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THE WORSENING FORECLOSURE CRISIS: IS IT TIME TO RECONSIDER BANKRUPTCY REFORM?

HEARING

BEFORE THE

SUBCOMMITTEE ON ADMINISTRATIVE OVERSIGHT AND THE COURTS

OF THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

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THE WORSENING FORECLOSURE CRISIS: IS IT TIME TO RECONSIDER BANKRUPTCY REFORM?

THURSDAY, JULY 23, 2009

U.S. SENATE,
SUBCOMMITTEE ON ADMINISTRATIVE OVERSIGHT AND THE COURTS,
COMMITTEE ON THE JUDICIARY,
Washington, D.C.

The Subcommittee met, pursuant to notice, at 10:01 a.m., in room SD–226, Dirksen Senate Office Building, Hon. Sheldon Whitehouse, Chairman of the Subcommittee, presiding.

Present: Senators Whitehouse, Feingold, Durbin, and Sessions.

OPENING STATEMENT OF HON. SHELDON WHITEHOUSE, A U.S. SENATOR FROM THE STATE OF RHODE ISLAND

Chairman WHITEHOUSE. The hearing will come to order. This is a hearing of the Senate Committee on the Judiciary's Subcommittee on Administrative Oversight and the Courts on the topic of "The Worsening Foreclosure Crisis: Is It Time to Reconsider Bankruptcy Reform?" I welcome the witnesses.

As many of you are probably very well aware, the Senate is extremely busy right now, and I expect that my colleagues will be in and out during the course of the hearing. No meaning is intended by either their arrivals or their departures, so take no offense if they get up and leave while you are speaking. It is a matter of schedule entirely and the many conflicting demands on Senate schedules.

Nearly 10 months ago, we enacted a $700 billion bailout package to rescue the economy from the subprime mortgage meltdown. This hearing will look at whether the foreclosure situation is worsening and what can be done for the millions of families in Rhode Island and across the Nation at risk of losing their homes.

We tried in October to include in the Troubled Asset Relief Program measures that would help homeowners on Main Street, in addition to the banks on Wall Street. Unfortunately, these efforts then proved fruitless. We included in the bailout legislation a requirement that the Treasury work to modify the mortgages that it purchased as part of the TARP. That requirement, too, was rendered meaningless by the outgoing Bush administration's decision not to purchase "toxic assets" as had originally been proposed. The money instead went directly to banks, and the Treasury held no mortgage-related assets to modify. So with nothing to modify, there were no modifications. Wall Street benefited, and Main Street was left in the cold.

I am delighted to welcome the Ranking Member, Senator Sessions.

Senator SESSIONS. Thank you.

Chairman WHITEHOUSE. Many of us in Congress, led by Senator Durbin, tried to include in the TARP legislation a provision that could have kept millions of families in their homes at zero cost—zero cost—to the taxpayers. This proposal would have corrected an anomaly in the Bankruptcy Code that prohibits judges from modifying primary residence mortgages the way they can modify every other type of contract from mortgages on vacation homes to car and jewelry and corporate loans. Despite the fact that a bankruptcy modification would spare the community the terrible costs of foreclosure, the mortgage banking industry has invested millions of dollars to lobby against this reform and has so far been able to prevent its passage.

As subprime mortgage teaser periods began to expire last year, and with the credit market dried up so they could not refinance, millions of homeowners faced higher monthly payments that they could not afford. In the final quarter of 2008, there were over 200,000 family home foreclosures. These homeowners faced this foreclosure wave with minimal assistance from their Government.

The new administration tried to address the foreclosure crisis. Through the Treasury's Making Home Affordable programs, President Obama encouraged loan servicers to start modifying mortgages. While these programs so far have kept 160,000 families in their homes through trial modifications, it is becoming increasingly clear that Congress must do more—much more—to address the worsening crisis.

As you will hear from one of the witnesses today, there is evidence that the worst of the foreclosure crisis is not behind us. Just as the wave of potential foreclosures from subprime mortgages begins to subside, a new wave of potential foreclosures tied to other mortgage instruments is just around the corner. The Center for Responsible Lending estimates that 9 million homes may be lost to foreclosure from 2009 through 2012. At their current rates of modification, the Treasury's voluntary programs would only assist 2 million or fewer families during that same period.

It is clear to me that Congress must do more to help struggling American homeowners, and specifically, that we need to take another serious look at the proposal to allow bankruptcy judges the same authority to modify the terms of mortgages on principal residences that they have for other loans. If we fail to act, I fear that we put ourselves at risk: that a vicious cycle of foreclosures, falling home values, and declining tax revenues will keep us in recession for years to come.

I look forward to hearing the views of today's panel on this proposal and others. I think what I will do now is introduce the Ranking Member to make any opening statement that he cares to. I will then recognize the distinguished Majority Whip, Senator Durbin, to make any opening statement that he cares to. And then I will introduce the witnesses, and we will proceed with the hearing.

Senator SESSIONS.

STATEMENT OF HON. JEFF SESSIONS, A U.S. SENATOR FROM THE STATE OF ALABAMA

Senator SESSIONS. Thank you, Senator Whitehouse.

This is an issue that we have discussed for a number of years, and Senator Durbin has been an articulate leader on the question. I would just say that when people borrow $200,000 to buy a house, somebody gave them that money. It did not come from nowhere. It came from somebody's pocket. It is money that has been lent to them at a certain interest rate.

As I have traveled the world, I am absolutely so saddened in many ways to see other countries not have a financial market. And the reason is, if you give someone $200,000 to buy a house or build a house, you have got to know you are going to be repaid. And if you are not going to be repaid, you have got a big problem here, and it drives up costs. And in the future, people may not be willing to loan money, because this is a 30-year loan. And when you go around the world and you see people with houses, as I have done, half-built—and I used to wonder why, and it has been explained to me. They did not have the money to put the windows in. They have the windows on the first floor and the doors, but the upstairs window would be open, just have a roof and inside. They are just trying to save a little more money so they can put up the next part of the house. We borrow the money up front and build the house, buy the house, and it is a fabulous thing. An average American can pay it back over 30 years at a reasonable interest rate.

And so I would just say that that is the fundamental thing that is concerning me about the whole deal. If we now say after someone has loaned a person money for 30 years that the Government is not going to come in and authorize the alteration of that contract, fewer people may be willing to loan in the future, and more people would have to pay a higher interest rate. That is what the bankers have produced information that shows this will result in a significant increase in the interest rate. And you know that if you are paying 5-percent interest and now you pay 6-percent interest, that is a 20-percent increase in your payment basically every month. So if you are paying $1,000 a month, now you are paying $1,200 a month for the same loan, essentially.

So there is just no free lunch here. We can maneuver with this, and I know we will. But I am worried about it.

What we do know is that loans do need to be renegotiated, and I have just seen a Forbes.com article where Wells Fargo announced that they have refinanced 750,000 mortgages already. Because they have an interest in doing this, it is their decision, and it makes sense. And it is not totally unrealistic to say a bankruptcy judge could do this.

Senator Durbin and I have worked on the cramdown on automobiles. We know it is done on automobiles. But I am dubious about it, because it is so much money, it is such a long loan. Houses do not normally decline over decades. They may go down for a while, but except in certain small, extreme areas of the country, I expect housing will, before too many years, get back to a normal level. So I am concerned about that, and I would hope that we can move forward.

I also am hopeful that there would be no effort to alter the credit counseling. I see Eileen Connelly with the Associated Press, and this is in the Washington Times headline: "People drowning in debt gain by consulting credit counselors." I do not know that that is a bad thing.

So, Mr. Chairman, this is important. One thing I would like to ask is: I have heard it said from my bankruptcy lawyers and judges that I have talked to in Alabama that there are occasions when nobody seems to be able to speak for the mortgage holder to negotiate a deal. And if nobody can, you know, maybe that is the kind of justification we might think about. But normally I would think a bank that has loaned somebody money under a law that says that they have the authority to negotiate if any negotiation is done would kind of be subjected to almost an ex post facto law to say you cannot—now the court can renegotiate your mortgage.

Thank you.

Chairman WHITEHOUSE. I think the distinguished Ranking Member has made a very good point. I think that there is a significant distinction between a homeowner in a community who has a mortgage loan from the community bank and they know each other and the homeowner can go into that community bank and can speak to somebody at the bank and can have an understanding about what their financial situation is, and together they can reach a meeting of the minds, if one is possible, about how to renegotiate and restructure that loan for both parties' mutual convenience.

That I think goes out the window when that loan has been carved up into dozens or even hundreds of strips and sold across the country and around the world, and now that poor homeowner is trying to find somebody who has some authority to negotiate with them, and they find that there is nobody to talk to. And that I think is a very frustrating and difficult situation.

Senator Durbin.

STATEMENT OF HON. RICHARD J. DURBIN, A U.S. SENATOR FROM THE STATE OF ILLINOIS

Senator DURBIN. Senator Whitehouse, thank you for doing this, and, Senator Sessions, I am glad you are here, and I know that we all share an interest in this.

I started on this trek more than 2 years ago, and I gave a very ominous forecast that if we did not do something quickly in 2007, we could face up to 2 million Americans losing their homes. It turns out that that was painfully naive on my part. As the banks and their disciples have told us over and over again that everything will work itself out, unfortunately the foreclosure rate in this country has skyrocketed. Let me show you a chart which illustrates it.

This is an indication of what is happening. It is pretty clear. And now over 9 million families are expected to lose their homes to foreclosure between now and the end of 2012. That is about one out of every five mortgages in America. That is a conservative estimate. So when I said 2 million in 2007, people scoffed, and now we are dealing with 9 million, headed up.

Let me show the second chart there, if you will, Brad, because this chart says that when it comes to resets, the red line is where we are at the moment. That is the past. This is the future. The resets are going to continue to grow, and we are going to see this crisis continue to grow.

I learned a valuable political lesson when I offered this amendment a second time, because the banking industry mobilized as one voice against this notion of dealing with the bankruptcy court. I expected it from the biggest banks. They have been opposed to this notion from the beginning. But the so-called independent community banks joined ranks with them. And then the credit unions joined ranks with them in opposing cramdown.

We even reached the point, after this went to conference, where we offered to the independent community banks and credit unions exemption from this so that they would not be covered. Their opposition was no longer needed because they would not be covered by this cramdown. They still joined at the American Banking Association and said, "We oppose it anyway." I think they have to take the word "independent" out of "independent community banks" after that. They are not independent anymore. They are part of the same operation.

And we know, because an e-mail—e-mails just float around the world now. An e-mail from the Arizona Banking Association, which I would be happy to share with the Committee, the head of the Arizona Banking Association sent an e-mail to all of the major bankers and their associations across America and said, "Be careful. Durbin is compromising. He really wants to get this out. We cannot compromise with him. There is no compromise acceptable."

So it is not as if we did not make a good-faith effort to do this. We did it over and over and over again. They just would not even consider it.

I am glad you did this hearing. I think we have to revisit this issue. This issue still remains, I think, at the core of the weakness of our economy. This great recession we are in has a lot to do with foreclosures and the housing market.

Professor Levitin, who is here, suggests we are about to enter a new phase of the crisis. Just as the subprime mortgage tsunami is beginning to recede, a new wave is coming. This time it is the option ARMs that are beginning to reset late this year. And at the same time, with high unemployment, with house prices depressing and falling, these resets will usually include a large payment shock that will cause an enormous number of these so-called pick-and-pay mortgages to fail. All the while, more fixed-rate borrowers will also lose their homes as job losses continue.

Second, after 2 years of effort that relies on banks to volunteer—that is what this has been about up until this point, waiting for the banks to step up and volunteer to solve the problem—it is time to admit that is not working. The banks have long said, "We are just going to ride this out." But as you can tell, it is not as if this is going to get bumpier. We are going to face a cliff at some point here. And we have to be honest about it, and I hope we are honest about it in enough time.

This is what David Kittle, who was then Chairman of the Mortgage Bankers Association, said in front of this Committee last November, and I quote: "The industry has been engaged in historic efforts to assist distressed homeowners, and we believe these have proven successful in stemming foreclosures."

Really? According to the Mortgage Bankers Association's own survey, foreclosures are skyrocketing. While the Obama administration's Home Affordable Modification Program has been in operation for only a few months, the initial results are not that encouraging. One hundred sixty thousand trial modifications were offered in the first 4 months. That translates to fewer than half of the administration's goal for this program. And the number of mortgages modified represents less than one-quarter of the foreclosures initiated. We are not keeping up with this. The foreclosures are growing far faster than our voluntary programs. We are falling further and further behind.

We cannot ignore this, and I thank you for calling this hearing. This economic crisis that began with the popping of a bubble in the housing market cannot be tamed until we stabilize the housing market. Toxic assets based on mortgages will remain toxic until the underlying mortgages are addressed. Regardless of how many billions of taxpayers' dollars are pumped into bank balance sheets with few strings attached, we have got to address the root cause of the illness, because when you lose your home, you are far less likely to buy anything, and that means companies that are trying to sell things need fewer workers to produce the things that folks would otherwise buy.

In 2009, the Center for Responsible Lending estimates foreclosures will cause nearly 70 million nearby homes to suffer price declines averaging $7,200. Folks, it is not just your neighbor. It is you. We are all in this together. Over $500 billion in home equity will be lost for families that have done absolutely nothing wrong and are faithfully making their mortgage payments. During the period 2009 to 2012, CRL projects that foreclosures will cost 92 million U.S. families $1.9 trillion in lower home values. Just what America needed while it watched its savings accounts diminish, now the home values are diminishing through no fault of the homeowners, because we are not addressing that foreclosed home right next door.

So thank you for this hearing. I will not go into this other than to say, Senator Sessions, we have really reached a point we cannot bring these folks to the table, and they are not going to do it on their own. That is clear. The bankruptcy court, at least as a possibility out there, is a motivator to get these folks to finally sit down, the lenders to finally sit down and try to work things out. They cannot save every soul, but we have got to put more effort in it.

Thank you.

Chairman WHITEHOUSE. Thank you, Senator Durbin. Thank you for your years of leadership on this issue; in addition, on the point that Senator Sessions raised about the poor homeowner who has got nobody to talk to because nobody on the other side can negotiate for the mortgage holder's interest because they have sold it in strips around the world and around the country, and there is just nobody to find or talk to. One solution to that problem is that a bankruptcy judge can make, "thunk," a final decision, and then people have to live with it, and I think that will also help get through that deadlock.

Senator DURBIN. Was that "thunk"?

Chairman WHITEHOUSE. That is the sound of the gavel coming down. I should have probably done it live. But I did not want to confuse anybody that the hearing was coming to an end.

The witnesses that we will hear from now are:

Joseph Verdelotti, Jr., a constituent of mine from West Warwick, Rhode Island, who will share his experience struggling with two mortgages during a period of rising costs and falling home prices. Mr. Verdelotti, a licensed electrician, and his wife, April, a hospital worker, have been unable to obtain mortgage modifications and may soon be forced to lose their home.

Alys Cohen is a staff attorney at the National Consumer Law Center's Washington office, where she advocates on predatory lending and sustainable homeownership issues. Ms. Cohen leads NCLC's mortgage policy. Ms. Cohen is a graduate of the University of Pennsylvania Law School.

Professor Adam Levitin of the Georgetown University Law Center is a nationally regarded expert in bankruptcy and consumer law. He serves as Special Counsel for Mortgage Affairs for the Congressional Oversight Panel. Professor Levitin is a graduate of Harvard, Columbia, and Harvard Law School.

Dr. Mark Calabria is Director of Financial Regulation Studies at the Cato Institute. Prior to joining the Cato Institute, Dr. Calabria was a senior professional staffer on the Senate Banking, Housing, and Urban Affairs Committee. He holds a doctorate in economics from George Mason University.

Richard Genirberg is a practicing attorney from Jonesboro, Georgia. He specializes in bankruptcy, collections, and criminal law. He earned his law degree from Georgia State University College of Law and his B.A. at Michigan State University. He also has an MBA from Georgia State University. Prior to owning his own firm, Mr. Genirberg was general counsel for the minority party at the Georgia House of Representatives.

We welcome the witnesses, and we will begin with the testimony of my constituent, Mr. Verdelotti. Please proceed.

STATEMENT OF JOSEPH VERDELOTTI, JR., HOMEOWNER, WEST WARWICK, RHODE ISLAND

Mr. VERDELOTTI. Chairman Whitehouse, Ranking Member Sessions, members of the Subcommittee, thank you for the opportunity to speak at today's hearing on this very important matter.

My name is Joe Verdelotti, Jr., and I am a licensed electrician from West Warwick, Rhode Island. My wife, April, works in the emergency room registering patients at the Roger Williams Medical Center in Providence, Rhode Island. We have been married for 9½ years and have known each other for nearly 20 years. We have one daughter, Brooke, who is 9, and two sons, Lorenzo who is 6, and Gianni who just celebrated his 1st birthday a few months ago. Needless to say, we have quite an active household. On January 26, 2006, we purchased a 1,100-square-foot home in West Warwick, Rhode Island, for $225,000.

Since we, like many other homeowners, did not have savings for a down payment, we took out two mortgages. The first mortgage, which covered 80 percent of the purchase price, is an adjustable rate mortgage that is currently at 6.5 percent but will adjust in the fifth year. The second mortgage, which covered the other 20 percent of the purchase price, has a fixed interest rate of 9.25 percent. Both mortgages were originally through Aurora Loan Services, but CitiMortgage subsequently purchased the second mortgage.

At the time we purchased our home, I was a fourth-year electrician's apprentice making $18 an hour. The construction industry was booming and times were good in Rhode Island. The good times did not last, however. Not long after we purchased our home, the recession began and work became scarce.

My company has had to lay off workers and make cutbacks just to stay afloat. As of today, we still have a wage freeze in effect, and our health care premiums have increased. My wife, too, has felt the effects of the recession at work and is also under a pay freeze. Despite our income freeze, the cost of living has not slowed and we are feeling the squeeze. Our utility bills, such as electric and water, have increased, as have our property taxes, and we may see further increases in the future. Our budget is stretched as tight as we can get it.

Like many of our neighbors, our home is "underwater." It just is not worth what we paid for it at the height of the housing bubble in 2006. We received a glimmer of hope last fall when the Help for Homeowners program took effect, but that proved to be a disappointment. The day the program started, my wife called the number listed on HUD's website and spent hours waiting and talking to someone at debt service about our situation. In the end, their only advice to her was to consider a roommate, get a part-time job, contact the United Way to locate food banks in our area, reduce spending, and contact legal aid for a consultation with a bankruptcy attorney. The person on the phone even recommended we consider walking away and letting the bank foreclose.

We called for help in saving our home, and we were told to consider food banks and foreclosure.

I later contacted Aurora Loan Service directly and spoke with a customer agent to see if they would be willing to work with us under the Help for Homeowners program. After giving the necessary information to the agent over the phone, I was met with another disappointing blow: the agent informed me that I did not make enough money for them to help us and that we should consider a short sale.

Next, we decided to apply for a financial hardship package through CitiMortgage. On February 26, 2009, we sent CitiMortgage the necessary documents through certified mail. The documents were received on March 2nd. On March 20th, my wife contacted CitiMortgage at approximately 1 p.m. to try to find out to the status of our hardship application, but all she got was the runaround. Each person she spoke to said she had the wrong department and that they would transfer her to the right one, but this never happened. This went on until I came home from work and I took over. Each person was clearly reading the same talking points: we always had the wrong department, and they would transfer us to the correct department. After listening to elevator music on hold for over an hour, I, too, gave up. We had been on the phone with CitiMortgage for over 5 hours and accomplished nothing.

On April 8, 2009, my wife contacted CitiMortgage again, and after several attempts to get a straight answer, she was informed that our case was closed since they never received our package. She informed them that that it was sent on February 26th and that we had delivery confirmation that they received it on March 2nd. After hearing this, they changed their story to, "It must have gotten lost," and that we would need to resubmit the application. This was quite unsettling to hear because that package contained all of our personal and financial information.

Since we have two mortgages, we also sent a hardship package to our first lien holder, Aurora Loan Service. In a letter dated March 11, 2009, just 2 days after receiving the package, Aurora denied our request.

In May, I once again requested a mortgage modification from CitiMortgage. This time we were rejected because, according to them, we make sufficient income to support our current mortgage payment. They also suggested that we consider a short sale. CitiMortgage apparently believes that we make enough to cover our mortgage, but that we should consider a short sale? This seems pretty contradictory to me.

Now, even though we are current on our financial obligations, we are hardly living comfortably. We have had to make even more adjustments in order to make ends meet, and it gets increasingly difficult. We are not sure how much longer we can survive like this. My health care premiums rose at the same time the Making Work Pay tax credit took effect, so I now take home $2 less a week than I used to. How can my family and others help stimulate the economy if Congress doesn't do something fast to help curb this foreclosure problem?

All we are asking for is a little help, a little consideration, and a little professionalism on the part of our mortgage holders. If we are able to negotiate a more manageable payment plan and keep our home, it becomes a win-win solution for everyone: We keep our home, the banks avoid the costs of foreclosure, and the community avoids a hit to property values and tax collections.

Senators, please do something to help struggling homeowners like my wife and me. Thank you again for the opportunity to tell my story.

[The prepared statement of Mr. Verdelotti appears as a submission for the record.]

Chairman WHITEHOUSE. Thank you, Mr. Verdelotti. I think you have very well captured and very well expressed the predicament of people across this country who are hard-working, who are honest and honorable, who have worked hard to make their financial obligations and have indeed kept them current through considerable stress, who do not want any special deals from anybody, but who simply cannot get even a straight answer from the industry. I appreciate it.

Ms. COHEN.

STATEMENT OF ALYS COHEN, STAFF ATTORNEY, NATIONAL CONSUMER LAW CENTER, WASHINGTON, D.C.

Ms. COHEN. Chairman Whitehouse, Ranking Member Sessions, Senator Durbin, thank you for inviting me to testify today. I testify here today on behalf of the National Consumer Law Center's low-income clients and on behalf of the National Association of Consumer Advocates and the National Association of Consumer Bankruptcy Attorneys.

For the last few months, I have been working with colleagues at NCLC and other organizations to promote large-scale solutions to the foreclosure crisis. During that time, the pleas for help from advocates on the front lines of saving homes have escalated in both number and in urgency. When the Home Affordable Modification Program, HAMP, was announced by the administration on March 4th, hopes were high that homeowners would finally have a means to prevent foreclosures. Unfortunately, that reality has not materialized. In fact, what we increasingly hear is that HAMP is not the essential tool it is intended to be.

It is not just that we get calls about the instances in which the program has had a blip of failure. It is that, in general, advocates find that HAMP loan modifications are hard to get at all and, when obtained, often are not compliant with program rules. Mr. Verdelotti's concerns, including the horrific consumer service he and his wife experienced, are typical of what we are hearing about participating servicers. He appears to have been denied HAMP processing by two participating servicers, but the lack of transparency in the system and the lack of accountability make it hard to know what happened. He and borrowers like him need to be given a clear opportunity to show that they are at risk of imminent default or in default and need help.

Moreover, even if HAMP operated at its full capacity as envisioned by Treasury officials, HAMP's loan modifications still would be substantially outpaced by foreclosures, and the modifications themselves lack the mandated principal reductions that many believe are necessary to stem the foreclosure tide.

While Treasury officials have been actively receptive to our operational concerns, progress is slow and core problems with HAMP's design have not been addressed. Even if implementation problems were fixed, the design of the program precludes transparency and, thus, accountability, and it also lacks mechanisms to assure long-term sustainability of the program.

The net present value test, which is the primary basis upon which a loan modification is granted or denied, is not available to the public, and thus homeowners have no ability to question whether a servicer's analysis is based on accurate information. Moreover, the lack of a mandate on principal reductions undermines the long-term effectiveness of the program.

Homeowners who could normally refinance their way out of a lost job or sell their home in the face of foreclosure are denied both options when they owe more on their home than it is worth. Without principal reductions, homeowners who lose their jobs, have a death in the family, or otherwise experience a drop in income are more likely to experience redefault and foreclosure.

Goldman Sachs estimates that starting at the end of the last quarter of 2008 through 2014, 13 million foreclosures will be started. Last week, Assistant Treasury Secretary Herbert Allison, in responding to questioning from the Senate Banking Committee, agreed that in order to meet Treasury's goals of doing 3 to 4 million modifications by 2012, they would need to do 1 million per year. Even if the administration reaches those numbers, that will address no more than one-third of all foreclosures. Using current figures, the program is on pace to modify only 480,000 mortgages a year, not even half of its annual goal, assuming that every trial modification, in fact, leads to a permanent modification.

Creating affordable and sustainable loan modifications for distressed homeowners is labor intensive. It is no surprise then that servicers continue to push homeowners away from HAMP loan modifications or delay the process substantially. In addition, servicers' profit is directly linked to the principal of mortgages they service and the timing for writing down loans. Also, servicers who hold second liens, many of whom service large portions of the first lien market, may prefer to gamble on a market recovery rather than accept the incentive payments under HAMP and recognize their losses now.

A time line should be set to evaluate HAMP and other existing programs. If the data confirm the experience of advocates nationwide, more stringent measures should be adopted. Congress should pass legislation to allow bankruptcy judges to modify appropriate mortgage loans and also should consider further servicing reform. Adoption of court-supervised mortgage loan modifications would sidestep many of the structural barriers in the servicing industry that today are preventing mass loan modifications from occurring.

Congress soon should recognize that voluntary measures, even with incentives, by entities that profit from homeowner default and unsustainable loan principals cannot lead us out of this crisis.

Thank you for the opportunity to testify before the Subcommittee today. We look forward to working with you to address the challenges that face our Nation's communities.

[The prepared statement of Ms. Cohen appears as a submission for the record.]

Chairman WHITEHOUSE. Thank you very much, Ms. Cohen.

Professor Levitin.

STATEMENT OF ADAM J. LEVITIN, PROFESSOR, GEORGETOWN UNIVERSITY LAW CENTER, WASHINGTON, D.C.

Mr. LEVITIN. Good morning, Mr. Chairman. My name is Adam Levitin. I am an Associate Professor of Law at the Georgetown University Law Center. I am also the Robert Zinman Resident Scholar at the American Bankruptcy Institute. I am not currently serving as Special Counsel for Mortgage Affairs for the Congressional Oversight Panel, however, and I want to make clear that I am not speaking in any context for the panel, nor do I speak on behalf of the American Bankruptcy Institute.

We are now in the second year of the foreclosure crisis—or really into the third now, and there is no light at the end of the tunnel. That is what is scary about this. There are plenty of foreclosures yet to come, and these are not just going to be subprime mortgages that are in foreclosure. These are going to be prime mortgages. This is going to be the mortgages held by families that have had good credit, that have taken out traditional, safe mortgage products.

I have some slides here that I would like to show the Committee, and this first one you have actually seen from Senator Durbin. This is the percentage of homes that are in foreclosure currently. As you can see it spiked to something almost four times the historical average.

The next slide shows that this is also happening in prime mortgages, that delinquencies are up and foreclosures are way up in prime mortgages. This is no longer a subprime crisis. This is a national foreclosure crisis.

Chairman WHITEHOUSE. Those are all prime mortgage——

Mr. LEVITIN. Those are three different measures for prime mortgages, and as you can see, they are all rising sharply currently.

This is not just my opinion based on current market measures. It is also what the market believes will happen. If you show the next slide, please—I am sorry. Go back one, please. The pink line in this slide shows sort of an index of national housing prices, and as you can see, there is a bubble that goes up, and it falls, and then the little blue triangles that more or less flatten off at the end, that is what housing market futures are predicting; that we are going to have housing prices go down for a while, still for maybe another year, and then a very slow recovery; that it is basically going to be flat until 2013. That means that families that purchased their homes between, say, 2003 and 2008, many of them will be trapped with negative equity, with very deep negative equity.

Even if the monthly payments are affordable, negative equity creates a long-term foreclosure problem. Families have to move from time to time. There are life events that happen—that you lose your job working at General Motors and you have to find a new job; that you get divorced; that you have a child and you need more space; or your kids move out of the house and there is no reason you should have a large house if you are an empty-nester; that a family member gets sick and needs special assistance; that a spouse dies.

These are events that are inevitable, and when families are trapped with negative equity in their home, they have a choice. If they have to move, they can either somehow find money to pay a large balloon payment in effect, or they can give up the house in foreclosure. Those are their choices. And that means that for the foreseeable future, for the next 5, maybe 10 years, we are going to have thousands, hundreds of thousands of families that are trapped in their home. This means labor market disruptions. This means continuing foreclosures that will continue at an elevated level. Even if not an acute crisis, it will create tremendous instability for housing markets because foreclosure rates will not be predictable.

Unfortunately, all the foreclosure mitigation efforts to date have not worked. I believe Ms. Cohen went into that in some detail, and I believe there is also broad agreement on that, that our efforts at foreclosure mitigation have not been working and are not likely to start working.

There is much less agreement as to why that is the case. I believe that Dr. Calabria and I have some disagreements as to the reasons these programs are not working, but I think we can agree that they are not working.

So where does that leave us? I believe that means that we only have one tool left in the box, and that tool is bankruptcy. Bankruptcy modification of mortgages can not only incentivize voluntary renegotiation, as Senator Durbin pointed out, but in the event that voluntary renegotiations do not happen, for whatever reason, bankruptcy modification is a route that will let families that are able to make reasonable payments save their houses. It is a method that will not cost the taxpayers anything.

Senator Sessions, I want to address something that you said in your statement. You asked the very important question about what cost bankruptcy modification will have to future borrowers, and we should be very concerned about that. We do not want to hurt the future economy at the cost of, say, helping people—we do not want to help people now at the cost of the future economy. But I think it is important to recognize that bankruptcy modification, it is not a choice for a lender between getting paid back in full and not getting paid back because of bankruptcy. That is not the choice a lender has. A lender's choice is taking a loss in foreclosure or taking a loss in bankruptcy, and the question is going to be: Which will be the greater loss? As long as the loss in bankruptcy will be smaller than the loss in foreclosure, it is not a problem for a lender in terms of their future rates, that the bankruptcy actually will be saving them money.

The best evidence on this is that bankruptcy will not cause greater losses than foreclosure. The structure of bankruptcy law basically guarantees that. It says that a secured creditor has to receive the value of their property as part of a Chapter 13 plan—the collateral, as part of their Chapter 13 plan. That is a floor that says you have to do at least as well as in foreclosure.

And with due respect, I think it is very important to note that the banking industry has not produced any evidence to the contrary. They have made assertions about this, and Mr. Kittle in particular, whom Senator Durbin referenced, from the Mortgage Bankers Association, has testified before saying rates will go up 2 percent or 1.5 percent—it is a changing number—but there is no evidence of that. It is just an assertion. So if the best evidence is that bankruptcy modification will not affect future mortgage costs and that it will help thousands of families, this is something we really should do. It is the only tool we have left in the box, and it is time we use it.

Thank you.

[The prepared statement of Mr. Levitin appears as a submission for the record.]

Chairman WHITEHOUSE. There was one slide that you showed and then have not discussed. You have a minute or so—actually, you are a little bit over, but with the Ranking Member's indulgence, would you explain this slide? It appears to show the first wave, which was the subprime mortgages, and then where we are now is the valley in the middle, and then there appears to be a just as steep, if not in some places steeper, second wave bearing down on us. Could you tell us what that is?

Mr. LEVITIN. That is correct. The foreclosure crisis has been happening in waves, and the first wave of defaults was primarily speculators, people who were buying houses as investment properties and looking to flip them.

The second wave, which you can see was peaking in 2007–2008, those were primarily subprime mortgages, and what this chart is showing is on adjustable rate mortgages when the interest rate will reset or, if it is pick-or-pay mortgage, a pay option ARM, when there will be a recast, because the pay option ARM, if there is too much negative equity, if you are not making amortizing payments——

Chairman WHITEHOUSE. And that is closely associated with foreclosure.

Mr. LEVITIN. That is right. And that is going to be a tremendous payment shock when it resets in a pay option ARM.

Chairman WHITEHOUSE. And so the second wave that we are looking at coming in, in your testimony, is not subprime families; it is families with traditional mortgages, with jumbo mortgages, with prime mortgages, with Alt-A mortgages.

Mr. LEVITIN. That is correct. For example, Countrywide Financial, the largest mortgage company in the country, most of the products that they underwrote were Alt-A pay option ARMs, heavily concentrated in California, which has already been just taking a beating in the foreclosure market, and it is going to get worse.

Chairman WHITEHOUSE. Thank you.

Dr. Calabria.

STATEMENT OF MARK A. CALABRIA, PH.D., DIRECTOR, FINANCIAL REGULATION STUDIES, CATO INSTITUTE, WASHINGTON, D.C.

Mr. CALABRIA. Subcommittee Chairman Whitehouse, Ranking Member Sessions, Senator Durbin, I appreciate the invitation. I do want to say before my testimony, my primary duties when I was up here at the Banking Committee were mortgage finance and housing, and in addition to my legislative duties, because I very much remember the 5 weeks we spent total on the Housing Recovery Act—because I spent that 5 weeks on the floor and I still have the scars to remember it—I also spent a considerable amount of time answering constituent calls, helping people. I actually literally helped dozens, many of which were from the State of Alabama, and I am very proud to be able to have helped people stay in their homes and negotiated with lenders. So I want to be very clear that none of my comments are meant to dismiss that. My comments are all meant to help us focus on what is driving it. But I have very much been in the shoes of you and your staff in terms of having heard from homeowners and having heard from your constituents about these problems.

That said, my testimony is going to address two very specific questions. The first is: Why have the Obama administration, the Bush administration, and the mortgage industry efforts to reduce foreclosures had so very little impact? And the second is: Given the reasons for that question, what should we do in terms of policy?

The short answer to why previous efforts to stem the current tide of foreclosures have largely failed is that such efforts, in my opinion, have grossly misdiagnosed the causes. An implicit assumption behind HOPE NOW, run by former Secretary Paulson, the FDIC's

IndyMac model, and the Obama administration's current efforts is that foreclosures are being driven almost exclusively as the result of predatory lending or exploding adjustable ARM rates—we just saw Adam's chart on the ARMs—and that you had these payment shocks that caused mortgages to be unaffordable. The simple truth, if you look at the data very carefully, is that the vast majority of mortgage defaults are being driven by the very same factors that have always driven mortgage defaults: a combination of negative equity position on the part of a homeowner coupled with a life event that often results in a substantial shock to their income, most often a job loss or reduction in earnings. Until both of these components—negative equity and a negative income shock—are addressed, I believe foreclosures will remain at highly elevated levels.

To address some of the points that ere made by others, if payment shock were the dominant driver of defaults, then we would observe most defaults occurring around the time of reset, specifically just after reset as that burden hits. Yet this is not what has been observed in the data. Of the loans that have reset features that have defaulted, the vast majority have defaulted long before the reset. Additionally, if payment shock were the driver of default, the fixed-rate mortgages without any payment shock would display default patterns significantly below those of adjustable-rate mortgages. We just saw from Adam's chart that prime mortgages are starting to increase. If you actually do some econometric statistical work and you control for the differences in credit, you will see that for the vast majority of differences in prime and subprime, those things almost always go away. I will give the example of we have what are called FHA loans in this country that are fixed-rate, no prepayment penalties, extensive borrower protections on an apples-to-apples basis looking at homeowner loans under the limit, the loan limit for FHA, FHA performs just as badly as subprime. So the argument that these are bad products driving it, well, the good products are performing terribly, too.

So the important shared characteristic of FHA and most of the subprime market is the widespread presence of zero or very little equity at the time of origination or near the time of the default. The characteristics of zero or negative equity explain almost all of defaults in this situation.

