records of OGC, during the past 10 years, 841 enforcement cases have been pursued for violations of section 8 of RESPA. As a result of those cases, $114 million has been returned to consumers in the form of restitution or to the Treasury as disgorgement of illegal profits.

Lastly, Madam Chairwoman, I would note that recent rule changes to RESPA that became effective in January 2010 significantly increased disclosure and transparency of fees and costs during purchase process. According to a survey by Ernst Publishing Company, these changes have resulted in disclosed prices being more accurate.

***Restoring Trust in America's Mortgage Markets***

And so, Madam Chairwoman, as you can see, this Administration is providing tools and enforcement mechanisms essential to protecting families and restoring trust in America's mortgage markets.

But government can't do the job alone.

Through this controversy and this crisis, the mortgage lenders and servicers have lost an enormous amount of trust from the American people. Whether it is reducing principal for underwater homeowners, adopting responsible underwriting practices that ensure fair access to credit or ensuring greater transparency and accountability in their own business practices, the industry needs to take steps to earn that trust back.

This Administration won't tolerate business as usual in the mortgage market – and the responsible actors in the industry shouldn't either.

President Obama has said that we won't stop every foreclosure – and he's right.

But by continuing to provide help to families—whether it's to stay in their homes, to ensure they can buy new homes, or to help them to transition to affordable rental housing—the sooner our neighborhoods will stabilize – and the sooner our economy will recover.

Identifying the full extent of the issues and fixing the problems that have been identified in mortgage servicing and foreclosure practices are an important piece of this overall effort. And that is why I am proud to join my colleagues today and thankful for this opportunity to testify before you today. Thank you.

For Release Upon Delivery
10:00 a.m., November 18, 2010

**TESTIMONY OF**

**JOHN WALSH**
**ACTING COMPTROLLER OF THE CURRENCY**

**before the**

**SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY**

**of the**

**COMMITTEE ON FINANCIAL SERVICES**

**U.S. HOUSE OF REPRESENTATIVES**

**November 18, 2010**

Statement Required by 12 U.S.C. § 250:

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

***Introduction***

Chairwoman Waters, Ranking Member Capito, and members of the Subcommittee, I appreciate this opportunity to discuss recently reported improprieties in the foreclosure processes used by several large mortgage servicers and actions that the Office of the Comptroller of the Currency (OCC) is taking to address these issues where they involve national banks. The occurrences of improperly executed documents and attestations raise concerns about the overall integrity of the foreclosure process and whether foreclosures may be inappropriately taking homes from their owners. These are serious matters that warrant the thorough investigation that is now underway by the OCC, other federal bank regulators, and other agencies.

The OCC supervises all national banks and their operating subsidiaries, including their mortgage servicing operations. The servicing portfolios of the eight largest national bank mortgage servicers[1] account for approximately 63 percent of all mortgages outstanding in the United States – nearly $33.3 million loans totaling almost $5.8 trillion in principal balances as of June 30, 2010.

To date, four large national bank servicers have publicly acknowledged procedural deficiencies in their foreclosure processes. The lapses that have been reported represent a serious operational breakdown in foreclosure governance and controls that we expect national banks to maintain. These lapses are unacceptable, and we are taking aggressive actions to hold national banks accountable, and to get these problems fixed. As soon as the problems at Ally Bank came to light, we directed the largest national bank mortgage servicers under our supervision to review their operations, to take corrective action to remedy identified problems, and to strengthen their foreclosure governance to prevent reoccurrences. At the

[1] Bank of America, Citibank, JPMorgan Chase, HSBC, MetLife, PNC, Wells Fargo, and U.S. Bank.

same time, we initiated plans for intensive, on-site examinations of the eight largest national bank mortgage servicers. Through these examinations we are independently testing the adequacy of governance over their foreclosure processes to ensure foreclosures are completed in accordance with applicable legal requirements and that affidavits and claims are accurate. As part of our examinations we also are reviewing samples of individual loan files where foreclosures have either been initiated or completed to test the validity of bank self-assessments and corrective actions, and to determine whether troubled borrowers were considered for loss mitigation alternatives such as loan modifications prior to foreclosure. Our examinations are still on-going.

My testimony provides a brief discussion of recently publicized foreclosure problems, and our most recent findings on trends in modifications, alternatives to modifications, and foreclosures from the *OCC and OTS Mortgage Metrics Report*. I then describe the OCC's actions with respect to loan modifications and problems that have arisen in the foreclosure process.

***Overview – Current Foreclosure Problems***

The current foreclosure problems represent another painful chapter of the recent financial crisis, stemming from a record number of borrower defaults which has strained servicer capacity to provide loss mitigation activities to troubled borrowers and ensure a large and growing number of foreclosures are properly processed.

The concerns about improper foreclosure practices initially centered on two issues that deal with the documentation required to effect foreclosure actions. The first issue involves requirements under some state laws for individuals to sign affidavits attesting *personal* knowledge of the accuracy and completion of required documentation essential to a valid foreclosure proceeding. The second issue is whether, in similar situations where required by state law, individual notaries may have violated procedures in notarizing documentation by, for example, notarizing the documents after they had been signed, rather than in the presence of the individual signing the affidavit. As the situation has evolved, concerns have broadened to include the accuracy of all information underlying the foreclosure process, and the physical possession and control over documents necessary to foreclose on a home. Our examinations are investigating all of these issues.

The signing and attestation of foreclosure documents are steps required by various state laws that govern the legal completion of a foreclosure proceeding—and as such, typically represent the final steps in what is a very lengthy and resource intensive process that banks undertake to deal with seriously delinquent borrowers. The time to complete a foreclosure process in most states can take 15 months or more and in many cases can be as long as two years. Foreclosure completion timelines are generally set by investors such as Fannie Mae and Freddie Mac, and there are penalties for servicers who do not meet the timelines mandated by these investors.

The specific requirements and the legal standards applied for determining personal knowledge vary across judicial foreclosure states, and thus require servicers to ensure that their processes conform to individual state, or in some cases, local law. To assist with meeting these requirements, mortgage servicers often outsource some of the requisite legal work to law firms familiar with local standards and other third parties for input and review. Fannie Mae and Freddie Mac in fact require servicers to use law firms approved for particular geographies when preparing foreclosure filings. For large mortgage servicers that operate nationwide, this often has resulted in a panoply of documents used in their mortgage foreclosure processes: one large mortgage servicer has indicated that they use over 250 different affidavit forms. These operational challenges, however, do not absolve the banks' from their responsibilities to have the appropriate staff, quality controls, and an effective audit process in place to ensure that documents are accurate and the foreclosure process is conducted in compliance with applicable state and local laws.

