PROBLEMS IN MORTGAGE SERVICING FROM MODIFICATION TO FORECLOSURE

S. HRG. 111–987

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HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

ON

EXAMINING PROBLEMS IN MORTGAGE SERVICING FROM MODIFICATION TO FORECLOSURE AND THE IMPACT THESE PROBLEMS HAVE HAD ON U.S. HOMEOWNERS AND THE HOUSING MARKET DURING THE ECONOMIC DOWNTURN

NOVEMBER 16 AND DECEMBER 1, 2010

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

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PROBLEMS IN MORTGAGE SERVICING FROM MODIFICATION TO FORECLOSURE

TUESDAY, NOVEMBER 16, 2010

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 3:20 p.m., in room SD–538, Dirksen Senate Office Building, Hon. Christopher J. Dodd, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN CHRISTOPHER J. DODD

Chairman DODD. The Committee will come to order. Let me first of all thank my colleagues and our witnesses for their patience and indulgence. This is a gathering today with the various caucuses meeting, unfortunately not at the same time, so it has made this a little awkward to try and schedule, Tim, the hearing. But you have all come a long way, my good friend Tom Miller, the Attorney General from Iowa as well, so I wanted to make sure we could have the hearing and yet accommodate the interests of all Members of the Committee. So we moved it to this time, Bob, and I am sure Senator Shelby will be here at some point shortly, and the idea being that I guess the Democratic caucus is sort of wrapping up, but there is a Republican caucus which is going to start in about an hour.

Chairman DODD. To which you are not invited.

[Laughter.]

Chairman DODD. And so I am going to try, and what I would like to do—and I have already asked the witnesses to do this. I will make some brief opening comments. Senator Shelby obviously will do so as well. And then we will turn to our witnesses and ask them if they can to try and abbreviate their comments even further so I can then accommodate—and I know this is a bit awkward, but to accommodate our Republican colleagues who are here, who still have an obligation to get to that caucus, in which case our own Members as they come out of the caucus will be showing up here. So it is a little different than we would normally proceed, but I want to make sure we give all Members a chance to be heard, and the witnesses who have come a long way with prepared testimony are going to get a good, healthy discussion.

I will also, at the appropriate time when we have a quorum, ask the Committee to fulfill its obligation of voting on the Diamond nomination to serve on the Federal Reserve Board. As my colleagues will recall, at the recess period the nomination under the law had to be—was sent back to the White House and resubmitted, therefore requiring yet another vote by the Committee, even though we have had a hearing and voted on the Diamond nomination once before. And so when that time comes, I will interrupt the hearing to perform that function, knowing that a quorum could slip from time to time.

So with that in mind, I would like to begin, and I will make my own opening comments, and then turn to Senator Shelby or Senator Bennett, whoever is here, for any thoughts they may have. And then we will turn to our witnesses. So I again thank all for participating.

Richard, how are you? Good to see you.

The hearing today, as you are all aware, is on the problems in mortgage servicing from modification to foreclosure. Obviously, it has received a great deal of attention over the last number of weeks in the media, and we thought it was appropriate that even in this lame duck session we invite those who have been involved in it, including our Attorneys General, represented by Tom Miller, and others including the institutions involved, to come and share their thoughts as to where we are with this matter and give us an opportunity to move forward. And, obviously, as I prepare to leave, Tim Johnson, Richard Shelby, and other Members here will pick up this issue. Evan Bayh will be traveling out the door with me, and then they will be moving to analyze this issue and respond accordingly.

I want to welcome again and thank our witnesses for appearing today and for their testimony about the problems in mortgage servicing from modification, as I said, to foreclosure. As many of us know, or all of you know, we have had numerous hearings on the problems of the mortgage industry. In fact, the second hearing that I held as Chairman of this Committee in the first week of February 2007 was on the residential mortgage markets and the problems. During that year of 2007, we had almost 80 different hearings on this subject matter at one time or another, including informal gatherings in this very room with some of the leading servicing companies in the Nation to talk about what plans they had to minimize the fallout from the mortgage crisis. So it is a subject matter over the last 4 years that this Committee has spent a great deal of time and attention on.

In addition to today's hearing, I intend to have another hearing—and, again, I will consult with Senator Shelby about timing to do this. We are only here for a couple of weeks. We have got the break for Thanksgiving. But if we can, we want to fit that hearing in to invite the regulators to come before us as well to share with us their thoughts on the subject matter.