I share your frustration. I share the frustration of everyone at the table, and I recognize that that is leading us to push for solutions. One of the solutions that has been talked about is to allow bankruptcy judges to reduce the principal balance of a mortgage to reflect the reduced value of the home. Many have called this "cramdown." I believe cramdown would have adverse consequences in the marketplace and actually provide very little real value.

I think the primary differences in opinion between Adam and myself is probably the extent of how much of this is employment driven. In Adam's testimony, and I believe in Richard's testimony, it is very clearly spelled out that if you have unemployment, you cannot put together a repayment plan, Chapter 13 is not going to work for you.

So given that we know that Chapter 13 is not going to work for you if you are unemployed, given we also know that about 40 percent of foreclosures today are second or vacation homes and you consider that—take your 50 percent unemployment, 40 percent from vacation and second homes, you get to 90 percent right off the bat. We will not be able to help 90 percent of foreclosures with cramdown. That is not to mean we should not help them. That means we need to find a solution that actually does help them, in cramdown or not.

I want to mention a couple other things. It has often been presented that cramdown is without cost. I want to note a couple of things. First of all, it is not the lenders who will bear the burden. The investors in mortgage-backed securities will bear almost all the burden. As we have seen in the recent auto restructuring, these investors are often pension funds of retired State and local employees. It is not clear to me why retired teachers, firefighters, and other public servants should actually bear the cost of mortgage foreclosures.

I also want to note that with the Government takeover of Fannie Mae and Freddie Mac, along with the Federal Reserve's holding of almost half a trillion in mortgage-backed securities, we, the American taxpayer, are the largest single investor in mortgage-backed securities. Any losses from cramdown will accrue to us, the taxpayer. So this is not simply a matter of we are taking from banks and giving to homeowners.

I also want to note, many people have talked about the CRL numbers. I have a tremendous amount of respect for Martin Eakes and Michael Calhoun there. I think they do good work. But I also think some of their forecasts have been wildly off. If you go look at what the Census Bureau numbers have actually said, between 2007 and 2009 a little more than a million households—and let me emphasize, this is from the Census Bureau. Not my numbers. This is independent estimates from the Census Bureau from 2007 to 2009, a little bit more than a million, 1 million, homeowners have transitioned to being renters. Not 2 million, not 4 million, not 9 million. One million. That clearly can be 1 million——

Chairman WHITEHOUSE. Mr. Calabria, I allowed Mr. Levitin go over his time a little bit, so I will extend you the same courtesy, but if you could begin to wrap up.

Mr. CALABRIA. With that I will wrap up and say that I just want to reiterate that the primary driver is negative income coupled with job loss. We need to focus almost all of our efforts on job loss——

Chairman WHITEHOUSE. Negative income or negative equity.

Mr. CALABRIA. Both. You have a negative income shock coupled with negative equity. And why that is important is if you lose your job and you have got equity, you can borrow against it. You can try to make that through. If you do not have negative equity—it is both, the combination of shocks, and it is very important that we address both, not just the negative equity, not just the negative income, but the combination of the two is the primary driver.

With that, I will wrap up.

[The prepared statement of Mr. Calabria appears as a submission for the record.]

Chairman WHITEHOUSE. Thanks, Mr. Calabria.

Mr. Genirberg.

STATEMENT OF RICHARD GENIRBERG, ATTORNEY, GENIRBERG LAW OFFICE, JONESBORO, GEORGIA

Mr. GENIRBERG. Chairman Whitehouse, Ranking Member Sessions, distinguished members of the Subcommittee, thank you kindly for inviting me to address bankruptcy reform in light of the worsening foreclosure crisis. I will share with you my experience of foreclosure in bankruptcy from the perspective not of an academician, but of a "country-lawyer" practitioner in the trenches. In my general trial and transaction practice, I represent consumers and creditors in Chapter 7 and Chapter 13 bankruptcy cases.

Before 2006, it was common in Chapter 7 and 13 cases to advise financially overwhelmed debtor clients to surrender late-model cars and trucks. Since 2006, it has become common for debtors instead to surrender the house. What is different now?

Since the bursting of the residential real estate asset bubble, my debtor clients owe more on their mortgages than their home is worth on the open market. Many of my clients are unaware that their home is financially "underwater." They have sought the protection of the bankruptcy court to avoid repossession of a car or because they are behind on their mortgage payments. My clients usually express their wish to retain their home. I find myself explaining that their home is a financial albatross around their necks, that it is a liability, not an asset. I inform Chapter 7 clients that I will not sign a reaffirmation agreement to ratify a debt on undervalued collateral. Such conversations usually are long, tense, and uncomfortable for all involved. It is not uncommon to repeat such a conversation two, three, or four times in office visits or over the phone before reality sets in that the debtors cannot keep house and hearth together. What brings my consumer clients to such a financially uncomfortable impasse? It has almost never been because of the interest rate on their home loan.

I see individuals compelled to file bankruptcy petitions because of medical catastrophe or because one or both spouses is laid off from a job or has become employed with reduced compensation after having lost a job. Upon further scrutiny of my clients' financial organization, I typically have found that individuals spent way too much and saved way too little. They bought houses, timeshares, and cars they could not afford. It is not uncommon to see my bankruptcy clients drive up to my building in a newer vehicle than I own. I see consumers having adopted a self-defeating, self-perpetuating mind-set of viewing spending through the lens of the monthly payment rather than with an eye to the long term. I pray that the Congress will not be so short-sighted. My clients often wish to retain all their collateralized purchases despite their inability to pay for all of them and to service their credit card debt as well.

My observation is that consumers have gone way overboard in borrowing for consumption. Americans would benefit from viewing borrowing money as a financial vehicle for businesses that plan to make a profit on the borrowed money. Americans would be wise to save more, to spend less, to establish a reserve of 6 months of income, and to buy cars for cash.

Would cramdown of residential real estate loans benefit my debtor clients? Of course it would. Any reduction of the cost of any collateralized debt would benefit my debtor clients. Not only would cramdown be beneficial, it would create a cottage industry within consumer bankruptcy practice of encouraging everyone earning under their median state income with an "underwater" residential loan to file bankruptcy expressly for the purpose of cramming down the loan. If cramming down a car loan older than 200 days would be moderately beneficial to a consumer debtor, cramming down a residential real estate loan would be so greatly beneficial to debtors that any residential loan underwater by more than $5,000 would benefit from a Chapter 13 bankruptcy. Under such a law, I imagine that consumer bankruptcy practice would thrive like never before. Legislating cramdown of residential real estate would create a veritable "license to steal" from mortgagees. The question this raises for the Congress is whether or not this would be beneficial for the American economy.

Finally, which consumer debtors would benefit from residential real estate loan cramdown? Ironically, the higher the income of the debtor, the more able would be the debtor to benefit from cramdown. Again, I return to my observation that debtors become unable to pay their mortgages primarily because of job loss, sometimes due to medical catastrophe. Chapter 13 plans seem to benefit those mainly who have experienced a temporary setback in income due to job loss or medical catastrophe, not those who have been laid off permanently. Those consumers with residential mortgages and steady employment whose only financial weakness is the loss in value of the market value of their home would be the cohort who I believe would benefit the most from mortgage cramdown.

Thank you very much for listening.

[The prepared statement of Mr. Genirberg appears as a submission for the record.]

Chairman WHITEHOUSE. Thank you for your testimony.

With the very courteous agreement of Ranking Member, we will ask Senator Durbin to lead with the questioning. He is the Deputy Majority Leader and has many demands on his time, whereas I have to and, frankly, will actually love to be here until the end of the hearing. But I do not have the same demands on my time that the distinguished Senator from Illinois does. So, again, with the courteous agreement of the Ranking Member, Senator Durbin, please proceed.

Senator DURBIN. Senator Whitehouse, if you are trying to get on my good side, it is working.

[Laughter.]

Senator DURBIN. Thank you. Thank you, Senator Sessions.

Mr. Verdelotti, what is your current value of your home?

Mr. VERDELOTTI. At this point I could not tell you, but we went to go refinance back in the beginning of this year, and it is under the $234,000 that I needed just to refinance, just to a lower mortgage rate of 5 percent with an FHA loan. So it is under what I owe.

Senator DURBIN. And that was the original purchase price?

Mr. VERDELOTTI. It was $225,000.

Senator DURBIN. So your current mortgage payments on the two mortgages that you talked about?

Mr. VERDELOTTI. $1,852.

Senator DURBIN. It is interesting. I may be off here, but usually a rule of thumb on principal and interest is about $600 for each

$100,000 of value of the home. So you are hitting a pretty heavy payment there based on your second mortgage, I imagine, which probably runs it up into such a high category. Maybe I am off, but that is usually my rule of thumb trying to figure out what a mortgage principal and interest payment would look like.

Your runaround, for instance, Citigroup was not the group that you initially did business with. You did not have your original mortgage with them, did you?

Mr. VERDELOTTI. No. Aurora Loan, they had both my mortgages when we signed the agreement. They turned around and sold the second, the 20-percent loan at 9.25 to CitiMortgage.

Senator DURBIN. I see. So you did not have anything to say about it. None of us do. It just kind of moved through the chain into the hands of another mortgage holder.

Mr. Calabria, Dr. Calabria, could you tell me the source of your statement?

Mr. CALABRIA. The 40 percent, that is from Freddie Mac.

Senator DURBIN. Freddie Mac?

Mr. CALABRIA. And that is also consistent with a variety of surveys that have been done by the National Association of Realtors on who——

Senator DURBIN. How did you know I was going to ask you about that?

Mr. CALABRIA. I have been following you for years, listening to you on the floor.

[Laughter.]

Mr. CALABRIA. It sort of just soaks in after a while.

Senator DURBIN. You have got to find a much more interesting hobby than following me.

And "license to steal," Mr. Genirberg? I guess you just characterized bankruptcy court as a license to steal, because right now you can go ahead and get cramdown on a farm, on a ranch, on a second home. You think that is a license to steal?

Mr. GENIRBERG. No, sir.

Senator DURBIN. Why? What is the difference?

Mr. GENIRBERG. I am trying to make a different point. The point I am making is that with cramdown of residential real estate, the amount that one could glean, the benefit that a debtor could glean from a bankruptcy would be so great that it would be worth it to file a Chapter 13 expressly for the purpose of the cramdown, even without any other factor that often forces people into Chapter 13s—or Chapter 7s—such as a temporary loss of job or medical catastrophe.

Senator DURBIN. You are familiar with the Bankruptcy Code reform that we passed a few years ago and the new standards of qualifying for bankruptcy and credit counseling requirements and all the things that are part of it? It is not an easy process. You have to qualify for it on the front end to be able to go into it.

Mr. GENIRBERG. I am very familiar with it, Senator.

Senator DURBIN. Yes, I am, too.

Let me ask you this, Ms. Cohen. It seems to me that our best efforts at voluntary renegotiation have really failed, and the numbers you gave us about the numbers of potentially voluntarily renegotiated mortgages says that this wave is just going to grow rather than diminish with that approach.

Ms. COHEN. So I think Professor Levitin's numbers also show and your numbers show that the foreclosure crisis is growing and that the modifications are not keeping up. We trace it primarily to the structure of the servicing industry, and for many, many years now, and for many different rounds of efforts, we keep hearing the servicers will do better.

Senator Dodd had a pow-wow with the servicers. We had Hope for Homeowners. We have HOPE Now. There is a long, long list, as everybody knows, of the voluntary measures. But as long as servicers profit because homeowners are in default, they are not going to voluntarily take a hit, and the investors are taking the hit at the same time that the homeowners are taking the hit. And so what we really need is a stick and not a carrot.

Senator DURBIN. And let me ask you, Professor Levitin, you have heard the point—and I am sure you have debated Dr. Calabria before on this issue. He talks about negative equity and negative income. It would seem the only place that you can address negative equity and negative income is in a bankruptcy court.

Mr. LEVITIN. That is correct. I agree with Dr. Calabria that negative equity and payment shocks together, whether it is from unemployment or a mortgage rate reset, whatever the cause, you need those two things together. Those are the two key ingredients. But the only place we can address those is bankruptcy. Bankruptcy addresses payments, and it addresses negative equity. I do not know of any other solution that does.

Senator DURBIN. And Mr. Genirberg's suggestion that these people going to bankruptcy court into Chapter 13 actually have an income is really stating the obvious. You could not go to Chapter 13 unless you had an income.

Mr. CALABRIA. That is correct.

Senator DURBIN. The question is whether you have an adequate income to even pay the restructured loans based on the assets you would bring into bankruptcy. That is just the nature of it. There is nothing sinister about this. I think that that is what Chapter 13 is there for, isn't it?

Mr. LEVITIN. That is right, and I think it is also really important to emphasize that Chapter 13 is not a fun process for a debtor. You talked about the difficulty of getting into Chapter 13. The real problem is once you are in Chapter 13, it is not fun. You are living on a court-supervised budget for the next 3 to 5 years. If you want your daughter to get braces, you are going to have to go and wrangle with the trustee and the judge about that. That is not something that people do for fun just to get rid of a little bit of mortgage debt.

Senator DURBIN. Thank you.

Thank you, Mr. Chairman.

Chairman WHITEHOUSE. Thank you, Senator Durbin.

The distinguished Ranking Member, Senator Sessions.

Senator SESSIONS. Mr. Calabria, do you want to respond to that?

Mr. CALABRIA. I actually wanted to draw some distinction between these two points because I think that they are incredibly important, and Adam is right, you need to have the combination of the two. But I would stress if it is solely a case of where you have a negative equity and, you know, your income stayed the same, your mortgage payment stayed the same, all it is is that the value of your house has declined, there is nothing physically stopping you from making your mortgage. And in those cases, there is nothing at all that we should be doing to encourage you not to pay your mortgage. You knew what the house price was. You knew what the value was. You have not lost your job. So for that category of people—and I think it is very interesting that Adam talks about in his testimony what he calls "strategic defaulters," and he is very clear about it. These are people who can pay their mortgage and who choose not to. And I think we need to be concerned about not encouraging voluntary defaults that would not happen otherwise.

Senator SESSIONS. Well, the question I was going to ask was: If you cramdown the principal—and we are talking about cramming down the principal, not stretching out payments—which a judge can do now. Can't they, Mr. Genirberg, in bankruptcy? Or can they? Can they——

Mr. GENIRBERG. On long-term loans, the payments generally stay the same. The altering of monthly payments or the altering of the payback on collateral really happens with short-term loans such as auto loans, those that can be paid back within 5 years. Long-term loans are just paid back as originally contracted.

Senator SESSIONS. The problem with principal, it seems to me, on an underwater loan is that we, in effect, would have altered the historic concept that it is the homeowner that takes the risk of a depressed housing price and not the person who lends them the money, that the homeowner has got to be careful when they buy a house to make sure they have a reasonable expectation that it will hold its value.

Mr. Calabria, do you have any thought about that?

Mr. CALABRIA. I do, and I think this is an incredibly important point. You know, when I got my mortgage, I certainly did not intend to share any of the appreciation with the lender, nor did I intend to expect the lender to share any of the loss. And I think you do need to parse out these separate things. You know, people who have lost their job, particularly if it is a mass layoff a company shuts down, they deserve our help, they deserve our sympathy. People who invested in a house solely as—you know, not just in the consumption aspect but because they wanted to, you know, share in the casino that our housing market had become, they took a gamble, they took a loss, and they should be expected to live up to that loss, if they can.

I think it sends the absolutely wrong message. In my mind, I am very concerned that as a society we are moving from thinking of a debt as an obligation to thinking of a debt as an option. You know, once that happens, we can just sort of forget about actually expecting to have that.

So I want to go back and say my continued focus on the employment side of that is, one, this is the primary driver and, two, this is something that we can directly address; and if we do not address it—because you can go into bankruptcy, and if your house has declined by 20 percent and they cram it down 20 percent but you are not working, that does not solve your problem.

So my point is that we need to be honest about—you know, my back-of-the-envelope is that, realistically, cramdown would maybe help 50,000, 60,000 people, not millions, not hundreds of thousands. And if Congress decides that to help 50,000 people this is worth it, that is fine. Congress can—you know, you weigh the balances; you do the cost/benefit, you decide that that is it. But I do not think we should fool ourselves in thinking that this is a solution that is going to keep millions of people in their houses. If you do not get at the core of this, none of the rest of it matters.

Senator SESSIONS. There is no doubt about that. We have seen that a lot of refinanced mortgages, even then they have not been able to keep the payments up. Is it, what, 40 percent default after——

Mr. CALABRIA. It is close—from the OTS, OCC data that they do on, where they have looked at—where they have done the reductions of 20 percent or more, you have about 38, 39 percent that redefault, you know, within the next year.

And I want to make another important point about cramdown, and I think Adam's projections of the housing market are about right. And the importance part of that is we could cram somebody down today—and as Adam points out in his testimony, he makes a very good point—they are not going to have positive equity. At best, they are going to have zero equity. But in 6 months, they are going to be underwater again.

So what is the solution? We re-cramdown everybody every 6 months? You know, we need to come up with a long-term solution.

Senator SESSIONS. We have a national interest in and the banks have an interest in not having too many houses fall on the market and collapse the price even further. And that is why they are voluntarily willing to renegotiate.

Mr. Genirberg, do you think that in your experience and, Ms. Cohen, in yours that it is often—or how often is it that there is no one to negotiate for the lender in lieu of bankruptcy? How often is it that these mortgage tranches with nobody who has the authority to negotiate an extended payment or reduced payment or reduced interest rate for a period of time?

Mr. GENIRBERG. Well, the fact that the mortgages are carved up into strips and tranches does not really make a difference because there is always one servicer that——

Senator SESSIONS. Is that servicer—some have told me that that servicer does not have the authority, because of contractual circumstances with the lenders who gave them the money, that they do not have the authority to negotiate a reduction.

Mr. GENIRBERG. I have had that experience. I have to agree with Ms. Cohen that my clients have uniformly found that it has been ineffective to try to negotiate with mortgagees because the mortgagee that does not have the authority or my clients often do not have the sophistication to have an ongoing conversation about these issues, and they just somehow do not get a very good response. They often get a response like Mr. Verdelotti talked about where it is just bureaucratic and frustrating.

So the experience that my clients have related to me 100 percent is that it has never worked to try to do a negotiation yet.

Senator SESSIONS. But apparently it is working. Wells Fargo says, what, 700,000 they have renegotiated. But——

Ms. COHEN. Senator Sessions, could I——

Senator SESSIONS. But I have no doubt it is not easy, and I take very seriously your experience as a practicing attorney. And that is what I am hearing from lawyers and bankruptcy judges, that this is a problem.

What would you say, Ms. Cohen?

Ms. COHEN. Thank you for your question, Senator Sessions. The way the agreements work between the servicers and the holders of the loans, a study from Credit Suisse has found that, in general, servicers have authority without very many limitations on their authority to negotiate with the homeowner, which is a separate question from whether Mr. Verdelotti can get somebody on the phone who will then do the right thing, and that is about the incentives of the servicer separate from what the holder is trying to accomplish.

With regard to certain servicers and their numbers, I would like to make a couple of points. One——

Senator SESSIONS. I am over, but it is okay to——

Ms. COHEN. I apologize.

Senator SESSIONS. That is all right.

Ms. COHEN. One is, like with Mr. Verdelotti's situation, we do not know why he was told no because there is no transparency in the system. And so a number of the big servicers have said X number of people do not quality for HAMP loan mods, for example, and Y number of people have received HAMP loan mods. I can tell you from talking to attorneys around the country who are very familiar with the HAMP guidelines that many people who purportedly are receiving HAMP loan mods are receiving loan modifications that do not comply with the requirements, and that when people are turned down for HAMP loan mods, we do not know whether that is justified or not.

I had one attorney in upstate New York tell me a story where her client was turned down for a HAMP loan mod, and she called the servicer and said, "You do not even have my client's income information yet. How can you turn my client down for a HAMP loan mod?"

I hear stories like that every day, and so we need a little more transparency before we know whether the numbers are real.

Senator SESSIONS. Well, that is what I am hearing, talking to real practitioners and judges. I think that is a recognition that there is no free lunch. Somebody will pay for when principal is crammed down. It is just—it will show up somewhere in the system in the future against somebody that is likely to be a good payer. But how we could improve the ability to get a clear answer—because it does advantage the lender if, for example, they could reduce the payment 40 percent because one of the family members is unemployed, and that person becomes employed 2 years from now, and they do not have to go through foreclosure, real estate commissions, and all the expense of foreclosing on a loan. So that is why they are willing, apparently, to renegotiate and try to keep things that realistically have a chance to succeed—

they have an interest in it. But it may be that there is not enough people at the front line——

Chairman WHITEHOUSE. Although I think that Ms. Cohen's testimony is that the person who is making that decision is the servicer, and that at the servicer's point of decision, they actually make more money and do better letting the property go into foreclosure than they do with a renegotiation. And so at the point of decision, the incentives are all in the wrong place, so that decision happens the wrong way.

Senator SESSIONS. If they do not agree with that, the free market guides. But I think that makes some sense.

Mr. CALABRIA. Senator Sessions, if I could——

Senator SESSIONS. I should not——

Chairman WHITEHOUSE. No, please. Go ahead, Mr. Calabria.

Mr. CALABRIA. If I could make two points, two comments on this, the first of which is there are very serious capacity constraints within the servicing industry. When I was Banking Committee staff 2 years ago, I sat across from a bunch of bankers and said, "You guys need to go out and staff up your loss mitigation, and you need to do it today because you are going to get hit with a wave of foreclosures." And, of course, they all nodded and said, "Yes, we are going to do that." And I do not think many of them have.

I do think it is important to keep in mind, you just cannot go down to McDonald's and grab somebody off the drive-thru and put them working phones in loss mitigation and expect that to work. So there are very serious training capacity response issues there.

You know, I will note that Congress up to this point has appropriated close to $300 million for nonprofits to service as those intermediaries. I do think we need to look at it and see if that is working, because one of the things that these intermediaries are supposed to do is get people prepped.

You know, I will also note—and Senator Whitehouse and Senator Durbin and everybody talked about the TARP money—Congress allocated $50 billion in the TARP to go to foreclosure mitigation. Not a dime of it has actually gone out the door. And one of the things that actually can be done with that money is to try to help build the infrastructure so that you have people there working the phones and the call centers, that you have training, that you have best practices around the industry. And none of that has been done, and I think that that is a real loss.

Senator SESSIONS. Where is it? Is it in GM or something?

Mr. CALABRIA. Actually, it is Treasury. Treasury still has the money. Treasury has $50 billion that they have allocated $15 billion of it, which has not been awarded and spent, so not a dime of that has actually been spent on building the infrastructure.

And I want to make a final point near Ms. Cohen's testimony. Given the incentives that lenders and servicers face because the problem facing the lender ex ante ahead of time is they do not know who actually is going to go into default. If they offer a mitigation, they do not know who is going to cure. So the situation facing the lender ahead of time is it is actually profit-maximizing for them to have a positive number of foreclosures that are individually negative value in which the homeowner and the lender would actually make out ahead of time. But the very real problem with that is the lender does not know that. They do not have that information. It is very easy to ex post say, "Well, if you had modified this, then everybody would have been better off."

I guess, you know, I would put it this way: I would not have to have bars on my windows at home if I knew exactly who was going to try to break into my house. But I do not. And you do not have that knowledge, and the lender does not have that knowledge.

Chairman WHITEHOUSE. But to play the devil's advocate, isn't that exactly the sort of question that bankruptcy courts sort out every day by looking at individual circumstances?

Mr. CALABRIA. To the extent that you would either have a court or I think a lot of the intermediaries, the nonprofits, one of the valuable things that they can actually provide is that sort of screening. I mean, this might sound sort of uncaring, but it is not. This is actually to help people. But you need to have a minor obstacle to weed out people who are not in trouble because of the capacity constraints. And one of the concerns I have greatly had with Obama's refinance plan in terms of Freddie and Fannie is they are focusing on people who are not even late yet. It is fine to try to help everybody, but to me it is a sort of reverse triage. You know, we are helping the guy who sprained his knee before we are helping the guy with the gunshot wound. It is the absolutely wrong way, I think, we should be going about it.

We should be focusing on—you know, all of our resources should be on those who look like they might be in the street basically in the next couple of weeks, not those who are going to be fine for 6 months. We have got it in reverse order in that way.

Chairman WHITEHOUSE. Let me jump in and ask some questions myself at this point. My first is Mr. Verdelotti is here. He has worked very hard to keep current on his payments, despite the financial difficulties that have been caused. He got a massive runaround from CitiMortgage and from Aurora both. I would—well, I will just ask you directly. Mr. Verdelotti, are you here seeking a license to steal from anyone?

Mr. VERDELOTTI. Absolutely not. I have a credit score right now in the 700s, and I am not looking to lose that. This world is built on credit, and I need it just as much as GM needs it. If I do not have credit, then I cannot buy a car. My purchases stop. That only hurts the economy in my eyes as well. If I ruin my credit, then where do I go? I will lose my house, I will lose my car. I cannot get to work without that. If I do not have credit, I cannot get an apartment. Everybody does credit checks.

So, no, I am not looking for a license to steal. I am just looking for help.

Chairman WHITEHOUSE. The point that you made so articulately about your experience, 5 hours on the phone, never getting anybody who could give you an answer, hours of elevator music, I mean, for a family where both parents are working that have three busy kids, an afternoon is a precious thing, you know? If you had a spare afternoon, you could go to the park. You could go to the beach. You could make a family memory. Instead, you burned that whole afternoon because you could not find one person on the phone in that whole company to give you the time of day and even be able to answer your questions.

Mr. VERDELOTTI. That is correct. Unfortunately, I do not have any time. My wife works nights. I work days. So we pass in the wind.

Chairman WHITEHOUSE. So that afternoon is a big, big cost on you and on your family.

Mr. VERDELOTTI. Time together is important, yes.

Chairman WHITEHOUSE. We would not ask you to burn that up for nothing. And we have heard Mr. Genirberg say that his clients do not get a very good response 100 percent of the time when they try to deal with the banks. We have heard Mr. Calabria in a much more professional way say there are very serious capacity restraints, which I would say is, you know, a little bit jargon for people are not being treated fairly. People are not being served.

And we heard Ms. Cohen's testimony about the endless runaround that she has heard about experiencing from her network of attorneys, but she has also said in her testimony that the servicing effort is, at best, erratic—that is one of the pieces of testimony from your long testimony—and that files are routinely lost. They claimed that they had lost your file.

There is an enormous lack of transparency. There is a whiff, at least, coming off some of this testimony that the servicing banks, in fact, have some pretty nasty strategies about blowing people off, not being available, losing their documents on purpose, and all that kind of stuff. I mean, we have just come through dealing with the credit card industry that declared the day over at 10:00 or 11:00 in the morning so that they could whack people whose mail came in that day on time that afternoon with increased penalties for failing to pay on time. Who would have thought a credit card company could declare a day over earlier than the day is actually over? But they did that, and they did it, and it was a really dirty trick against the American public.

So the notion that this is an industry that is incapable of really dirty tricks against the American public is one that has already been—you know, we have been disabused of that notion. They are clearly capable of it. They did it with that stunt in the credit card business.

Do you have the sense that there is more to look at here in terms of whether they are deliberately keeping families on hold so they cannot get through and ask for these modifications, whether they are deliberately losing the mail? I mean, at some point incompetence becomes strategic in terms of innocent incompetence, strategic incompetence, and a nefarious plan. Where do you think the servicers range?

Ms. COHEN. Senator, I can give you some hints about why I think it is more than just incompetence. I cannot answer the question of whether files are lost on purpose. There do seem to be some servicers who—most servicers—completely lack commitment to making this work.

For example, there is some information in my testimony——

Chairman WHITEHOUSE. Federal Express does not lose packages hardly ever, and they deal with a lot more packages than these servicers do.

Ms. COHEN. I am interested to know on the origination side whether they lose the documents when they are trying to make a loan or not. So that is sort of one question.

One servicer in my testimony is cited as having information on their answering machine that says, "If you call more than once, you will be put to the bottom of the queue. And so that is one way that they are dealing with it.

But the bigger issue really is what is happening beyond staff-level incompetence on the front lines. We are seeing on the websites of participating servicers inaccurate information about who qualifies: You can only get a HAMP modification if you have a GSE loan, a Fannie or Freddie invested loan. That is not true.

We are seeing waivers of people's legal rights in loan modification offers that directly violate Treasury's guidelines. Those are not mistakes by a random untrained person on the front lines. Those are systemic problems that can be found by management. If I can find them, they can find them.

Chairman WHITEHOUSE. And these are not little, bitty corporations that have, you know, Mom-and-Pop businesses that might be expected to get lost in this stuff. These are big corporations with billions of dollars in business, with lawyers and staff and all that, right?

Ms. COHEN. Without question——

Chairman WHITEHOUSE. This is CitiMortage, for God's sake.

Ms. COHEN. For example, Ocwen's 10–K recently identified that their income from servicing improved from 52 present—from 42 percent in 2008 as compared to 2007. So they are making a lot of money. I know that the servicers have some financial challenges and that they have a lot of paperwork they have to do. But we are really talking about a power differential between corporations that profit off of people's disadvantage and individuals like Mr. Verdelotti who are just trying to get a decent answer.

One other reminder about bankruptcy, you take a huge credit hit on your credit score for many, many years if you file for bankruptcy. And so people do not do that lightly. People like Mr. Verdelotti all over the country are foregoing medicine and food and utilities so that they can pay their bills.

Chairman WHITEHOUSE. And still not get a straight answer.

The other question, I think we really have very strong agreement on the panel from the point of view of treating consumers in anything resembling a humane or civilized fashion. There is a catastrophic failure on the part of the industry here, and perhaps the bankruptcy stick would get their attention a little better.

The other place we seem to have a lot of agreement is between Professor Levitin and Dr. Calabria that there is a pairing of circumstances that leads to the foreclosure problem, and that is, on the one hand—I think you both used almost identical words—negative equity in the home and some adverse life event, whether it is the loss of a job, a reset, or a health care disaster or something else in the family. And when those two things converge, that is when you get a real problem.

And as I understand it, as a lawyer, as somebody who has been a receiver companies, the only place you can adjust the negative equity part of something is a bankruptcy court—or a court. It has to be a court in America, because due process of law does not allow somebody's equity to be taken away without a judge signing off on it. You would agree with that, both of you, that it has to be a judge who makes an equity adjustment and takes away equity so that negative equity becomes on the bubble?

Mr. LEVITIN. Unless it is a voluntary agreement, yes.

Chairman WHITEHOUSE. Yes.

Mr. LEVITIN. And I think it is very important to emphasize that the modifications that have happened, almost none of them have involved principal reductions. So the modifications that have been happening have dealt with the affordability of the loan—or sometimes actually they have not. In many cases, many modifications actually increase monthly payments rather than decrease them, even now. But almost none of them have dealt with problems of negative equity.

There is another slide I would like to show. This comes from the Office of the Comptroller of the Currency and the Office of Thrift Supervision, their most recent data from the first quarter of 2009, the percentage of loan modifications involving principal reduction by the type of ownership. So Fannie Mae, Freddie Mac, and private label securitizations, there were all of four loan modifications listed that involved a reduction in principal. My guess is that those four were actually data errors.

For portfolio loans, it was some 3,000 that had principal reductions.

Senator SESSIONS. What is a portfolio loan?

Mr. LEVITIN. I am sorry?

Senator SESSIONS. What is a portfolio loan?

Mr. LEVITIN. A portfolio—the lender owns—the servicer actually owns the loan itself, rather than servicing for someone else.

Chairman WHITEHOUSE. So this goes back to the point we talked about earlier about the person who is going into the community bank and is talking to somebody, and it actually happens there.

Senator SESSIONS. Look, I can see this is a huge thing for the Government to somehow force a person who has loaned somebody a bunch of money, given it to them, on a promise it will be paid back. It is one thing to delay the payments, reduce the payments, extend them over a period of time. It is another thing to say, "I am voluntarily going to give you part of that money, and you do not have to pay it back."

So I think that is a pretty big issue, but I would think, however, that the portfolio loans, the people who know what is happening out there, probably made good decisions, because at some point you need not to be—you need to count the cost of foreclosure, the bank taking over property, and all the headaches that go with that. And it might just be better if you could have some reasonable expectation that with some modification the lender may be able to work its way through that.

I wanted to ask Mr. Genirberg one more—well, I will not. Go ahead, Mr. Calabria.

Mr. CALABRIA. I was going to make a couple comments in response, and since you brought up that point, you know, I think my approach to this is, second, that without addressing the income element of it—for starters, if it is just purely a case of you have lost value in the home and nothing else happened, I do not think that is a public policy rationale to intervene, you have lost on an investment. And if cramdown does not deal with the job loss, then you are not exactly dealing with the underlying cause. But I do want to get at a point that you made and sort of a counterpoint that Alys made, which is a lot of people have talked about this as a stick, and that fundamentally is something I have a problem with. I think it is more than fine to try to cajole lenders. I think it is very different to try to coerce lenders.

It is a very different debate if we have decided——

Senator SESSIONS. Let me just ask you this: In the future, if a person is thinking about investing in providing money to be loaned out to home buyers in hopes of a return, I do not think there is any doubt that they could become skittish in the future if they do not know what Congress next will invalidate, the written contract they had when they loaned the money. So this is not a little, bitty matter.

Let us go back to the one thing that we might could make some progress with. Apparently we have some TARP money that is designed to help avoid some of these problems. You have raised that, Dr. Calabria. Mr. Levitin, would you like to comment on it. Is there a way that we could somehow incentivize these loan servicers to take the time to actually meet with the borrowers and invest some effort in that and to maybe negotiate a loan that would enable them to get back on a legitimate payment rate and avoid foreclosure, avoid losses for the bank, and help our economy by not dumping too many houses on the market all at once?

Mr. LEVITIN. I wish that there were. I do not think anyone wants to encourage more bankruptcy filings. Unfortunately, the Obama administration's HAMP program offers incredibly generous incentives, or one might even call them bribes, to servicers to engage in loan modifications. This has not been working.

Senator SESSIONS. Why?

Mr. LEVITIN. Maybe it is not a—well, part of it may be is just is not a big enough bribe, but part of it also, I think, is the capacity issue, that servicers—one reason, I think, why we do not—you know, to modify a loan is like doing an underwriting afresh, and when you are doing it on a distressed underwriting, that is very difficult. That takes some experience. You cannot do it from an automated desktop underwriting model. It is very individualized. Servicers do not have the personnel that are trained in that, and we cannot create them overnight.

Senator SESSIONS. I am not sure they cannot. Bankers are being laid off all over the country. They are not making the new-home loans. There is some expertise out there.

Mr. LEVITIN. I am not sure you want the people who underwrote these loans in the first place doing the modifications.

Senator SESSIONS. Well, branch managers or people who have dealt with customers, they know people who are phony and who are not.

Mr. LEVITIN. I do not think we have the trained resources——

Senator SESSIONS. I just think there are personnel out there.

Mr. LEVITIN. Most servicers outsource a tremendous amount of their operations to India. For example, Ocwen's or Ocwen Financial, which is one of the best servicers out there, actually, has about two-thirds of its employees based in India. I do not believe that an India-based employee is capable of doing a U.S. loan mod, that there are too many factors that you would have to know that are culturally contingent in order to do it. You cannot just do it on the numbers. If you see that the homeowner works at a Chrysler dealership, you are going to view that differently than if they are employed by the U.S. Government, let us say. These are culturally contingent factors.

The capacity problem, I think there is broad agreement that there is a capacity problem, and it is something that we cannot fix immediately. Even if we have a legion of unemployed former community bankers out there, which I do not believe we do, we cannot just plug them in the system tomorrow and have loan modifications turned out.

Bankruptcy is different. Bankruptcy is immediately available. The capacity is there. We have bankruptcy judges who are trained in doing this. They can handle the cases, and when you file for bankruptcy, there is an automatic stay. It stops the foreclosure process so that even if capacity ramps up, there is some time to sort this through.