Servicers typically move forward with foreclosure proceedings only after thoroughly evaluating a borrower's eligibility for loan modifications and other alternatives, such as short sales or deed-in-lieu-of-foreclosures.[2] As a practical matter, many investors for whom loans are serviced, including Fannie Mae and Freddie Mac, require servicers to attempt loss mitigation actions, including modifications, prior to foreclosing on a home. The largest national bank mortgage servicers are participants in Treasury's Home Affordable Modification Program (HAMP) and are required to evaluate troubled borrowers to determine their eligibility for a HAMP modification. For borrowers that fail to qualify for a HAMP loan modification, servicers also typically consider whether the borrowers would qualify for a modification under their proprietary programs. In the vast majority of cases, it is only after these loan modification efforts have been exhausted that final foreclosure actions are taken.

***Recent Trends in Mortgage Modifications and Foreclosure Activity***

Since 2008, the OCC has collected loan level data from the large national banks we supervise and published this information in quarterly mortgage metrics reports. We have since expanded our data collection and reporting efforts and joined with the Office of Thrift Supervision (OTS) to publish data on the performance of loans and loan modifications, and to highlight trends in loss mitigation activities, foreclosures, and re-defaults occurring on mortgages serviced by large national banks and federally regulated thrifts. Our most recent

[2] Short sales refer to sales of mortgaged properties at prices that net less than the total amount due on the loans. Servicers and borrowers negotiate repayment programs, forbearance, or forgiveness for any remaining deficiency on the debt. Short sales typically have less adverse impact than foreclosures on borrowers' credit records. Deed-in-lieu-of-foreclosure actions refer to actions in which borrowers transfer ownership of the properties (deeds) to servicers in full satisfaction of the outstanding mortgage debt to lessen the adverse impact of the debt on borrowers' credit records.

report, released in September, provides data through second quarter 2010 for nearly 34 million first-lien mortgages, totaling nearly $6 trillion in outstanding balances—representing approximately 65 percent of all first-lien residential mortgages in the country.[3] Key trends from that report are summarized below.

*Overall Mortgage Performance*

As shown in Table 1, the percentage of current and performing mortgages remained unchanged from the previous quarter at 87.3 percent. The percentage of mortgages 30 to 59 days delinquent increased to 3.1 percent at the end of the second quarter of 2010, compared with 2.8 percent at the end of the previous quarter and 3.2 percent a year ago. The percentage of seriously delinquent mortgages[4] was 6.2 percent, a decrease of 5.3 percent from the previous quarter but up 16.1 percent from a year ago. Foreclosures in process were 3.4 percent of the total portfolio, a 1.4 percent decrease from the previous quarter but a 16.1 percent increase from a year ago.

| Table 1. Overall Portfolio Performance [illegible] | | | | | | | |
|---|---|---|---|---|---|---|---|
| | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| Current and Performing | 88.0% | 87.2% | 86.4% | 87.3% | 87.3% | 0.1%* | -1.4% |
| 30-59 Days Delinquent | 3.2% | 3.4% | 3.4% | 2.8% | 3.1% | 11.0% | -3.5% |
| Seriously Delinquent | 5.3% | 6.3% | 7.1% | 6.5% | 6.2% | -5.3% | 16.1% |
| Foreclosures in Process | 2.9% | 3.2% | 3.2% | 3.5% | 3.4% | -1.4% | 16.1% |
| [illegible] | | | | | | | |
| Current and Performing | 29,982,283 | 29,686,984 | 29,217,743 | 29,574,957 | 29,483,014 | -0.3% | -1.6% |
| 30-59 Days Delinquent | 1,078,663 | 1,154,825 | 1,136,822 | 939,306 | 1,038,422 | 10.6% | -3.7% |
| Seriously Delinquent | 1,798,532 | 2,111,566 | 2,388,938 | 2,219,393 | 2,083,585 | -5.7% | 15.8% |
| Foreclosures in Process | 982,234 | 1,081,428 | 1,079,388 | 1,170,765 | 1,149,770 | -1.8% | 15.8% |

[3] A full copy of the *OCC and OTS Mortgage Metrics Report, Second Quarter 2010* is available at: http://www.occ.gov/publications/publications-by-type/other-publications/mortgage-metrics-q2-2010/mortgage-metrics-q2-2010-pdf.pdf.

[4] Seriously delinquent loans are those mortgages that are 60 or more days past due and all mortgages held by bankrupt borrowers whose payments are 30 or more days past due.

*Home Retention Actions*

As shown in Table 2, servicers implemented 902,800 permanent loan modifications (shown as "Other Modifications" and "HAMP Modifications") over the past five quarters with HAMP modifications accounting for approximately 26 percent of this total. During the second quarter 2010, servicers initiated or implemented 504,292 home retention actions. This included 273,419 HAMP and other permanent loan modifications, an increase of 18.1 percent from the first quarter of 2010. Loan modifications implemented in second quarter 2010 represent 13.1 percent of seriously delinquent borrowers, up from 7.9 percent in the second quarter 2009. While the number of permanent modifications increased, the number of trial modifications and other payment plans declined as servicers worked through their portfolio of seriously delinquent mortgages to determine borrower eligibility under HAMP and each servicer's own proprietary loan modification programs.

*Table 2. Number of New Home Retention Actions*

| | 6/30/09 | 9/30/09 | 12/31/09 | 3/31/10 | 6/30/10 | 1Q %Change | 1Y % Change |
|---|---|---|---|---|---|---|---|
| Other Modifications | 142,362 | 130,464 | 103,617 | 131,207 | 164,473 | 25.4% | 15.5% |
| HAMP Modifications | -- | 783 | 20,679 | 100,269 | 108,946 | 8.7% | -- |
| Other Trial Period Plans | 64,201 | 127,902 | 96,048 | 101,764 | 73,673 | -27.6% | 14.8% |
| HAMP Trial Period Plans | 79,994 | 272,709 | 259,015 | 188,503 | 64,666 | -65.7% | -19.2% |
| Payment Plans | 131,974 | 163,551 | 121,722 | 120,587 | 92,534 | -23.3% | -29.9% |
| Total | 418,531 | 695,409 | 601,081 | 642,330 | 504,292 | -21.5% | 20.5% |

*Changes to Borrowers' Monthly Payments Resulting from Modifications*

Early in the mortgage crisis, servicers' informal payment plans and loan modifications were done in low volume and often resulted in mortgage payments that increased or did not change. This traditional approach to loss mitigation gave delinquent borrowers experiencing temporary financial problems a chance to catch-up on making their loan payments. However, as the mortgage crisis deepened, unemployment climbed, and the number of delinquent borrowers increased to unprecedented levels, it became clear that more formal and permanent modifications were needed. The OCC's mortgage metrics data provided factual evidence that loan modifications completed in 2008 were experiencing high re-default rates. As a result of those high re-default rates, in March 2009, the OCC directed the largest national banks to take corrective action to implement loan modification programs designed to achieve more sustainable modifications.