First let me explain what we mean by mortgage servicing. When a homeowner takes out a mortgage, that loan is often bundled with a pool of similar mortgages and sold in the secondary market as a mortgage-backed security, commonly known as MBSs. After the origination, all processing related to the loan is managed by a mortgage servicing company. The four largest banks—JPMorgan Chase, Wells Fargo, Bank of America, and Citi—are also the largest mortgage servicers. Mortgage servicers bill and collect monthly payments, operate customer service centers, maintain records of payments and balances, and distribute payments according to the terms of a trust. Principal and interest are distributed to the investors of the mortgage-backed securities through a trustee. Taxes and insurance are paid to local governments and insurers—servicers retain a servicing fee. That is a brief description of how this is supposed to work.

It is the problems that have arisen with this process that have led me to call the hearing today. It has not generally been my habit to quote the Wall Street Journal editorials in my Committee statements, but I thought the following from a column last month captured perfectly the essence of the issues we will examine today. The column is entitled "A Foreclosure Sitcom." It starts by saying, "First we learned America's biggest banks could not properly lend." It goes on to say:

> Then we learned they could not keep themselves solvent without taxpayer assistance. Then we learned they could not effectively work with troubled borrowers in a bursting housing bubble. And now we have learned they do not even know how to foreclose.

"This is more than just a little paperwork problem," it went on.

> Ohio Attorney General Richard Cordray put it best: 'This is about the private property rights of homeowners facing foreclosure and the integrity of our court system, which cannot enter judgments based on fraudulent evidence.'

This editorial provides a sharp description, in my view, of the situation in which millions of Americans find themselves today, whether we are talking about a homeowner facing possible eviction, an investor in an MBS, or simply an average American family watching the value of their home drop as more and more homes go into foreclosure around them.

I want to provide a bit more context, if I can, for today's proceedings. In April of 2007, after holding a number of hearings on predatory lending, as my colleagues will recall, and the foreclosure crisis to which it would lead, I hosted a meeting of large mortgage servicers in this very room, including regulators, civil rights and consumer groups, and others, to discuss ways that we could better prepare for the wave of loan defaults and foreclosures many of us expected. That summit that we held in this very room resulted in a statement of principles to which all participants agreed on May 2nd of 2007.

Among the items to which the servicers agreed were the following: early contact and evaluation, modification to create long-term affordability, and providing dedicated teams or resources to achieve the kind of scale many knew would be necessary to face the coming tidal wave of foreclosures.

Unfortunately, rather than living up to these commitments, many in the industry wasted a lot of time denying culpability for the mortgage problems or arguing that the problems would not be as severe as they turned out to be. As a result, we see even today, more than 2 years later, a number of points: servicers struggling to keep up with demand; numerous and repeated cases of lost paperwork; serious allegations by investors, including the New York Federal Reserve, and advocates of self-dealing at some of the largest mortgage servicers in the country and people needlessly losing their homes, including, according to some press reports, people who have no mortgages on their homes at all.

More than a month ago, the robo-signing scandal, of course, hit the press. Many in the industry were too quick, in my view, to call the problems technical alone and to insist that nobody is losing a home to foreclosure without cause.

However, the focus of the robo-signing problem is too limited, in my view. Many believe that the robo-signing errors are simply the tip of a much larger iceberg, that they are emblematic of much deeper problems at the mortgage servicing business, problems that have resulted in homeowners, of course, losing their homes and unjustifiable foreclosures. In fact, servicing practices may be putting homeowners at risk.

Even the industry now acknowledges that the current mortgage servicing business model is broken and is simply not equipped to deal with the current crisis. Many observers point out that the interests of third-party mortgage servicers are not aligned with the interests of either homeowners or investors. So, for example, a permanent modification might result in a homeowner keeping the family's home and the investor being assured of a better return. But that same modification could cause the servicer to lose money.

The upshot is that there could be extensive problems throughout the servicing process that may have led to, in the words of the Federal Reserve Board Governor Sarah Bloom Raskin, and I quote her, "a Pandora's box of predatory servicing tactics."

According to Governor Bloom Raskin, these tactics include padding of fees, strategic misapplication of payments which can sometimes cause the loan to be considered in default, what some people call service-driven defaults, and the inappropriate assessment of forced placed insurance, which is extremely costly to the homeowner.

To her list let me add other issues that have arisen, including failure to properly record transfer and ownership of notes and/or mortgages, failure to maintain proper custody of title, failure to properly administer the Home Affordable Modification Program, failure to meet the requirements of the foreclosure process, such as by the use of robo-signers, and failure to establish or administer mortgage trusts in accordance with applicable law or contractual agreements. This hearing will explore these potential problems and their implications.