Even with the $50 billion sitting in Treasury, there are ways maybe Treasury could improve things on the margins, but it is not going to change—there is not another—there really is no other option than bankruptcies, either muddling through this and seeing millions of houses lost in foreclosure or trying the bankruptcy option. And maybe Dr. Calabria is right and bankruptcy will not help very many people in the end. And if it does not, I do not think we should be particularly worried about its effect on the economy. But maybe he is wrong and bankruptcy actually can help a lot of people. And that is a chance that I think is well worth taking.

Ms. COHEN. Senator Sessions, I have a couple of things to add to what Professor Levitin said.

First, your concern about the cost of credit increasing, you were talking before about your work with Senator Durbin about auto lending, and so in the 1970s, the FTC passed a rule that affected the liability of assignees, the holders of the loans, who we were just talking about, for cars, and there was a huge outcry that the cost of lending, auto lending, was going to go up significantly because of the increased burden and uncertainty in the assignee liability market. And the answer is that there was really no significant change in the cost of lending. My understanding is there is also similar research about bankruptcy, but I wanted to provide that historical example.

Further, you asked about how can we get the servicers incentivized to do the loan modifications. It appears that the large payoffs or payouts that the Treasury Department is willing to give for the loan modifications cannot compete with the monthly payment stream and the residuals, which are sort of interests in a level of the tranche that the servicers have. And as soon as they do the loan modification, their income directly goes down. And so it is very hard to bring them to the table with that dynamic.

We have seen some mediation programs in Philadelphia and elsewhere, where if you get a human to the table with another human, they can work it out. But when I talked to people in Chicago and they told me how many foreclosures they have there, the question really is: What do we need to do on a national basis? And on the national basis, we need something that is a little stronger and provides greater leverage to homeowners.

Senator SESSIONS. Mr. Genirberg, you have heard the discussion. You are in the real world dealing with real borrowers who are in trouble. Many of them, it is so sad. I mean, there are people losing their jobs. We have got a lot of people that are not working today that had decent incomes just a few years ago. A lot of them are bankers, because they have all slashed their employment, too. So there are a lot of higher-income people, lower-income people, middle-income people that are losing jobs.

How do you see this discussion about the ability of the lender to effectively renegotiate a loan to their own advantage if they were able to do so?

Mr. GENIRBERG. In the bankruptcy context, it is not so much a negotiation as a litigation. So, for example, with car loans, when someone—when I file a bankruptcy, a Chapter 13 for an individual and there is a car loan, I write a plan based on income and based on expenses, and I set terms. There is not a negotiation. I do not call up a car lender, the financier of a car, and say, "Well, here is what I propose that we do." I simply write a plan. If there is an objection, then we go into litigation in the bankruptcy court.

So within the bankruptcy context, there is not a real negotiation with the servicer. There is simply an assertion. They file a claim, and if they do not like the plan that I have set up, then they are going to litigate it. And then there will be a negotiation of sorts to see if we can settle, just like with any lawsuit.

So once it gets into the bankruptcy context, there is not really a conversation with the lender, and right now there is no way to have a conversation with the lender before we get into the bankruptcy context because it just does not really work despite there having been 750,000, apparently. I just have not seen it.

Chairman WHITEHOUSE. And in terms of the plan that you would file on behalf of your client, you would not be making that plan up out of whole cloth. You would be making it up based on your experience of having done plans like these over and over, knowing what elements in the plan would cause a lender to object and to interrupt and to cause this to go to litigation rather than continue to go smoothly for your client. So there is an element of learned behavior on the system's part in the efficiency that you see of being able to file a plan and put it through and file a plan and put it through, without litigation or negotiation. Correct?

Mr. GENIRBERG. Yes, Senator. Over time, we sort of come to a subliminal agreement. If you go this far, I will not object, and——

Chairman WHITEHOUSE. Sort of a meta-negotiation.

Mr. GENIRBERG. It is a meta-negotiation. You know, the saying in bankruptcy always is that pigs get fat and hogs get slaughtered. If you seek too much——

Chairman WHITEHOUSE. Yes. That is true in politics, also.

Mr. GENIRBERG. Yes, sir.

Chairman WHITEHOUSE. Let me wrap up, if I may, with one additional point, and if the distinguished Ranking Member would care to respond, I would, of course, give him whatever time he needed. But it strikes me that based on the testimony that we have heard, which actually shows a very surprising degree of agreement among all the witness, a welcome degree of agreement to me, that we have almost a kind of mechanical problem here, which is that we have the wave of first subprime resets, and then option adjustable, Alt-A, prime, and jumbo resets that Professor Levitin has chronicled, this slide right here. And that is coming at us, and those resets are one of the life events that, combined with negative equity, provoke the foreclosure problem. And so we can see from this that there is very likely to be a very significant second wave of foreclosures.

That then precipitates into the problem of once you foreclose, you drive down values, particularly in neighborhoods where these foreclosures are happening. There is a lot of evidence that a foreclosure down the block hurts the values up the street. You get two of them, the effect is compounded. So now the person up the street who was doing Okay has an even bigger negative equity problem, and the thing begins to be a vicious cycle.

One of the ways that you can get out of the vicious cycle is that really forever, whenever there is an inability-to-pay problem, you go to an organized place like bankruptcy court, and you work out who gets what, and that way you maximize the return to everybody, and you can bring an end to the sort of death spiral.

But as Ms. Cohen has testified, the safety valve of modification is not working both because the HAMP program is not adequate to the scale of the problem and because the servicers are not complying with the terms of the HAMP program and because their incentives are all in the wrong place in terms of actually making those adjustments. And so the natural outlet that would defuse that potential vicious cycle has been jammed up. And my worry in all of this is that when you saw what this country had to go through with the subprime mortgages and the cost of the TARP and the political rows that the whole TARP caused, if we have another one of those coming up, and this time it is not going to be just subprime folks, it is going to be the folks who live down the street from us who have jumbo mortgages, the folks who have good credit and have good jobs, and it is, you know, a bunch of people who thought that hey kind of go through this all right, and now suddenly it is not, we are going to be facing a great deal of trouble. And we need to make sure that that vicious cycle—that there are mechanisms for interrupting it.

I see most heads nodding, and I want to take this moment to thank the witnesses. We have a statement from Senator Feingold, who was here earlier but could not stay, unfortunately. Without objection, I would like to put that into the record. His final page makes the point I just did: Foreclosures lead to falling real estate prices, which lead to more foreclosures. Local businesses are deeply affected as well, and empty houses lead to crime and greater costs for social services offered by local governments, as well as lower property taxes to offset that. After all the money that we have spent to save the banks, it is irresponsible for Congress to let this vicious cycle continue while an obvious and cost-free solution is starting us in the face. So I thank Senator Feingold for his statement, and without objection, it will be in the record.

[The prepared statement of Senator Feingold appears as a submission for the record.]

Chairman WHITEHOUSE. The record will remain open for a week for anything that any witness wishes to add or that anybody else wishes to add. I thank the very distinguished Ranking Member for his courtesy throughout this hearing, and I look forward to working with him to see if there is a way that we can address this in a helpful, thoughtful, bipartisan way.

With that, the hearing is adjourned.

[Whereupon, at 11:42 a.m., the Subcommittee was adjourned.]

[Submissions for the record follow.]

QUESTIONS AND ANSWERS

Question from Senator Whitehouse

Mr. Calabria, in your testimony, you state that investment properties constitute approximately 40 percent of current foreclosures and that "the unemployed [are] likely making up to around 50 percent." Please provide your specific sources for these figures/estimates.

More specifically, second homes. Economists from Freddie Mac have publicly used the 40% number as Freddie's experience. It has appeared in several media accounts (see for an example http://www.cnbc.com/id/30984467). Freddie Mac has not made the underlying data available to the general public.

As a reality check on the data point, I looked to see if it was consistent with other similar, but not exactly the same, data points. For instance, in James Barth's new book, *the Rise and Fall of the US Mortgage and Credit Markets*, he uses Loan Performance data to estimate that just about 20% of foreclosures are occupied, but not by the owner, most likely renters. The Mortgage Bankers Association has estimated for non-occupied at about 20% - while probably some overlap between the two, they come to 40%. In addition, the National Association of Realtors regularly estimated 2nd home share of purchases - which averaged 25% during the boom, reaching a peak of 28% in 2005. One would expect investment properties to default more often than their share of the overall market - an extreme example; the *Las Vegas Sun* estimated that 74 % of Las Vegas foreclosures were investment properties.

The National Low Income Housing Coalition also estimates that over 20% of foreclosures are renter-occupied homes (www.nlihc.org).

A point to keep in mind is that some non-trivial number of "owner-occupied" foreclosures were actually second homes. But there is no good data on that. However, both bank SARs data and FBI fraud reports indicate a very large amount of second home buyers lying about their occupancy status, which would lead me to believe Barth's estimates are biased downwards.

On the employment side James Barth's book provides estimates. Also Edward Gramlich's book, *Subprime Mortgages*, estimates that in 2007, 47 percent of mortgage delinquencies were due to job loss.

While no single sources appears to have solid data on all the individual components, bringing various data sources together, and checking them against other mortgage market measures, leads to the conclusions that employment and second homes constitute the bulk of foreclosures.

January 24, 2010

Responsive answers to Questions for the Record Submitted by Senator Jeff Sessions:

1. Please explain in what way(s) cramdown of a residential real estate loan would differ from cramdown of a second home and automobile loan.

The Bankruptcy Code distinguishes long-term and short-term debt. For purposes of a Chapter 13 bankruptcy case, long-term means a period of time greater than the length of the Chapter 13 Plan. In a five-year plan, a debt expected to be paid off in greater than five years would be considered a long-term debt. "Cramdown" (see 11 U.S.C. § 506, Determination of secured status) or reduction of the principal amount owed on a debt from the contract balance due to replacement value of the collateral securing the debt, has been, and is currently available in a Chapter 13 bankruptcy case only for short-term debt, that is, those debts that can be paid off during the term of a plan. Cramdown currently may be applied to loans secured by non-residential real estate or purchase-money automobile loans older than 910 days pre-petition [see the hanging paragraph of 11 U.S.C. § 1325(a)(9)] only so long as the debt can be paid off during the length of the plan.

In my experience, the vast majority of residential mortgage debt treated in a Chapter 13 bankruptcy plan is long-term, that is, the term of the debt is greater than the length of the Chapter 13 plan. Providing for cramdown of long-term residential debt under the bankruptcy code would constitute a radical departure from the American tradition of permitting cramdown only on short-term debt and nearly never on residential real-estate debt.

2. Article I, section 8 of the federal Constitution gives Congress the authority to "establish . . . uniform Laws on the subject of Bankruptcies throughout the United States[.] In your view, and personal experience as a practicing bankruptcy attorney, for whose benefit do we craft bankruptcy legislation?

For my perspective as a practitioner, not a scholar, bankruptcy serves to provide a fresh start (Chapter 7) or debt consolidation (Chapter 13) to individuals mired in debt so they can overcome very unlucky circumstances, such as job layoff or medical catastrophe, or reconcile and resolve their financial lapses or errors and reinitiate a financially productive life so they will not be a financial burden on their families and others in their community. Bankruptcy is not welfare; it is a reconciliation process to reclaim individuals lost to terrible bad luck or financial profligacy.

Respectfully submitted,

Richard Genirberg, JD, MBA, MA
Atlanta, Georgia

July 30, 2009

Chairman Whitehouse, Ranking Member Sessions and members of the Subcommittee, the undersigned organizations thank you for the opportunity to submit this statement for the record for the July 23, 2009, Senate Judiciary Subcommittee on Administrative Oversight and the Courts hearing entitled, "The Worsening Foreclosure Crisis: Is it Time to Reconsider Bankruptcy Reform?"

Modifying the bankruptcy laws to permit the cram down of mortgages on principal residences is simply not an effective way to save American's homes. Turning secured debt into unsecured debt will harm, not help, the housing market. As the experience with Chapter 12 has shown, allowing cram down on mortgages increases borrowing costs for all borrowers. Raising borrowing costs is exactly the wrong thing to do in the current recession. This is why the Senate has wisely rejected cram down proposals on a bi-partisan basis.

In addition, as the testimony at this hearing demonstrated, cram down is only appropriate where the borrower can repay the full amount during the course of a Chapter 13 plan, typically five years. In fact, under current law, if a loan secured by a second home or a vacation home is to be bifurcated into separate secured and unsecured portions, the full amount of the secured portion must be paid in full during the repayment plan. The cram down proposals voted down in the Senate, in contrast, abandon this important limitation and would permit borrowers to repay the secured portion over 30 years.

Everybody loses when a home goes into foreclosure. A homeowner loses his or her home, the mortgage company loses a customer, the lien holder loses money by taking back the home, and the American economy loses. In most cases, it is more beneficial for the mortgagee to keep the borrower in their home. However, there are situations where the borrower's situation may require foreclosure, a short sale or deed-in-lieu of foreclosure. The Obama Administration has recognized this fact and is working to modify the Making Home Affordable plan to facilitate short sales and deeds-in-lieu where the borrower chooses to leave the property rather than seek a modification but still avoid foreclosure.

Over the last two years as foreclosures have increased, we have seen historic efforts by the government, the financial services industry and consumer groups to help millions of borrowers stay in their homes. This positive collaboration has come with a number of challenges and there remain a number of obstacles that must be overcome to achieve maximum success.

The industry continues to receive sharp criticism that it has not helped enough borrowers. Before we discuss the obstacles that still remain, we think it is important to inform the Subcommittee of some of the results to date. HOPE NOW, which is an alliance of counselors, mortgage companies, investors and mortgage market participants, has been collecting data since the third quarter of 2007 to help monitor industry efforts. According to the HOPE NOW June 2009 data (chart attached), since mid-2007, the mortgage industry has provided approximately **4.7 million workout solutions** to help homeowners avoid foreclosure through repayment plans and loan modifications. In the first half of 2009, more than 1.5 million homeowners have been helped through mortgage workout plans.

In fact, in June, mortgage servicers industry helped 310,000 homeowners complete workout solutions to stay in their homes – a 25 percent increase over May. HOPE NOW members and other mortgage servicers modified 96,000 mortgages in June and initiated 214,000 repayment plans. While completed foreclosure sales increased from 83,000 in May to 94,000 in June, it is important to note that foreclosures for the first 6 months of 2009 were flat when compared with the first six months of 2008.

At a July 16 Senate Banking Committee hearing on homeownership preservation, Wells Fargo indicated that it has refinanced three-quarters-of-a-million customers through various programs. These results are impressive and the industry will continue to address current requests for assistance. However, there are two major challenges that mortgage servicers continue to face on a daily basis: call volume and government program implementation challenges.

As a number of government programs have been announced, borrowers eager for assistance are reaching out for help at staggering numbers. For example, at the July 16 Senate Banking Committee hearing, Bank of America indicated that it receives over 1.8 million calls per month – or 80,000 per day. That in itself presents a huge challenge.

Oftentimes, government programs are announced well before servicers have the necessary details and essential guidelines to implement the programs. This creates significant consumer interest and increases the call volume to mortgage servicers. For example, on February 18, 2009, the administration announced the Making Home Affordable (MHA) program. While the announcement indicated the program would begin in April, troubled homeowners began calling their servicers almost immediately. In addition, mortgage servicers were not given detailed guidance on the MHA program until April 6th. This did not give servicers the necessary lead time to change their computer systems and handle additional changes to their processes before they began receiving inquiries about the program.

At a July 16th Senate Banking Committee hearing on homeownership preservation, Bank of America highlighted this point:

> *"The current method of publicly announcing new guidelines or changes concurrently with their effective dates creates immediate demand with insufficient lead time for operational readiness. This can lead to negative customer experience, and ultimately, public backlash against the programs."*

The mortgage industry is optimistic about the MHA program. Mortgage servicers and Treasury have had to work through several challenges that were resolved in the last month. According to administration statements, to date, over 350,000 trial modification offers have been extended and approximately 200,000 HAMP trial modifications are already underway. This is a very positive start. It is a significant task to implement these programs and, as we have seen with the MHA program, it takes several months before they begin to run as intended. We believe the HAMP program will have a very

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significant impact in assisting homeowners, in addition to the other options servicers offer to at-risk borrowers who may not qualify for a HAMP modification.

Another recent criticism of mortgage servicers is the lack of initial use of the Hope for Homeowners (H4H) refinance program. The H4H program, which was initially authorized in 2008, required several legislative changes to increase its usefulness and availability to borrowers. Some of these changes were made as part of the "Helping Families Save Their Homes Act" which President Obama signed into law in May of 2009. These changes will provide mortgage servicers with another tool for assisting troubled borrowers.

While mortgage servicers continue to receive criticism for not utilizing the H4H program, it is important for this Subcommittee to recognize that mortgage servicers are still awaiting final guidance from the Department of Housing and Urban Development (HUD) on implementing the new program. However, the H4H program will never have the same level of volume as other types of modifications due to the permanent write down or reduction of principal. In almost all cases, a servicer will be able to structure a modification to achieve the same or better payment for the borrower without incurring a permanent write down.

Additionally, we note that beginning on August 4, 2009, Treasury will begin publishing servicer-specific results on a monthly basis – detailing the number of trial modification offers extended, the number of trial modifications under way and the number of official modifications offered and the long term success of each modification. Also, Treasury has asked Freddie Mac (acting as compliance agent for the program) to develop a "second look" process to audit a sample of MHA modifications which have been declined in an effort to ensure that borrower applications are not overlooked or inadvertently declined. These two additions to the program will increase transparency and help to ensure that all applications are given the review and attention required to ensure as many modifications are made as is possible.

There are many reasons why troubled borrowers are not qualifying for loan modifications under MHA and refinances under H4H.

Any successful modification relies on borrower income and, as we have seen unemployment rise to 9.5 percent, a large number of troubled borrowers simply cannot qualify for these government programs because they have lost their source of income. Also, a number of borrowers are not owner occupants, fail to complete the necessary documentation or have sufficient income or assets to pay their current debts. In addition, mortgage servicers continue to face difficulties in contacting borrowers and are finding that roughly 30-40 percent of delinquent loans are on vacant homes.

In light of these challenges, mortgage servicers participating in MHA's Home Affordable Mortgage Program (HAMP) have made the following recommendations for strengthening and accelerating the implementation of the program:

1) Standardize and simplify documentation and definitions for the Fannie Mae, Freddie Mac and Treasury programs. Uniform and simplified documents would improve servicers' ability to best match the programs for particular borrowers.

2) The government should work with industry to create a central Web portal that would allow borrowers to enter their information for pre-qualification purposes. This would also increase transparency for borrowers and third-party counselors by allowing status checks on applications.

3) Improve the current process for program changes prior to announcing them to the public. As indicated above, when program changes are announced, there becomes an increased demand and expectation from borrowers before servicers are given the necessary guidance for implementation. Servicers should be given 30-60 days notice prior to public announcements. Changes should be consistent and provide servicers with appropriate time to review and understand them.

4) HUD should issue guidelines for the H4H program so that servicers can begin implementation. H4H can be a another tool to help avoid foreclosure, but it should be recognized that the structure of the program, which requires principal write down or extinguishment, will always hamper the program as compared to modification and other borrower assistance alternatives.

5) HUD should issue guidance implementing its new authority to permit partial claims on FHA loans in the amount of 30 percent of the outstanding principal. Today, FHA loans are not part of the MHA program. The new authority, however, would allow FHA loans to participate.

We would like to emphasize servicers continue to increase their capacity to deal with the large volumes of borrowers seeking assistance and are working closely with a number of government agencies as the new programs are being implemented. These new programs are dealing with very complex transactions and have thus caused the need for a number of adjustments by Treasury, HUD, Fannie Mae and Freddie Mac. These programs became operational just a few months ago, and we are still awaiting final guidance on the H4H program. There is no question that more can be done and will be done.

Again, we appreciate the opportunity to inform the committee on mortgage servicers' efforts and the current obstacles to helping some borrowers.

American Bankers Association
Consumer Bankers Association
The Financial Services Roundtable
The Housing Policy Council
Mortgage Bankers Association
Securities Industry and Financial Markets Association
U.S. Chamber of Commerce

HOPE NOW June 2009 Data Release

BORROWER LOAN WORKOUT PLANS

	2007 Q3	2007 Q4	2008 Q1	2008 Q2	2008 Q3	2008 Q4	2009 Q1	2009 Q2	Jun-09	Jul 2007-Jun 2009 ("Life to Date") Totals
Repayment Plans	357,900	348,531	314,453	302,565	335,152	345,078	340,384	502,595	214,756	**2,846,658**
Prime	154,383	160,127	148,814	141,840	179,864	203,752	215,778	342,534	143,587	1,547,091
Subprime	203,517	188,404	165,639	160,725	155,288	141,327	124,606	160,061	71,170	1,299,567
Modifications	72,773	133,467	170,216	220,349	256,188	314,602	370,436	318,044	96,046	**1,856,076**
Prime	29,714	36,634	48,148	56,202	70,503	92,125	121,011	128,093	40,316	582,429
Subprime	43,058	96,833	122,068	164,147	185,685	222,477	249,425	189,951	55,730	1,273,646
Workout Plans	430,673	481,998	484,669	522,914	591,340	659,680	710,820	820,639	310,803	**4,702,733**
Prime	184,097	196,761	196,961	198,042	250,367	295,877	336,788	470,627	183,903	2,129,521
Subprime	246,575	285,237	287,708	324,872	340,973	363,803	374,032	350,012	126,900	2,573,213

FORECLOSURE SALES

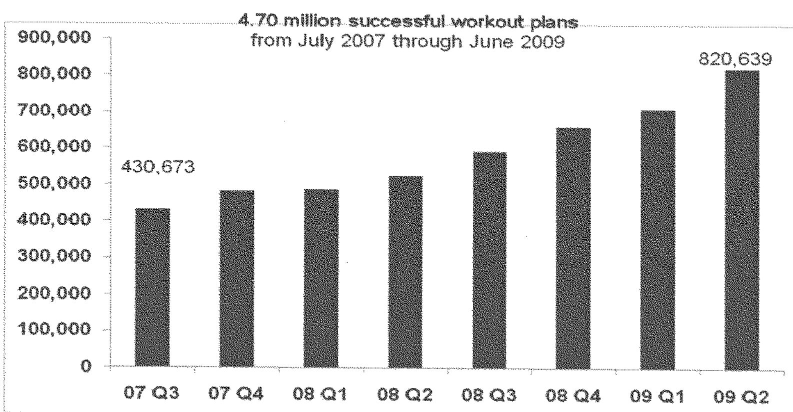
	2007 Q3	2007 Q4	2008 Q1	2008 Q2	2008 Q3	2008 Q4	2009 Q1	2009 Q2	Jun-09	Jul 2007-Jun 2009 ("Life to Date") Totals
Foreclosure Sales	153,408	168,213	203,503	246,192	263,326	201,603	201,314	239,303	93,924	**1,676,862**
Prime	60,699	64,958	83,352	108,202	130,700	101,519	113,309	154,108	62,603	816,849
Subprime	92,709	103,255	120,151	137,990	132,626	100,084	88,005	85,196	31,321	860,014

(Workout Plans = Repayment Plans + Modifications)

Repayment Plans: A plan that allows the borrower to become current and catch up on missed payments that are appropriate to the borrower's circumstances, which involves deferring or rescheduling payments but the full amount of the loan is expected ultimately to be paid.

Modifications: A modification occurs any time any term of the original loan contract is permanently altered. This can involve a reduction in the interest rate, forgiveness of a portion of principal or extension of the maturity date of the loan.

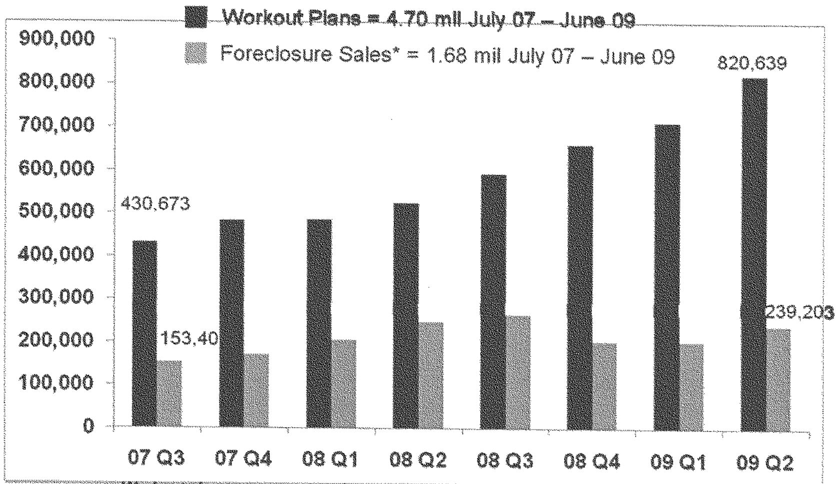
Mortgage Workout Plans



Workout plans = repayment plans + loan modifications

Source: HOPE NOW, "National Data: June 09"

Workouts & Foreclosures



*Workout plans = repayment plans + modifications / *Foreclosures = completed sales only. does not include mortgages at-risk of or in the process of foreclosure*

Source: HOPE NOW. "National Data: June09"

SUBMISSIONS FOR THE RECORD

Testimony of Mark A. Calabria, Ph.D.
Director, Financial Regulation Studies, Cato Institute
Before the
Senate Committee on the Judiciary
Subcommittee on Administrative Oversight and the Courts
On "The Worsening Foreclosure Crisis: Is It Time to Reconsider Bankruptcy Reform?"
July 23, 2009

Mark A. Calabria, Ph.D. is Director of Financial Regulation Studies at the Cato Institute. Before joining Cato in 2009, he spent six years as a member of the senior professional staff of the U.S. Senate Committee on Banking, Housing and Urban Affairs. In that position, he handled issues related to housing, mortgage finance, economics, banking and insurance for Ranking Member Richard Shelby (R-AL). Prior to his service on Capitol Hill, Calabria served as Deputy Assistant Secretary for Regulatory Affairs at the U.S. Department of Housing and Urban Development, and also held a variety of positions at Harvard University's Joint Center for Housing Studies, the National Association of Home Builders and the National Association of Realtors. Calabria has also been a Research Associate with the U.S. Census Bureau's Center for Economic Studies. He has extensive experience evaluating the impacts of legislative and regulatory proposals on financial and real estate markets, with particular emphasis on how policy changes in Washington affect low and moderate income households. He holds a doctorate in economics from George Mason University. http://www.cato.org/people/mark-calabria

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Testimony of Mark A. Calabria, Ph.D.
Director, Financial Regulation Studies, Cato Institute
Before the
Senate Committee on the Judiciary
Subcommittee on Administrative Oversight and the Courts
On "The Worsening Foreclosure Crisis: Is It Time to Reconsider Bankruptcy Reform?"
July 23, 2009

Subcommittee Chairman Whitehouse, Ranking Member Sessions, and distinguished members of the Subcommittee, I thank you for the invitation to appear at today's important hearing. I am Mark Calabria, Director of Financial Regulation Studies at the Cato Institute, a nonprofit, non-partisan public policy research institute located here in Washington. Before I begin my testimony, I would like to make clear that my comments are solely my own and do not represent any official policy positions of the Cato Institute. In addition, outside of my interest as a citizen and a taxpayer, I have no direct financial interest in the subject matter before the subcommittee today, nor do I represent any entities that do.

My testimony today will address two specific questions. The first is: why have the Obama and Bush Administration efforts, along with those of the mortgage industry, to reduce foreclosures had so little impact on the overall foreclosure numbers?

The second question is: given what we know about why previous efforts have had such little impact, what are our policy options?

In answering both these questions, I rely on an extensive body of academic literature, the vast majority of which has been subjected to peer review, which has examined the determinates of mortgage delinquency and default. Foremost among this literature is a series of recent papers written by economists at the Federal Reserve Banks of Boston and Atlanta, in particular the work of Paul Willen, Christopher Foote and Kristopher Gerardi. My testimony owes a considerable intellectual debt to this research.

Why haven't previous efforts stemmed the foreclosure tide?

The short answer to why previous federal efforts to stem the current tide of foreclosures have largely failed is that such efforts have grossly misdiagnosed the causes of mortgage defaults. An implicit assumption behind former Treasury Secretary Paulson's HOPE NOW, FDIC Chair Sheila Bair's IndyMac model, and the Obama Administration's current foreclosure efforts is that the current wave of foreclosures is almost exclusively the result of predatory lending practices and "exploding" adjustable rate mortgages, where large payment shocks upon the rate re-set cause mortgage payment to become "unaffordable."

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The simple truth is that the vast majority of mortgage defaults are being driven by the same factors that have always driven mortgage defaults: generally a negative equity position on the part of the homeowner coupled with a life event that results in a substantial shock to their income, most often a job loss or reduction in earnings. Until *both* of these components, negative equity and a negative income shock are addressed, foreclosures will remain at highly elevated levels.

Given that I am challenging the dominant narrative of the mortgage crisis, it is reasonable to ask for more than mere assertions. First, if payment shock alone were the dominate driver of defaults then we would observe most defaults occurring around the time of re-set, specifically just after the re-set. Yet this is not what has been observed. Analysis by several researchers has found that on loans with re-set features that have defaulted, the vast majority of defaults occurred long before the re-set. Of course some will argue that this is due to such loans being "unaffordable" from the time of origination. Yet according to statistical analysis done at the Boston Federal Reserve, the borrower's initial debt-to-income (DTI) had almost no predictive power in terms of forecasting subsequent default.

Additionally if payment shock was the driver of default, the fixed rate mortgages without any payment shocks would display default patterns significantly below that of adjustable rate mortgages. When one controls for owner equity and credit score, the differences in performance between these different mortgage products largely disappears. To further illustrate this point, consider that those mortgages generally considered among the "safest" – mortgages insured by the Federal Housing Administration (FHA), which are almost exclusively fixed rate with no-prepayment penalties and substantial borrower protections, perform, on an apples to apples basis, as badly as the subprime market in terms of delinquencies.

The important shared characteristic of FHA and most of the subprime market is the widespread presence of zero or very little equity in the mortgage at origination. The characteristics of zero or negative equity also explain the poor performance of most subprime adjustable rate mortgages. Many of these loans also had little or no equity upon origination, providing the borrower with little equity cushion when prices fell. Recognizing the critical role of negative equity of course raises the difficult question as to what exactly it is that homeowners are losing in the event of a foreclosure.

"Unnecessary" foreclosures

Central to the arguments calling for greater government invention in the mortgage market is that many, if not most, of the foreclosures being witnessed are "unnecessary" or avoidable. Generally it is argued that investors and loan servicers do not face the same incentives and that in many cases in would be better for the investor if the loan were modified, rather than taken to foreclosure, but still the servicer takes the loan to foreclosure.

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The principal flaw in this argument is it ignores the costs to the lender of modifying loans that would have continued paying otherwise. Ex Ante, a lender has no way of separating the truly troubled borrowers, who would default, from those that would take advantage of the system, if they knew they could get a modification just by calling. As long as potentially defaulting borrowers remain a low percentage of all borrowers, as they are today, it is in the best interest of the investor to reject many modifications that might make sense ex post. In addition, lenders may institute various mechanisms to help distinguish troubled borrowers from those looking to game the system.

It is also claimed that the process of securization has driven a wedge between the interests of investors and servicers, with the implication that servicers would be happy to modify, and investors would prefer modifications, but that the pooling and servicing agreements preclude modifications or that servicers fear being sued by investors. The first fact that should question this assumption is the finding by Boston Fed researchers that there is little difference in modification rates between loans held in portfolio versus those held in securitized pools. There is also little evidence that pooling and servicing agreements preclude positive value modifications. According to recent Credit Suisse report, less than 10 percent of agreements disallowed any modifications. While the Congressional Oversight Panel for the TARP has been critical of industry efforts, even that Panel has found that among the sample of pools it examined with a 5-percent cap on the number of modifications, none of the pools examined had actually reached that cap. If few pools have reached the cap, it would seem obvious that the 5 percent cap is not a binding constraint on modifications. In many instances the pooling agreements also require the servicer to act as if the servicer held the whole loan in its portfolio, raising substantial doubts as the validity of the "tranche warfare" theory of modifications. .

A careful review of the evidence provides little support for the notion that high transaction costs or a misalignment of incentives is driving lenders to make foreclosures that are not in their economic interest. Since lenders have no way to separate troubled borrowers from those gaming the system, some positive level of negative value foreclosures will be profit-maximizing in the aggregate.

Is cramdown the answer?

The high level of foreclosures has left many policymakers and much of the public understandably frustrated and searching for answers. One "solution" that has been regularly presented is to allow bankruptcy judges to reduce the principal balance of a mortgage loan to reflect the reduced value of the home, the so-called "cramdown." For a variety of reasons, I believe allowing cramdowns would have adverse market consequences while also providing little real relief to borrowers.

Given the unemployment-driven nature of most foreclosures, and the inability of unemployed individuals to put forth a repayment plan under Chapter 13 of the bankruptcy code, it appears that cramdowns would do nothing for those most in need, the unemployed.

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As proponents of cramdowns point out, vacation and investment properties can currently be subjected to cramdown. This raises the question: why aren't the significant number of foreclosures involving investment properties being resolved via bankruptcy rather than the foreclosure process? The most likely reason is that property speculators realize that even a reduced mortgage value is likely to exceed the home value in the near future. With home prices still declining, a crammed down mortgage would be underwater in few months. The incentive facing most speculators is often to simply walk away and let the home fall into foreclosure. This would not be a significant problem if investment properties did not constitute approximately 40 percent of current foreclosures.

At this point, it is worth reflecting on these two points: cramdowns do little or nothing to help the unemployed and speculators can already pursue that route, but largely choose not to, as it isn't in their economic interest. With speculators making up about 40 percent of foreclosures, and the unemployed likely making up to around 50 percent, it becomes apparent that at minimum cramdowns will do little to help at least 90 percent of borrowers currently in foreclosure.

The main function of a cramdown would be to serve as reduction in outstanding principal, thereby lowering the monthly payment. Even significant payment reductions may not offer long-term solutions. According to the most recent OTS/OCC mortgage metrics report, of those delinquent borrowers seeing a payment reduction of 20 percent or more 37.6 percent were again delinquent twelve months later. Continuingly re-modifying the same loan is not a solution for the borrower, investor, or lender.

We often use the term "speculator" to refer to purchasers that do not intend to live in the home and often quickly "flip" the home to make a quick profit. That definition is useful, but far too narrow. Many borrowers purchasing a home for occupancy did not do so solely for the consumption benefits of homeownership, but also for the investment returns. They were both consumers and speculators. As these speculators were generally not offering to share potential gains with their lenders, it is not clear why they should be allowed to share their losses.

Of the remaining borrowers, who were neither pure speculators nor unemployed, many of these borrowers invested little of their own cash in the home purchase. Once again, the empirical evidence demonstrates that minimal or zero downpayments on the part of borrowers are the leading mortgage characteristic in terms of predicting default. If borrowers, who have placed no money of their own at risk, are allowed to reduce their losses via cramdown, while also reaping any future appreciation, we are only encouraging future speculation in our housing markets. We should not act surprised if the next housing cycle of bubble and bust is even worst than the most recent.

Proponents of cramdown have also misrepresented the treatment of vacation homes and investor properties during a Chapter 13 bankruptcy. While the current Bankruptcy Code does allows secured debts other than those secured by a principal residence to be crammed down; if they are crammed down, the debtor is required to pay off the entire amount of the secured claim within the three-to-five year duration of the Chapter 13 plan.

The debtor does not have 30 years to pay off a modified mortgage as the original loan term may provide. The borrower in these instances is required to pay the entire amount of the secured mortgage by the end of their payment plan. This is one of the reasons many owners of investment choose to walk way rather than seek bankruptcy protection.