As a result, servicers have focused efforts on improving the quality of their loan modifications and the performance of those modifications over time. This is evidenced by the increase in modifications that are reducing borrowers' monthly mortgage payments and the corresponding decline in re-defaults (as measured by serious delinquencies) subsequent to modification since the OCC's direction to servicers in 2009. As shown in Table 3, mortgage modifications that lowered monthly principal and interest payments increased to more than 90 percent of all modifications during the second quarter 2010. The emphasis on payment affordability and sustainability has resulted in a 62 percent increase in the average monthly savings in mortgage payments from mortgage modifications from a year ago. As shown in Table 4, modifications made during the second quarter of 2010 reduced monthly payments by an average of $427. Further, 56 percent of the modifications made during the second quarter reduced the borrower's monthly payment by 20 percent or more, representing an average savings to the consumer of $698 a month. These actions for more sustainable payments are also reflected in lower re-default rates for more recently modified loans. Modifications made after the end of the first quarter of 2009 have experienced about half the re-default rates of modifications made prior to that time.[5]

[5] *See OCC and OTS Mortgage Metrics, Second Quarter,* page 7.

| *Table 3.* Changes in Monthly Principal and Interest Payments Resulting from Modifications (Percentage of Modifications)* | | | | | | | |
|---|---|---|---|---|---|---|---|
| | 6/30/09 | 9/30/09 | 12/31/09 | 3/31/10 | 6/30/10 | 1Q %Change | 1Y %Change |
| Decreased by 20% or More | 38.8% | 37.0% | 41.8% | 54.9% | 56.4% | 2.9% | 45.5% |
| Decreased by 10% to Less than 20% | 19.6% | 18.3% | 19.1% | 17.7% | 17.6% | -0.4% | -10.2% |
| Decreased Less than 10% | 19.9% | 24.4% | 21.1% | 14.9% | 16.1% | 8.1% | -19.3% |
| **Subtotal for Decreased** | **78.3%** | **79.7%** | **82.0%** | **87.4%** | **90.1%** | **3.1%** | **15.1%** |
| Unchanged | 4.3% | 3.6% | 4.8% | 2.7% | 1.9% | -30.8% | -55.8% |
| Increased | 17.4% | 16.8% | 13.2% | 9.9% | 8.0% | -18.9% | -54.0% |
| **Subtotal for Unchanged and Increased** | **21.7%** | **20.3%** | **18.0%** | **12.6%** | **9.9%** | **-21.4%** | **-54.4%** |
| Total | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | | |
| (Number of Modifications) | | | | | | | |
| Decreased by 20% or More | 54,860 | 48,151 | 51,036 | 126,379 | 153,730 | 21.6% | 180.2% |
| Decreased by 10% to Less than 20% | 27,691 | 23,786 | 23,338 | 40,663 | 47,875 | 17.7% | 72.9% |
| Decreased Less than 10% | 28,213 | 31,707 | 25,748 | 34,271 | 43,827 | 27.9% | 55.3% |
| Subtotal for Decreased | 110,764 | **103,644** | 100,122 | 201,313 | 245,432 | 21.9% | 121.6% |
| Unchanged | 6,038 | 4,630 | 5,822 | 6,273 | 5,136 | -18.1% | -14.9% |
| Increased | 24,665 | 21,829 | 16,142 | 22,750 | 21,831 | -4.0% | -11.5% |
| Subtotal for Unchanged and Increased | 30,703 | **26,459** | 21,964 | 29,023 | 26,967 | -7.1% | -12.2% |
| Total | 141,467 | 130,103 | 122,086 | 230,336 | 272,399 | 18.3% | 92.6% |

*Payment change information was not reported on 895 modifications in the second quarter of 2009; 1,144 in the third quarter of 2009; 2,210 in the fourth quarter of 2009; 1,140 in the first quarter of 2010; and 1,020 in the second quarter of 2010.

| Table 4. Average Change in Monthly Payments Resulting from Modifications (All Modifications) | | | | | | | |
|---|---|---|---|---|---|---|---|
| | 6/30/09 | 9/30/09 | 12/31/09 | 3/31/10 | 6/30/10 | 1Q %Change | 1Y %Change |
| Decreased by 20% or More | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| Decreased by 10% to Less than 20% | [illegible] | $196 | [illegible] | [illegible] | $167 | 1.2% | [illegible] |
| Decreased Less than 10% | [illegible] | [illegible] | [illegible] | $67 | [illegible] | [illegible] | [illegible] |
| Unchanged | — | — | — | — | — | — | — |
| Increased | $145 | $146 | $153 | [illegible] | $132 | [illegible] | [illegible] |
| Overall | [illegible] | [illegible] | [illegible] | [illegible] | $427 | [illegible] | [illegible] |

*Home Forfeiture Actions – Short Sales, Deed-in-Lieu-of-Foreclosures, and Foreclosures*

As previously noted, mortgage servicers generally do not proceed with home forfeiture actions until they have evaluated the borrower's eligibility for a loan modification that would allow the borrower to stay in his or her home. Unfortunately, loan modification programs cannot help borrowers who simply cannot make even reduced mortgage payments. In these cases, servicers turn to home forfeiture actions to protect the interests of lenders and investors.

Completed home forfeiture actions—foreclosure sales, short sales, and deed-in-lieu-of-foreclosure actions—totaled 221,474 during the second quarter, an increase of 14.2 percent from the previous quarter (see Table 5). Short sales and deed-in-lieu-of-foreclosure actions increased significantly during the quarter, but they remain only 26 percent of home forfeiture actions overall. While home forfeiture actions increased in the second quarter, servicers implemented about 2.3 times more home retention actions—loan modifications, trial period plans, and payment plans—than total home forfeiture actions.

**Table 5. Completed Foreclosures and Other Home Forfeiture Actions**

| | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
|---|---|---|---|---|---|---|---|
| Completed Foreclosures | 106,004 | 118,606 | 128,869 | 152,654 | 162,612 | 6.7% | 53.6% |
| New Short Sales | 25,129 | 30,766 | 37,583 | 40,043 | 56,926 | 42.2% | 126.5% |
| New Deed-in-Lieu-of-Foreclosure Actions | 1,120 | 1,333 | 1,054 | 1,185 | 1,736 | 46.5% | 55.0% |
| Total | 132,253 | 150,605 | 167,496 | 193,882 | 221,474 | 14.2% | 67.5% |
| Newly Initiated Home Retention Actions Relative to Completed Foreclosures and Other Home Forfeiture Actions | 316.5% | 461.7% | 308.9% | 331.3% | 227.7% | -51.3% | -28.1% |

The number of newly initiated foreclosures decreased by 21.2 percent, to 292,072, during the second quarter of 2010, the lowest level in more than a year. The lower number is partly attributable to the increase in permanent modifications made during the quarter. In addition, HAMP guidelines now preclude the servicer from initiating a foreclosure action until the borrower has been determined to be ineligible for a HAMP modification. Similarly, the number of loans in process of foreclosure decreased by 1.8 percent from the previous quarter to 1,149,770, reflecting the increases in permanent modifications and completed foreclosures during the quarter as well as the drop in newly initiated foreclosure actions. Notwithstanding these positive trends, we expect the number of foreclosure actions will remain elevated as the large inventory of seriously delinquent loans and loans in process of foreclosure works through the system.