In addition, the Congressional Oversight Panel has raised concerns today that the failure of servicers and others to correctly handle mortgages and mortgage documents could create systemic risk for the financial system. Professor Levitin will also discuss this in his testimony this afternoon.

This is a very important issue to explore, both here today and with the regulators at our next hearing. In my view, we created the Financial Stability Oversight Council to examine exactly this kind of issue. The FSOC needs to really drill down, in my view, and find out the scope of the problem and determine the steps that may need to be taken to prevent systemic problems from growing, if they conclude that there are systemic implications, in fact.

Let me assure everyone here that I do not want this hearing to be simply about casting blame. It is extremely important to lay out the problems and challenges, and today's hearing is designed to do exactly that. But I also hope we can work toward solutions. As we do, we need to keep in mind that bad mortgage servicing is far more than a technical issue. At the same time, we must all acknowledge that not every delinquent borrower's home ought to be saved or can be saved. In my view, we need to strike a balance; we need more robust loan modifications, including loan modifications that result in real principal forgiveness that will finally help put an end to our housing crisis.

At the same time, I hope we can agree that we should expedite foreclosures that cannot be prevented. For example, a significant portion of homes awaiting foreclosure are vacant today in the country. There is no reason in the world to slow down the process on these homes. We will need to work together going forward if we hope to finally put an end to this housing crisis, and I look forward to these witnesses' testimony and the comments and questions raised by my colleagues.

We do have a quorum? Oh, good.

[Whereupon, at 3:33 p.m., the Committee proceed to other business and reconvened at 3:44 p.m.]

Chairman DODD. Richard, before you came in, what I said is I know you have got a caucus to go to as well, so we are going to do this a little differently. You make your opening statement; they are going to make brief comments, our witnesses.

Senator SHELBY. OK.

Chairman DODD. And then I am going to turn to my Republican colleagues for questions so that you can get your questions in before you have to go to the caucus.

STATEMENT OF SENATOR RICHARD C. SHELBY

Senator SHELBY. Thank you. You are charitable. We like you as Chairman right now. We are going to miss you. Thank you.

Thank you, Mr. Chairman. I will go back to the subject matter now. On October the sixth, I called for an investigation into the growing controversy surrounding home foreclosures. At this point, there appear to be a number of key issues—Senator Dodd has raised a lot of them—that need to be examined very thoroughly.

First, we need to determine the extent of the problem. It appears that thousands of so-called robo-signers working on behalf of banks to service loans signed foreclosure-related court documents swearing that they had personal knowledge of the facts of each foreclosure case. It now appears that few, if any, of these people had such knowledge that they swore to.

Second, we need to determine whether the flaws in the process led to improper results. In other words, were any homeowners foreclosed upon when they should not have been? I think that is a big issue.

Third, we need to examine the activities of the law firms that work for the servicers. Many questions have been raised regarding the conduct of these firms during their engagement in foreclosure proceedings.

Fourth, what role did the GSEs and the larger securitization market play in this debacle? Did their actions contribute to the problem? Were Fannie and Freddie complicit in any way?

Finally, we need to examine the role of the regulators here. Where were they in this process? What were they supposed to be doing, and what were they doing, and if not, why not? I think these questions have got to be asked and answered.

And in order to determine the extent of the problem, we need to speak with all of the major servicers. Unfortunately, we only have a small subset present today. For example, Allied Financial was the first major servicer to recognize that it had problems with its process. That firm, among others, Mr. Chairman, for some reason is not here today.

Mr. Chairman, it is my understanding that many, if not all, of the law firms under investigation were selected by the housing GSEs. In order to best understand how and why these firms were chosen, I believe we need to hear from Fannie Mae and Freddie Mac. Unfortunately, they also did not make the witness list today.

Perhaps the most complex facet of this examination involves securitization. As highlighted in the Congressional Oversight Panel's most recent report, the most severe potential fallout from this will be found in the securitization market. According to that report, this could have a devastating effect on our broader financial system.

On this critical topic, we have a professor from Georgetown University, the Iowa Attorney General, and finally the CEO of MERS. Each witness has an important viewpoint to share with the Committee, but none of them represent the views or perhaps the expertise of the securitizers. Given the complexity of this issue, perhaps the Committee should have invited others, and perhaps, as the Chairman said, maybe have another hearing or so regarding the securitization community to answer our questions.