Cramdown is often presented as simply a way to put pressure on lenders to negotiate, or to "bring them to the table." It is no more appropriate, in a free society, to use the coercive stick of the state to bring lenders to the table, than it would be to use that stick to bring borrowers to the table. A government focused on the common good, the general welfare, does not choose sides in private disputes.

Less tangible, but perhaps more important in the cramdown debate is the message it sends to market participants, particularly investors. It has long been established in law, and in common sense for that matter, that the body of law relevant to and existing at the time of a contract enters into and comprises part of that contract. To change by legislative fiat the terms of contracts that have already been agreed to is to change the contract itself. I fear if the cramdown were to become law, we send a signal that any private agreement is subject to being re-written depending on which way the political winds are blowing. This is a sure recipe to reduce investment and the overall reliance of market participants on contract. In order to rebuild public trust in both our markets and our government, I believe Congress should affirm its own trust in the voluntary decisions of private parties. To do otherwise is to weaken the very bonds that make a free and civilized society possible.

In speaking of investors, it is also important to remember that cramdown is not simply an issue of taking from lenders and giving to borrowers. As bad as that would be, it is made all the worse as the ultimate investors in mortgage related assets that will suffer losses rather than the largest banks. As the largest banks are mostly just servicers and not the ultimate investor, they will pass along any losses from cramdown to investors. As we have seen in the recent auto restructuring, often these investors are not large corporations or wealthy individuals; they are pension funds representing the retirement savings of millions, usually retired state and local government employees. I have yet to hear a compelling reason why retired teachers and firefighters should be forced to bear the burden of irresponsible borrowing and lending.

Non-coercive solutions

At its core, the cramdown proposal is little more than a coerced taking of wealth from one group of citizens and transferring that wealth to another group. We should reject any proposed "solutions" that are based upon applying coercion to parties in what is essentially a private contract. I urge Congress to look for only those solutions that are truly voluntary.

Some voluntary alternatives to consider: encouraging bank regulators to give lenders more flexibility to lease out foreclosed homes to the current residents. Typically banks come under considerable pressure from their regulators not to engage in long term property leasing or management, as that activity is not considered a core function of banks. I believe we can avoid the larger debate of banks being property managers by giving banks greater flexibility in retaining properties with non-performing mortgages as rentals, preferably to current residents.

In order to separate out deserving borrowers, who are trying to get back on their feet, from those simply walking away from a bad investment, Federal lending entities, such as FHA and the GSEs, should engage in aggressive recourse against delinquent borrowers who have the ability to pay, but simply choose not too. We should make every effort to turn away from becoming a society where legally incurred debts are no longer obligations to be honored but simply options to be exercised.

Conclusions

In concluding my testimony, I again wish to strongly state: the current foreclosure relief efforts have largely been unsuccessful because they have misidentified the underlying causes of mortgage default. It is not exploding ARMs or predatory lending that drives the current wave of foreclosures, but negative equity driven by house prices declines coupled with adverse income shocks that are the main driver of defaults on primary residences. Defaults on speculative properties continue to represent a large share of foreclosures. Accordingly for any plan to be successful it must address both negative equity and reductions in earnings. Cramdown fails on both accounts. I thank you for your attention and welcome your questions.

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The Worsening Foreclosure Crisis: Is It Time to Reconsider Bankruptcy Reform?

Written Testimony

of

Alys Cohen
National Consumer Law Center

also on behalf of
National Association of Consumer Advocates and
National Association of Consumer Bankruptcy Attorneys

Before the United States Senate
Subcommittee on Administrative Oversight and the Courts
of the Committee on the Judiciary

July 23, 2009

I. Introduction

Chairman Whitehouse, Ranking Member Sessions, and members of the Subcommittee, thank you for inviting me to testify today regarding the worsening foreclosure crisis, the limits of current approaches to increasing loan modifications, and the role that bankruptcy courts could play in stemming the tide of foreclosures.

I am a staff attorney at the National Consumer Law Center (NCLC).[1] In my work at NCLC, I provide training and technical assistance to attorneys across the country representing homeowners who are facing foreclosure, and I also lead the Center's Washington mortgage policy work. Prior to my work at the National Consumer Law Center, I focused on mortgage lending issues as an attorney at the Federal Trade Commission's consumer protection bureau, where I was involved in investigations and litigation regarding lending abuses (and where I drafted the Commission's first testimony regarding predatory mortgage lending in the late 1990s). I testify here today on behalf of the National Consumer Law Center's low-income clients. On a daily basis, NCLC provides legal and technical assistance on consumer law issues to legal services, government and private attorneys representing low-income consumers across the country. I also testify here today on behalf of the

1 The **National Consumer Law Center, Inc.** (NCLC) is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of eighteen practice treatises and annual supplements on consumer credit laws, including *Truth In Lending* (6th ed. 2007) and *Cost of Credit: Regulation, Preemption, and Industry Abuses* (3d ed. 2005) and *Foreclosures* (2d ed. 2007), as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low-income people, conducted training for thousands of legal services and private attorneys on the law and litigation strategies to deal predatory lending and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. This testimony was written by Alys Cohen, Staff Attorney, and Diane E. Thompson, Of Counsel, NCLC.

National Association of Consumer Advocates[2] and the National Association of Consumer Bankruptcy Attorneys[3].

We are facing in this country a foreclosure tsunami, which threatens to destabilize our entire economy, devastate entire communities, and destroy millions of families. Large-scale, sustainable modifications are widely recognized as an essential component of restoring economic health to our country—a goal that is not yet in sight.

The Home Affordable Modification Program (HAMP) announced by President Obama's administration on March 4, 2009, is a laudable attempt to overcome long standing reluctance by servicers to perform large numbers of sustainable loan modifications. HAMP seeks to change the dynamic that leads servicers to refuse even loan modifications that would be in the investors' best interests by providing both servicers and investors with payments to support successful loan modifications. Several months into the Home Affordable Modification Program (HAMP), however, homeowners and their advocates report that the program is not providing a sufficient number of loan modifications to homeowners, the modifications offered often do not meet the guidelines of the program, and the program itself still presents serious barriers to mass loan modifications. Moreover, even if HAMP operated at its full capacity as envisioned by Treasury officials, HAMP's loan modifications still would be substantially outpaced by foreclosures, and the modifications themselves lack the mandated principal reductions that many believe are necessary to stem the foreclosure tide.

[2] The **National Association of Consumer Advocates** (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.

[3] The **National Association of Consumer Bankruptcy Attorneys** (NACBA) is the only national organization dedicated to serving the needs of consumer bankruptcy attorneys and protecting the rights of consumer debtors in bankruptcy. NACBA has more than 4,000 members located in all 50 states and Puerto Rico. NACBA has been actively involved in promoting reasonable and fair bankruptcy legislation since it was founded in 1992.

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To date, implementation of the program by servicers has been slow and sporadic. The Administration's efforts to hold servicers accountable[4] are a welcome and necessary step forward, however, further changes to the program's design are needed for the program to reach even its stated goals. A timeline should be set to evaluate whether HAMP, along with other existing programs, can sufficiently address foreclosures. If the data confirm the experience of advocates nationwide , which seems likely in light of structural barriers in the servicing industry that inhibit efficient loan modifications (even when they are in the interest of investors), more stringent measures should be adopted. Congress should pass legislation to allow bankruptcy judges to modify appropriate mortgage loans and also should consider further servicing reform. Adoption of court-supervised mortgage loan modifications would sidestep many of the structural barriers in the servicing industry that today are preventing mass loan modifications from occurring. Congress soon should recognize that voluntary measures, even with incentives, by entities that profit from homeowner default can not lead us out of this crisis.

A. Problems with Servicers' Implementation of HAMP Plague Homeowners Seeking Loan Modifications.

- Participating servicers violate the HAMP guidelines:
    - Servicers still require waivers.
    - Some participating servicers offer non-compliant loan modifications.
    - Some participating servicers refuse to offer HAMP modifications.
    - Servicers charge fees to homeowners for the modification.

[4] Renae Merle, *White House Prods Banks: Letter Tells Chiefs To Start Backing Mortgage Relief*, Wash. Post, July 10, 2009, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2009/07/09/AR2009070902928.html?nav=rss_business.

- Servicers are continuing to initiate foreclosures and sell homes at foreclosure sales while the HAMP review is pending.

❖ Servicer staffing and training still lag behind what is needed.

- Homeowners and counselors report waits of months to hear back on review for a trial modification, followed by very short time frames to return documents.
- Staff of participating servicers continue to display alarming ignorance of HAMP.
- Non-participating servicers continue to represent themselves as participating in HAMP.

❖ Lack of transparency and accountability is resulting in summary denials and other unreasonable acts by servicers.

B. Certain HAMP Policies Must Be Changed to Provide Sustainable Modifications and Save Communities.

❖ Transparency must be improved.

- The Net Present Value model for qualifying homeowners must be available to the public.
- The layers of documents governing HAMP, the guidelines, the Supplemental Directives, the various FAQ's, and the servicer contracts, should be consolidated, reconciled, and clarified.
- Participating subsidiaries must be clearly identified.

❖ Mechanisms for enforcement and compliance should be adopted.

- All foreclosure proceedings must be stopped upon the initiation of a HAMP review, not just at the point before sale.
- Homeowners should be provided with an independent review process when denied a loan modification.
- Homeowners should have access to an ombudsman to address complaints about the process.
- Denials based in part on a borrower's credit score should be accompanied by an adverse action notice under the Fair Credit Reporting Act.

❖ The HAMP guidelines should be adjusted to provide more meaningful relief to homeowners without reducing their existing rights.

- Homeowners need principal reductions, not forbearance.
- Homeowners suffering an involuntary drop in income should be eligible for a second HAMP loan modification.
- Homeowners in bankruptcy should be provided clear access to the HAMP program.
- Mortgages should remain assumable as between spouses, children, and other persons with a homestead interest in the property.
- Fair lending principles must be ensured throughout the HAMP process.
- HAMP application procedures should better recognize and lessen the impact of exigent circumstances.
- The trial modification program should be further formalized and clarified, such that homeowners receive assurances of the terms of the permanent modification and homeowners are not put into default on their loans if they are current at the onset of the trial modification.

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- The final modification agreement should make clear that the homeowners do not waive any rights nor are required to reaffirm the debt in order to enter into the modification.
- The second lien program should be further developed to promote coordination with first lien modifications; servicers should be required to participate in both programs.

❖ Data collection and reporting should provide broad, detailed information in order to support the best HAMP outcomes.

II. Foreclosures Far Outweigh Loan Modifications.

Goldman Sachs estimates that, starting at the end of the last quarter of 2008 through 2014, 13 million foreclosures will be started.[5] The Center for Responsible Lending, based on industry data, predicts 2.4 million foreclosures in 2009, and a total of 9 million foreclosures between 2009 and 2012.[6] At the end of the first quarter of 2009, more than 2 million houses were in foreclosure.[7] Over twelve percent of all mortgages had payments past due or were in foreclosure and over seven percent were seriously delinquent—either in foreclosure or more than three months delinquent.[8] Realtytrac recently reported that an additional 300,000 homes go into foreclosure every

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5 Goldman Sachs Global ECS Research, *Home Prices and Credit Losses: Projections and Policy Options* (Jan. 13, 2009), at 16; *see also* Rod Dubitsky, Larry Yang, Stevan Stevanovic & Thomas Suehr, Credit Suisse Fixed Income Research, *Foreclosure Update: Over 8 Million Foreclosures Expected* 1 (Dec. 4, 2008) (predicting 9 million foreclosures for the period 2009-2012).

6 Center for Responsible Lending, Soaring Spillover 1 (May 2009), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/soaring-spillover-3-09.pdf.

7 Mortgage Bankers' Ass'n, Nat'l Delinquency Survey Q109 at 4 (2009) (reporting that 3.85% of 44,979,733, or 1.7 million, mortgages serviced were in foreclosure). Roughly half of these were serviced by national banks or federal thrifts. *See* Office of the Comptroller of the Currency & Office of Thrift Supervision, OCC and OTS Mortgage Metrics Report: Disclosure of National Bank and Federal Thrift Mortgage Loan Data, First Quarter 2009, at 8 (June 2009), *available at* http://files.ots.treas.gov/482047.pdf (reporting that 884,389 foreclosures were in process by national banks and federal thrifts at the end of the first quarter of 2009). The estimate of more than 2 million homes in foreclosure is achieved by extrapolating from the MBA numbers. The MBA survey only covers approximately 80% of the mortgage market. Thus, (44979733*3.85%)/0.8=2.16 million.

8 Mortgage Bankers' Ass'n, Nat'l Delinquency Survey Q109 at 4 (2009).

month.[9] These spiraling foreclosures weaken the entire economy and devastate the communities in which they are concentrated.[10] Neighbors lose equity;[11] crime increases;[12] tax revenue shrinks.[13] Communities of color remain at the epicenter of the crisis; targeted for subprime, abusive lending, they now suffer doubly from extraordinarily high rates of foreclosure and the assorted ills that come with foreclosure.[14]

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9 Realtytrac, 1.9 Million Foreclosure Filings Reported On More Than 1.5 Million U.S. Properties in First Half of 2009, *available at* http://www.realtytrac.com/ContentManagement/PressRelease.aspx?channelid=9&ItemID=6802.

10 *See, e.g.,* Ben S. Bernanke, Chairman, Bd. of Governors, Fed. Reserve Sys., Address at the Federal Reserve System Conference on Housing and Mortgage Markets (Dec. 4, 2008), *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20081204a.htm#f12; Ira J. Goldstein, The Reinvestment Fund, Lost Values: A Study of Predatory Lending in Philadelphia, at 62/-/63 (2007), *available at* www.trfund.com/resource/downloads/policypubs/Lost_Values.pdf (discussing disastrous community impact left behind by failed subprime lenders).

11 *See* John P. Harding, Eric Rosenblatt, & Yao Vincent, The Contagion Effect of Foreclosed Properties (July 15, 2008), *available at* http://ssrn.com/abstract=1160354_; Letter, Senator Dodd to Senator Reid (Jan. 22, 2008) (describing cycle of disinvestment, crime, falling property values and property tax collections resulting from foreclosures), *available at* http://dodd.senate.gov/multimedia/2008/012308_ReidLetter.pdf; Staff of the J. Economic. Comm., 110th Cong., 1st Sess., The Subprime Lending Crisis: The Economic Impact on Wealth, Property Values and Tax Revenues, and How We Got Here (2007), *available at* http://jec senate.gov/index.cfm?FuseAction=Reports.Reports&ContentRecord_id=c6627bb2-7e9c-9af9-7ac7-32b94d398d27&Region_id=&Issue_id= (projecting foreclosed home owners will lose $71 billion due to foreclosure crisis, neighbors will lose $32 billion, and state and local governments will lose $917 million in property tax revenue); Dan Immergluck & Geoff Smith, *The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values*, 17 Housing Pol'y Debate 57, 69, 75 (2006) ("for each additional conventional foreclosure within an eighth of a mile of a house, property value is expected to decrease by 1.136 percent"; estimating total impact in Chicago to be between $598 million and $1.39 billion); William C. Apgar, Mark Duda, & Rochelle Nawrocki Gorey, The Municipal Cost of Foreclosures: A Chicago Case Study (Hous. Fin. Policy Research Paper 2005), at 1, *available at* www.995hope.org/content/pdf/Apgar_Duda_Study_Full_Version.pdf; John P. Harding, Eric Rosenblatt, & Yao Vincent, The Contagion Effect of Foreclosed Properties (July 15, 2008), *available at* http://ssrn.com/abstract=1160354 ; Letter, Senator Dodd to Senator Reid (Jan. 22, 2008) (describing cycle of disinvestment, crime, falling property values and property tax collections resulting from foreclosures), *available at* http://dodd.senate.gov/multimedia/2008/012308_ReidLetter.pdf.

12 *See, e.g.,* J.W. Elphinstone, *After Foreclosure, Crime Moves In*, Boston Globe, Nov. 18, 2007 (describing Atlanta neighborhood now plagued by house fires, prostitution, vandalism and burglaries); Dan Immergluck & Geoff Smith, *The Impact of Single-Family Mortgage Foreclosures on Neighborhood Crime*, 21 Housing Stud. 851 (2006), *available at* www.prism.gatech.edu/~di17/housingstudies.doc (calculating that for every 1% increase in the foreclosure rate in a census tract there is a corresponding 2% increase in the violent crime rate).

13 *See, e.g.,* ., Staff of the J. Economic Comm., 110th Cong., 1st Sess., The Subprime Lending Crisis: The Economic Impact on Wealth, Property Values and Tax Revenues, and How We Got Here (2007), *available at* http://jec.senate.gov/index.cfm?FuseAction=Reports.Reports&ContentRecord_id=c6627bb2-7e9c-9af9-7ac7-32b94d398d27&Region_id=&Issue_id= (projecting foreclosed home owners will lose $71 billion due to foreclosure crisis, neighbors will lose $32 billion, and state and local governments will lose $917 million in property tax revenue); William C. Apgar, Mark Duda, & Rochelle Nawrocki Gorey, The Municipal Cost of Foreclosures: A Chicago Case Study (Hous. Fin. Policy Research Paper), 2005, at 1, *available at* www.995hope.org/content/pdf/Apgar_Duda_Study_Full_Version.pdf.

14 *See, e.g.,* Michael Powell & Janet Roberts, *Minorities Affected Most as New York Foreclosures Rise*, N.Y. Times, May 15, 2009; Mortgage Foreclosure Filings in Pennsylvania: A Study by the Reinvestment Fund for the Pennsylvania Department of Banking 36 (Mar. 2005), *available at* www.trfund.com/policy/pa_foreclosures.htm; Paul Calem, Kevin Gillen & Susan Wachter, *The Neighborhood Distribution of Subprime Mortgage Lending*, 29 J. Real Estate Fin. & Econ. 393

Modifications have not made a dent in the burgeoning foreclosures. A recent paper in the Boston Federal Reserve Bank's Public Policy series found that less than eight percent of all the loans 60 days or more delinquent were modified during 2007-2008.[15] Professor Alan White, in examining pools of securitized mortgages, found that the number of modifications varied dramatically by servicer, ranging from servicers who modified as many as 35 percent of the loans in foreclosure to as few as 0.28 percent of the loans in foreclosure in November 2008.[16] Even at the high end of 35 percent of all mortgages in foreclosure, the modification rate is not enough to reduce the foreclosure rate to pre-crisis levels.[17]

Worse, the modifications offered pre-HAMP (and presumably still by servicers not offering HAMP modifications) were overwhelmingly ones that increased the borrower's payment and principal balance. Only about three percent of the delinquent loans studied in Boston Federal Reserve Bank paper received modifications that reduced the payment.[18] Professor White's data shows that, in the

(2004); Ira Goldstein, The Reinvestment Fund, Predatory Lending: An Approach to Identify and Understand Predatory Lending (2002) (showing that areas within the City of Philadelphia that are predominately African American or Latino also tended to have higher concentrations of foreclosure sales and were more vulnerable to predatory lending); *cf.* AARP Pub. Pol'y Inst., A First Look at Older Americans and the Mortgage Crisis 5 (2008), http://assets.aarp.org/rgcenter/econ/i9_mortgage.pdf (African Americans and Hispanics are foreclosed on at roughly three times the rate of white Americans).

15 Manuel Adelino, Kristopher Gerardi & Paul S. Willen, *Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitization* 35 (Fed. Reserve Bank of Boston Pub. Pol'y Paper No. 09-4, July 6, 2009), *available at* http://www.bos.frb.org/economic/ppdp/2009/ppdp0904.pdf.

16 Alan M. White, *Deleveraging the American Homeowner: The Failure of 2008 Voluntary Mortgage Modification Contracts,* Conn. L. Rev. 12-13 (forthcoming 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1325534.

17 *See* Ben S. Bernanke, Chairman, Bd. of Governors, Fed. Reserve Sys., Address at the Federal Reserve System Conference on Housing and Mortgage Markets (Dec. 4, 2008), *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20081204a.htm#f12 (noting that the number of foreclosures has more than doubled from pre-crisis levels).

18 Manuel Adelino, Kristopher Gerardi & Paul S. Willen, *Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitization* (Fed. Reserve Bank of Boston Pub. Pol'y Paper No. 09-4, July 6, 2009), *available at* http://www.bos.frb.org/economic/ppdp/2009/ppdp0904.pdf.

aggregate, modifications increase the principal balance.[19] While the first quarter 2009 data from the OCC and OTS shows that a majority of the modifications (excluding short term payment plans or forbearance agreements) decreased the payment, most of those modifications also increased the principal balance by capitalizing arrears.[20] Unsurprisingly, redefault rates on loan modifications remain high.[21]

HAMP's redefault rate will depend on the quality of the modifications offered. While in theory, HAMP modifications should have a lower rate of redefault because payments are reduced, there remain serious questions about the quality of HAMP modifications. We do not yet have any data on the characteristics or performance of the HAMP loan modifications. However, extensive reports from advocates around the country show that the quality of loan modifications offered too often does not comport with HAMP guidelines. Advocates for homeowners continue to report problems with implementation of the program.[22] Servicers are all too often refusing to do HAMP modifications, soliciting a waiver of homeowners' rights to a HAMP review, and structuring offered modifications in ways that violate HAMP. These violations may be harder to detect than the gross failure of servicers to date to process a meaningful number of modifications, but they will vitiate HAMP just as surely. As discussed below, even if HAMP operated at the highest level of

19 Alan White, *Rewriting Contracts, Wholesale: Data on Voluntary Mortgage Modifications from 2007 and 2008 Remittance Reports,* Fordham Urb. L. J. 20 (forthcoming 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1259538#

20 Office of the Comptroller of the Currency & Office of Thrift Supervision, OCC and OTS Mortgage Metrics Report: Disclosure of National Bank and Federal Thrift Mortgage Loan Data, First Quarter 2009, at 5 (June 2009), *available at* http://files.ots.treas.gov/482047.pdf.

21 Office of the Comptroller of the Currency & Office of Thrift Supervision, OCC and OTS Mortgage Metrics Report: Disclosure of National Bank and Federal Thrift Mortgage Loan Data, First Quarter 2009, at 6 (June 2009), *available at* http://files.ots.treas.gov/482047.pdf.

22 *See, e.g.,* California Reinvestment Coalition, *The Ongoing Chasm Between Words and Deeds: Abusive Practices Continue to Harm Families and Communities in California* (2009); Peter S. Goodman, *Paper Avalanche Buries Plan to Stem Foreclosures,* N.Y. Times, June 29, 2009.

expectations, it appears that foreclosures still would outpace modifications. While not every homeowner can and should receive a modification, more will need to be done.

Moreover, the lack of mandated principal reductions under HAMP raises questions about the long-term sustainability of the modifications. Absent a mandate of principal reduction, almost all borrowers are likely denied the possibility of principal reductions, which undermines the long-term success of their modifications, and thus their homeownership. The double-whammy of declining home values and job losses helps fuel the current foreclosure crisis.[23] Homeowners who could normally refinance their way out of a lost job or sell their home in the face of foreclosure are denied both options when they owe more on their home than it is worth. Without principal reductions, homeowners who lose their jobs, have a death in the family, or otherwise experience a drop in income are more likely to experience redefault and foreclosure.[24] The threat of high rates of redefault looms without a meaningful way to reduce the principal balance of mortgages.
HAMP will, at best, reduce foreclosures by one-third; it is unlikely to shrink the foreclosure numbers to pre-crisis levels. Last week, Assistant Treasury Secretary Herbert Allison, in responding to questioning from the Senate Banking Committee, agreed that in order to meet Treasury's goals of doing 3 to 4 million modifications by 2012, they would need to do 1 million per year—approximately 20,000 per week.[25] Even if the Administration reaches those numbers, that will

[23] *Preserving Homeownership: Progress Needed to Prevent Foreclosures: Hearing Before the Senate Commi. on Banking, Housing & Urban Affairs*, 111th Cong. (July 16, 2009), at 4-5 (testimony of Paul Willen).
[24] This is especially so since the HAMP modification program does not permit a second HAMP modification for any reason, even if there is a subsequent, unavoidable drop in income.
[25] *Preserving Homeownership: Progress Needed to Prevent Foreclosures: Hearing Before the Senate Commi. on Banking, Housing & Urban Affairs*, 111th Cong. (July 16, 2009) (Senator Schumer's question of Assistant Treasury Secretary Herbert Allison).

address no more than one-third of all foreclosures.[26] This leaves a majority of all foreclosures still unaddressed, and the foreclosure rate still significantly elevated compared to more normal times.[27]

The numbers to date offer slim hope that the anything like one million mortgages a year will be modified under HAMP..[28] The good news is that, on paper at least, 85 percent of all the loans in the country should be covered by HAMP.[29] The bad news is that Treasury's initial report indicated that only 55,000 trial modifications had been offered and only 300,000 letters with information about trial modifications had been sent to homeowners. More recent reports by Treasury in Congressional testimony—of 325,000 offers of trial modifications and 160,000 actual trial modifications,[30] --are not much more encouraging. At 160,000 trial modifications every four months, the program is on pace to modify only 480,000 mortgages a year—not even half of its annual goal—assuming that every trial modification in fact leads to a permanent modification.

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26 If we compare the Center for Responsible Lending's predictions of 9 million foreclosures for the period 2009-2012, Center for Responsible Lending, Soaring Spillover 1 (May 2009), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/soaring-spillover-3-09.pdf., with Treasury's prediction that HAMP will provide 3-4 million modifications over the same period, and then recognize that not every modified loan would have resulted in a foreclosure absent modification, one-third seems a generous estimate for the amount of reduction in the foreclosure rate afforded by HAMP.

27 *See* Ben S. Bernanke, Chairman, Bd. of Governors, Fed. Reserve Sys., Address at the Federal Reserve System Conference on Housing and Mortgage Markets (Dec. 4, 2008), *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20081204a.htm#f12 (noting that the number of foreclosures has more than doubled from pre-crisis levels). While a substantial portion of the homeowner whose loans will not be modified by HAMP may be unemployed or have reduced paychecks, some portion of these homeowners will be able to support a loan modification or qualify for other temporary assistance.

28 United States Department of the Treasury, *Making Home Affordable Progress Report,* May 14, 2009, *available at* http://www.treas.gov/press/releases/docs/05142009ProgressReport.pdf. Assistant Treasury Secretary Herbert Allison recently testified that trial modification offers are up to 325,000, and, in response to questioning, he stated that approximately 160,000 trial modifications are in process, although his written testimony put that number in the tens of thousands. *Preserving Homeownership: Progress Needed to Prevent Foreclosures: Hearing Before the Senate Commi. on Banking, Housing & Urban Affairs,* 111th Cong. (July 16, 2009) (testimony of Assistant Treasury Secretary Herbert Allison)

29 *Preserving Homeownership: Progress Needed to Prevent Foreclosures: Hearing Before the Senate Commi. on Banking, Housing & Urban Affairs,* 111th Cong. (July 16, 2009) (testimony of Assistant Treasury Secretary Herbert Allison); *see also* United States Department of the Treasury, *Making Home Affordable Progress Report,* May 14, 2009, *available at* http://www.treas.gov/press/releases/docs/05142009ProgressReport.pdf.(75% of loans serviced by participating institutions as of May 2009).

30 *Preserving Homeownership: Progress Needed to Prevent Foreclosures: Hearing Before the Senate Commi. on Banking, Housing & Urban Affairs,* 111th Cong. (July 16, 2009)(testimony of Assistant Treasury Secretary Herbert Allison).

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In part, this slow start reflects problems with staffing at the servicers. Servicers are still staffing up to deal with homeowners in distress.[31] Administration officials have admitted that the industry is not yet up to the task.[32] The progress servicers have made in hiring loan modification staff, although real, is not keeping up with the numbers of foreclosures filed by those same servicers. In part, the slow numbers of HAMP modifications reflect a general decline in the pace of loan modifications this year: although modifications increased during the first quarter of 2009, all data indicate that the number and rate of total modifications fell back during the second quarter.[33]

As a result, the numbers of modifications are, as the President acknowledges, outstripped by foreclosures .[34] The 325,000 letters containing information about trial modifications are obscured by the more than 2 million homeowners in foreclosure and the over 770,000 new foreclosure starts in the first quarter alone.[35] The total letters sent over first four months under HAMP—325,000—barely keep pace with the monthly foreclosure starts [36] Actual HAMP trial mods, of 160,000 over the first four months, are outpaced more than two times by a single month's foreclosure starts.

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31 *See, e.g.,* Peter S. Goodman, *Promised Help Is Elusive for Some Homeowners*, N.Y. Times, June 3, 2009.

32 Peter S. Goodman, *Paper Avalanche Buries Plan to Stem Foreclosures*, N.Y. Times, June 29, 2009) (quoting Michael Barr, Assistant Secretary for Financial Institutions at the Treasury Department: "They need to do a much better job on the basic management and operational side of their firms . . . .What we've been pushing the servicers to do is improve their infrastructure to make sure their call centers are doing a better job. The level of training is not there yet.').

33 *See, e.g.,* Gretchen Morgenson, *Fair Game—So Many Foreclosures, So Little Logic*, N.Y. Times, July 4, 2009 (reporting that modifications peaked in February 2009 and have since declined while the number of foreclosures and delinquencies has continued to rise); California Reinvestment Coalition, *The Ongoing Chasm Between Words and Deeds: Abusive Practices Continue to Harm Families and Communities in California* (2009) (reporting observations by housing counselors that loan modifications declined in the second quarter); *Home Foreclosures: Will Voluntary Mortgage Modification Help Families Save Their Homes?: Hearing Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary*, 111th Cong. (2009) (testimony of Alan M. White).

34 Tami Luhby, *Obama Mortgage Pan Needs Work: Many borrowers are not getting help under president's modification or refinancing plan*, CNN Money.com, July 8, 2009; Press Conference by the President, The White House, Office of the Press Secretary (June 23, 2009), *available at* http://www.whitehouse.gov/the_press_office/Press-Conference-by-the-President-6-23-09/ ("Our mortgage program has actually helped to modify mortgages for a lot of our people, but it hasn't been keeping pace with all the foreclosures that are taking place,").

35 Mortgage Bankers' Ass'n, Nat'l Delinquency Survey Q109 at 4 (2009) (reporting that 3.85% of 44,979,733 mortgages surveyed were in foreclosure in the first quarter and that 1.37% of mortgages surveyed had foreclosure starts in the first quarter; the MBA survey data covers 80% of the mortgage market, so the numbers are extrapolated by dividing the MBA numbers by 80%).

36 Realtytrac, 1.9 Million Foreclosure Filings Reported On More Than 1.5 Million U.S. Properties in First Half of 2009, *available at* http://www.realtytrac.com/ContentManagement/PressRelease.aspx?channelid=9&ItemID=6802.

Moreover, these are still only trial modifications, with no assurance that they will lead to permanent modifications.

III. Servicers' Lack of Alignment with the Interests of Investors or Homeowners Contributes to the Failure to Do Loan Modifications.

As discussed above, despite widespread calls for more modifications, the number of modifications remains paltry compared to the number of foreclosures. And investors are losing mind-boggling large sums of money on foreclosures.[37] The available data suggests that investors lose ten times more on foreclosures than they do on modifications.[38] In particular, leading investor groups have advocated broader use of principal reductions as part of the anti-foreclosure arsenal, but only a handful of servicers have obliged.[39]

A. Servicers Have Different Interests Than Investors.

In attempting to make sense of this puzzle, we should remember that servicers are not investors. Investors hold the note, or a beneficial interest in it, and are, in general, entitled to repayment of the interest and principal. Servicers collect the payments from the homeowners on behalf of the investors. The bulk of their income comes from a percentage payment on the outstanding principal balance in the pool; the bulk of their net worth is tied to the value of the mortgage servicing rights they purchased. A servicer may or may not lose money—or lose it in the same amounts or on the

37 *Home Foreclosures: Will Voluntary Mortgage Modification Help Families Save Their Homes? Hearing Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary*, 111th Cong. (2009) (testimony of Alan M. White) (65% loss severity rates on foreclosures in June 2009).

38 *Home Foreclosures: Will Voluntary Mortgage Modification Help Families Save Their Homes? Hearing Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary*, 111th Cong. (2009) (testimony of Alan M. White).

39 *Preserving Homeownership: Progress Needed to Prevent Foreclosures: Hearing Before the Senate Commi. on Banking, Housing & Urban Affairs*, 111th Cong. (July 16, 2009) (testimony of Curtis Glovier, on behalf of the Mortgage Investors Coalition).

same scale—when an investor loses money. And it is servicers, not investors, who are making the day-to-day, on the ground, decisions as to whether or not to modify any given loan.

Servicers continue to receive most of their income from acting as largely automated pass-through accounting entities, whose mechanical actions are performed offshore or by personified computer systems.[40] Their entire business model is predicated on making money by skimming profits from what they are collecting: through a fixed percentage of the total loan pool, fees charged homeowners for default, interest income on the payments during the time the servicer holds them before they are turned over to the owners, and affiliated business arrangements. Servicers make their money largely through lucky or strategic investment decisions: purchases of the right pool of mortgage servicing rights and the correct interest hedging decisions. Performing large numbers of loan modifications would cost servicers upfront money in fixed overhead costs, including staffing and physical infrastructure.

B. Servicers' Business Model Involves As Little Service As Possible.

As with all businesses, servicers add more to their bottom line to the extent that they can cut costs.[41] Servicers have cut costs by relying more on voicemail systems and less on people to assist homeowners, by refusing to respond to homeowners' inquires and by failing to resolve borrower disputes. Servicers sometimes actively discourage homeowners from attempting to resolve matters.

As one attorney in Michigan attempting to arrange a short sale with Litton reports, the voice mail warns "If you leave more than one message, you will be put at the end of the list of people we call

[40] *See, e.g., In re* Taylor, 2009 WL 1885888 (Bankr.E.D.Pa. Apr 15, 2009).
[41] *See* Joseph R. Mason, Servicer Reporting Can Do More for Modification than Government Subsidies 17 (Mar. 16, 2009), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1361331(noting that "servicers' contribution to corporate profits is often . . . tied to their ability to keep operating costs low").

back." Recent industry efforts to "staff-up" loss mitigation departments have been woefully inadequate.[42] As a result, servicers remain unable to provide affordable and sustainable loan modifications on the scale needed to address the current foreclosure crisis. Instead homeowners are being pushed into short-term modifications and unaffordable repayment plans.

Creating affordable and sustainable loan modifications for distressed homeowners on a loan-by-loan basis is labor intensive.[43] Under many current pooling and servicing agreements, additional labor costs incurred by servicers engaged this process are not compensated by the loan owner. By contrast, servicers' costs in pursuing a foreclosure are compensated. In a foreclosure, a servicer gets paid before an investor; in a loan modification, the investor will usually continue to get paid first. Under this cost and incentive structure, it is no surprise that servicers continue to push homeowners into less labor-intensive repayment plans, non-HAMP loan modifications, or foreclosure.

Post hoc reimbursement for individual loan modifications is not enough to induce servicers to change their existing business model. This business model—of fee-collecting and fee-skimming—has been extremely profitable. A change in the basic structure of the business model to active engagement with homeowners is unlikely to come by piecemeal tinkering with the incentive structure. Indeed, some of the attempts to adjust the incentive structure of servicers have resulted in confused and conflicting incentives, with servicers rewarded for some kinds of modifications, but

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42 Larry Cordell, Karen Dynan, Andreas Lehnert, Nellie Liang, & Eileen Mauskopf, *The Incentives of Mortgage Servicers: Myths and Realities* 9-10 (Fed. Reserve Bd. Fin. & Econ. Discussion Series Div. Research & Statistical Affairs Working Paper No. 2008-46); State Foreclosure Prevention Working Group, Analysis of Subprime Mortgage Servicing Performance, Data Report No. 3 at 8 (2008), http://www.csbs.org/Content/NavigationMenu/Home/SFPWGReport3.pdf; Preston DuFauchard, California Department of Corporations, Loss Mitigation Survey Results 4 (Dec. 11, 2007); *cf.* Aashish Marfatia, Moody's, U.S. Subprime Market Update November 2007 at 3 (2008) (expressing concern as to servicers' abilities to meet staffing needs).