Table 6. Number of Newly Initiated Foreclosures and Foreclosures in Process

| | 6/30/09 | 9/30/09 | 12/31/09 | 3/31/10 | 6/30/10 | 1Q %Change | 1Y %Change |
|---|---|---|---|---|---|---|---|
| Number of Newly Initiated Foreclosures | | | | | | | |
| Total | 369,226 | 369,209 | 312,520 | 370,636 | 292,072 | -21.2% | -20.9% |
| Number of Foreclosures in Process | | | | | | | |
| Total | 992,504 | 1,091,620 | 1,079,366 | 1,170,785 | 1,149,770 | -1.8% | 15.8% |

***OCC Supervisory Efforts***

*Emphasis on Sustainable Loan Modifications and Accurate Financial Reporting*

As the volume of problem loans surged to record levels and has worked its way through the financial system, servicers have struggled to maintain the needed capacity and resources to effectively deal with the number of consumers who require assistance. We have used our examination process and our Customer Assistance Group (CAG) to address issues as they have arisen.

Our primary supervisory focus in assessing how servicers work with borrowers experiencing payment problems over the past two years has centered on their efforts to offer sustainable loan modifications that avoid foreclosure and allow troubled borrowers to remain in their homes. As previously noted, when our mortgage metrics data showed that an inordinately high percentage of loan modifications made in 2008 were re-defaulting, we directed large national bank mortgage servicers to take corrective action and revise their loan modification programs to produce loan modifications that resulted in more sustainable loan payments. In most cases, this requires concessions to the terms of the loan, rather than simply granting a borrower a payment deferral that capitalizes arrearages, which was typical in many traditional modifications.

Some observers have stated that the banking agencies' accounting policies and supervisory treatment of second-lien mortgages are preventing servicers from being more aggressive in their loan modification efforts. We do not agree with this assertion. We have repeatedly encouraged banks to work with troubled borrowers, but have also stressed that bankers cannot use loan modifications as a means to mask or defer recognition of losses. In this regard, we have told our examiners that we expect loan modifications to be undertaken in a manner that improves the likelihood that a borrower can repay the restructured credit under the modified terms and in accordance with a reasonable repayment schedule. Regardless of whether a loan is modified or not, we expect banks to maintain systems to identify problem assets, estimate incurred credit losses for those assets, and establish loan loss reserves and/or initiate write-downs sufficient to absorb estimated losses consistent with generally accepted accounting principles and regulatory policies.

We apply the same expectations to second-lien mortgages held by national banks, and have noted that the presence of second liens does not impede servicers' ability to modify first-lien mortgages because modifications do not adversely affect the first-lien position of lenders or investors. As with first-lien mortgages, we expect banks to work with borrowers and to hold appropriate loan loss reserves against the elevated risks facing second-lien mortgages. Over the last two years, national banks have recognized $43.5 billion in losses from nonperforming second mortgages according to the federal financial call report, more than five times the losses recognized over the previous five years.

Lenders must also reserve against the elevated risk of default and loss associated with current and performing second liens that stand behind delinquent or modified first liens. The volume of current and performing second liens held by national banks behind delinquent or modified first liens remains relatively small. The OCC analyzed second liens held by national banks and matched more than 60 percent of them ($293 billion) to first-lien mortgages. Of these 5,000,000 matched second mortgages, about 6 percent, or 235,000, were current and performing but behind delinquent or modified first liens. The balance of those current and performing second liens behind delinquent or modified first mortgages totaled less than $18 billion. The OCC has directed national banks that hold such performing second liens to properly reflect the associated credit impairment for those second liens through an increase in the allowance for loan losses, or in many cases, a charge-off of the loan where appropriate.

*Oversight of and Responses to Foreclosure Documentation Issues*

When reviewing a bank's foreclosure governance process, such as practices involved with the preparation and filing of affidavits for foreclosure proceedings, examiners determine if the bank has appropriate policies, procedures, and internal controls in place to ensure the accuracy of information relied upon in the foreclosure process and compliance with federal and state laws. An appropriate governance process would include the testing of those policies and procedures through periodic internal audits and the bank's on-going quality control function. Examiners generally do not directly test standard business process or practices, such as the validity of signed contracts, or the processes used to notarize documents or the actual physical presence of notes with document custodians, unless there is evidence of a material weakness or breakdown in governance and internal controls over these activities. In making such a determination, examiners will review on-going quality control activities, internal or third-party audits, and consumer complaints. In this regard, neither internal quality control nor internal or third party audits at the largest servicers, or our CAG data revealed that foreclosure document processing was an area of concern.

When the problems at Ally Bank – an institution that is not supervised by the OCC – became public, the OCC took immediate action to determine if procedural breakdowns at national bank servicers could be resulting in similar foreclosure affidavit problems. On September 29, 2010, we ordered the eight largest national bank servicers to conduct a comprehensive self-assessment of their foreclosure management processes, including file review and affidavit processing and signature. We also made clear that where deficiencies were identified, the servicers needed to take prompt action to remedy any improper documentation, including as applicable, making appropriate re-filings with local courts. Equally important, we also directed banks to strengthen foreclosure governance to ensure the accuracy of the information relied upon in the foreclosure process and prevent re-occurrences of documentation problems.

Concurrent with this directive, we began logistical plans for on-site examinations at each of these large servicers and their mortgage servicing operational centers. Our objectives are to independently test and verify the adequacy and integrity of bank self-assessments and corrective actions; the adequacy and effectiveness of governance over servicer foreclosure processes to ensure foreclosures are completed in accordance with applicable legal requirements and that affidavits and claims are accurate; and to determine whether troubled borrowers were considered for loss mitigation alternatives such as loan modifications prior to foreclosure.

These examinations are now underway at each of the eight servicers. The Federal Reserve Board (FRB) and Federal Deposit Insurance Corporation (FDIC) are participating in these examinations. The examination teams include examiners from the OCC, FRB, and FDIC. The OCC has approximately 100 examiners working on this effort. Legal support is provided by staff attorneys from both the OCC and FRB. We have established an interagency foreclosure review team to provide oversight and direction to on-site examination teams to ensure consistency in our examination work.

As noted above, a key objective of our examinations is to determine the adequacy and effectiveness of governance over the foreclosure process. The scope of work to assess governance is extensive and includes an assessment of each servicer's foreclosure policies and procedures, organizational structure and staffing, vendor management, quality control and audit, loan documentation including custodial document management, and foreclosure work flow processes. As part of these reviews, examiners are conducting interviews with personnel involved in the preparation, review, and signing of foreclosure documents. Our objective in conducting these interviews is to understand current and past practices with respect to preparation of foreclosure documents, whether the staff conducting these functions had sufficient knowledge and training, including training in relevant requirements, to effectively complete and sign-off on foreclosure affidavits, and to help assess the underlying cause of any identified deficiencies.

Examiners will also be reviewing samples of individual borrower foreclosure files from judicial and non-judicial states that include both in-process and completed foreclosures.

In reviewing these files, examiners will determine whether foreclosed borrowers were appropriately considered for alternative loss mitigation actions such as a loan modification. Examiners will also check for the following:

- A documented audit trail that demonstrates that data and information (e.g., amount of indebtedness and fees) in foreclosure affidavits and claims are accurate and comply with state laws;
- Possession and control over the underlying, critical loan documents such as original note, mortgage, and deed of trust to support legal foreclosure proceedings; and
- Evidence that the affidavit and documents were independently and appropriately reviewed, and that proper signatures were obtained.

In addition to these loan file reviews, examiners will review the nature, volume, and resolution of foreclosure-related complaints. These will include complaints received by the OCC's Customer Assistance Group as well as complaints received by the banks.

Finally, examiners will assess the adequacy of each bank's analysis and financial reporting for the potential adverse impact on the bank's balance sheet and capital that may arise from the increased time and costs needed to correct any procedural errors; losses (if any) resulting from inability to access collateral; and expected litigation costs. We are directing banks to maintain adequate reserves for potential losses and other contingencies and to make appropriate disclosures, consistent with applicable Securities and Exchange Commission's disclosure rules.

Using our authority under the Bank Service Company Act, we also are conducting interagency examinations of two major non-bank mortgage service providers. The OCC, in coordination with the FRB, FDIC, and Federal Housing Finance Agency, is leading an on-site examination of the Mortgage Electronic Registration System (MERS). A key objective of the MERS examination is to assess MERS corporate governance, control systems, and accuracy and timeliness of information maintained in the MERS system. Examiners assigned to MERS will also visit on-site foreclosure examinations in process at the largest mortgage servicers to determine how servicers are fulfilling their roles and responsibilities relative to MERS.

We are also participating in an examination being led by the FRB of Lender Processing Services, Inc., which provides third-party foreclosure services to banks.

We expect to have most of our on-site examination work completed by mid to late December. We then plan to aggregate and analyze the data and information from each of these examinations to determine whether or what additional supervisory and regulatory actions may be needed. We are targeting to have our analysis completed by the end of January.

We recognize that the problems associated with foreclosure processes and documentation have raised broader questions about the potential effect on the mortgage market in general and the financial impact on individual institutions that may result from litigation or other actions by borrowers and investors. Obviously, for a host of reasons – from fair treatment of borrowers to the fundamentals of the mortgage marketplace – mortgage servicers must get this right. We are directing banks to take corrective action where we find errors or deficiencies, and we have an array of informal and formal enforcement actions and penalties that we will impose if warranted. These range from informal memoranda of understanding to civil money penalties, removals from banking, and criminal referrals.

*H.R. 3451*

The Subcommittee has requested the OCC's views on H.R. 3451, which requires lenders and servicers to engage in loss mitigation activities and prohibits foreclosure unless that requirement is satisfied. The OCC supports initiatives that seek to prevent avoidable foreclosures by assisting troubled borrowers with effective and sustainable loan modifications. As bank supervisors, however, we are concerned that the loss mitigation framework that would be established by H.R. 3451 has the potential to raise serious safety and soundness issues. For example, the legislation prohibits lenders or servicers from considering a borrower's prior default history when evaluating the borrower's eligibility for a loan modification. Such a provision could require lenders to engage in a protracted series of loan modifications even in those circumstances where the borrower lacks the resources to pay and can show no reasonable prospect of being able to make even reduced mortgage payments going forward. Moreover, the legislation lacks a standard for determining when, if at all, a lender or servicer will be deemed to have satisfied its obligation to engage in reasonable loss mitigation activities. Courts may well differ in their application of that requirement, and the resulting uncertainty may have the practical effect of precluding foreclosures – and the lender's or servicer's ability to mitigate its losses. We would be happy to provide more detailed comments on H.R. 3451, and OCC staff are available to work with Subcommittee staff to address concerns such as these.

***Conclusion***

The OCC is focused on identifying and rectifying problems so that the basic function and integrity of the foreclosure process is restored; the rights of all homeowners subject to the foreclosure process are protected; and the basic functioning of the U.S. mortgage market is not disrupted. As we move forward we will continue to cooperate with the many inquiries and investigations that are taking place and provide updates to the Congress.

FEDERAL HOUSING FINANCE AGENCY
Office of the Director

January 11, 2011

The Honorable Maxine Waters
U.S. House of Representatives
2344 Rayburn House Office Building
Washington DC 20515

Dear Chairwoman Waters:

In response to the questions for the record submitted subsequent to the Housing and Community Opportunity Subcommittee hearing entitled "Robo-Signing, Chain of Title, Loss Mitigation and Other Issues in Mortgage Servicing" on November 18, 2010, I am happy to provide the responses below.

1) **Why did FHFA's October 13 guidance to the Enterprises not address the issue of how to verify that trusts are in possession of the notes they purport to hold?**

On October 13, 2010, FHFA issued a four-point policy framework for use by Fannie Mae and Freddie Mac (the Enterprises) in working with their respective servicer to identify and resolve problems in the foreclosure process of Enterprise loans. This framework was designed to provide an orderly and expeditious resolution of foreclosure process issues that will provide greater certainty to homeowners, lenders, investors, and communities alike.

In summary, the framework calls for servicers to: 1) verify that their foreclosure processes are proper and in compliance with legal requirements, 2) remediate any problems found, 3) refer any fraudulent activity discovered to appropriate authorities and, 4) avoid delay in the foreclosure process in the absence of any identified problems.

The first step of the framework encompasses issues affecting documentation for foreclosure, including procession of notes. Generally, when a seller/servicer sells a mortgage loan to either Enterprise, it must deliver the original note for each mortgage loan, together with any power of attorney or modifying instrument (such as a modification agreement, conversion agreement, assumption of liability or release of liability agreement) to a document custodian, which holds the documents in trust for the Enterprises. These custodians are under contract with the Enterprises and must meet specific requirements in their seller/servicer guides. The Enterprises have processes for loans they purchase that place tighter controls to assure a strong claim of title and the ability to access documents.

**2) Does robo-signing and false notarization meet the Enterprises' seller-servicer agreements? If not, what penalties and/or sanctions to the Enterprises plan to institute for the servicers?**

Under the terms of the Enterprises' contractual agreements with seller/servicers, servicers are obligated to perform their work in accordance with applicable laws, regulations, and requirements imposed by the Enterprises.
To the degree that servicers do not comply with these contractual obligations by failing to perform their duties in accordance with applicable laws and regulations, they may be in breach of the seller/servicer agreement. In that case, there are a variety of options and remedies available to the Enterprises. These options range from monetary damages for errors to putting back the loans to the servicer and, if errors and deficiencies are widespread, suspension or termination of the seller-servicing agreement. The Enterprises will pursue their remedies vigorously once the scope of the problem and the costs are better known.