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

not others,[44] or told both to proceed with a foreclosure and with a modification. Until recently, servicers received little if any explicit guidance on which modifications were appropriate and were largely left to their own devices in determining what modifications to make.[45] In the face of an entrenched and successful business model, fragmented oversight, and weak, inconsistent, and post hoc incentives, servicers need powerful motivation to perform significant numbers of loan modifications. Servicers clearly have not yet received such powerful motivation.

Servicers may make a little money by making a loan modification, but it will definitely cost them something. On the other hand, failing to make a loan modification will not cost the servicer any significant amount out-of-pocket, whether the loan ends in foreclosure or cures on its own. Until servicers face large and significant costs for failing to make loan modifications, until servicers are actually at risk of losing money if they fail to make modifications, no incentive to make modifications will work. What is lacking in the system is not a carrot; what is lacking is a stick.[46] Servicers must be required to make modifications, where appropriate, and the penalties for failing to do so must be certain and substantial.

C. Servicers Maximize Income in Ways that Hurt Both Homeowners and Investors.

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44 *See, e.g.,* Ben S. Bernanke, Chairman, Bd. of Governors of the Federal Reserve System, Speech at the Federal Reserve System Conference on Housing and Mortgage Markets: Housing, Mortgage Markets, and Foreclosures (Dec. 4, 2008), *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20081204a.htm ("The rules under which servicers operate do not always provide them with clear guidance or the appropriate incentives to undertake economically sensible modifications.").

45 American Securitization Forum, Discussion Paper on the Impact of Forborne Principal on RMBS Transactions 1 (June 18, 2009), *available at* http://www.americansecuritization.com/uploadedFiles/ASF_Principal_Forbearance_Paper.pdf.

46 *See Helping Families Save Their Homes: The Role of Bankruptcy Law: Hearing Before the S. Comm. on the Judiciary,* 110th Cong., 2nd Sess. (Nov. 19, 2008), *available at* http://judiciary.senate.gov/hearings/testimony.cfm?renderforprint=1&id=3598&wit_id=4083 (statement of Russ Feingold, Member, Sen. Comm. on the Judiciary) ("One thing that I think is not well understood is that because of the complex structure of these securitized mortgages that are at the root of the financial calamity the nation finds itself in, voluntary programs to readjust mortgages may simply be doomed to failure.").

Servicers are designed to serve investors, not borrowers. Despite the important functions of mortgage servicers, homeowners have few market mechanisms to employ to ensure that their needs are met. Rather, in the interest of maximizing profits, servicers have engaged in a laundry list of bad behaviors, which have considerably exacerbated foreclosure rates, to the detriment of both investors and homeowners.[47]

Most servicers derive the majority of their income based on a percentage of the outstanding loan principal balance.[48] For most pools, the servicer is entitled to take that compensation from the monthly collected payments, even before the highest-rated certificate holders are paid. The percentage is set in the PSA and can vary somewhat from pool to pool, but is generally 25 basis points for prime loans and 50 basis points for subprime loans.[49] This compensation may encourage servicers to refuse principal reductions and to seek capitalizations of arrears and other modifications that increase the principal balance.

Servicers also receive fees paid by homeowners and the "float"—the interest earned on funds they are holding prior to their disbursement to the trust.[50] For many subprime servicers, late fees alone constitute a significant fraction of their total income and profit.[51] Servicers thus have an incentive to push homeowners into late payments and keep them there: if the loan pays late, the servicer is more

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47 *See* National Consumer Law Center, Foreclosures, Ch. 6 (2d ed. 2007 & Supp.) (describing the most common mortgage servicing abuses).

48 *See, e.g.,* Ocwen Fin. Corp., Annual Report (Form 10-K), at 3 (Mar. 17, 2008) (typically receive 50 basis points annually on the total outstanding principal balance of the pool).

49 Anthony Pennington-Cross & Giang Ho, *Loan Servicer Heterogeneity & The Termination of Subprime Mortgages* 2 (Fed. Res. Bank of St. Louis Working Paper No. 2006-024A); 26 NCLC Reports, *Follow the Money: How Servicers get Paid* May/June 2008..

50 *See generally In re* Stewart, 391 B.R. 327, 336 (Bankr.E.D.La. 2008) (overviewing servicer compensation).

51 *See, e.g.,* Ocwen Fin. Corp., Annual Report (Form 10-K), at 3 (Mar. 17, 2008); Kurt Eggert, *Limiting Abuse and Opportunism by Mortgage Servicers,* 15 Housing Pol'y Debate 753, 758 (2004).

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likely to profit than if the loan is brought and maintained current. Float income encourages servicers to delay turning over payments to investors for as long as possible.

For servicers, their most important asset is the value of their mortgage servicing rights. Whether or not the servicer made the correct speculative investment decision when it bought the mortgage servicing rights to a pool of mortgages does more to shape its profitability than any other single factor. A servicer's performance has only a marginal impact on the performance of the loan pool; the way a servicer increases its net worth is not by doing a top-notch job of servicing distressed mortgages but by gambling on market trends. Servicers with thin margins may need to squeeze all they can out of increasing performance from delinquent loans; servicers with stronger pools are likely to be less invested in the performance of the loans they manage.[52] This dynamic leaves many servicers indifferent to the performance of the loans they service and unmotivated to hire and train the staff needed to improve performance.

D. Servicers Have Disincentives to Perform Principal Reductions, Even When Doing So Would Benefit the Trust

Some servicers, notably Ocwen, Litton, and, to a lesser extent, Carrington, have made significant numbers of principal reductions. But other servicers—including those who are also major lenders—have not. In part, this represents nothing more than experience: Ocwen has more experience modifying loans than many other servicers. In part, it reflects the varying incentives servicers have weighing against loan modifications.

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52 Vikas Bajaj & John Leland, *Modifying Mortgages Can Be Tricky,* N.Y. Times, Feb. 18, 2009 (reporting views of Credit Suisse analyst that "[s]maller companies . . . that are under more financial pressure and have more experience in dealing with higher-cost loans have been most aggressive in lowering payments" than larger companies, who offer weaker modifications).

Of key importance is whether or not the loss of a principal reduction is recognized immediately or if it is delayed. Most PSAs are silent on the treatment of principal reductions or forebearance.[53] If recognition of the loss is immediate, servicers face reduced income in two ways, their monthly servicing fee and income from any subordinate tranches. Only if recognition of the loss is delayed are servicers likely to be neutral or even positive towards principal reductions.[54] This accounting nicety accounts, in part, some industry analysts believe, for the high rate of loan modifications with principal reductions performed by Ocwen in 2007.[55]

As discussed above, servicers derive the bulk of their income from the monthly servicing fee. The monthly servicing fee is set as a percentage of the outstanding loan principal balance in the pool. Once a principal write down is recognized, the outstanding principal balance of the pool declines and so does the servicer's monthly fee.

Servicers will also take a hit against their residual income if the loss is recognized immediately. Commonly, servicers hold the lowest level investment interests in the pool, called residuals.[56] Residuals represent payment of the surplus income after the senior certificate holders have been paid. If the pool shrinks, through foreclosure, prepayment, or principal reduction, or the interest

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53 *See* American Securitzation Forum, Discussion Paper on the Impact of Forborne Principal on RMBS Transactions 1 (June 18, 2009), *available at* http://www.americansecuritization.com/uploadedFiles/ASF_Principal_Forbearance_Paper.pdf.

54 *See generally* American Securitzation Forum, Discussion Paper on the Impact of Forborne Principal on RMBS Transactions (June 18, 2009), available at http://www.americansecuritization.com/uploadedFiles/ASF_Principal_Forbearance_Paper.pdf (discussing impact of accounting for principal forbearance).

55 Ocwen was apparently not recognizing the loss immediately, and thus shifting more of the pain to senior bond holders and away from the subordinate tranches. Rod Dubitsky, Larry Yang, Stevan Stevanovic, Thomas Suer, Credit Suisse, Subprime Loan Modifications Update 7-8 (2008).

56 *See, e.g.,* Ocwen Fin. Corp., Annual Report (Form 10-K), at 20 (Mar. 17, 2008); Joseph R. Mason, Mortgage Loan Modification: Promises and Pitfalls 8 (Oct. 2007) (servicers who own residual interests always lose money when loans are modified). In some cases, the servicer may even bet against itself, by purchasing a credit default swap on the pool, in which case it makes money if there is a foreclosure. *See* Patricia A. McCoy & Elizabeth Renuart, The Legal Infrastructure of Subprime and Nontraditional Home Mortgages 36 (2008), *available at* http://www.jchs.harvard.edu/publications/finance/understanding_consumer_credit

rate drops on the loans in the pool due to modifications, there will be less of a surplus, and the servicer will suffer a loss. Once a pool suffers a certain level of loss, further payments out of residual income are cut off. If the loss is recognized immediately, the subordinate tranches in most cases bear the entire cost.[57] Since industry practice, despite the silence in the PSAs, has now moved towards recognizing the principal write down as an immediate loss, many servicers may be doubly reluctant to write down principal, regardless of the investors' druthers.[58]

E. The Possibility of Cure Does Not Explain Servicers' Failure to Make Loan Modifications in the Current Market.

A recent paper confirms that extremely few loan modifications are being done and, in an attempt to solve the puzzle, propounds an economic model to explain the dearth of loan modifications.[59] Under the terms of that economic model, investors recover more if a borrower brings the loan current or refinances than if the lender modifies the loan. This is a commonsense and unobjectionable observation. Both the FDIC Loan Mod-in-a-Box NPV test and the HAMP NPV test build in the likelihood of cure in determining whether a loan modification or foreclosure is the more profitable path for investors.

In more normal times, it is surely rational for a servicer to spare itself the time and expense of modifying a loan in favor of the possibility of cure. In normal times, when cure rates exceeded

57 *See* American Securitzation Forum, Discussion Paper on the Impact of Forborne Principal on RMBS Transactions 3-6 (June 18, 2009), *available at* http://www.americansecuritization.com/uploadedFiles/ASF_Principal_Forbearance_Paper.pdf.

58 *See* Rod Dubitsky, Larry Yang, Stevan Stevanovic, Thomas Suer, Credit Suisse, Subprime Loan Modifications Update 7-8 (2008).

59 Manuel Adelino, Kristopher Gerardi & Paul S. Willen, *Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitization* 35 (Fed. Reserve Bank of Boston Pub. Pol'y Paper No. 09-4, July 6, 2009), *available at* http://www.bos.frb.org/economic/ppdp/2009/ppdp0904.pdf.

foreclosure rates, an investor would have little objection to the wait-and-see-approach.[60] However, this model cannot explain the failure to perform loan modifications when we observe real world conditions: dropping cure rates, due in part to the restricted ability to refinance, even for homeowners with high credit scores;[61] homes so deeply underwater that investors lose 65 percent of the mortgage debt on average in foreclosure;[62] and a lack of other, more attractive places, to invest funds. The study does not run actual net present value analyses on actual loans: many loans that it would not make sense to modify in a market with rising home prices, easy refinancing, and plentiful alternative investment channels do make sense, purely from the standpoint of financial return to investors, to modify in today's economic market. The paper presents no hard data on whether or not servicers, in this climate, are serving the best interests of investors in refusing to modify loans. Servicers, moreover, may have different incentives than investors, and it is not clear that servicers do always make loan modification based upon the best interests of the trust as a whole.

What we know from this study is that servicers are not making modifications. We believe that more modifications could be made that would serve the interests of both investors and homeowners, as well as the national economy. As Professor Alan White noted in his recent testimony before a House subcommittee,[63] and as the authors acknowledge,[64] there may be compelling public policy

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60 Alan White, *Rewriting Contracts, Wholesale: Data on Voluntary Mortgage Modifications from 2007 and 2008 Remittance Reports,* Fordham Urb. L. J 17-18 (forthcoming 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1259538#; *see also* Aashish Marfatia, Moody's, U.S. Subprime Market Update November 2007 at 5 (2008) (reporting that half of all active loans facing reset in the first three-quarters of 2007 refinanced; more than one-quarter of all remaining loans refinanced after reset); State Foreclosure Prevention Working Group, Analysis of Subprime Mortgage Servicing Performance, Data Report No. 3 at 8 (2008), http://www.csbs.org/Content/NavigationMenu/Home/SFPWGReport3.pdf (reporting that 23% of closed loss mitigation efforts in May 2008 were either refinancings or reinstatements in full by the borrower).

61 David Streitfeld, *Tight Mortgage Rules Exclude Even Good Risks,* N.Y. Times, July 10, 2009.

62 *Home Foreclosures Will Voluntary Mortgage Modification Help Families Save Their Homes? Hearing Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary,* 111th Cong. (2009) (testimony of Alan M. White).

63 *Home Foreclosures: Will Voluntary Mortgage Modification Help Families Save Their Homes? Hearing Before the Subcomm. on Commercial and Administrative Law of the H. Comm on the Judiciary,* 111th Cong. (2009) (testimony of Alan M. White).

reasons to increase the number of modifications. Foreclosures impose high costs on families, neighbors, extended communities, and ultimately our economy at large.[65] It would be short-sighted indeed to fail to act.

IV. HAMP Design and Implementation Present Substantial Barriers to High Volume, High Quality Loan Modifications

HAMP has the potential to increase both the quantity and the quality of loan modifications made. By mandating a take-one, take-all policy, requiring servicers of GSE loans to modify loans, and standardizing the loan modification process, HAMP should increase the total number of modifications. By mandating affordable payments, limiting the fees charged, and permitting principal reductions, HAMP will increase the quality of the loan modifications offered. Yet the program has significant limitations both in design and implementation. HAMP's ability to guarantee an increase in sustainable modifications is dependent on voluntary servicer participation in the program. Several large servicers are still not participating, and the patchwork coverage is confusing to homeowners and their advocates alike.

More seriously, homeowners have no leverage to obtain a HAMP loan modification from even a participating servicer. It is unclear if the Administration's compliance efforts will be able to detect and remedy servicer noncompliance. Whether or not HAMP's equalization of the incentives for principal or interest rate reductions will be enough to boost the number of modifications that reduce principal also remains to be seen. Since loan modifications with principal reductions appear to have

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64 Manuel Adelino, Kristopher Gerardi & Paul S. Willen, *Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitization* 8 (Fed. Reserve Bank of Boston Pub. Pol'y Paper No. 09-4, July 6, 2009), *available at* http://www.bos.frb.org/economic/ppdp/2009/ppdp0904.pdf.

65 Ben S. Bernanke, Chairman, Bd. of Governors, Fed. Reserve Sys., Address at the Federal Reserve System Conference on Housing and Mortgage Markets (Dec. 4, 2008), *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20081204a.htm#f12

the lowest redefault rates,[66] HAMP's long-term success may be contingent on increasing the number of loan modifications with principal reductions and its great weakness in ensuring sustainable modifications may be its failure to mandate principal reductions. Moreover, it is not clear that even a best case HAMP scenario is sufficient to keep up with the foreclosure crisis. The leverage missing from HAMP is directly addressed by other proposals, including judicial modifications of distressed mortgages.

A. Problems with Servicers' Implementation of HAMP Plague Homeowners Seeking Loan Modifications.

Servicers' compliance with HAMP is, at best, erratic. There is widespread violation of the HAMP guidelines across many servicers. The lack of compliance arises in part from obvious and persistent short falls in staffing and training. Yet some of the violations of HAMP are embodied in form documents, perhaps reflecting a more conscious attempt to evade the HAMP requirements. Lack of transparency prevents homeowners from identifying violations. Lack of accountability prevents homeowners from obtaining any redress when violations are identified.

1. Participating servicers violate existing HAMP guidelines.

Waivers of claims and defenses are still being required by servicers.

The HAMP rollout language prohibits waivers of legal rights. Yet servicers still are seeking waivers from homeowners or an admission of default.[67] We have learned of many instances in which servicers require homeowners to waive all claims and defenses in order to obtain a loan modification

[66] *See, e.g.,* Roberto G. Quercia, Lei Ding, Janneke Ratcliffe, *Loan Modifications and Redefault Risk: An Examination of Short-Term Impact* (Center for Community Capital, March 2009), *available at* http://www.ccc.unc.edu/documents/LM_March3_%202009_final.pdf.

[67] *See* Attachment A, Ocwen Loan Servicing Loan Modification Agreement dated June 1, 2009 (seeking waiver of all legal rights by homeowner) Attachment B, Aurora Loan Services "workout agreement" dated May 20, 2009 (seeking homeowner admission of default and stating that the trial payments will not remove the homeowner from delinquency).

or even a loan modification review. Servicers also have asked homeowners to waive their right to a HAMP loan modification review in favor of a non-HAMP loan modification.[68] Not only does this violate HAMP rules but it demonstrates bad faith. Some servicers also are requiring homeowners to sign a waiver that states that any HAMP loan modification will be suspended if the homeowner subsequently files for bankruptcy.[69] These are form documents and thus unlikely to represent a random mistake by a line-level employee.

Some participating servicers offer non-compliant loan modifications.

All homeowners who request a HAMP review are entitled to one. Homeowners may elect a non-HAMP modification, but that should be the borrower's choice, informed by disclosure of all modification options.

Nonetheless, some servicers have told homeowners that they are providing a HAMP modification, only to provide documents that do not comport with the HAMP guidelines. These loan modifications are usually significantly less sustainable than a HAMP modification would be and often have higher costs. In addition to the waiver issue discussed above, advocates have been told that homeowners must pay large advance fees before a modification will be considered, homeowners have been required to complete hefty repayment plans before a review is conducted, and homeowners have been offered, as HAMP modifications, modifications limited to five years, with no limitation on interest rate increases after that time. Aurora, for example, represented to one advocate that it does not have the "right documents," although they have been publicly available for months, and so instead offered the borrowers old forms that contain waivers and are otherwise not

68 *See, e.g.,* Attachment C (Chase Agreement seeking to obtain waiver of homeowner's right to a HAMP loan modification in favor of a non-HAMP loan modification offered prior to March 4, 2009).

69 *See, e.g.,* Attachment D (WaMu HAMP trial plan agreement requiring waiver of HAMP loan modification if homeowner later enters bankruptcy).

HAMP compliant. Select Portfolio Servicing has insisted that a New York borrower make payments at a 44 percent debt-to-income ratio instead of the 31 percent mandated by HAMP.

Some participating servicers refuse to offer HAMP modifications.

The HAMP servicer contracts require that participating servicers review all homeowners in default for HAMP eligibility and that any borrower who requests a HAMP review be granted one, even if the borrower is not yet in default. Homeowners not yet in default but who are at imminent risk of default are eligible for a HAMP modification. Servicers may only refuse to perform a HAMP review if the pooling and servicing agreement (PSA) forbids modification. In that case, servicers are still expected to use all reasonable efforts to obtain an exception to the PSA.

Staff at some participating servicers routinely refuse to do HAMP loan modifications.[70] For example, in a New York case, the employee stated that the investor did not permit loan modifications, yet refused to produce a copy of the PSA or even identify the investor, much less attempt to obtain a release from the restrictions as required by HAMP. One California advocate pursuing a HAMP modification for a loan serviced by Wells Fargo was told repeatedly that the holder did not do modifications. After protracted discovery, the servicer identified the holder as Wells Fargo Home Mortgage. Wells Fargo Home Mortgage, of course, is owned by Wells Fargo Bank, a participating servicer under HAMP. In another case, a Select Portfolio Servicing representative said that the PSA prevented a HAMP modification, but could not provide the PSA due to "system errors." Other times servicers tell homeowners that they are not participating or that they are only participating for GSE loans. Bank of America has told homeowners in both

[70] *See, e.g., Home Foreclosures: Will Voluntary Mortgage Modification Help Families Save Their Homes? Hearing Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary*, 111th Cong. (2009) (testimony of Irwin Trauss) (Saxon Mortgage "simply reject[s] homeowners for consideration under HAMP, for no reason that is in any way connected with the program requirements, with no notice of any kind to the homeowner or to her counsel.").

Pennsylvania and Florida that it is only modifying loans that are owned by the GSEs.[71] Bank of America is a participating servicer under HAMP and therefore required to evaluate all loans for modification under HAMP. Some servicers have asserted that loans held by the GSEs require a higher debt-to-income ratio than HAMP, despite the implementation of nearly identical programs by both Fannie Mae and Freddie Mac. Advocates in both Ohio and Florida have been driven to file court documents to compel Wells Fargo to do a HAMP review and stay foreclosure proceedings, after Wells Fargo failed to complete a HAMP review.[72]

HAMP may even be causing a drop off in loan modifications. Loan modifications rose through the first quarter of the year, but fell after HAMP's roll out in March.[73] Bank of America informed an advocate that future HAMP modifications are put on hold while Treasury reviews Bank of America's version of the Net Present Value calculation. Other advocates and homeowners have been told more generally that their servicer is participating but that the servicer does not yet have a program to evaluate homeowners for HAMP. Ocwen, for example, told an advocate on July 1 that it did not know when it would be rolling out its HAMP modifications. Ocwen signed a contract as a participating servicer on April 16, two and a half months earlier. One Brooklyn, New York advocate was told that the investor was not allowing any modifications because they were waiting for the federal government to act. In the meantime, of course, foreclosures continue.

Servicers charge fees to homeowners for the modification.

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71 *See, e.g., Home Foreclosures: Will Voluntary Mortgage Modification Help Families Save Their Homes? Hearing Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary*, 111th Cong. (2009) (testimony of Irwin Trauss).

72 Motion to Set Aside the Judgment, Modify the Loan, and Dismiss the Foreclosure, U.S. Bank National Ass'n as Trustee HEAT 2006-1 v. Pitman, No. 2008-CV-337 (Greene County, Ohio, 2009); Motion to Stay/Abate, Deutsche Bank Nat'l Trust Company, as Trustee for HIS Asset Securitization Trust 2007-HE1 v. Hoyne, No. 42-2009-CA-002178 (Marion County, Fla., 2009).

73 Gretchen Morgenson, *Fair Game—So Many Foreclosures, So Little Logic*, N.Y. Times, July 4, 2009

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HAMP forbids any upfront payments as a precondition to review or trial modification. Several homeowners have reported being told by various servicers that they must make payments before being considered for HAMP.[74] Sometimes these payments take the form of a special forbearance agreement or lump-sum payment of arrearages; other times it is less clear what the payment is for. A Bank of America loss mitigation representative informed a Pennsylvania homeowner's counsel that if the homeowners paid $2,200.00 to Bank of America, then Bank of America would "consider" a loan modification. America's Servicing Company, a division of Wells Fargo Home Mortgage, told a New York borrower that only upon completion of a three month repayment plan, followed by a balloon payment of $18,000, could the borrower be considered for HAMP. Select Portfolio Servicing representatives demanded a payment in the amount of the original mortgage payment in order to enter the trial period agreement in order to demonstrate the borrower's "good faith."

Servicers are continuing to initiate foreclosures and sell homes at foreclosure sales while the HAMP review is pending. HAMP requires that no foreclosures be initiated and no foreclosure sales be completed during a HAMP review, although existing foreclosure actions may be pursued to the point of sale. Reports from around the country indicate that servicers are routinely placing homeowners into foreclosure during a HAMP review and, far worse, selling the home at foreclosure while the homeowner is waiting on the outcome of the HAMP review.

Servicers often negotiate loan modifications on a separate track from the personnel pursuing foreclosure. This structure results in homeowners being placed in foreclosure, and being subject to a foreclosure sale, while HAMP review is occurring.

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74 *See, e.g.,* Attachment A, Ocwen Loan Servicing Loan Modification Agreement dated June 1, 2009.

2. Servicer staffing and training still lag behind what is needed.

Homeowners encounter numerous bureaucratic barriers in attempting to negotiate a loan modification.

Homeowners' loan files are routinely lost.[75] Counselors report waits of months to hear back on review for a trial modification. In one case, Select Portfolio Services advised counsel for a New York borrower on three separate occasions over six weeks that the necessary broker price opinion had been cancelled due to "system errors" and a new request would have to be submitted. A Florida homeowner had his HAMP trial modification cancelled by Citimortgage for non-compliance, despite having submitted all required documents and payments as required, only to receive a HAMP solicitation letter the same day. His lawyer, in describing the situation to us, wrote, "It is driving the poor guy bananas."

To add insult to injury, homeowners are expected to return the documents within days of receipt. Homeowners in both New York and Florida have reported receiving the trial modification agreements the same day the servicer required their return. One Illinois homeowner received her trial modification agreement three days after she was required to return the agreement.

Staff of participating servicers continue to display alarming ignorance of HAMP.

Staff of participating servicers have told homeowners that HAMP does not exist. Several homeowners have reported being told to contact HUD since HAMP is a government program. HUD, of course, does not administer HAMP; participating servicers do. Bank of America apparently told the homeowners in one case that they were not eligible for HAMP because they were not in default.[76] This misinformation was given to the homeowner despite the fact that servicers are given an additional $500 incentive payment for modifying a loan prior to default. In

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75 Peter S. Goodman, *Paper Avalanche Buries Plan to Stem Foreclosures,* N.Y. Times, June 28, 2009.

76 Freda R. Savana, *Some Banks Not With the Program,* Bucks County Courier Intelligencer, July 14, 2009.

another case, Bank of America refused to modify a first lien position home equity line of credit, apparently under the belief that modifications of home equity lines of credit were banned as second liens, whether or not they actually were junior liens.

In one case, Select Portfolio Servicing (SPS) claimed that it could only take 80% of the applicants' gross income into consideration, regardless of HAMP guidelines and that the clients would have to reduce their debt obligations by $300 to be considered for a modification. The representatives appeared to be operating under SPS's standard screening process for non-HAMP modifications and were not familiar with the HAMP standards. In the same case, another SPS representative claimed that the investor on the loan would only allow for payment modifications at 44 percent debt-to-income ratio, not the 31 percent mandated by HAMP. In many cases, it is not clear if staff are applying the net present value test or if they are applying it correctly.[77]

A recent blurb from *Mortgage Servicing News Bulletin* captures the problem: "Confused About the Rescue Plan?"[78] Apparently many servicers are.

Non-participating servicers continue to represent themselves as participating in HAMP.

Some servicers give conflicting information on whether or not they participate in HAMP. American Home Mortgage Servicing, for example, conveyed on its web site, automated answering service, and through its loan modification staff that it was a participating servicer under HAMP. Yet at least some of the loan modifications it offered were not HAMP-compliant, nor is it, as of July 13, 2009, listed as a participating servicer.

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77 *See, e.g., Home Foreclosures: Will Voluntary Mortgage Modification Help Families Save Their Homes? Hearing Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary*, 111th Cong. (2009) (testimony of Irwin Trauss) (discussing a case involving Wells Fargo).

78 Mortgage Servicing News Bull., July 14, 2009.

3. Lack of transparency is resulting in summary denials and other unreasonable acts by servicers.

Even when servicers do a HAMP review, they sometimes use the wrong numbers, which advocates are only able to uncover after a protracted battle. In one case involving a New York borrower, Select Portfolio Servicing representatives initially advised that the clients were ineligible for a HAMP loan modification, based on their budget. When asked for clarification about the grounds for this determination, SPS representatives claimed that the clients' expenses exceeded their income, making it impossible for them to afford their mortgage. Upon further discussion, it was revealed that SPS was using the clients' original mortgage payment as an input value for these calculations, rather than the proposed modified payment amount that would have made their mortgage affordable.

Some servicers are scrutinizing homeowner expenses and using back-end ratios as a basis for denying HAMP loan modifications. Back-end ratios, the ratio between all of the borrowers' fixed monthly obligations and income, should not disqualify a borrower under HAMP unless the reduced payment will cause the borrower severe financial hardship; instead, homeowners with back-end ratios above 55 percent are to be referred to HUD-certified housing counselors. In other cases, homeowners are turned down for loan modifications without any explanation.

Servicers refuse to provide the final payment amounts even when the borrower provides all verified information before the beginning of the trial modification period. In one case, three days after the servicer had supplied the borrower with the first set of trial modification documents and nearly two months after the borrower had submitted verified income information, the servicer increased the monthly payment amount, without any apparent justification.

The permanent modifications offered often include arrears that are undocumented and apparently overestimated. While HAMP permits arrearages and some fees to be capitalized, HAMP does not permit unpaid late fees to be capitalized. Given the widespread practice by servicers of padding fees in foreclosure or bankruptcy,[79] homeowners and their advocates have good reason to seek review of the legitimacy of the fees.

Some servicers claim they are doing a large volume of modifications for homeowners not eligible for HAMP, as well as many HAMP loan modifications. Whether or not the homeowners with the non-HAMP modifications were in fact eligible for HAMP is uncertain. As discussed above and exemplified in Attachment C, some servicers are requiring homeowners to waive their eligibility for a HAMP review in order to obtain any modification. The lack of public accountability makes it impossible to know how many of those reported as ineligible for HAMP were, in fact, ineligible, and how many were simply steered away from HAMP modifications.

In addition, determining whether or not any individual servicer is or is not participating is not trivial. As discussed above, some servicers represent themselves on their websites as participating, but fail to provide any HAMP review. As discussed below, confusion as to coverage of affiliated servicers is widespread.

B. Certain HAMP Policies Must Be Changed to Provide Sustainable Modifications and Save Communities.

1. Transparency must be improved.

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79 *See, e.g., In re* Stewart, 391 B.R. 327 (Bankr. E.D. La. 2008); *In re* Sacko, 394 B.R. 90 (Bankr. E.D. Pa. 2008); *In re* Prevo, 394 B.R. 847 (Bankr. S.D. Tex. 2008); *In re* Porter, 399 B.R. 113 (Bankr. D. N.H. 2008); Katherine Porter, *Misbehavior and Mistake in Bankruptcy Mortgage Claims,* 87 Tex. L. Rev 121 (2009).

The NPV model for qualifying homeowners must be available to the public.

A homeowner's qualification for a loan modification under HAMP is determined primarily through an analysis of the Net Present Value ("NPV") of a loan modification as compared to a foreclosure. The test measures whether the investor profits more from a loan modification or a foreclosure. Most investors require that servicers perform some variant of this test prior to foreclosure.[80] The outcome of this analysis depends on inputs including the homeowner's income, FICO score, current default status, debt-to-income ratio, and property valuation, plus factors relating to future value of the property and likely price at resale. Participating servicers are required to apply this analysis to all homeowners who are 60 days delinquent and those at imminent risk of default. Homeowners and their advocates need access to the program to determine whether servicers have actually and accurately used the program in evaluating the homeowner's qualifications for a HAMP modification. Without access to the NPV analysis, homeowners are entirely reliant on the servicer's good faith.

The lack of NPV transparency makes servicer turndowns hard to counteract. NPV turndowns must be detailed and in writing, and based on a transparent process that conforms to HAMP guidelines.

The layers of documents governing HAMP, the guidelines, the Supplemental Directives, the various FAQ's, and the servicer contracts, should be consolidated, reconciled, and clarified.

Homeowners, their advocates, and servicers have no one source of guidance on HAMP. The initial guidelines differ slightly from the Supplemental Directives, and the FAQs provide different interpretations. All of this complicates compliance.

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80 American Securitization Forum, *Statement of Principles, Recommendations and Guidelines for the Modification of Securitized Subprime Residential Mortgage Loans* (June 2007), *available at* http://www.americansecuritization.com/uploadedFiles/ASF%20Subprime%20Loan%20Modification%20Principles_060107.pdf.

Participating subsidiaries must be clearly identified

Participating servicers may, but need not, require their subsidiaries to participate, so long as the subsidiary is a distinct legal entity. However, if the subsidiary is not a distinct legal entity, then the subsidiary must participate. The public list of participating servicers still does not make these distinctions clear. One example of the confusion is Wells Fargo. On financialstability.gov, Wells Fargo Bank is listed as a participating servicer. Wells Fargo Bank, N.A., is, according to the National Information Center maintained by the Federal Reserve, the parent company of Wells Fargo Home Mortgage. The contract posted on financialstability.gov variously represents the covered servicer as Wells Fargo Bank, N.A. (when giving the address for notices) and Wells Fargo Home Mortgage, a division of Wells Fargo Bank, N.A. (above the signature lines). Does this contract mean that both Wells Fargo Bank, N.A., and Wells Fargo Home Mortgage are covered? And is America's Servicing Company, a division of Wells Fargo Home Mortgage also covered? The answer to both questions appears to be yes but has not been uncontested. Asking homeowners and counselors to wade through these legal relationships invites confusion and frustration.[81]

2. Mechanisms for enforcement and compliance should be adopted.

All foreclosure proceedings must be stopped upon the initiation of a HAMP review, not just at the point before sale.

While many servicers are placing homeowners in foreclosure and proceeding to sale in violation of HAMP guidelines (as described above), even compliance with the current rule is pushing homeowners into costlier loan modifications and tilting the scales toward foreclosure. In judicial foreclosure states, servicers are aggressively pursuing foreclosures while reviewing homeowners for loan modifications. As a result, homeowners are incurring thousands of dollars in foreclosure costs. Servicers either demand these payments upfront (an apparent violation of HAMP) or capitalize the

[81] We understand and appreciate that the Treasury Department is working on this issue. As is apparent, providing full information to the public on participating servicers is essential.

costs without permitting any review by the homeowner. In either event, these costs make it harder to provide an affordable loan modification and the continuation of the foreclosure causes homeowners great stress. All foreclosure proceedings should be stayed while HAMP reviews occur. Staying the foreclosures during the pendency of a HAMP review would encourage servicers to expedite their HAMP reviews, rather than delaying them.

Homeowners should be provided with an independent review process when denied a loan modification.

It seems unlikely that all servicers will always accurately evaluate the qualifications of every homeowner who is eligible for HAMP. Homeowners who are wrongly denied must be afforded an independent review process to review and challenge the servicer's determination that the borrower does not qualify for HAMP.

Homeowners should have access to an ombudsman to address complaints about the process.

Homeowners currently have no resource for addressing complaints, whether with a servicer's failure to return phone calls or offer of a non-compliant modification. Any forum for addressing homeowners' complaints must adhere to time lines for addressing complaints and provide public accounting as to the nature of the disputes and their resolution.

Denials based in part on a borrower's credit score should be accompanied by an adverse action notice under the Fair Credit Reporting Act.

The Fair Credit Reporting Act requires that if an adverse action in the provision of credit is taken based in part on the borrower's credit score that the borrower be advised of that adverse action and of the credit score upon which the decision was based.[82] The reason for that requirement is that

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82 15 U.S.C. §1681m.

credit scores often have errors, which a borrower may correct—but only if the borrower is aware of the error.

The Net Present Value test relies on credit scores to determine default and redefault rates. It is at least possible that those credit scores could result in the failure of the NPV test and the denial of a loan modification. Absent full transparency regarding the NPV calculation, homeowners are unlikely to know of the program's reliance on their FICO score or, if they do, whether or not their FICO score was the cause of their denial for a HAMP modification. An adverse action notice alerts homeowners to the possibility that an incorrect FICO score—which could be corrected—might be the reason their servicer denied a HAMP modification. Without an adverse action notice homeowners have little opportunity to address any potential problems.

3. The HAMP guidelines should be adjusted to provide more meaningful relief to homeowners without reducing their existing rights.

Homeowners need principal reductions, not forbearance.