I want to thank you for the time and effort that you and your staff have dedicated to this important issue. As conservator and regulator of the Enterprises, I am committed to working to resolving any issues in the foreclosure process.

Sincerely,

Edward J. DeMarco

Edward J. DeMarco
Acting Director

**(1) Since March of 2010, of the borrowers who started trial HAMP modifications, what proportion failed to achieve permanent modifications because they did not pay their mortgages during the trial period? What proportion failed to achieve permanent modifications because they failed to submit the requisite paperwork?**

In the period since March 2010, more than 70% of borrowers who received trial modifications (and who have now received final modification decisions) have achieved permanent modifications. Of the 30% of borrowers who have failed to achieve permanent modification in the period since March 2010, 18.4% failed because they did not pay their mortgages during the trial period, and 4.1% failed because they did not submit the requisite paperwork.

**(2) Does Citi consider document recreation to be fraud? Specifically, what are the instances in which recreating documents contained in a collateral file would not constitute fraud?**

We are uncertain what the phrase "document recreation" in this question is intended to reference. If the phrase is intended to refer to a practice of creating a document that falsely purports to be an original promissory note where the original promissory note has been lost, that would not, of course, be proper, and Citi does not, through vendors or otherwise, engage in such activity.

We note, however, that there may infrequently be circumstances in which the original of a document contained in a collateral file cannot be located. In those limited circumstances, photocopies of such documents, such as mortgages, may be obtained from public records. Those photocopies, denoted as photocopies, may be used if appropriate and permitted under applicable laws, rules and regulations. In addition or in the alternative, a lost note affidavit or similar document may be prepared and used if appropriate and permitted under applicable laws, rules and regulations. However, a lost note affidavit, in our view, would not be a "recreation" of the lost note: instead, a lost note affidavit would state that the note cannot be located, and would set forth relevant information about the note.

**(3) Do you believe that document recreation was pervasive throughout the mortgage servicing industry?**

We are not able to speak to the practices of other mortgage servicers. As noted above in response to request (2), Citi does not, through vendors or otherwise, engage in such activity.

**(4) Has your firm ever ordered document creation services from any company? If so, which companies? If not, can you so deny categorically? How do you know?**

Please see the responses to request (2) above and request (6) below.

**(5) Do you outsource your legal work on foreclosures? If so, how do you monitor that the law firms handling the foreclosures are not fabricating or backdating documents?**

Legal work on foreclosure related matters is generally handled by outside counsel retained by Citi. Before permitting any law firm to perform foreclosure work for us, we conduct extensive due diligence on the firm, which includes completing a detailed questionnaire and conducting searches for any complaints or lawsuits with the state bar, regulatory agencies and state and federal courts. Law firms are informed of our standards and expectations with respect to affidavits and other filings submitted on our behalf in foreclosure proceedings, the control processes such firms must have in place concerning foreclosure-related documentation, and the escalation of any issues to us. Among other things, each law firm is required, as a condition of its representation of Citi, to follow all local, state and federal laws regarding their legal work on our behalf, and to be familiar with and comply with each specific state's laws and processes regarding foreclosure. We also do periodic on-site legal audits to review selected files, observe default-related processes at the law firm, and review new legal requirements and challenges in the relevant state. If deficiencies are found, appropriate corrective action is required. In addition, if a foreclosure is contested or encounters unexpected issues, the law firm escalates the matter to us, and we may elect to direct the law firm to cease or take certain actions.

**(6) Why doesn't Citi track the number of lost note affidavits you use on foreclosure cases? Does Citi have any plans to begin tracking the use of lost note affidavits? How does Citi verify that the use of a lost note affidavit is appropriate – does Citi physically check that the note is, in fact, lost and not held in a warehouse operated by the trustee (or another party)?**

Prior to execution by Citi of a lost note affidavit, the collateral file is reviewed, the custodian or records center is contacted, and system notes are reviewed to determine the location of the note.

Citi has now developed a mechanism to track the number of lost note affidavits.

**(7) Why has Citi chosen not to participate in the $790 million principal reduction component of California's Keep Your Home program? What program changes would be needed in order for Citi to participate?**

Citi is in discussions about potential participation in this program.

**(8) Is there any advantage provided to a borrower for having their mortgage servicer affiliated with either a loan originator, a loan securitizer, or a trustee?**

Citi is a full service bank and many of our customers seek out and take advantage of multiple services offered by the bank for convenience and other reasons.

(9) **What has your experience been with the Neighborhood Assistance Corporation of America with respect to the organization sending personal information about constituents to the offices of members of Congress?**

We have spoken to a senior official from the Neighborhood Assistance Corporation of America about this concern. He assured us that they do get privacy releases and include them in the package, and the package is mailed from the consumer to the Congressman, not from NACA, although NACA helps the consumer put the package together.

**RESPONSES TO SUPPLEMENTAL QUESTIONS SUBMITTED BY THE HOUSE FINANCIAL SERVICES COMMITTEE**

**Following are the responses of Ally Financial Inc. ("Ally") and GMAC Mortgage, LLC ("GMACM") to the questions included with the letter dated December 9, 2010 from the House Financial Services Committee. These responses are as of December 27, 2010 unless otherwise indicated in the response.**

**These responses are based on information currently known by GMACM. However, GMACM's review of issues concerning the execution of foreclosure documents is continuing.**

- **Why doesn't Ally Financial/GMAC track the number of foreclosure cases that involve lost note affidavits? Does Ally Financial have any plans to begin tracking the use of lost note affidavits? How does Ally Financial/GMAC verify that the use of lost note affidavit is appropriate – does GMAC/Ally Financial physically check the note is, in fact, lost and not held in a warehouse operated by the trustee (or another party)?**

  Lost note affidavits are imaged and included for the relevant cases, however, foreclosure cases utilizing lost note affidavits are not specifically tracked as such by GMACM. GMACM has not tracked the number of foreclosure cases that involve use of a lost note affidavit because we have not, to date, identified a business need for tracking such affidavits. For this same reason, GMACM does not have plans to begin tracking cases that involve use of a lost note affidavit.

  GMACM has a policy of verifying that the use of a lost note affidavit is appropriate by checking internally, as well as with the custodian, and, if necessary, the prior servicer and settlement agent, to attempt to locate the original note prior to preparing a lost note affidavit.

- **Does Ally Financial/GMAC consider document recreation to be fraud? Specifically, what are the instances in which recreating documents contained in a collateral file would not constitute fraud?**

  We are unclear on the definition of "document recreation." It is a term that may encompass many practices, ranging from acceptable business practices to violations of the law. It may also mean the retention of third-party companies such as DOCX to create new foreclosure files. Therefore, determining what is fraud — which is a legal question — depends on what practices are being considered and the facts and circumstances of a particular case. We have not ordered the creation of new foreclosure files from third-party companies such as DOCX.

- **Do you believe that document recreation was pervasive throughout the mortgage servicing industry?**

  Again, "document recreation" is a term that may encompass many practices, ranging from acceptable business practices to violations of the law. It is therefore difficult for us to determine if we have a basis to know if document recreation was pervasive throughout the industry.

- **Has your firm ever ordered document creation services from any company? If so, which companies? If not, can you so deny categorically? How do you know?**

We have not ordered the creation of new foreclosure files from third-party companies such as DOCX.

- **Do you outsource the legal work on foreclosures? If so, how do you monitor that the law firms handling the foreclosures are not fabricating or backdating documents?**

  Because legal work must be done by an attorney licensed to practice in each relevant state, legal work on judicial foreclosures is performed by external foreclosure counsel in each state. Additionally, many of GMACM's foreclosures are performed on behalf of Fannie Mae and Freddie Mac. Fannie Mae requires use of designated foreclosure counsel in specific states and Freddie Mac provides incentives for servicers to use designated counsel. GMACM has relied upon the approval status given by GSEs to their designated foreclosure counsel.

  GMACM endeavors to select qualified counsel and is implementing new policies and procedures for more robust monitoring of foreclosure counsel.

- **In your testimony, you noted that on loans serviced by Ally Financial/GMAC, 19 percent of borrowers who executed a HAMP trial modification failed to reach a permanent HAMP modification because the borrower did not make the required payments during the trial period and 12.8 percent of borrowers failed to reach a permanent modification because of insufficient paperwork.**

  - **Of the remaining 68.2 percent of homeowners, what were the reasons for their failure to convert to permanent modifications?**

    We may not have communicated the information on this point clearly. Our testimony was that of all the borrowers who expressed interest in a HAMP loan modification and were not offered a trial payment, 12.8% did not receive an offer because they failed to submit complete financial analysis packages. The remaining borrowers did not receive trial payments because they did not qualify under HAMP. For instance, they did not meet the target debt to income ratio after interest rate reduction, term extension and principal forbearance, or had a debt to income ratio already below the target ratio, or were seeking a HAMP modification on a non-owner occupied property. If a borrower does not qualify for HAMP, we consider them for other types of loan modification solutions.

    Of those borrowers who did submit complete packages and began HAMP loan modification trials, 19% failed to reach a permanent HAMP loan modification because they did not make the required payments during the trial period.

    The remaining 81% of the borrowers who executed a HAMP trial (and did make the required trial payments) were offered a permanent HAMP loan modification; some such borrowers, however, never returned the signed permanent modification agreement and thus the permanent modification was not executed.

  - **Are homeowners that make all HAMP trial modification payments ever re-directed to Ally Financial/GMAC proprietary modifications, rather than given permanent HAMP modifications? If so, what are the reasons for this occurring?**

Homeowners who make all HAMP trial modification payments, barring rare circumstances, are offered permanent HAMP loan modification. In those rare circumstances a homeowner is not offered a permanent HAMP loan modification or if the homeowner for some reason fails to return a signed document agreeing to the permanent HAMP loan modification, the borrowers are reviewed for other loan modification options if proper under investor guidelines. The objective is to find an affordable and sustainable payment solution for the homeowner.

JPMorgan Chase & Co.

**Stephanie B. Mudick**
Executive Vice President
Member of Executive Committee

January 21, 2011

Mr. Thomas G. Duncan
General Counsel
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

Dear Mr. Duncan:

I write on behalf of JPMorgan Chase Bank, N.A. ("Chase") in response to your December 9, 2010 letter with additional questions from Chairwoman Waters in connection with my November 18, 2010 testimony before the Subcommittee on Housing and Community Opportunity. Set forth below are those questions and our responses.

- **Would JPMorgan Chase have instituted a foreclosure moratorium recently if other major servicers had not first instituted such a moratorium?**

Chase's decision to temporarily halt foreclosure proceedings was based on its review of its document execution practices. When another servicer announced that it would be halting foreclosures due to issues relating to affidavits filed in foreclosure proceedings, Chase reviewed its own procedures and found that it had similar issues in connection with the preparation of affidavits. Chase determined that the most prudent course was to temporarily halt foreclosure proceedings to allow for further evaluation and remediation of its affidavit processes.

- **Does JPMorgan Chase consider document recreation to be fraud? Specifically, what are the instances in which recreating documents contained in a collateral file would not constitute fraud?**

Chase categorically denies engaging in fraud in connection with mortgage-related documentation. There are instances in which a mortgage note is lost where Chase may, as is permitted by applicable law, enforce the note by proving its terms through means other than presenting the note itself, such as through a lost note affidavit. In other instances, assignments are updated by authorized signatories prior to commencement of the foreclosure proceeding to accurately reflect prior transfers of the note and mortgage. Such measures are appropriate and do not reflect fraud.

- **Do you believe that document recreation was pervasive throughout the mortgage servicing industry?**

Chase can speak only to its own practices and not those of others. As noted, Chase does not engage in fraud in connection with mortgage-related documentation.

- **Has your firm ever ordered document creation services from any company? If so, which companies? If not, can you so deny categorically? How do you know?**

We do not understand the meaning of the phrase "document creation services." Chase has in the past used third party contractors to assist with document preparation. However, Chase no longer uses such third party contractors to execute affidavits in connection with mortgage foreclosure proceedings.

- **Do you outsource the legal work on foreclosures? If so, how do you monitor that the law firms handling the foreclosures are not fabricating or backdating documents?**

Yes, Chase refers all foreclosure cases to outside counsel who are licensed to practice law in the jurisdiction. These foreclosure counsel are charged with understanding local laws and practices, and ensuring compliance with these requirements. Counsel also are officers of the court with an independent duty to abide by all legal and regulatory requirements. Chase monitors these firms through periodic audits.

- **Does JPMorgan Chase track the number of lost note affidavits used in foreclosure cases? If so, in what proportion of cases are lost note affidavits used? (please note that this was asked in JPMorgan Chase's hearing invitation letter but was not answered in your written testimony). If JPMorgan Chase does not track the use of lost note affidavits, please explain why. Does JPMorgan Chase have any plans to track the use of these affidavits? How does JPMorgan Chase verify that the use of a lost note affidavit is appropriate — does JPMorgan. Chase physically check that the note is, in fact, lost and not held in a warehouse operated by the trustee (or another party)?**

Chase has not historically tracked the frequency of lost note affidavits because there has been no need for such information in the past. Chase is generally unable to determine the total number of lost note affidavits submitted during the time frame identified in the request.