Principal forgiveness is necessary to make loan modifications affordable for some homeowners. A significant fraction of homeowners owe more than their homes are worth.[83] The need for principal reductions is especially acute – and justified – for those whose loans were not adequately underwritten and either 1) received Payment Option Adjustable Rate Mortgage loans that negatively amortize until as much as 125 percent of the original balance is owed; or 2) obtained loans that were based on inflated appraisals. As a matter of equity and commonsense, homeowners should not be trapped in debt peonage, unable to refinance or sell.

83 *See* Renae Merle & Dina ElBoghdady, *Administration Fills in Mortgage Rescue Details*, Wash. Post, Mar. 5, 2009 (reporting that one in five homeowners with a mortgage owe more on their mortgages than their home is worth).

Practically, principal reductions may be key to the success of HAMP. Being "underwater" increases the risk of default, particularly when coupled with unaffordable payments.[84] Built into the HAMP NPV calculations is an assumption that default increases as a function of how far underwater the homeowner is. Existing data on loan modifications shows that loan modifications with principal reductions tend to perform better.[85] In order to bring down the redefault rate and make loan modifications financially viable for investors, principal reductions must be part of the package.[86]

The Federal Reserve Board's loan modification program directly requires principal reductions for those homeowners most underwater. Under that program, principal reductions are mandated when the outstanding loan balance exceeds 125 percent of the home's current market value. Not incidentally, under the most recent revisions to the Making Home Affordable refinance program, once the mark-to-market loan-to-value ratio is 125 percent, a homeowner may refinance. Thus, once the loan value is reduced to 125 percent of current market valuation, there is, at least for some homeowners, the possibility of refinancing. While a loan-to-value ratio of 125 percent still leaves homeowners underwater and restricts their options, it gives them some hope, as it permits the possibility of refinancing or even sale, after several years of payments or subsequent to a market rebound. A reduction only to 125 percent is still sufficiently harsh that it is likely to contain any moral hazard problems, yet it puts a finite bound on the homeowner's debt peonage.

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84 *See, e.g.,* Kristopher Gerardi, Christopher L. Foote, & Paul S. Willen, *Negative Equity and Foreclosure: Theory and Evidence* (Fed. Reserve Bank of Boston Pub. Pol'y Paper No. 08-3 , June 2008); Andrey Pavlov & Susan Wachter, *Aggressive Lending and Real Estate Markets* (Dec. 20, 2006), *available at* http://realestate.wharton.upenn.edu/newsletter/pdf/feb07.pdf.

85 Roberto G. Quercia, Lei Ding, Janneke Ratcliffe, *Loan Modifications and Redefault Risk: An Examination of Short-Term Impact* (Center for Community Capital, March 2009), *available at* http://www.ccc.unc.edu/documents/LM_March3_%202009_final.pdf.

86 *See* Ben S. Bernanke, Chairman, Bd. of Governors, Fed. Reserve Sys., Address at the Federal Reserve System Conference on Housing and Mortgage Markets (Dec. 4, 2008), available at http://www.federalreserve.gov/newsevents/speech/bernanke20081204a.htm#f12 ("[P]rincipal write-downs may need to be part of the toolkit that servicers use to achieve sustainable mortgage modifications.").

HAMP permits principal reductions, but does not mandate them, not even in the most extreme cases. HAMP does require forbearance, but only as a method for reducing payments. While forbearance provides affordable payments, it prevents a homeowner from selling or refinancing to meet a needed expense, such as roof repair or college tuition, and sets both the homeowner and the loan modification up for future failure. For all of these reasons, the HAMP guidelines should be revised so that they at least conform to the Federal Reserve Board's loan modification program by reducing loan balances to 125 percent of the home's current market value.

Homeowners suffering an involuntary drop in income should be eligible for a second HAMP loan modification. Even after a loan modification is done successfully and is performing, homeowners may still become disabled, lose their jobs, or suffer 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.

The failure to offer a second chance modification intensifies the problems with the failure to mandate principal reductions. Homeowners who experience adverse life events often refinance or sell their homes in order to avoid a foreclosure. But both of those options are foreclosed if homeowners owe more than their homes are worth. Without a second chance at a loan modification, homeowners who are underwater at the beginning of the modification are likely to be unable to avoid foreclosure should they suffer an involuntary drop in income.

Some servicers provide modifications upon re-default as part of their loss mitigation program. This approach should be standard and mandated, and should include continued eligibility for HAMP modifications rather than only specific servicer or investor programs.

Homeowners in bankruptcy should be provided clear access to the HAMP program.

As a result of the HAMP guidelines providing servicer discretion on whether to provide homeowners in bankruptcy access to HAMP modifications, homeowners generally are being denied such modifications. In at least one instance, a servicer is reported to have refused a modification on the basis of a former bankruptcy, a clear violation of the HAMP guidance. The HAMP guidelines should provide clear guidance on instances where a loan modification should be provided to homeowners in bankruptcy. The HAMP guidelines should explicitly provide that servicers must consider a homeowner seeking a modification for HAMP even if the homeowner is a debtor in a pending bankruptcy proceeding.

Some servicers have explained their reluctance to do loan modifications in bankruptcy by citing a fear of violating the automatic stay in bankruptcy. Neither the automatic stay nor the discharge order should be a bar to offering an otherwise eligible homeowner a loan modification. HUD, in recent guidance to FHA servicers, has explicitly recognized that offering a loan modification does not violate the automatic stay or a discharge order.[87]

Servicers should be required, upon receipt of notice of a bankruptcy filing, to send information to the homeowner's counsel indicating that a loan modification under HAMP may be available. Upon request by the homeowner and working through homeowner's counsel, servicers should offer

87 HUD Mortgagee Letter 2008-32, October 17, 2008.

appropriate loan modifications in accordance with the HAMP guidelines prior to discharge or dismissal, or at any time during the pendency of a chapter 13 bankruptcy, without requiring relief from the automatic stay, and, in the case of a chapter 7 bankruptcy, without requiring reaffirmation of the debt. The bankruptcy trustee should be copied on all such communications. All loan modifications offered in pending chapter 13 cases should be approved by the Bankruptcy Court prior to final execution, unless the Court determines that such approval is not needed. If the homeowner is not represented by counsel, information relating to the availability of a loan modification under HAMP should be provided to the homeowner with a copy to the bankruptcy trustee. The communication should not imply that it is in any way an attempt to collect a debt.

Two changes to the modification rules should also be made to facilitate access for homeowners in bankruptcy. First, the payment rules should take into account the fact that payments may be passed through the bankruptcy trustee, rather than directly from homeowner to servicer. Supplemental Directive 09-03 requires that the servicer receive a payment by the end of the first month that the trial plan is in effect. If the servicer does not receive the payment, the trial modification is terminated and the homeowner is disqualified from a permanent modification under HAMP. There is often an initial lag between passing the payments from the bankruptcy trustee to the servicer; homeowners should not be penalized for a delay over which they have no control and which is occasioned solely by their exercise of their right to file bankruptcy.

Second, the modification documents should explicitly prohibit servicers from requiring homeowners to reaffirm mortgage debts. Although the guidance and supplemental directive appear to allow homeowners not to reaffirm in bankruptcy, the form modification agreement requires reaffirmation by its terms in paragraph 4E. The modification agreement should be amended to restate explicitly that the borrower does not waive any claims by entering into the modification and that no reaffirmation of the debt is required. Because reaffirmations of home mortgages have the potential to deny homeowners a fresh start, many bankruptcy judges refuse to approve them. Congress recognized this concern with an amendment to the Bankruptcy Code in 2005 that permits mortgages to be serviced in the normal course after bankruptcy even if the mortgage has not been reaffirmed. These purported reaffirmation agreements made outside the mandatory notice and review procedures of section 523(c) and (d) of the Bankruptcy Code have no effect, are not enforceable, and the government should not be involved in encouraging the practice.

Mortgages should remain assumable as between spouses, children, and other persons with a homestead interest in the property.

Federal law, the Garn-St Germain Depository Act of 1982, specifically forbids acceleration when the property is transferred from one spouse to another and permits a spouse or child to assume the mortgage obligations.[88] Such transfers are most likely to occur upon death or divorce. They may also occur in the context of domestic violence. Freddie Mac has long allowed mortgage assumptions by relatives as one method of working out delinquent mortgages.

Following these policies, the HAMP program should allow mortgages for certain homeowners to be assumable. Homeowners who have recently suffered the death of a loved one should not find themselves immediately faced with foreclosure or suddenly elevated mortgage payments.

Fair lending principles must be ensured throughout the HAMP process.

[88] 12 U.S.C. § 1701j-3(d)(6) (2008) (transfer from borrower to spouse or children); 12 U.S.C. § 1701j-3(d)(7) (2008) (transfer to spouse pursuant to divorce decree or legal separation agreement).

Incentive payments for pre-default homeowners are aimed at the necessary policy of ensuring that homeowners already facing hardship obtain sustainable loans, yet the additional funds for such reviews may implicate fair lending issues. The home price decline protection program may result in payments focused more on non-minority areas and should be reviewed for fair lending concerns. Servicer incentive payments based on reductions in the dollar amount of a payment also may raise fair lending considerations. Moreover, hardship affidavits and paperwork must be made available in appropriate languages to ensure wide access to the program. Data on loan modifications and applications are essential to ensuring equitable access to the program; these data must all be available as of fall 2009. Any further delay will limit transparency and delay accountability.

HAMP application procedures should better recognize and lessen the impact of exigent circumstances.

Aspects of the loan modification procedures, or gaps in current guidance, create hurdles for certain homeowners. For example, victims of domestic violence are unlikely to be able to obtain and should not be required to obtain their abuser's signature on loan modification documents. While predatory lending and predatory servicing can create default and an imminent risk of default, as recognized by the HAMP plan, the hardship affidavit does not contain an explicit reference to either category. Thus, at present, a loan modification would be available only to a homeowner who realizes that the fraud and predatory behavior that resulted in unreasonable levels of debt are legitimate grounds for seeking a modification and who is able to articulate and defend that categorization to a line-level employee of the servicer who may be relying in a formulaic way on the categories contained in the hardship affidavit or may be outright hostile to claims of predatory behavior.

The trial modification program should be further formalized and clarified, such that homeowners receive assurances of the terms of the permanent modification and homeowners are not put into default on their loans if they are current at the onset of the trial modification.

The trial modification program currently complicates matters for participating homeowners by increasing costs and failing to maximize the chances for long-term success. Moreover, by binding homeowners but not servicers, it may further discourage some homeowners from participating.

Payments received during the trial modification period should be applied to principal and interest, not held in suspense until the end of the trial period. Trial modification payments should be applied as if the modification, and any capitalization, occurred at the outset of the trial period, with payments allocated accordingly between principal and interest. The policy of capitalizing arrears at the end of the modification period, including any difference between scheduled and modified payments, penalizes homeowners (including those not in default at the time of the trial modification) by raising the cost of the modification and increasing the chances that some homeowners will not pass the NPV test. The use of suspense accounts and capitalizing arrears after the trial period render meaningless the term "modification" in "trial modification."

In addition, homeowners who are not delinquent at the start of the trial period and who are making payments as agreed under the trial plan currently are reported to credit bureaus as making payments under a payment plan; this may register as a black mark against their credit. Homeowners should not face decreased credit scores simply because they are seeking to attain a responsible debt load. For homeowners in bankruptcy, the new rules defining when trial payments are "current" fail to take into account the delay in initial disbursement that may occur when payments are made through the chapter 13 trustee.

Finally, homeowners need some assurance at the time of the trial modification that, if their income is as represented upon approval of the trial modification, the servicer will provide a final modification on substantially similar terms. Homeowners are bound by the trial modification; it is not clear that servicers are.

The borrower is required to sign the trial modification documents, but the servicer is not. This one-sided contract discourages some homeowners and advocates. Homeowners may decide that the costs of a trial modification—the capitalized interest, the sunk payments, the potential adverse credit reporting—are not worth the uncertain benefit of a permanent modification. Some servicers compound this problem by telling homeowners seeking modifications that they are under no obligation to offer a permanent modification. Indeed, the trial modification agreement itself, in paragraph 2F, appears to allow servicers to choose not to complete a permanent modification. According to paragraph 2F, homeowners are not entitled to a permanent modification if the servicer fails to provide the borrower with "a fully executed copy of this Plan and the Modification Agreement." Should a servicer fail to provide the borrower with a fully executed copy, the borrower is left without a permanent modification and without any recourse, while the servicer may then retain the payments made and proceed to a foreclosure. Faced with this uneven exchange, many homeowners will rationally refuse to complete a trial modification, even if they would qualify for and benefit from a permanent modification.

The final modification agreement should make clear that the homeowners do not waive any rights nor are required to reaffirm the debt in order to enter into the modification.

Although the HAMP guidelines prohibit waiver of claims and defenses,[89] the language in paragraph 4E of the modification agreement, "[t]hat the Loan Documents are composed of duly valid, binding agreements, enforceable in accordance with their terms and are hereby reaffirmed," could be construed as a waiver of some claims, particularly claims involving fraud in the origination or execution of the documents. In addition to the problems posed by reaffirmation of the debt in bankruptcy, reaffirmation of the debt and loan documents outside of bankruptcy could be construed as a waiver of defenses to the debt. Servicers, as discussed above and demonstrated by the attachments, are seeking even stronger waivers of legal rights; the form documents should give such unauthorized behavior no shelter. The modification agreement should clearly state that the borrower does not waive any claims and defenses by entering into the agreement and that the borrower is not required to reaffirm the debt.

The second lien program should be further developed to promote coordination with first lien modifications; servicers should be required to participate in both programs.

Servicers continue to express ignorance of the second lien program and widely refuse to modify second liens. For example, Bank of America told a Pennsylvania borrower that a home equity line of credit could not be modified because it was "written" as a second lien, even though it was the primary, and only, lien against the property.

Servicers will often service both the first and second liens. Frequently, servicers themselves hold the second lien. Yet often servicers refuse to address the second lien, despite the incentives in HAMP to do so. Servicers who hold second liens may prefer to gamble on a market recovery rather than

[89] Supplemental Directive, 09-01, at 2, *available at* hmpadmin.com.

accept the incentive payments under HAMP and recognize their losses now. Many servicers will choose not to participate in the second lien program absent a federal mandate.

The second lien program should work in concert with the primary lien modification program to the greatest extent possible. Only such coordination will result in maximizing the potential of the program to save homes and communities.

4. Data collection and reporting should support the best HAMP outcomes possible.

The maximum amount of data should be made available to the public, including data on a loan-by-loan basis. The data should be made available in user-friendly formats that are easy to obtain and that allow for additional and varied processing and analysis. The data should be made available on a basis as close to real time as possible. Data collected by the government and disclosed to the public, including HAMP monitoring data and other data, should enable the government and the public to compare the performance of HAMP against specific benchmarks. The data should enable the government and the public to assess the extent to which HAMP is serving equitably those most heavily targeted for high risk loans (especially African-American, Latino and older borrowers).

V. Congress Should Pass Legislation Allowing For Judicial Mortgage Loan Modifications and Other Servicing Reforms If HAMP Does Not Produce Sufficient Results in Short Order.

Creating affordable and sustainable loan modifications for distressed homeowners is labor intensive. It is no surprise, then, that servicers continue to push homeowners away from HAMP loan modifications or delay the process substantially.

Initial data collection will make a more exact review of the HAMP program possible within the next few months. Freddie Mac already is engaged in substantial oversight. Our work nationwide on behalf of homeowners facing foreclosure and unaffordable loans tells us that many qualified homeowners are being unnecessarily turned away from HAMP, those receiving loan modifications often obtain terms quite different from HAMP, and even the HAMP-compliant modifications are limited in what they can do for homeowners with high loan principal balances.

We anticipate that the data will reflect the experience of hundreds of homeowners and their advocates, showing that HAMP is too narrow and too hard to implement. When the data substantiates our necessarily impressionistic description of the failures of HAMP, Congress should enact legislation to allow bankruptcy judges to modify appropriate mortgages in distress. First-lien home loans are the only loans that a bankruptcy judge cannot modify.[90] The failure to allow bankruptcy judges to align the value of the debt with the value of the collateral contributes to our ongoing foreclosure crisis. Moreover, it provides a solution to the severe implementation problems homeowners face when they are forced to seek help directly from mortgage servicers. The exclusion of home mortgages from bankruptcy supervision dates back to the 1978 Bankruptcy Code, when mortgages were generally conservative instruments with a simple structure. The goal was to support mortgage lending and homeownership. Today, support for homeownership demands that homeowners have greater leverage in their effort to avoid foreclosure. Congress also should mandate loan modifications where they are more profitable to investors than foreclosure. Loss mitigation, in general, should be preferred over foreclosure.

90 Second liens can be modified if they are, as many are in the current market, completely unsecured because the amount of the first lien equals or exceeds the market value of the property.

VI. Conclusion

Thank you for the opportunity to testify before the Subcommittee today. The foreclosure crisis is continuing to swell. We are drowning in the detritus of the lending boom of the last decade. The need to act is great. If it becomes clear, as is likely, that HAMP can not do the job on its own, additional steps that do not rely on voluntary measures by the mortgage industry are in order. Unless HAMP both increases its reach and mandates principal reductions, Congress should pass legislation to allow bankruptcy judges to modify home loans in bankruptcy and also should consider further reforms to the servicing industry. We look forward to working with you to address the challenges that face our nation's communities.

Attachment A—Ocwen Loan Modification Agreement

Ocwen Loan Servicing, LLC
P.O.Box 785052
Orlando, Florida 32878

WWW.OCWEN.COM

June 1, 2009

[redacted]

Loan Number: [redacted]
Property Address: [redacted]

PROPOSED MODIFICATION AGREEMENT

Dear Borrower(s):

Enclosed please find a proposed modification agreement (the "Agreement") on your loan referenced above for your review and consideration.

In order to accept this modification on your loan, you must complete ALL of the following steps **on or before** June 12, 2009, ("Due Date"):

1. **SIGN** the bottom of the Agreement on the line(s) for the Borrower(s);	
2. **FAX** the fully executed Agreement to:	Attention: Home Retention Department (407) 737-5693
3. **PAY** the full down payment in the amount of:	$1,281.00 *[See Payment Instructions Attached]*
4. **NEW MONTHLY PAYMENT:**	$737.82 **(which may or may not include escrow)** starting on July 1, 2009.
5. **SEND** proof of insurance coverage* (Send proof of insurance ONLY to Escrow Dept. DO NOT include the Agreement.)	Attention: Escrow Department Fax: 1-888-882-1816 E-mail:dateinsuranceinfo@ocwen.com

* Proof of insurance and the Agreement must be sent separately to the correct departments using the fax numbers provided above. Failure to send proof of insurance coverage before the Due Date will constitute acceptance of a force placed policy and agreement to pay the costs of such force placed policy, so long as all other items are complete.

Time is of the essence on this offer. If ALL of the items above are not completed by the Due Date, the Agreement shall have no force or effect and any down payment received will be returned to you. Please be advised that Ocwen Loan Servicing, LLC will not delay, postpone or otherwise stop any collection efforts until ALL of the steps above have been completed.

If you have any questions or require additional information, please contact the Home Retention Department directly at (877) 596-8580.

Sincerely,

Ocwen Loan Servicing, LLC

6348635

Ocwen Loan Servicing, LLC
P.O.Box 785052
Orlando, Florida 32878

WWW.OCWEN.COM

PAYMENT REMITTANCE INFORMATION
PLEASE DON'T FORGET TO:

1. Make checks payable to Ocwen Loan Servicing, LLC.
2. Always include your loan number with your payment.
3. The down payment must be in the form of certified funds.

OVERNIGHT DELIVERY
(Money Order & Certified Checks Only)
OCWEN LOAN SERVICING, LLC
ATTN: CASHIERING DEPARTMENT
12650 INGENUITY DRIVE
ORLANDO, FL 32826

MONEY GRAM
RECEIVER CODE: 3237
PAYABLE TO: OCWEN LOAN SERVICING, LLC
CITY: ORLANDO
STATE: FLORIDA
REFERENCE: [redacted]
AGENT LOCATER: (800) 926-9400

BY WUQC
Code City: Ocwen
State: FL
Reference: Loan # [redacted]
Attn: Home Retention Department,
Home Retention Consultant

BANK WIRE
BANK: JPMorgan Chase Bank, NA
ABA: 021000021
ACCOUNT NAME: Ocwen Financial Corporation
ACCOUNT NUMBER: 00113339999
REFERENCE: Loan Number, Property Address, and Borrower Name

Email: Transferfunds@ocwen.com with the details of the wire.

LOAN MODIFICATION AGREEMENT

Ocwen Loan Servicing, LLC ("Ocwen") is offering you this Loan Modification Agreement ("Agreement"), dated June 1, 2009, which modifies the terms of your home loan obligations as described in detail below:

A. the Mortgage, Deed of Trust, or Security Deed (the "Mortgage"), dated and recorded in the public records of CLAY County, and

B. the Note, of the same date and secured by the Mortgage, which covers the real and personal property described in the Mortgage and defined therein as the "Property", located at [redacted]

Pursuant to our mutual agreement to modify your Note and Mortgage and in consideration of the promises, conditions, and terms set forth below, the parties agree as follows:

1. You agree that the new principal balance due under your modified Note and the Mortgage will be $125,056.60. Upon modification, your Note will become contractually current; however, fees and charges that were not included in this principal balance will be your responsibility.

2. You promise to make an initial down payment in the amount of $1,281.00 on or before June 12, 2009, after which you will commence payments of principal and interest in the amount of $555.87 beginning on July 1, 2009 and continuing on the same day of each succeeding month for a five (5) year period. At the end of this period, your payment is subject to change based on paragraph 4 below.

3. Any payments due for taxes and insurance will be your responsibility in addition to the payments of principal and interest required under the terms of this modification. If this loan is currently escrowed, Ocwen will continue to collect the escrow amounts with your monthly principal and interest payment.

4. Upon Modification, the annual rate of interest charged on the unpaid principal balance of your loan will be 4.42100%. This rate will remain in effect until the end of a five (5) year period beginning with your first payment after the down payment. At the end of this period, your interest rate will be calculated according to the terms of your original loan documentation.

6348635

Ocwen Loan Servicing, LLC
P.O.Box 785052
Orlando, Florida 32878

WWW.OCWEN.COM

5. You promise to make payments of principal and interest on the same day of each succeeding month until May 1, 2036, at which time a final balloon payment in an amount equal to all remaining amounts under the Note and Modification will be due.

6. You will comply with all other covenants, agreements, and requirements of your Mortgage, including without limitation, the covenants and agreements to make all payments of taxes, insurance premiums, assessments, escrow items, impounds, and all other payments that you are obligated to make under the Mortgage, except as otherwise provided herein.

7. If you sell your property, refinance, or otherwise payoff your loan during the 12 months following the date of Modification, the Modification will be voidable at the sole option of Ocwen and all amounts owed under the obligations existing prior to the Modification will be due and owing.

8. You understand and agree that:

   (a) All the rights and remedies, stipulations, and conditions contained in your Mortgage relating to default in the making of payments under the Mortgage will also apply to default in the making of the modified payments hereunder.

   (b) All covenants, agreements, stipulations, and conditions in your Note and Mortgage will remain in full force and effect, except as herein modified, and none of the your obligations or liabilities under your Note and Mortgage will be diminished or released by any provisions hereof, nor will this Agreement in any way impair, diminish, or affect any of Ocwen's rights under or remedies on your Note and Mortgage, whether such rights or remedies arise there under or by operation of law. Also, all rights of recourse to which Ocwen is presently entitled against any property or any other persons in any way obligated for, or liable on, your Note and Mortgage are expressly reserved by Ocwen.

   (c) Any expenses incurred in connection with the servicing of your loan, but not yet charged to your account as of the date of this Agreement, may be charged to your account after the date of this Agreement.

   (d) You have no right of set-off or counterclaim, or any defense to the obligations of your Note or Mortgage.

   (e) Nothing in this Agreement will be understood or construed to be a satisfaction or release in whole or in part of your Note and Mortgage.

   (f) You agree to make and execute such other documents or papers as may be necessary or required to effectuate the terms and conditions of this Agreement which, if approved and accepted by Ocwen, will bind and inure to your heirs, executors, administrators, and assigns.

   (g) You understand that this agreement is legally binding and that it affects your rights. You confirm that you have had the opportunity to obtain, independent legal counsel concerning this Agreement and are signing this Agreement voluntarily and with full understanding of its contents and meaning.

   (h) Corrections and Omissions. You agree to execute such other and further documents as may be reasonably necessary to consummate the transactions contemplated herein or to perfect the liens and security interests intended to secure the payment of the loan evidenced by the Note.

9. BY EXECUTING THIS MODIFICATION, YOU FOREVER IRREVOCABLY WAIVE AND RELINQUISH ANY CLAIMS, ACTIONS OR CAUSES OF ACTION, STATUTE OF LIMITATIONS OR OTHER DEFENSES, COUNTERCLAIMS OR SETOFFS OF ANY KIND WHICH EXIST AS OF THE DATE OF THIS MODIFICATION, WHETHER KNOWN OR UNKNOWN, WHICH YOU MAY NOW OR HEREAFTER ASSERT IN CONNECTION WITH THE MAKING, CLOSING, ADMINISTRATION, COLLECTION OR THE ENFORCEMENT BY OCWEN OF THE LOAN DOCUMENTS, THIS MODIFICATION OR ANY OTHER RELATED AGREEMENTS.

10. BY EXECUTING THIS MODIFICATION, YOU IRREVOCABLY WAIVE ALL RIGHTS TO A TRIAL BY JURY IN ANY ACTION, PROCEEDING OR COUNTERCLAIM ARISING OUT OF OR RELATING TO THIS MODIFICATION AND ANY RELATED AGREEMENTS OR DOCUMENTS OR TRANSACTIONS CONTEMPLATED IN THIS MODIFICATION.

____________________ ____________________

6348635

Ocwen Loan Servicing, LLC
P.O.Box 785052
Orlando, Florida 32878

WWW.OCWEN.COM

Ocwen Loan Servicing, LLC

Borrower: [redacted]

By: ______________________

6348635

This communication is from a debt collector attempting to collect a debt; any information obtained will be used for that purpose. However, if the debt is in active bankruptcy or has been discharged through bankruptcy, this communication is not intended as and does not constitute an attempt to collect a debt.

Ocwen Loan Servicing, LLC
P.O.Box 785052
Orlando, Florida 32878

WWW.OCWEN.COM

June 3, 2009

[redacted]

Loan Number: [redacted]
Property Address: [redacted]

PROPOSED MODIFICATION AGREEMENT

Dear Borrower(s):

Enclosed please find a proposed modification agreement (the "Agreement") on your loan referenced above for your review and consideration.

In order to accept this modification on your loan, you must complete ALL of the following steps **on or before** June 12, 2009, ("Due Date"):

1. **SIGN** the bottom of the Agreement on the line(s) for the Borrower(s);	
2. **FAX** the fully executed Agreement to:	Attention: Home Retention Department (407) 737-5693
3. **PAY** the full down payment in the amount of:	$287.00 *[See Payment Instructions Attached]*
4. **NEW MONTHLY PAYMENT:**	$94.12 **(which may or may not include escrow)** starting on July 1, 2009.
5. **SEND** proof of insurance coverage* (Send proof of insurance ONLY to Escrow Dept. DO NOT include the Agreement.)	Attention: Escrow Department Fax: 1-888-882-1816 E-mail:dateinsuranceinfo@ocwen.com

* Proof of insurance and the Agreement must be sent separately to the correct departments using the fax numbers provided above. Failure to send proof of insurance coverage before the Due Date will constitute acceptance of a force placed policy and agreement to pay the costs of such force placed policy, so long as all other items are complete.

Time is of the essence on this offer. If ALL of the items above are not completed by the Due Date, the Agreement shall have no force or effect and any down payment received will be returned to you. Please be advised that Ocwen Loan Servicing, LLC will not delay, postpone or otherwise stop any collection efforts until ALL of the steps above have been completed.

If you have any questions or require additional information, please contact the Home Retention Department directly at (877) 596-8580.

Sincerely,

Ocwen Loan Servicing, LLC

6348643

Ocwen Loan Servicing, LLC
P.O.Box 785052
Orlando, Florida 32878

WWW.OCWEN.COM

PAYMENT REMITTANCE INFORMATION
PLEASE DON'T FORGET TO:

1. Make checks payable to Ocwen Loan Servicing, LLC.
2. Always include your loan number with your payment.
3. The down payment must be in the form of certified funds.

OVERNIGHT DELIVERY
(Money Order & Certified Checks Only)
OCWEN LOAN SERVICING, LLC
ATTN: CASHIERING DEPARTMENT
12650 INGENUITY DRIVE
ORLANDO, FL 32826

MONEY GRAM
RECEIVER CODE: 3237
PAYABLE TO: OCWEN LOAN SERVICING, LLC
CITY: ORLANDO
STATE: FLORIDA
REFERENCE: [redacted]
AGENT LOCATER: (800) 926-9400

BY WUQC
Code City: Ocwen
State: FL
Reference: Loan [redacted]
Attn: Home Retention Department,
Home Retention Consultant

BANK WIRE
BANK: JPMorgan Chase Bank, NA
ABA: 021000021
ACCOUNT NAME: Ocwen Financial Corporation
ACCOUNT NUMBER: 00113339999
REFERENCE: Loan Number, Property Address, and Borrower Name

Email: Transferfunds@ocwen.com with the details of the wire

LOAN MODIFICATION AGREEMENT

Ocwen Loan Servicing, LLC ("Ocwen") is offering you this Loan Modification Agreement ("Agreement"), dated June 3, 2009, which modifies the terms of your home loan obligations as described in detail below:

A. the Mortgage, Deed of Trust, or Security Deed (the "Mortgage"), dated and recorded in the public records of CLAY County, and

B. the Note, of the same date and secured by the Mortgage, which covers the real and personal property described in the Mortgage and defined therein as the "Property", located at [redacted]

Pursuant to our mutual agreement to modify your Note and Mortgage and in consideration of the promises, conditions, and terms set forth below, the parties agree as follows:

1. You agree that the new principal balance due under your modified Note and the Mortgage will be $31,082.01. Upon modification, your Note will become contractually current; however, fees and charges that were not included in this principal balance will be your responsibility.

2. You promise to make an initial down payment in the amount of $287.00 on or before June 12, 2009, after which you will commence payments of principal and interest in the amount of $94.12 beginning on July 1, 2009 and continuing on the same day of each succeeding month for a five (5) year period. At the end of this period, your payment is subject to change based on paragraph 4 below.

3. Any payments due for taxes and insurance will be your responsibility in addition to the payments of principal and interest required under the terms of this modification. If this loan is currently escrowed, Ocwen will continue to collect the escrow amounts with your monthly principal and interest payment.

4. Upon Modification, the annual rate of interest charged on the unpaid principal balance of your loan will be 2.00000%. This rate will remain in effect until the end of a five (5) year period beginning with your first payment after the down payment. At the end of this period, your interest rate will be calculated according to the terms of your original loan documentation.

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Ocwen Loan Servicing, LLC
P.O.Box 785052
Orlando, Florida 32878 WWW.OCWEN.COM

5. You promise to make payments of principal and interest on the same day of each succeeding month until May 1, 2021, at which time a final balloon payment in an amount equal to all remaining amounts under the Note and Modification will be due.

6. You will comply with all other covenants, agreements, and requirements of your Mortgage, including without limitation, the covenants and agreements to make all payments of taxes, insurance premiums, assessments, escrow items, impounds, and all other payments that you are obligated to make under the Mortgage, except as otherwise provided herein.

7. If you sell your property, refinance, or otherwise payoff your loan during the 12 months following the date of Modification, the Modification will be voidable at the sole option of Ocwen and all amounts owed under the obligations existing prior to the Modification will be due and owing.

8. You understand and agree that:

(a) All the rights and remedies, stipulations, and conditions contained in your Mortgage relating to default in the making of payments under the Mortgage will also apply to default in the making of the modified payments hereunder.

(b) All covenants, agreements, stipulations, and conditions in your Note and Mortgage will remain in full force and effect, except as herein modified, and none of the your obligations or liabilities under your Note and Mortgage will be diminished or released by any provisions hereof, nor will this Agreement in any way impair, diminish, or affect any of Ocwen's rights under or remedies on your Note and Mortgage, whether such rights or remedies arise there under or by operation of law. Also, all rights of recourse to which Ocwen is presently entitled against any property or any other persons in any way obligated for, or liable on, your Note and Mortgage are expressly reserved by Ocwen.

(c) Any expenses incurred in connection with the servicing of your loan, but not yet charged to your account as of the date of this Agreement, may be charged to your account after the date of this Agreement.

(d) You have no right of set-off or counterclaim, or any defense to the obligations of your Note or Mortgage.

(e) Nothing in this Agreement will be understood or construed to be a satisfaction or release in whole or in part of your Note and Mortgage.

(f) You agree to make and execute such other documents or papers as may be necessary or required to effectuate the terms and conditions of this Agreement which, if approved and accepted by Ocwen, will bind and inure to your heirs, executors, administrators, and assigns.

(g) You understand that this agreement is legally binding and that it affects your rights. You confirm that you have had the opportunity to obtain, independent legal counsel concerning this Agreement and are signing this Agreement voluntarily and with full understanding of its contents and meaning.

(h) Corrections and Omissions. You agree to execute such other and further documents as may be reasonably necessary to consummate the transactions contemplated herein or to perfect the liens and security interests intended to secure the payment of the loan evidenced by the Note.

9. BY EXECUTING THIS MODIFICATION, YOU FOREVER IRREVOCABLY WAIVE AND RELINQUISH ANY CLAIMS, ACTIONS OR CAUSES OF ACTION, STATUTE OF LIMITATIONS OR OTHER DEFENSES, COUNTERCLAIMS OR SETOFFS OF ANY KIND WHICH EXIST AS OF THE DATE OF THIS MODIFICATION, WHETHER KNOWN OR UNKNOWN, WHICH YOU MAY NOW OR HEREAFTER ASSERT IN CONNECTION WITH THE MAKING, CLOSING, ADMINISTRATION, COLLECTION OR THE ENFORCEMENT BY OCWEN OF THE LOAN DOCUMENTS, THIS MODIFICATION OR ANY OTHER RELATED AGREEMENTS.

10. BY EXECUTING THIS MODIFICATION, YOU IRREVOCABLY WAIVE ALL RIGHTS TO A TRIAL BY JURY IN ANY ACTION, PROCEEDING OR COUNTERCLAIM ARISING OUT OF OR RELATING TO THIS MODIFICATION AND ANY RELATED AGREEMENTS OR DOCUMENTS OR TRANSACTIONS CONTEMPLATED IN THIS MODIFICATION.

____________________ ____________________

6348643

Ocwen Loan Servicing, LLC
P.O.Box 785052
Orlando, Florida 32878

WWW.OCWEN.COM

Ocwen Loan Servicing, LLC

By: ______________________

Borrower: [redacted]

6348643

This communication is from a debt collector attempting to collect a debt; any information obtained will be used for that purpose. However, if the debt is in active bankruptcy or has been discharged through bankruptcy, this communication is not intended as and does not constitute an attempt to collect a debt.

Attachment B—Aurora Loan Services Letter and Workout Agreement

Received Fax : May 23 2009 8:11PM Fax Station : COLART AND COLART PA p. 2

FROM :PROJEKT GROUP FAX NO. :561-272-6295 May. 23 2009 10:24PM P2

Aurora • Loan Services

LMIT 0038261699

2617 COLLEGE PARK • P.O. BOX 1706 • SCOTTSBLUFF, NE 69363-1706
PHONE: 800-550-0508 • FAX: 303-728-7648

May 20, 2009

12C

3640038261699534LM22405-20-09

[redacted]

RE: Loan No. [redacted]
Property Address: [redacted]

Dear Customer(s):

Enclosed please find two copies of a Special Forbearance Agreement which has been prepared on your behalf. Please sign, date and return one copy to Aurora Loan Services and retain the second copy for your records.