Two businesses acquired by Chase in 2008 – EMC (which Chase acquired in March 2008) and Washington Mutual (certain assets of which Chase acquired in September 2008) – did use systems that kept track of affidavits that were submitted to Chase for execution that local counsel characterized as Lost Note Affidavits. However, Chase's systems did not keep track of whether these affidavits were actually executed and filed.

Chase is keeping track of the number of Lost Note Affidavits submitted in connection with foreclosure actions on a going forward basis. Chase has procedures to check its servicing systems and records of warehoused documents to verify that a note is lost before executing a lost note affidavit.

- **Of the borrowers whose trial HAMP modifications failed to become permanent modifications, what proportion of those borrowers failed to achieve permanent modifications because they did not pay their mortgages during the trial period? What proportion failed to achieve permanent modifications because they failed to**

**submit the requisite paperwork? This question was in JPMorgan Chase's hearing invitation letter but was not answered in your written testimony. Are homeowners that make all HAMP trial modification payments ever redirected to JPMorgan Chase proprietary modifications, rather than given permanent HAMP modifications? If so, what are the reasons for this occurring?**

Of the borrowers who entered a HAMP Trial from April 2009 through August 2010, as of October 30, 2010:

- 23% did not make all required scheduled payments during the trial period;
- 77% made all of their trial payments. Of these borrowers:
  - 30% were converted to a permanent HAMP modification;
  - 14% received an alternative modification;
  - 2% are still in process (final stages of document refinement and/or pending underwriting);
  - 31% were not converted to a permanent modification because: (i) the borrower did not provide all necessary documents, (ii) their payment ratio to verified gross income was less than 31%, (iii) the property was not owner occupied, or (iv) once the full documentation was submitted, the loan was not approved for a permanent modification during the underwriting process.

As noted, homeowners who make all trial payments but do not qualify for a HAMP modification once all of the documentation is provided may be offered a GSE or Chase Proprietary modification. In addition, Fannie Mae and Freddie Mac had specific programs for borrowers who made all of their payments as part of the trial modification program but did not provide documents necessary to qualify for a permanent HAMP modification as long as the trial payments were completed by November 30$^{th}$.

It is important to note that in the 2$^{nd}$ Quarter 2010, the modification process shifted to a verified model in which the borrower was not placed into a trial modification until the complete modification application was submitted. As a result, more recent trial modification should have many fewer borrowers who do not qualify for permanent modifications for reasons other than non-payment of the trial modifications.

- **Why has JPMorgan Chase chosen not to participate in the $790 million principal reduction component of California's *Keep Your Home* program? What program changes would be needed in order for JPMorgan Chase to participate?**

Chase is actively working with the California team on California's ***Keep Your Home program*** and effective 1/10 went live across the state after piloting since mid December on the Unemployment and Re-instatement components of the pilot. At this juncture, Chase is not participating in the principal reduction component. Based on prior experience, Chase believes that the key determinant of success of modifications is reduction of monthly payments (i.e., improving the mortgage payment affordability), and that success of modifications is not strongly correlated to loan-to-value (LTV) ratios. Therefore, Chase's focus in connection with modifications has been reducing monthly payments through interest rate reductions, lengthening the term of loans, and if necessary, deferring a portion of the principal through principal forbearance until the loan is paid off. We do not believe that principal reduction would materially improve the performance of modified loans.

Investors also have objected to including principal reduction as a component of loan modifications. For example, the GSEs are not participating in the HAMP PRA or the principal reduction component of California's ***Keep Your Home*** program. Chase-serviced loans owned by GSEs are thus ineligible for principal reduction. Certain Pooling and Servicing Agreements for securitizations also would preclude modifications with principal reduction.

We are continuing our discussions with the California team to better understand the mechanics of the principal reduction component.

- **Is there any advantage provided to a borrower for having their mortgage servicer affiliated with either a loan originator, a loan securitizer, or a trustee?**

Chase believes that borrowers benefit from a firm's ability to offer them a comprehensive suite of financial services. For example, one of the advantages is the ease of refinancing transactions – originators often receive permission to do streamlined refinances if they also service the loans.

- **Why did JPMorgan Chase stop using MERS?**

Chase does not record Chase-originated loans in the name of MERS. However, Chase services many loans that were originated by other lenders, which are recorded in the name of MERS. In the foreclosure context, a MERS member firm may proceed to foreclosure in two ways stipulated by the MERS membership agreement. First, it may assign the mortgage from MERS to the beneficial owner of the note. Under this procedure, foreclosure proceedings would be instituted in the name of the note holder. Second, the member firm may bring the foreclosure action in the name of MERS. In order to do so, the beneficial note holder must endorse the note to blank and deliver it to a MERS Certifying Officer. Since 2006 (and for loans originally serviced by WaMu, since 2008, when certain WaMu assets were acquired by Chase), Chase has utilized only the first procedure and Chase has not brought suit in the name of MERS. Chase's decision not to foreclose in the name of MERS was made, in an excess of caution, after certain courts expressed concerns about this practice.

Please let me know if you have any additional questions.

Sincerely,

Stephanie Mudick
Head, Office of Consumer Practices

**Questions for the Hearing on "Robo-Signing, Chain of Title, Loss Mitigation and Other Issues in Mortgage Servicing"**
**November 18, 2010**

*1. Please describe the sampling methodology being used by the OCC.*

The OCC led interagency, onsite examinations at each of the major national bank mortgage servicers. These examinations included a review of samples of individual borrower foreclosure files and determined whether foreclosed borrowers were considered for alternative home retention actions such as loan modifications. In addition, examiners looked for evidence that financial information in affidavits was accurate and complied with state laws, and that the fees charged were correct. Examiners determined whether the servicer had possession and control over critical loan documents needed to support a legal foreclosure proceeding, and sought evidence that affidavits and documents were independently and appropriately reviewed and that proper signatures were obtained.

The examination of individual borrower foreclosure files included a review of 200 foreclosure files at each major national bank mortgage servicer to test and validate the bank's self-assessments and foreclosure governance processes and controls. The foreclosure file sample at each national bank was selected by examiners and not by the banks under examination. Examiners sought a diverse sample of files to review and used the criteria below to determine which files to review.

- Examiners selected individual foreclosure files to include both foreclosures that had previously been completed and those that still were in-process in 2010;
- Examiners selected individual foreclosure files from all 23 judicial states;
- Examiners selected individual foreclosure files for some, but not all, non-judicial states; and
- Examiners selected individual foreclosure files from those that the bank reviewed in its self-assessments.

*2. Is the OCC examining foreclosure document samples from all 50 states?*

No, the OCC did not examine foreclosure document samples from all 50 states. However, we examined foreclosure files from all 23 judicial states, and from a some, but not all, non-judicial states.

*3. Is the OCC allowing servicers to select these samples?*

No. The OCC-led interagency examination team selected the foreclosure files to be reviewed.



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