You have been conditionally approved for this Special Forbearance Agreement as a result of the information that you provided to Aurora Loan Services. Your approval for the Special Forbearance Agreement is conditional upon Aurora Loan Services verifying the information that you provided.

Please execute the attached Special Forbearance Agreement and return it along with (1) the information requested in the enclosed package; (2) the completed financial statement; and (3) your initial payment in the amount of $870.41. This payment as well as the requested information must be received in our office on or before 06/01/2009.

To expedite processing of your Special Forbearance Agreement, please fax the signed Agreement to Aurora Loan Services at 866-517-7975, and remit the initial payment via Western Union Quick Collect. When sending funds via Western Union, please use the Code City: BLUFF, NE and always include your Aurora Loan Services loan number for prompt posting to your account. Any funds received after 5:00 p.m. ET will be posted the next business day.

Certified Funds should be made payable to Aurora Loan Services. Please include your Aurora Loan Services loan number on the certified funds and mail the funds separately to our Payment Processing Center at:

Overnight Delivery Services	or	U.S. Postal Delivery Services
Aurora Loan Services		Aurora Loan Services
Attn: Cashiering Dept.		Attn: Cashiering Dept.
10350 Park Meadows Drive		P.O. Box 5180
Littleton, CO 80124		Denver, CO 80217-5180

IMPORTANT INFORMATION ON PAGE 2

LENDER AURORA LOAN SERVICES LLC

55519.075

Received Fax : May 23 2009 8:11PM Fax Station : GOLANT AND GOLANT PA p. 3

FROM :PROJEKT GROUP FAX NO. :561-272-6295 May. 23 2009 10:25PM P3

Aurora • Loan Services

2617 COLLEGE PARK • P.O. BOX 1706 • SCOTTSBLUFF, NE 69363-1706
PHONE: 800-550-0508 • FAX: 303-728-7648

Loan No. [redacted]

Page 2 of 2

Please mail all correspondence, requested information and the executed agreement to our Servicing Center at:

Overnight Delivery Services	or	U.S. Postal Delivery Services
Aurora Loan Services		Aurora Loan Services
Attn: Home Retention		Attn: Home Retention
2617 College Park		P.O. Box 1706
Scottsbluff, NE 69361		Scottsbluff, NE 69363-1706

Not withstanding anything to the contrary contained in the Special Forbearance Agreement, the parties hereto acknowledge the effect of a discharge in bankruptcy that may have been granted to the Borrower(s) prior to the execution hereof and that the Lender may not pursue the Borrower(s) for personal liability. However, the parties acknowledge that the Lender retains certain rights, including but not limited to the right to foreclose its lien under appropriate circumstances. The parties agree that the consideration for this Agreement is Aurora Loan Services' forbearance from presently exercising its rights and pursuing its remedies under the Security Instrument as a result of the Borrower's default of its obligations there under. Nothing herein shall be construed to be an attempt to collect against the Borrower(s) personally or an attempt to revive personal liability.

Signing the attached documents in no way affects or eliminates any rights you have been given in this letter or any correspondence attached hereto.

If you have any questions, please contact one of our Home Retention Counselors at the address above or by calling 800-550-0509.

Sincerely,

Home Retention Group
Aurora Loan Services

Enclosure

Aurora Loan Services is a debt collector. Aurora Loan Services is attempting to collect a debt and any information obtained will be used for that purpose. However, if you are in bankruptcy or received a bankruptcy discharge of this debt, this communication is not an attempt to collect the debt against you personally, but is notice of a possible enforcement of the lien against the collateral property.

Received Fax : May 23 2009 8:11PM Fax Station : GOLANT AND GOLANT PA p. 4

FROM :PROJEKT GROUP FAX NO. :561-272-6295 May. 23 2009 10:25PM P4

Aurora • Loan Services

2617 COLLEGE PARK • P.O. BOX 1706 • SCOTTSBLUFF, NE 69363-1706
PHONE: 800-550-0508 • FAX: 303-728-7648

WORKOUT AGREEMENT

BY AND BETWEEN AURORA LOAN SERVICES

AND

[redacted]

Property Address: [redacted] Loan No. [redacted]

This Workout Agreement is made May 20, 2009, by and between AURORA LOAN SERVICES ("Lender") located at 2617 College Park, Scottsbluff, NE 69361, and [redacted] (individually and collectively, "Customer").

WHEREAS, Lender is the servicing agent and/or the owner and holder of a certain Note dated 06-14-06, executed and delivered by Customer, in the original principal amount of $ 256,000 (the "Note"). The Note is secured by a mortgage, deed of trust or comparable security instrument dated 06-14-06, (the "Security Instrument"), on the property located at the address specified above (the "Property"). The Note and Security Instrument are collectively referred to as the "Loan Documents".

WHEREAS, Customer is in default under the Loan Documents, has failed to make payment of monthly installments of principal, interest, and escrow, if any, and has incurred additional expenses authorized under the Loan Documents, resulting in a total arrearage now due of $ 30,515.07, as more particularly set forth below:

Unpaid monthly payment(s) of PITI* from 07-01-08 through and including 05-20-09	$	25,906.65
Accrued Late Charges		689.92
NSF Charges		.00
Legal Fees		1,808.00
Corporate Advances**		2,110.50
Other Fees***		.00
Minus Credit (suspense balance/partial payment)		.00
Total Amount Due (the "Arrearage")	$	30,515.07

* "PITI" means the monthly payment of principal, interest, and escrows, required, for taxes and insurance premium installments.

** "Corporate Advances" include, but are not limited to, property inspection fees, property preservation fees, legal fees, foreclosure fees and costs, appraisal fees, BPO (i.e. broker price opinion) fees, title report fees, recording fees, and subordination fees.

*** "Other Fees" include, but are not limited to, short payment advances and Speed ACH fees.

EQUAL HOUSING LENDER AURORA LOAN SERVICES LLC

Aurora • Loan Services

2617 COLLEGE PARK • P.O. BOX 1706 • SCOTTSBLUFF, NE 69363-1706
PHONE: 800-550-0508 • FAX: 303-728-7648

Loan No. [redacted]

WHEREAS, as a result of Customer's default, Lender (i) has the right to accelerate, and to require Customer to make immediate payment in full, all of the sums owed under the Note and secured by the Security Instrument, (ii) has so accelerated and declared due in full all such sums, and (iii) may have already commenced foreclosure proceedings to sell the Property.

WHEREAS, as of the date of execution of the Agreement, Lender commenced Foreclosure proceedings to sell the property on 10/29/08 by legal filing in the county and state where the Property is located A Foreclosure sale has not yet been scheduled.

WHEREAS, customer has requested Lender's forbearance in exercising its rights and remedies under the default provisions of the Loan Documents and with regard to any foreclosure action that may now be pending.

WHEREAS, Customer has requested and Lender has agreed to allow Customer to repay the Arrearage pursuant to a loan work-out arrangement on the terms set forth herein.

NOW, THEREFORE, in consideration of the promises and mutual covenants herein contained, the parties hereto agree as follows:

1. Term. This Agreement shall expire on the "Expiration Date," as defined in Attachment A.

2. Lenders Forbearance. Lender shall forbear from exercising any or all of its rights and remedies now existing or arising during the term of this Agreement under the Loan Documents, provided there is no "Default", as such term is defined in paragraph 5.

3. Customer's Admissions. Customer admits that the Arrearage is correct and is currently owing under the Loan Documents, and represents, agrees and acknowledges that there are no defenses, offsets, or counterclaims of any nature whatsoever to any of the Loan Documents or any of the debt evidenced or secured thereby.

Customer admits and agrees that any and all postponements of a foreclosure sale, made during the term of this Agreement or in anticipation of this Agreement, are done by mutual consent of the Customer and Lender and that, to the extent allowed by applicable law, any such foreclosure sale may be postponed from time to time until the loan evidenced by the Note is fully reinstated or the foreclosure sale is consummated. Lender shall be under no obligation to dismiss a pending foreclosure proceeding until such time as all terms and conditions of this Agreement and Attachment A have been fully performed.

4. Terms of Workout. See Attachment A, which is made a part hereof.

Aurora • Loan Services

2617 COLLEGE PARK • P.O. BOX 1706 • SCOTTSBLUFF, NE 69363-1706
PHONE: 800-550-0508 • FAX: 303-728-7648

Loan No. [redacted]

5. Default. If Customer fails to make any of the payments specified in Attachment A on the due dates and in the amount stated, or otherwise fails to comply with any of the terms and conditions herein or therein (any such even hereby defined as a "Default"), Lender, at its sole option, may terminate this Agreement without further notice to Customer. In such case, all amounts that are then owing under the Note, the Security Instrument, and this Agreement shall become immediately due and payable, and Lender shall be permitted to exercise any and all rights and remedies provided for in the Loan Documents, including, but not limited to, immediate commencement of a foreclosure action or resumption of a pending foreclosure action without further notice to Customer.

6. No Waiver. Nothing contained herein shall constitute a waiver of any of all of the Lender's rights or remedies, including the right to commence or resume foreclosure proceedings. Failure by Lender to exercise any right or remedy under this Agreement or as otherwise provided by applicable law shall not be deemed to be a waiver thereof.1

7. Status of Default and Foreclosure. Customer acknowledges that if the Lender previously notified the Customer that the account was in default, that the Note and Security Instrument are accelerated and the debt evidenced by the Note is due in full, the account remains in default, such Loan Documents remain accelerated, and such debt due in full, although Customer may be entitled by law to cure such default by bringing the loan evidenced by Note current rather than paying it in full. Lender's acceptance of any payments from Customer which, individually, are less than the total amount due to cure the default described herein shall in no way prevent Lender from continuing with collection action, or require Lender to re-notify Customer of such default, re-accelerate the loan, re-issue any notice, or resume any process prior to Lender proceeding with collection action if Customer Defaults. Customer agrees that a foreclosure action if commenced by the Lender against Customer will not be withdrawn unless Lender determines to do so by applicable law. In the event Customer Defaults, the foreclosure will commence, or resume from the point at which it was placed on hold, without further notice.

8. Limited Modification. Except as otherwise provided in this Agreement, the Note and Security Instrument, and any amendments thereto, are ratified and confirmed and shall remain in full force and effect.

---

1 A typical example of this would be if Lender decides to accept a partial or untimely payment from Customer instead of returning such payment or terminating this Agreement as provided herein, Lender shall not be precluded from rejecting a subsequent partial or untimely payment, terminating this Agreement, or taking any other action permitted by applicable law.

Received Fax : May 23 2009 8:11PM Fax Station : GOLANI AND GOLANI PA p. 7

FROM :PROJEKT GROUP FAX NO. :561-272-6295 May. 23 2009 10:27PM P7

Aurora • Loan Services

2617 COLLEGE PARK • P.O. BOX 1706 • SCOTTSBLUFF, NE 69363-1706
PHONE: 800-550-0508 • FAX: 303-728-7648

Loan No. [redacted]

9. Application of Payments. The payments received by Lender from Customer pursuant to this Agreement shall be applied, at Lender's sole option, first to the earliest monthly payment under the Note that is due. Any amounts received by Lender that are less than the full payment under then due and owing under this Agreement shall be, at Lender's sole option, (1) returned to Customer, or (2) held by Lender in partial or suspense payment balance until sufficient sum is received by Lender to apply a full payment. If this Agreement is canceled and/or terminated for any reason, any remaining funds in this partial or suspense payment balance shall be credited towards Customer's remaining obligation owing in connection with the loan and shall not be refunded.

10. Methods of Making Payments. All payments made to Lender under this Agreement shall (i) contain the Lender's loan number shown above, (ii) unless otherwise agreed to by the Lender, be payable in certified funds by means of cashier's check, Western Union (code city: Bluff,NE) money order, or certified check, and (iii) be sent to AURORA LOAN SERVICES as specified in Attachment A. Any payment made other than strictly pursuant to the requirements of this paragraph 10 and Attachment A shall not be considered to have been received by Lender, although Lender may, in its sole discretion, decide to accept any non-conforming payment.

11. Credit Reporting. The payment status of Customer's loan in existence immediately prior to execution of this Agreement will be reported monthly to all credit reporting agencies for the duration of this Agreement and thereafter. Accordingly, Lender will report the loan subject to this Agreement as delinquent if the loan is not paid current under the Loan Documents, even if Customer makes timely payments to Lender under this Agreement. However, Lender may disclose that Customer is in a repayment or work-out plan. This Agreement does not constitute an agreement by Lender to waive any reporting of the delinquency status of loan payments.

12. Property Taxes, Insurance, and Other Amounts. If Customer's loan is not escrowed for taxes and insurance premium payments, it is Customer's responsibility to pay all property taxes, premiums for insurance, and all other amounts Customer agreed to pay as required under the terms of the Loan Documents. Customer's failure to pay property taxes, amounts owed on any senior lien security instrument, other amounts that may attain priority over the Security Instrument, or insurance premiums, in each case before their due date, shall constitute a Default hereunder.

13. The Entire Agreement. This Agreement sets forth all of the promises, covenants, agreements, conditions and understandings between the parties hereto with respect to the subject matter hereof. This Agreement supersedes all prior understandings, inducements or conditions, express or implied, oral or written, with respect thereto except as contained or referred to herein. This Agreement may not be amended, waived, discharged or terminated orally but only by an instrument in writing.

Aurora • Loan Services

2617 COLLEGE PARK • P.O. BOX 1706 • SCOTTSBLUFF, NE 69363-1706
PHONE: 800-550-0508 • FAX: 303-728-7648

Loan No. [redacted]

14. Time is of the Essence. The Customer agrees and understands that TIME IS OF THE ESSENCE as to all of the Customer's obligations under this Agreement. The grace period for monthly payments under the Loan Documents will not apply to payment under this Agreement. Therefore, the Lender must receive the payments under this Agreement on or before the Due Dates specified in Attachment A.

15. Assignment by Customer Prohibited. This Agreement shall be non-transferable by Customer. However, if the legal or beneficial interest or the servicing of this loan is transferred by Lender, this Agreement inures to the benefit of any subsequent servicer or beneficial interest holder of the Note.

16. Severability. To the extent that any word, phrase, clause, or sentence of this Agreement shall be found to be illegal or unenforceable for any reason, such word, phrase, clause, or sentence shall be modified or deleted in such a manner so as to make the Agreement, as modified, legal and enforceable under applicable law, and the balance of the Agreement or parts thereof shall not be affected thereby, the balance being construed as severable and independent; provided that no such severability shall be effective if it materially changes the economic benefit of this Agreement to either party.

17. Execution in Counterparts. This Agreement may be executed and delivered in two or more counterparts, each of which, when so executed and delivered, shall be an original, but such counterparts shall together constitute but one and the same instrument and Agreement. Facsimile signatures shall be deemed as valid as originals.

18. Customer Contact. If Customer has any questions regarding this matter, Customer should contact one of Lender's Loan Counselors at the address above or by calling 800-550-0509.

IN WITNESS HEREOF, the parties hereto have caused this Agreement to be duly executed as of the date signed.

Dated: ____________________ [redacted] Borrower

Dated: ____________________ [redacted] Borrower

Aurora Loan Services
Dated: ____________________ ____________________

Aurora Loan Services is a debt collector. Aurora is attempting to collect a debt and any information obtained will be used for that purpose. However, if you are in bankruptcy or received a bankruptcy discharge of this debt, this communication is not an attempt to collect the debt against you personally, but is notice of a possible enforcement of the lien against the collateral property.

EQUAL HOUSING LENDER AURORA LOAN SERVICES LLC

Aurora • Loan Services

2617 COLLEGE PARK • P.O. BOX 1706 • SCOTTSBLUFF, NE 69363-1706
PHONE: 800-550-0508 • FAX: 303-728-7648

ATTACHMENT A-STIPULATED PAYMENTS

a.1 For purposes of repayment of the Arrearage, Customer shall pay $870.41, on or before 06/01/2009. Thereafter, Customer shall pay three (3) stipulated monthly payments each in the amount of $870.41 (each, a "Plan payment"). On or before 06/01/2009 (the "Agreement Return Date"), Customer shall execute and return the Agreement, including this Attachment A, in accordance with the following instructions:

If by overnight mail service to or	if by US Postal Services to
Aurora Loan Services	Aurora Loan Services
Attention: Home Retention	Attention: Home Retention
2617 College Park	P.O. Box 1706
Scottsbluff, NE 69361	Scottsbluff, NE 69363-1706

The Agreement will be of no force and effect unless Lender receives the executed Agreement, including Attachment A, as well as the first Plan payment by the Agreement Return Date. Customer shall remit to Lender the first Plan payment, in the amount specified above, made payable to Aurora Loan Services in certified funds by means of cashier's check, money order, Western Union (code city: Bluff, NE), or certified check. All Plan payments, including the first Plan payment, shall contain the Lender's loan number shown in the Agreement and, unless otherwise agreed to by the Lender, shall be payable in certified funds as described above are to be sent to Lender's Payment Processing Center in accordance with the following instructions:

If by overnight mail service to or	if by US Postal Services to
Aurora Loan Services	Aurora Loan Services
Attention: Cashiering Department	Attention: Cashiering Department
10350 Park Meadows Drive	P.O. Box 5180
Littleton, CO 80124	Denver, CO 80217-5180

a.2 Plan payments are to be paid on or before the 1st day of every month (each, a "Due Date"). Lender must receive each Plan payment by the Due Date of each month. The Agreement shall expire on the Due Date of the last Plan payment contemplated by section a.1 above (the "Expiration Date"). At the time Customer makes the third (3rd) Plan payment under this Agreement, it shall be the Customer's responsibility to provide Aurora with accurate and complete financial information in support of the Customer's request for a loan modification or other workout option. Customer must also provide Lender with a completed Borrower's Financial Statement and proof of income (copies of Customer's two (2) most recent pay stubs) to enable Lender to properly evaluate Customer's current financial situation and the Customer's request for a loan modification or other loan workout option. Tender of the last Plan payment shall not be deemed acceptance by Aurora of a workout plan or loan modification.

EQUAL HOUSING LENDER AURORA LOAN SERVICES LLC

Received Fax May 23 2009 8:11PM Fax Station : GOLANT AND GOLANT PA p. 10

FROM :PROJEKT GROUP FAX NO. :561-272-6295 May. 23 2009 10:29PM P10

Aurora • Loan Services

2617 COLLEGE PARK • P.O. BOX 1706 • SCOTTSBLUFF, NE 69363-1706
PHONE: 800-550-0508 • FAX: 303-728-7648

Loan No. [redacted]

b. The aggregate Plan payment will be insufficient to pay the Arrearage. At the Expiration Date, a portion of the Arrearage will still be outstanding. Because payment of the Plan payments will not cure the Arrearage, Customer's account will remain delinquent. Upon the Expiration Date, Customer must cure the Arrearage through a full reinstatement, payment in full, loan modification agreement or other loan workout option that Lender may offer (individually and collectively, a "Cure Method.") Customer's failure to enter into a Cure Method will result in the loan being disqualified from any future Lender Home Retention Group program with respect to the loan evidenced by the Note, and regular collection activity will continue, including, but not limited to, commencement or resumption of the foreclosure process, as specified in paragraphs 5 and 7 of the Agreement.

IN WITNESS HEREOF, the parties hereto have caused this Attachment A to be duly executed as of the date signed below.

Dated: ____________________ ____________________
[redacted] Borrower

Dated: ____________________ ____________________
[redacted] Borrower

Aurora Loan Services

Dated: ____________________ By: ____________________

Title: ____________________

LENDER AURORA LOAN SERVICES LLC

Received Fax May 23 2009 8:11PM Fax Station : GOLANT AND GOLANT PA

FROM :PROJEKT GROUP FAX NO. :561-272-6295 May. 23 2009 10:29PM P11

Aurora • Loan Services

2617 COLLEGE PARK • P.O. BOX 1706 • SCOTTSBLUFF, NE 69363-1706
PHONE: 800-550-0508 • FAX: 303-728-7648

May 20, 2009

3640038261699534LM02905-20-09

RE: Loan No. [redacted]
Borrower(s): [redacted]r
[redacted]r
Property Address: [redacted]
[redacted]45

ITEMIZATION OF FEES, COSTS AND OTHER CHARGES

Dear Customer(s):

This Addendum supplements the Attached Letter.

Below is a detailed itemization of the unpaid fees, costs and other charges due on the above-referenced loan.

Description	Unpaid Balance
Foreclosure Fees	$1,609.50
Post Liquidation Transaction	$96.00
Property Value Fee	$405.00

Attachment C—Chase Waiver of HAMP Rights

JPMorgan Chase Bank, National Association,
successor interest to Washington Mutual Bank ("Lender")
has offered to try to qualify you for a modification (an "MHA Modification") under the Making Home Affordable Plan announced by the Obama Administration on March 4, 2009. You have declined to be considered for an MHA Modification, opting instead to go forward with the modification offer made by Lender to you prior to the March 4, 2009 announcement (the "Prior Modification").

Had you qualified for an MHA Modification, you may have been entitled to the following:

- A reduction in monthly payment to no more than 31% of documented and verified gross monthly income (DTI).
- A modification sequence requiring the Lender to first reduce the interest rate (subject to a rate floor of 2%), then if necessary extend the term or amortization of the loan up to a maximum of 40 years, and then if necessary forbearing principal to get to the 31% DTI.
- Up to $1,000 of principal reduction payments on your mortgage each year for up to five years for making your payments on time each year.

By signing below, you acknowledge that (i) you have been advised of and understand the above features of an MHA Modification, (ii) you understand and agree that Lender is not obligated to match such features in the Prior Modification, (iii) you have voluntarily declined consideration for an MHA Modification, and (iv) you have agreed to hold Lender, its successors and assigns, harmless as a result of your decision to decline consideration for an MHA Modification and enter into the Prior Modification.

Borrower Name	Date
Borrower Name	Date
Borrower Name	Date
Borrower Name	Date
Borrower Name	Date
Borrower Name	Date

First American Loan Production Services

Attachment D—WaMu HAMP Trial Plan Agreement provision requiring waiver of loan modification upon subsequent bankruptcy filing.

Page 3
Loan Number **WaMu**

Washington Mutual
7255 Baymeadows Way
Jacksonville, FL 32256

TRIAL PLAN AGREEMENT

* Your loan is now due for the months of 06/09 to 06/09.
* You must send $0.00 to reduce your total delinquency.
* We must receive the initial payment of $922.37 along with your signed Trial Plan Agreement ("Agreement") by 07/01/09. After that, the payment schedule outlined below must be followed. If you do not make your payments on time, or if any of your payments are returned for non-sufficient funds, this Agreement will be in breach and collection and/or foreclosure activity will resume.

Your payments must be received in our office on or before the following dates:

$922.37	08/01/09
$922.37	09/01/09

Payments are subject to change due to escrow analysis and or interest rate changes, if applicable. If you are notified of a payment adjustment, please contact our office immediately so we can adjust the terms of your Agreement accordingly. If all payments are made as scheduled, we will reevaluate your application for assistance and determine if we are able to offer you a permanent workout solution to bring your loan current.

All of the original terms of your loan remain in full force and effect, unless specifically mentioned within this Agreement. If any part of this Agreement is breached, Washington Mutual has the option to terminate the Agreement and begin or resume foreclosure proceedings pursuant to your loan documents and applicable law.

You acknowledge that in the event you file a petition in bankruptcy, Washington Mutual may elect to take any and all actions necessary, including, but not limited to voiding this Agreement, filing a Motion for relief from the automatic stay or a Motion to dismiss or any permitted state law remedies, which in Washington Mutual's judgment are reasonably necessary to secure or protect our security, the value of the security and/or to enforce our rights under the original terms of your loan.

I/We agree to the above Agreement and will make payments as outlined above. I/We understand that foreclosure action can be taken if the terms of this Agreement are not met.

[redacted] Date

LA-LM036-004-B9E.5797.071006

Equal Housing Lender

For the Record

Senator Russell D. Feingold
"The Worsening Foreclosure Crisis:
Is It Time to Reconsider Bankruptcy Reform?"
Senate Judiciary Committee
Subcommittee on Administrative Oversight and the Courts
July 23, 2009

Mr. Chairman, thank you for holding this hearing. I must say that I'm very disappointed by the Senate's lack of progress on this issue, and I appreciate your leadership and continued attention to it. I believe this is now the third hearing in the Judiciary Committee to consider the question of whether bankruptcy courts should have the power to modify home mortgages. The first was held back in December 2007, well before the severe economic downturn that we saw during the fourth quarter of 2008.

A significant cause of the downturn, of course, was the huge number of foreclosures on subprime mortgages, contributing to falling real estate values and creating a ripple effect whose ultimate cost we don't yet even know. And yet Congress and two administrations have not yet addressed this problem in an adequate way. Their collective efforts to protect Americans from losing their homes have ranged from ineffective to insufficient. While I am hopeful that the Obama administration's Making Home Affordable Plan will generate additional loan modifications, I have been disappointed by the lack of modifications that have taken place to date and the fact that too many homeowners around the country, including in Wisconsin, cannot even get timely information from their loan servicers about whether or not they qualify

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for a modification under the Making Home Affordable Plan. I have urged the Treasury Department to improve servicer response time and capacity so that we can increase participation in the plan.

It is clear that the legislative and administrative efforts thus far are not enough and those who supported providing ~~greater powers to~~ bankruptcy courts, so far unsuccessfully, have every reason to say: "I told you so." But the lending industry said, and continues to say, "absolutely not" to letting these bad mortgages be modified in a bankruptcy proceeding. Congress and this Administration repeatedly have refused to stand up to that self-centered and short-sighted position. And the American people have suffered as a result.

Voluntarily loan modification programs are just not making enough ~~of a dent on the~~ foreclosure problem. Seven million American homes are expected to be in foreclosure by the end of 2010. The reasons that these programs aren't working as intended are not entirely clear, and I hope the witnesses today can shed some light on that question. But anecdotal evidence certainly suggests that some lenders are simply refusing to make assistance available to some eligible homeowners. If nothing else, that dynamic would change if bankruptcy courts had the power to order mortgage modifications.

Mr. Chairman, I've said this before unfortunately – there simply is no more time to waste. People are losing their homes and the ripple effects of rising

foreclosures are enormous. Foreclosures lead to falling real estate prices which lead to more foreclosures. Local businesses are deeply affected as well, and empty houses lead to crime and greater costs for social services offered by local governments. After all the money that we have spent to save the banks, it is irresponsible for Congress to let this vicious cycle continue while an obvious and cost-free solution is staring us in the face.

Mr. Chairman, I thank you for continuing to work on this issue.

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Testimony of Richard Genirberg, J.D., M.B.A., M.A.
Genirberg Law Office
Jonesboro, Clayton County, Georgia

**"The Worsening Foreclosure Crisis:
Is It Time to Reconsider Bankruptcy Reform?"**

Hearing before the Senate Committee on the Judiciary
Subcommittee on Administrative Oversight and the Courts
Thursday, July 23, 2009
Dirksen Senate Office Building, Room 226 (10:00 a.m.)

Chairman Whitehouse, Ranking Member Sessions, and distinguished members of the Subcommittee, thank you kindly for inviting me to address bankruptcy reform in light of the worsening foreclosure crisis. I will share with you my experience of foreclosure in bankruptcy from the perspective not of an academician, but of a "country-lawyer" practitioner in the trenches. In my general trial and transaction practice, I represent consumers and creditors in Chapter 7 and Chapter 13 bankruptcy cases.

Before 2006, it was common in Chapter 7 and 13 cases to advise financially overwhelmed debtor clients to surrender late-model cars and trucks. Since 2006, it has become common for debtors instead to surrender the house. What is different now?

Since the bursting of the residential real estate asset bubble, my debtor clients owe more on their mortgages than their home is worth on the open market. Many of my clients are unaware that their home is financially "underwater." They have sought the protection of the bankruptcy court to avoid repossession of a car or because they are behind on their mortgage payments. My clients usually express their wish to retain their home. I find myself explaining that their home is a financial albatross around their necks, that it is a liability, not an asset. I inform Chapter 7 clients that I will not sign a reaffirmation agreement to ratify a debt on under-valued collateral. Such conversations usually are long, tense, and uncomfortable for all involved. It is not uncommon to repeat such a conversation two, three, or four times in office visits or over the phone before reality sets in that the debtors cannot keep house and hearth together. What brings my consumer clients to such a financially uncomfortable impasse? It has almost never been because of the interest rate on their home loan.

I see individuals compelled to file bankruptcy petitions because of medical catastrophe, or because one or both spouses is laid off from a job or has become employed with reduced compensation after having lost a job. Upon further scrutiny of my clients' financial organization, I typically have found that individuals spent way too much and saved way too little. They bought houses, timeshares, and cars they could not afford. It is not uncommon to see my bankruptcy clients drive up to my building in a newer vehicle than I own. I see consumers having adopted a self-defeating, self-perpetuating mind-set of viewing spending through the lens of the monthly payment, rather than with an eye to the long term. I pray that the Congress will not be so short-sighted. My clients often wish to retain all their collateralized purchases despite their inability to pay for all of them and to service their credit card debt as well.

My observation is that consumers have gone way overboard in borrowing for consumption. Americans would benefit from viewing borrowing money as a financial vehicle for businesses that plan to make a profit on the borrowed money. Americans would be wise to save more, to spend less, to establish a reserve of six months of income, and to buy cars for cash.

Would cramdown of residential real estate loans benefit my debtor clients? Of course it would. *Any* reduction of the cost of *any* collateralized debt would benefit my debtor clients. Not only would cramdown be beneficial, it would create a cottage industry within consumer bankruptcy practice of encouraging everyone earning under their median state income with an "underwater" residential loan to file bankruptcy *expressly for the purpose of cramming down the loan.* If cramming down a car loan older than 210 days would be moderately beneficial to a consumer debtor, cramming down a residential real estate loan would be so greatly beneficial to debtors that any residential loan underwater by more than $5,000.00 would benefit from a Chapter 13 bankruptcy. Under such a law, I imagine that consumer bankruptcy practice would thrive like never before. Legislating cramdown of residential real estate would create a veritable "license to steal" from mortgagees. The question this raises for the Congress is whether or not this would be beneficial for the American economy.

Finally, which consumer debtors would benefit from residential real estate loan cramdown? Ironically, the higher the income of the debtor, the more able would be the debtor to benefit from cramdown. Again, I return to my observation that debtors become unable to pay their mortgages primarily because of job loss, sometimes due to medical catastrophe. Chapter 13 plans seem to benefit those mainly who have experienced a temporary setback in income due to job loss or medical catastrophe, not those who have been laid off permanently. Those consumers with residential mortgages and steady employment whose only financial weakness is the loss in value of the market value of their home would be the cohort who I believe would benefit the most from mortgage cramdown.

1789

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
Senate Committee on the Judiciary
Subcommittee on Administrative Oversight and the Courts

"The Worsening Foreclosure Crisis: Is It Time to Reconsider Bankruptcy Reform?"

July 23, 2009

Witness Background Statement

Adam J. Levitin in an Associate Professor of Law at the Georgetown University Law Center, in Washington, D.C., where he teaches courses in bankruptcy and commercial law. He is also Director of the Georgetown-Hebrew University in Jerusalem Executive LLM Program in Business and Commercial Law and the Robert Zinman Resident Scholar 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. Professor Levitin has also served as Special Counsel for Mortgage Affairs for the Congressional Oversight Panel and as law clerk to the Honorable Jane R. Roth on the United States Court of Appeals for the Third Circuit.

Professor Levitin's research focuses on financial institutions and their role in consumer and business finance, including credit card and mortgage lending, securitization, identity theft, DIP financing, and bankruptcy claims trading. His articles have appeared in numerous law reviews and finance journals and have won the 2007 Editors' Prize of the *American Bankruptcy Law Journal* and the 2009 Article Prize of the American College of Consumer Financial Services Lawyers. Professor Levitin is also a regular commentator on *Credit Slips*, a blog devoted to credit and bankruptcy issues.

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, all with honors.

Professor Levitin has not received any Federal grants nor has he received any compensation in connection with his testimony and does not represent any party with regard to mortgage regulatory issues. The views expressed in Professor Levitin's testimony are his own and do not represent the positions of the American Bankruptcy Institute.

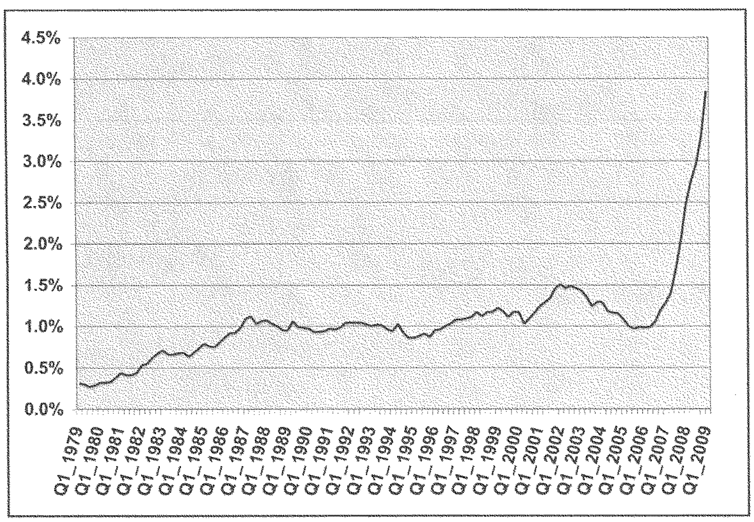
Mr. Chairman, Members of the Committee:

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. My research and writing focus on consumer finance and corporate bankruptcies. In particular, I have written about the obstacles to mortgage modification in the current crisis. I have also recently served as Special Counsel for Mortgage Affairs for the Congressional Oversight Panel for the Troubled Asset Relief Program, and am currently the Robert Zinman Resident Scholar at the American Bankruptcy Institute. The views I express today are my own.

I. Where We Are Now

We are now well into the third year of the foreclosure crisis, and there is no end in sight. Since 2007 between five and six million homes entered foreclosure. As of March 31, 2009, the Mortgage Bankers Association reported that 3.85% of residential mortgage loans were currently already in foreclosure, a rate nearly quadruple historical averages. (See Chart 1.) Additionally, 5.65% of mortgages were more than 60 days delinquent and 9.12% were at least a month delinquent. By the end of 2010, another 7 million homes are expected to enter foreclosure.[1] *Unless the crisis is abated, by the time it runs its course, as many as one in five residential borrowers will have gone into foreclosure.*

Chart 1: Percentage of 1-4 Family Residential Mortgages in Foreclosure[2]



[1] *Not Much Relief*, NEW YORK TIMES, July 5, 2009, at WK7.
[2] Mortgage Bankers Association, National Delinquency Surveys

Private lenders, industry associations, and two successive administrations have made a variety of efforts to mitigate the crisis and encourage loan modifications and refinancings, including a series of much vaunted initiatives—the HOPE Now Alliance, FHASecure, Hope4Homeowners, and the Making Home Affordable Program—but these have only had what can charitably be described as limited success. There is still limited data on the Making Home Affordable Program, and it shows greater promise than past initiatives, but there is no indication that it will affect a substantial shift in the foreclosure balance. Instead, these programs all seem like exercises in rearranging the deck chairs on the Titanic.

Unfortunately, there is still no consensus on why we are seeing so few loan modifications, even with tremendous government incentive payments to mortgage servicers. Some have argued that securitization structures create a variety of obstacles to loan modification, including outright contractual prohibitions and limitations, litigation risk, and adverse incentives for the servicers who make the modification decisions.[3] Others have argued that factors like redefault risk and self-cure risk make loan modification a poor bet economically for mortgagees, and that the simple reason modifications are not happening is that they are not profitable, even compared to losses of sixty cents on the dollar in foreclosure.[4] Others have pointed to factors like lack of servicer experience and capacity in loan modification.[5] And of course these are hardly exclusive positions. Different factors may play different roles depending on the particular mortgagee.

Whatever the explanation for lack of modifications, we are presented with the inescapable fact that a distressingly large number of American families are losing their homes. These families are not just speculators who were looking to flip homes or cash out equity on refinancings or even greedy purchasers who bought McMansions they really couldn't afford by putting little money down in hopes of quickly accumulating home equity in an appreciating market. These families now include people who played by the traditional mortgage market rules, put their 20% down, got traditional fixed-rate mortgages, and bought houses that in normal market conditions would be within their means.

We are also presented with the terrible knowledge that the foreclosures are not about to stop anytime soon. In fact, they are likely to get much worse.

II. The Shifting Causes of Default and Foreclosures

The foreclosure crisis has gone in waves of defaults. First there were the speculators, who borrowed close to 100% of property values and maybe more with construction mortgages. As soon as property values flattened, much less dropped, they bailed, as the costs of carrying the mortgages was more than the appreciation that they anticipated receiving on sale. Many of these loans were non-recourse and the speculators simply walked away.

Next came a wave of defaults caused by payment reset shock, primarily from expiration of teaser rates on hybrid ARMs. Hybrid ARMs have a fixed teaser rate for one to three years,

[3] *See, e.g.*, Anna Gelpern & Adam J. Levitin, *Rewriting Frankenstein Contracts: Workout Prohibitions in Residential Mortgage-Backed Securities*, 82 S. CAL. L. REV. (forthcoming 2009).

[4] *See, e.g.*, Manuel Adelino, *Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitization,* Fed. Reserve Bank of Boston, Public Policy Discussion Paper No. 09-4, July 6, 2009, *at* http://www.bos.frb.org/economic/ppdp/2009/ppdp0904.pdf.

[5] *See, e.g.*, Congressional Oversight Panel, *The Foreclosure Crisis: Working Toward a Solution, at* http://cop.senate.gov/reports/library/report-030609-cop.cfm.

and then an adjustable rate that is usually substantially higher. (These loans are often called 2/28s or 3/27s, with the numerator in reference to the length of the teaser and the denominator in reference to the remaining term of the mortgage.) The teaser rate made occupancy for the teaser period quite affordable. Many hybrid ARMs were subprime loans, meaning that they were at a substantially above-market rate. Sometimes this was because of the risk posed by the borrower, sometimes it was because the borrower wanted to get a low teaser rate by gambling on the ability to refinance later when the teaser expired, and sometimes it was simply because prime borrowers were duped or steered into taking out these mortgages.

Homeowners who took out hybrid ARMs anticipated being able to refinance the properties when the teaser rate expired. A refinancing, however, requires some equity in the property (and in the declining market, substantial equity in the property). Many of these mortgages were made by homeowners who had little equity in the property to begin with, but who anticipated accumulating it quickly in the appreciating market of the housing bubble. When the market fell, they lacked the equity to refinance. What's more, many faced stiff prepayment penalties if they refinanced.

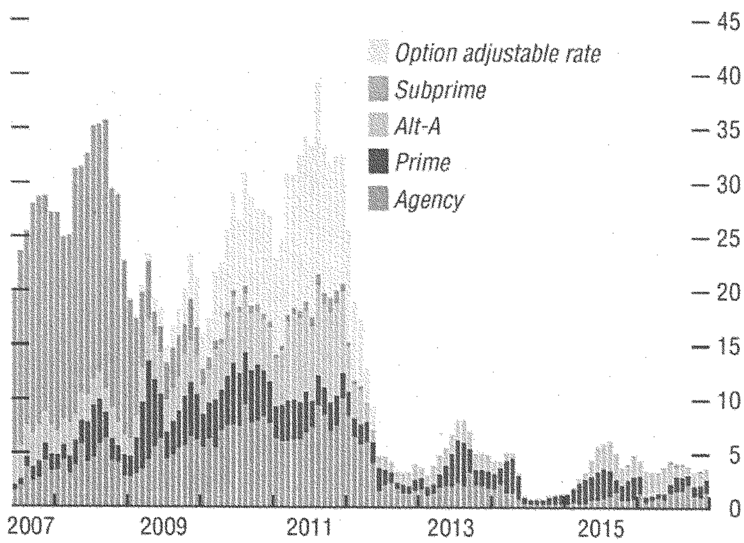
As a result, they were stuck with the hybrid ARMs when the teaser period expired. Most of these loans had been underwritten based on an ability to pay the teaser rate, rather than the reset rate, and even the teaser rate underwriting was often a stretch. When the rates reset, payment on these mortgages was frequently unaffordable, and even when it was, the homeowners were caught with negative equity and facing a declining market. The result was another wave of defaults.

Many of the hybrid ARMs were made in 2005 and 2006 with two-year teasers. Many of the teaser expirations have already occurred, so this wave has crested, and low interest rates have mitigated some of the rate reset effect. There are, however, also a significant number of so-called 5/1 ARMs with a rate reset occurring five years after the loan's origination. The rate resets on the 5/1s underwritten during the bubble still lie ahead.

Now we are looking at another wave of defaults from interest rate resets, this time on so-called pick-a-pay or pay-option ARMs. Pay-option ARMs permit the borrower to choose the level of monthly payment. Typically there are four choices—as if the loan were amortizing over 15 years; as if the loan were amortizing over 30 years; interest only (non-amortizing); and negatively amortizing. The interest rate in a pay-option ARM is always adjustable based on an index rate. Pay-option ARMs generally have negative amortization limits. If there is too much negative amortization (often 10-15%), then the loan will be recast into an amortizing ARM. If the homeowner has been making too many payments at the negatively amortizing rate, the payment shock of the reset will be significant. Moreover, because these loans are negatively amortizing, they would be difficult to refinance even in a good market, but in a falling market they are impossible to refinance because they are underwater.

Most pay-option ARMs were not subprime loans. Instead, they were made to prime borrowers, but were often underwritten with reduced documentation, making them so-called "Alt-A" loans. Credit Suisse has estimated that most of the pay-option ARM market will be experiencing rate resets over the next two years (see graphic below). Again, while low interest rates will mitigate the payment reset shock, the switch from negative amortization to positive amortization alone will result in a greatly increased monthly payment for many pay-option borrowers, who will then be confronted with making significantly greater monthly payments for a property in which they have no equity.

Figure 1.7. Monthly Mortgage Rate Resets
(First reset in billions of U.S. dollars)



Source: Credit Suisse.

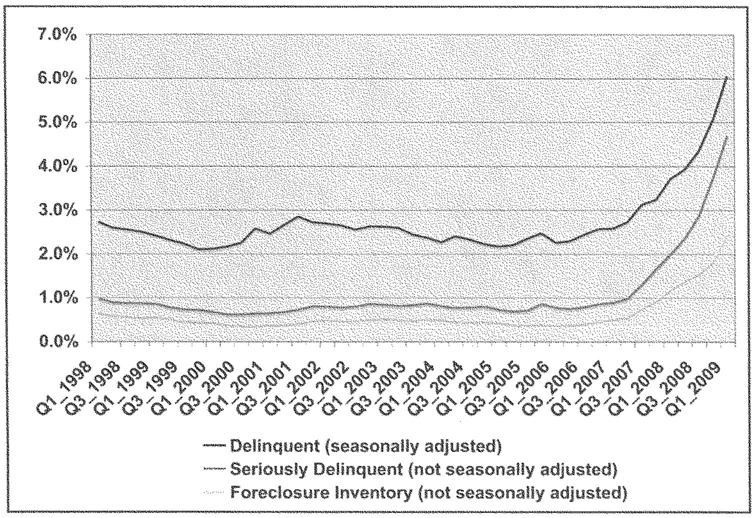
The fourth wave of defaults has already begun, and the worst is still ahead of us. This wave is fueled by a declining market, as underwater homeowners with no prospect of positive equity in the near future strategically default on their mortgages. (By strategic default, I mean default by a homeowner who can pay a mortgage, but does not because it is not economically sensible to do so.) A number of studies have identified negative equity as a, if not the, primary factor in current foreclosures.[6]

[6] *See, e.g.*, Congressional Oversight Panel, *The Foreclosure Crisis: Working Toward a Solution*, *at* http://cop.senate.gov/reports/library/report-030609-cop.cfm; Stan Leibowitz, *New Evidence on the Foreclosure Crisis*, Wall St. J., July 3, 2009 at A13; Michael LaCouer-Little, *Follow the Money: A Close Look at Recent Southern California Foreclosures*, Mar. 5, 2009, paper presented at the American Real Estate and Urban Economics Association 2009 Mid-Year Meeting, *at* http://www.areuea.org/conferences/papers/download.phtml?id=2133.

For homeowners who purchased in the past five years, over 30% are underwater, and perhaps a quarter of all residential mortgagors are underwater. Unfortunately, foreclosures create negative feedback loops that result in more foreclosures. Foreclosures push down housing prices. Depressed housing prices contribute to negative equity. And negative equity encourages strategic defaults and more foreclosures.

Rising unemployment will only exacerbate the problems of negative equity. When a home is both underwater *and* the monthly payments are unaffordable out of current earnings, a default is nearly inevitable. Not surprisingly, defaults are spreading into the conventional prime market, jumbo prime, second lien, and HELOC markets, with unemployment and negative equity, rather than payment reset shock as drivers. Prime defaults and foreclosures started to surge sharply at the close of 2008 and have continued to do so into 2009. (See Chart 2, below.)

Chart 2: Prime Mortgage Delinquencies and Foreclosures[7]



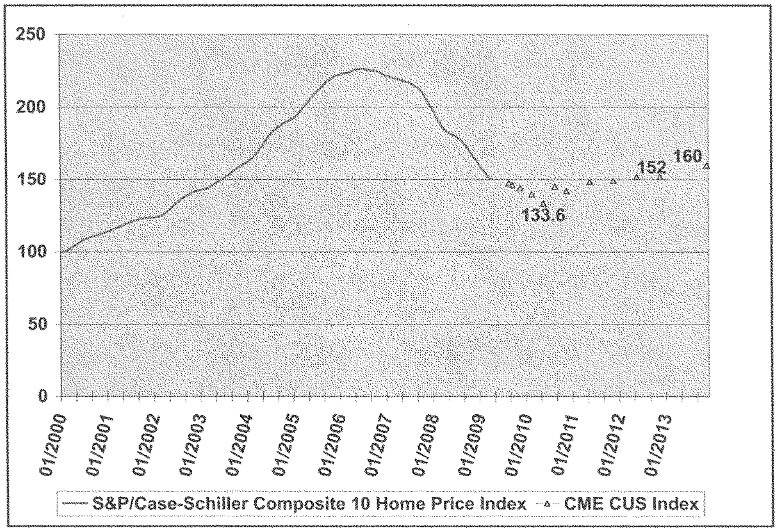
III. Housing Futures Predict Further Market Declines and a Slow Recovery

These are not just my pessimistic predictions, or even those of bearish analysts. It is also what the market as a whole believes. U.S. housing market futures based on the Case-Shiller Home Price Index are traded on the Chicago Mercantile Exchange. The Index is pegged to January 2000 as 100. At its peak in June 2006, the Index was at 226.29. As of April 2009, the Case-Shiller Index stands at 150.34, a 33% drop from peak. The futures market anticipates it falling to a low of 133.6 in May 2010 (down 41% from peak) and still not climbing above 160 in November 2013 (down 29% from peak), which is where it stood in January 2009 and October

[7] Mortgage Bankers Association, National Delinquency Surveys.

2003. In other words, the market anticipates that housing prices will only rise 6% over the next four years. (See Chart 3.)

Chart 3: S&P/Case-Shiller Composite 10 Home Price Index and Chicago Mercantile Exchange Futures on Composite 10 Index



While this would mean the housing market hitting a bottom and recovering somewhat, it also means that it will take four years for prices to get back to their already depressed values of this year. It also means that many of the families that took out mortgages between 2003 and 2008 will have negative equity in their homes.

This presents a problem not just for current foreclosures, but for years into the future. The nature of life is that people have different housing needs at different stages of life and have to move from time to time. The birth of children, illness, death, divorce, and new jobs all necessitate moves. If a homeowner who has to move has negative equity, the choice is between foregoing the move, somehow finding the cash to make up the negative equity, and losing the house in foreclosure. Many will choose the foreclosure route, and this means years of elevated foreclosure rates, even if there will not be an acute crisis.

Not only does this mean more families losing their homes in foreclosure, more losses for lenders and MBS investors, and more blighted properties for communities, but it also means that true stabilization for the U.S. housing market will be delayed and investors will have difficulty pricing investments because of uncertainty about default rates. As the Congressional Oversight Panel noted in its March 2009 report on the foreclosure crisis:

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> Homeowners with negative equity cannot sell their homes unless they can make the balloon payment that lurks in the background. Many homeowners will eventually need to move for jobs, for assisted living, for larger or smaller living spaces, or to be near family. If they can find rental housing at an equivalent monthly payment price, they will abandon homes burdened by negative equity. Significant negative equity raises the serious risk that foreclosures have merely been postponed, not prevented.
>
> Negative equity will create significant distortions in the labor, elderly care, and housing markets. Moreover, negative equity will keep foreclosures above their historically low levels. These delayed foreclosures will continue to plague the U.S. housing market and financial institutions' books for decades.[8]

Unfortunately, none of the current loan modification or refinancing efforts attempt to deal with the negative equity problem in a way that offers a long-term solution. The Home Affordable Refinance Program permits borrowers with loans owned or guaranteed by Fannie Mae and Freddie Mac to refinance at up to 125% of the property's current appraised value. This allows underwater homeowners to lower their monthly payments, which addresses affordability issues. But it also means that these homeowners will still be paying mortgages on loans worth far more than their houses (and assuming a 7% broker's fee on sale, anyone with a 93% LTV ratio or higher is effectively underwater). Some individuals might be willing to pay a 25% premium to retain their home. But for others that will prove too much, if not immediately, than in the near future when life events present an impetus to relocate.

To recapitulate:

- We know we are in the midst of an economic catastrophe for the American family and for many communities and that more trouble is to come.
- We know that these problems are likely to last not just for another six months, but for several years, and that they will place a drag on the entire economy, ensuring that recovery, whenever it comes, will be slow.
- We know that there are two factors driving defaults on mortgages—unaffordable payments (often due to rate resets and unemployment) and negative equity (due to high initial loan-to-value ratios and falling housing prices).
- We know that foreclosures place downward pressure on home prices and beget more foreclosures, creating a negative feedback loop or death spiral in the housing market.
- We know that there still aren't nearly enough loan modifications being done to offset the tide of foreclosures.
- We know that almost no loan modifications address negative equity by reducing principal balances. Of the 185156 loan modifications in the first quarter of 2009, only 3,389 or

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[8] Congressional Oversight Panel, *The Foreclosure Crisis: Working Toward a Solution*, *at* http://cop.senate.gov/reports/library/report-030609-cop.cfm, at 50.

1.8% involved principal balance reductions, and all but four of these were for loans held in portfolio, rather than securitized.[9]

- We also know many loan modifications do not address affordability by reducing monthly payments. 45.8% of the loan modifications done in the first quarter of 2009 resulted in monthly payments remaining unchanged or even increasing (in 18.5% of cases).[10]
- We also know that we still don't have consensus about why the numerous refinancing and modification programs attempted by industry, the Bush administration, and the Obama administration haven't made significant headway against the volume of defaults and foreclosures, but we can say that it is likely multicausal and not subject to a silver bullet cure.

IV. Bankruptcy Modification of Mortgages

This situation leaves only one option on the table for the federal government: permit homeowners to modify their mortgages in bankruptcy. Whatever the factors may be that are inhibiting voluntary and government-subsidized loan modifications, they are immaterial if a mortgage loan can be modified in bankruptcy. Permitting the modification of single-family principle residence mortgages in bankruptcy would create a mechanism that would address the negative equity problem as well as the affordability problem while also denying relief to speculators who would abuse the system, and homeowners who cannot realistically afford even a modified mortgage.[11] This mechanism could be immediately available and would have no additional cost to the taxpayers, and it would not result in higher mortgage costs or less mortgage credit availability as long as lenders' foreclosure losses remain greater than bankruptcy modification losses.

Chapter 13 of the Bankruptcy Code permits qualified debtors to propose a 3- or 5-year repayment plan, during which time all collection actions against the debtor are stayed.[12] Secured debts and priority must be paid in full,[13] and the debtor's entire statutorily defined disposable income must go to paying unsecured creditors.[14] Upon successful completion of the plan, the consumer's remaining pre-bankruptcy debts are discharged.[15]

Within these parameters, however, the debtor has significant leeway to restructure or modify almost any type of debt. Interest rates can be reduced, amortization schedules changed,

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[9] Office of Comptroller of the Currency and Office of Thrift Supervision, , OCC and OTS Mortgage Metrics Report, First Quarter 2009, *at* http://www.occ.treas.gov/ftp/release/2009-77a.pdf at 21, 23.

[10] *Id.* at 25.

[11] It is important to emphasize, however, that even with cramdown, Chapter 13 cannot help a homeowner, unless the homeowner has regular income. Regular income is a threshold eligibility requirement for Chapter 13. In a two-earner family, there need be only one regular income, but if a family's difficulty in paying its mortgage is caused by unemployment of the sole earner, Chapter 13 would not be an option. The reason I emphasize the importance of regular income for Chapter 13 eligibility is that unemployment will be a major factor in the coming wave of foreclosures.

[12] 11 U.S.C. §§ 1301-1328 (Chapter 13 provisions generally); 11 U.S.C. § 109(e) (Chapter 13 eligibility requirements); 11 U.S.C. § 362 (2005) (stay).

[13] 11 U.S.C. §§ 1325(a)(5) (secured creditors must receive present value of their collateral or the collateral itself under a plan); 1322(a)(2) (priority creditors must receive deferred cash payments for their full claim).

[14] 11 U.S.C. § 1325(b) (2005).

[15] 11 U.S.C. § 1328(a) (2005). There are certain exceptions to discharge. *Id.*

loan tenors increased, and negative equity erased. A consumer debtor can modify car loans, credit card debt, student loans, yacht loans, jet-ski loans, snowmobile loans, airplane loans, computer loans, jewelry loans, and appliance loans, as well as investment property mortgages and vacation home mortgages. A consumer debtor can also modify a principal residence mortgage if it is a multifamily property. This means that a consumer who rents out the basement or the attic can modify the mortgage on her house in bankruptcy. The only type of debt that a consumer cannot modify in bankruptcy is debt on a single-family principal residence.[16] Currently, single-family principal residence mortgages must be repaid according to their original terms or the bankruptcy stay will be lifted and the mortgagee permitted to foreclose.

The policy behind the special protection for single-family principal residences is that Congress believed in 1978 that if mortgage lenders were shielded from losses in bankruptcy, competition would ensure that lenders would pass on these gains to consumers in the form of lower mortgage costs, thereby encouraging homeownership.[17]

Unfortunately, the economic assumption behind the special protection for single-family principal residence mortgages in bankruptcy is incorrect. *It is unlikely that bankruptcy modification of mortgages will result in higher costs of credit or less credit availability, despite the banking industry's protestations to the contrary.* The banking industry has not presented a scintilla of evidence that permitting cramdown would affect credit prices. Instead, they have made declarations based on a simplistic economic view that greater access to bankruptcy necessarily results in higher costs of credit and lower credit availability. The economics of bankruptcy, however, are more complicated.

I have conducted the only empirical work on the topic,[18] and the clear finding from my research is that mortgage prices are largely insensitive to bankruptcy modification risk. No premium compensating for bankruptcy modification appears in primary mortgage pricing, secondary mortgage market pricing, or, most crucially, in private mortgage insurance pricing, and there is no discernible effect on homeownership rates from the protection. Permitting bankruptcy modification is unlikely to result in higher mortgage costs or lower mortgage credit availability.

This should not be a surprising finding. Lenders will only raise prices in reaction to permitting bankruptcy modification of all mortgages if it would result in greater losses to them than the alternative—foreclosure. The choice a mortgagee faces is not bankruptcy loss versus no loss, but bankruptcy loss versus foreclosure loss. So long as bankruptcy losses are smaller than foreclosure losses, permitting bankruptcy modification will not result in higher prices.

Thus, it all comes down to the question of whether lenders lose more in bankruptcy than in foreclosure. The best evidence on the question says they do not, and this is not surprising; bankruptcy law guarantees that lenders will recover at least as much as in a foreclosure.

[16] 11 U.S.C. §§ 1123(b)(5); 1322(b)(2) (2005).

[17] Nobelman v. American Savings Bank, 508 U.S. 324 (1993). The legislative history on the anti-modification provision 11 U.S.C. § 1322(b)(2) is scant and not particularly illuminating of Congressional intent (it is more illuminating of Congressional skepticism in response to mortgage industry claims). Moreover, the history of the anti-modification provision suggests that it was intended only to prevent adjustments to mortgage rates and amortizations, not interfere with 11 U.S.C. § 506, a generally applicable provision of the Bankruptcy Code that limits the amount of a secured claim to the value of the collateral, with any excess claim being treated as unsecured.

[18] Adam J. Levitin, *Resolving the Foreclosure Crisis: Modification of Mortgages in Bankruptcy*, 2009 WISC. L. REV. 565 (2009).

Any attempt to mitigate foreclosures faces the challenges of quickly deciding which homeowners to help, addressing the twin problems of negative equity and affordability, avoiding moral hazard, and determining who will bear the cost of loan modifications. Bankruptcy modification helps solve these very issues and can do so more effectively and cheaply than any other proposed solution. Bankruptcy modification is also the only way to bypass the contractual, legal, practical, and economic problems created by securitization.

Permitting mortgage modification in Chapter 13 would provide an immediate solution to much of the current home foreclosure crisis. Bankruptcy courts are capable of immediately handling a large volume of filings, and the bankruptcy automatic stay[19] would function like a foreclosure moratorium until cases could be sorted through.

Bankruptcy modification would not yield a windfall to housing speculators or second home purchasers and would only help homeowners who could ultimately afford a reasonable mortgage. A mortgage loan modification in bankruptcy can occur only as part of a repayment plan. The automatic stay would likely be lifted on an investment property (or second home) before a plan could be confirmed. Accordingly, speculators and homeowners intent on keeping their second homes are unlikely to file for bankruptcy to seek mortgage modification in the first place.

To qualify for Chapter 13 bankruptcy, in which a loan can be modified, a homeowner must have a regular income,[20] and Chapter 13 plans must be feasible given the debtor's means.[21] This does not mean that any modification is permissible; federal common law of bankruptcy requires that modified loans reflect a reasonable risk premium for the debtor,[22] and the Bankruptcy Code requires that a mortgagee receive at least the present value of the property.[23] Only a debtor who can afford a loan modified within these limits will be able to keep her home. Permitting bankruptcy modification of primary home mortgages thus steers a true course between extending the right sort of relief and not extending it too broadly.

Nor would bankruptcy provide a windfall to homeowners in the event that property values appreciate in future years. While the homeowner would benefit from future appreciation, lenders have no reasonable expectation of this appreciation. Bankruptcy is supposed to, at the very least, give lenders what they would get in foreclosure, and when a home is sold in foreclosure, the lender gets cash for the value of the house, and does not receive any benefit from the property's future appreciation.

Bankruptcy modification would also provide a solution for both of the distinct mortgage crises—negative equity and payment shock. Bankruptcy modification would help negative equity homeowners by eliminating their negative equity position ("cramdown"), which would reduce their incentive to abandon the property.[24] Likewise, homeowners who are unable to

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[19] 11 U.S.C. § 362 (2005).

[20] 11 U.S.C. § 109(e) (2005).

[21] 11 U.S.C. § 1325(a)(6) (2005).

[22] Till v. SCS Credit Corp., 541 U.S. 465 (2004).

[23] 11 U.S.C. § 1325(a)(5) (2005). *See* Stan Leibowtiz, *New Evidence on the Foreclosure Crisis*, WALL ST. J., July 3, 2009; Congressional Oversight Panel, *The Foreclosure Crisis: Working Toward a Solution*, *at* http://cop.senate.gov/reports/library/report-030609-cop.cfm.

[24] Chapter 13 "cramdown," also known as "strip down" or "lien stripping" or "claim bifurcation," is not to be confused with the unrelated but eponymous Chapter 11 "cramdown," the confirmation of a plan of reorganization under 11 U.S.C. § 1129(b) (2005), over the objections of a dissenting class of creditors or interests.

afford their mortgage because of a rate reset could modify their loans to make monthly payments fixed and affordable level.

Permitting bankruptcy modification would not create moral hazard for lenders or debtors. Lenders will lose loan value. While they will generally do better than in foreclosure, and the loss is not because of bankruptcy *per se*, there is still a high price for lenders that will discourage reckless lending. As for homeowners, Chapter 13 bankruptcy is not a "drive-by" process. In order to receive a discharge in Chapter 13, a debtor must live on a court-supervised, means-tested budget for 3 or 5 years,[25] and fully repay certain debts, including allowed secured claims, domestic support obligations, and tax liabilities.[26] There are also limitations on how often a debtor may receive a bankruptcy discharge.[27] Nor would bankruptcy modification give homeowners a windfall. At best, a homeowner with negative equity would end up with zero equity, not positive equity. Given the large transaction costs to a sale, debtors are unlikely to sell their properties for anything beyond a *de minimis* profit over the next few years.

Finally, one of the greatest advantages of bankruptcy modification is that it has no cost for taxpayers. In an age of a trillion dollars in government bailouts, bankruptcy modification is a rare bargain. Bankruptcy courts are well staffed relative to historic filing levels, and court fees cover the administrative costs of the process. Bankruptcy modification has no cost to taxpayers, and stabilizing housing markets would greatly help economically beleaguered local governments.

The foreclosure crisis is not about to stop any time soon. Judicially-supervised restructuring of mortgages is the only tool we have left in the box. It's a tool we know can work. It's a tool that can save hundreds of thousands of families their homes and help stabilize communities, housing markets, and the economy. It's time to use it.

[25] 11 U.S.C. § 1325(b) (2005).
[26] 11 U.S.C. §§ 1322(a); 1325(a)(5) (2005).
[27] 11 U.S.C. §§ 727(a)(7)-(9); 1328(f)(2) (2005).

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Chairman Whitehouse, Ranking Member Sessions, Members of the Subcommittee, thank you for the opportunity to speak at today's hearing on this very important matter.

My name is Joe Verdelotti Jr. and I'm a licensed electrician from West Warwick, Rhode Island. My wife April works in the emergency room registering patients at the Roger Williams Medical Center in Providence, RI. We have been married for 9 ½ years, and have known each other for nearly 20 years. We have one daughter, Brooke who is 9, and two sons, Lorenzo who is 6, and Gianni who just celebrated his 1st birthday a few months ago. Needless to say we have quite an active household. On January 26, 2006, we purchased a 1,100 square-foot home in West Warwick, Rhode Island for $225,000.

Since we, like many other homeowners, did not have savings for a down payment, we took out two mortgages. The first mortgage, which covered 80% of the purchase price, is an Adjustable Rate Mortgage that is currently at 6.5%, but will adjust in the fifth year. The second mortgage, which covered the other 20% of the purchase price, has a fixed interest rate of 9.25%. Both mortgages were originally through Aurora Loan Services, but CitiMortgage subsequently purchased the second mortgage.

At the time we purchased our home, I was a fourth-year electrician's apprentice making $18.00 an hour. The construction industry was booming and times were good in Rhode Island. The good times did not last, however. Not long after we purchased our home, the recession began and work became scarce.

My company has had to lay off workers and make cut-backs just to stay afloat. As of today, we still have a wage freeze in effect, and our health care premiums have increased. My wife too has felt the effects of the recession at work and is also under a pay freeze. Despite our income freeze, the cost of living has not slowed and we are feeling the squeeze. Our utility bills, such as electric and water, have increased, as have our property taxes – and we may see further increases in the future. Our budget is stretched as tight as we can get it.

Like many of our neighbors, our home is "underwater." It just isn't worth what we paid for it at the height of the housing bubble in 2006. We received a glimmer of hope last fall when the Help for Homeowners program took effect, but that proved to be a disappointment. The day the program started, my wife called the number listed on HUD's website and spent hours waiting and talking to someone at debt service about our situation. In the end, their only advice to her was to consider a roommate, get a part time job, contact the United Way to locate food banks in our area, reduce spending, and contact legal aid for a consultation with a bankruptcy attorney. The person on the phone even recommended we consider walking away and letting the bank foreclose.

We called for help in saving our home and were told to consider food banks and foreclosure.

I later contacted Aurora Loan Service directly and spoke with a customer service agent to see if they would be willing to work with us under the Help for Homeowners program. After giving the necessary information to the agent over the phone, I was met with another disappointing blow: the agent informed me that I did not make enough money for them to help us and that we should consider a short sale.

Next, we decided to apply for a financial hardship package through CitiMortgage. On February 26, 2009 we sent CitiMortgage the necessary documents through certified mail. The documents were received on March 2. On March 20, my wife contacted CitiMortgage at approximately 1pm to try to find out to the status of our hardship application, but all she got was the run around. Each person she spoke to said she had the wrong department and that they would transfer her to the right one, but this never happened. This went on until I came home from work and I took over. Each person was clearly reading the same talking points: we always had the wrong department and they would transfer us to the correct department. After listening to elevator music on hold for over an hour, I too gave up. We had been on the phone with CitiMortgage for over five hours and accomplished nothing!

On April 8, 2009, my wife contacted CitiMortgage again and, after several attempts to get a straight answer, she was informed that our case was closed since they never received our packet. She informed them that that it was sent on February 26 and that we had delivery confirmation that they received it on March 2. After hearing this, they changed their story to "It must have gotten lost" and that we would need to resubmit the application. This was quite unsettling to hear because that package contained all of our personal and financial information.

Since we have two mortgages we also sent a hardship package to our 1st lien holder, Aurora Loan Service. In a letter dated March 11, 2009, just 2 days after receiving the package, Aurora denied our request.

In May, I once again requested a mortgage modification from CitiMortgage. This time we were rejected because, according to them, we make sufficient income to support our current mortgage payment. They also suggested that we consider a short sale. CitiMortgage apparently believes that we make enough to cover our mortgage, but that we should consider a short sale... This seems pretty contradictory to me.

Now, even though we are current on our financial obligations, we are hardly living comfortably. We have had to make even more adjustments in order to make ends meet, and it gets increasingly difficult. We are not sure how much longer we can survive like this. My health care premiums rose at the same time the Making Work Pay tax credit took effect so I now take home $2.00 less a week than I used to. How can my family and others help stimulate the economy if Congress doesn't do something fast to help curb this foreclosure problem?

All we are asking for is a little help, a little consideration, and a little professionalism on the part of our mortgage holders. If we're able to negotiate a more manageable payment plan and keep our home, it becomes a win-win solution for everyone: we keep our home, the banks avoid the costs of foreclosure, and the community avoids a hit to property values and tax collections.

Senators, please do something to help struggling homeowners like my wife and me. Thank you again for the opportunity to tell my story.

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Statement of

The Honorable Sheldon Whitehouse

United States Senator
Rhode Island
July 23, 2009

Opening Statement of Sheldon Whitehouse
Chairman, Senate Judiciary Subcommittee on Oversight and the Courts
Hearing on "The Worsening Foreclosure Crisis: Is It Time to Reconsider Bankruptcy Reform?"
As Prepared for Delivery

The hearing will come to order.

Nearly ten months ago we enacted a $700 billion bailout package to rescue the economy from the subprime mortgage meltdown. This hearing will look at whether the foreclosure situation is worsening and what can be done for the millions of families in Rhode Island and Alabama and across the nation at risk of losing their homes.

We tried in October to include in the Troubled Asset Relief Program measures that would help homeowners on Main Street, in addition to the banks on Wall Street. Unfortunately, these efforts proved fruitless. We included in the bailout legislation a requirement that the Treasury work to modify the mortgages it purchased as part of the TARP. That requirement was rendered meaningless by the outgoing Administration's decision not to purchase "toxic assets" as initially proposed. The money went directly to banks, and the Treasury held no mortgage-related assets to modify. Wall Street benefited, and Main Street was left in the cold.

Democrats in Congress, led by Senator Durbin, tried unsuccessfully to include in the TARP legislation a provision that could have kept millions of families in their homes at zero cost to the taxpayers. This proposal would have corrected an anomaly in the Bankruptcy Code that prohibits judges from modifying primary residence mortgages the way they can modify every other type of contract from mortgages on vacation homes to car and jewelry and corporate loans. Despite the fact that a bankruptcy modification would spare the community the terrible costs of foreclosure, the mortgage banking industry invested millions of dollars to lobby against this reform and has so far been able to prevent its passage.

As subprime mortgage teaser periods began to expire last year, and with the credit market dried up so they could not refinance, millions of homeowners faced higher monthly payments that they could not afford. In the final quarter of 2008, there were over 200,000 residential foreclosures. These homeowners faced this foreclosure wave with minimal assistance from their government.

The new administration has tried to address the foreclosure crisis. Through the Treasury's Making Home Affordable programs, President Obama encouraged loan servicers to start modifying mortgages. While these programs so far have kept 160,000 families in their homes through trial modifications, it is becoming increasingly clear that Congress must do more – much more - to address the worsening crisis.

As you will hear from one of the witnesses today, there is evidence that the worst of the foreclosure crisis is not behind us. Just as the wave of potential foreclosures from subprime mortgages begins to subside, a new wave of potential foreclosures tied to rate resets on other, exotic mortgage instruments is just around the corner. The Center for Responsible Lending estimates nine million homes may be lost to foreclosure from 2009 through 2012. At their current rates of modification, the Treasury's voluntary programs may only assist two million or fewer families during that period.

It is clear to me that Congress must do more to help struggling American homeowners, and specifically, that we need to take another serious look at the Durbin proposal to allow bankruptcy judges to modify the terms of mortgages on principal residences. If we fail to act, I fear that we put ourselves at risk: that a vicious cycle of foreclosures, falling home values, and declining tax revenues will keep us in recession for years to come.

I look forward to hearing the views of today's panel on this proposal and others.

Joseph Verdelotti, Jr., a constituent of mine from West Warwick, Rhode Island will share his experience struggling with two mortgages during a period of rising costs and falling home prices. Mr. Verdelotti, a licensed electrician, and his wife April, a hospital worker, have been unable to obtain mortgage modifications and may soon be forced to leave their home.

Alys Cohen is a staff attorney at the National Consumer Law Center's Washington office, where she advocates on predatory lending and sustainable homeownership issues. Ms. Cohen leads NCLC's mortgage policy. Ms. Cohen is a graduate of the University of Pennsylvania Law School.

Professor Adam Levitin of the Georgetown University Law Center is a nationally regarded expert in bankruptcy and consumer law. He serves as Special Counsel for Mortgage Affairs for the Congressional Oversight Panel. Professor Levitin is a graduate of Harvard, Columbia, and Harvard Law School.

Dr. Mark Calabria is Director of Financial Regulation Studies at the Cato Institute. Prior to joint the Cato Institute, Dr. Calabria was a senior professional staffer on the Senate Banking, Housing, and Urban Affairs Committee. He holds a doctorate in economics from George Mason University.

Richard Genirberg is a practicing attorney from Jonesboro, Georgia. He specializes in bankruptcy, collections, and criminal law. He earned his law degree from Georgia State University College of Law and his B.A. at Michigan State University. He also has an MBA from Georgia State University. Prior to owning his own firm, Mr. Genirberg was General Counsel for the minority party at the Georgia House of Representatives.

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