Finally, the regulators are also significant players here, or should be. Each of the major servicers have regulators onsite in their operations. How did those regulators miss the widespread foreclosure problems at the firms they were supposed to be regulating? That is the question. We could ask them, but unfortunately, they, too, are not here today, and Senator Dodd said he is going to have another hearing.

Mr. Chairman, I expect this hearing to be focused on the foreclosure process. As I have already stated and you have mentioned, too, there is a great deal to examine on this topic alone. It appears that this hearing will also become a foreclosure mitigation hearing. Mortgage modifications is an important topic, to be sure, and certainly one that warrants its own hearing. But if we are going to examine the issue of foreclosure mitigation, I believe we should study the extent to which borrower fraud has distorted the modification process and inflated overall foreclosure numbers. This is a critical issue, considering that the U.S. taxpayer has spent more than $50 billion on foreclosure mitigation programs. We need to know where our mitigation efforts are best directed and where our money is being wasted as a result of fraud. I understand that there are no witnesses here today that can address the topic of borrower fraud, but we should have that.

Mr. Chairman, I called for a full investigation on this matter in early October because I believe that those who face foreclosure should, at the very least, know that the process is being handled fairly and legally according to the law. While I believe that we will learn a great deal from this hearing, I hope that it does not represent the Committee's complete examination of this important issue and I commend you for saying you will look into it some more.

Chairman DODD. Well, thank you very much, and obviously this is a matter that will go far beyond even the time constraints we have over the next couple of weeks in the lame duck session. I will be watching C–SPAN from hopefully some comfortable spot in January as Tim Johnson and Richard Shelby hold extensive hearings on the subject matter, and Bob Bennett may be joining me along with Evan Bayh from Indiana and watching you go forward.

[Laughter.]

Chairman DODD. Let me turn, first of all, to the Attorney General of Iowa. Tom, we thank you very much, and I know you have done a lot of work on this issue along with others. In fact, the new Senator from the State of Connecticut, of course, Dick Blumenthal, the Attorney General of my State for the last 18 years, I know has worked with you on this issue, as well, so we are anxious to hear what you have to say and we will move right along.

I am not going to do extensive introductions of all of you. I will put that in the record so that your children and families can make sure you were recognized appropriately here for your contributions to mankind. Attorney General?

STATEMENT OF THOMAS J. MILLER, ATTORNEY GENERAL, STATE OF IOWA

Mr. MILLER. Thank you, Mr. Chairman, and thank you, Members of the Committee. I think that this hearing makes a lot of sense. These are very, very important issues that have difficult questions and difficult resolutions but are very, very important to Americans. The housing market, the home to individuals, very, very important to everybody.

We have 50 Attorney Generals working together on this issue. We have more than half of the banking regulators working with us. We have developed over the last 10 years a remarkable working relationship with the State banking regulators. We have gone through three cases together, major cases, and we have worked since 2007 on the Foreclosure Prevention Task Force. It is a very important relationship and we work together.

What the 50 of us and the banking regulators are looking at is a series of issues. It was triggered by the robo-signing. First of all, let me say very clearly that we do not view that as a technical issue. It is an issue that is an affront to State courts. Signing an oath to produce a judgment of foreclosure in a court is a very, very serious matter.

We are following sort of the outline of the Chairman, Senator Dodd, in terms of looking at other aspects, as well, that have appeared in our investigation and we think are important. They include other servicing issues, the whole issue of the paperwork being lost and people having to start over and over again, not hearing from the servicers for two or 3 months. That is an issue.

The modification, the decision concerning modification is an important issue. I think that after 3 years, the servicers, whoever is making the decision on modification, there should be a rhythm. There should be a pattern. They should see patterns developing, and very quickly, people fall within modification or out or marginally. It is more ad hoc, we think, and that just has not come together.

We are concerned about some of the fees that are charged, particularly the forced insurance. We are concerned about assignment issues. Those are something that we are looking at. The so-called dual track issue is something that is important, as well, and by that we mean a person who is working on modification and all of a sudden the foreclosure process starts at the same time. It is enormously frustrating.

Second liens create a problem when the banks hold the second lien and also do the servicing. There is a dynamic there that does not work as well as it should.

We are talking. We are working a lot with the Federal people. The level of cooperation with the Federal agencies, particularly Justice and Treasury, is like never before. I have been around for a while, worked with a lot of Administrations, Democrats and Republicans. We have never had a working relationship this good and this productive as we do with this Administration.

We have opened up a dialogue with the investors. We think they are an important part of the solution of this whole problem and have started productive meetings with them. We have had sessions with Bank of America, two sessions recently. They have been productive.

We view this as a chance to solve some or much of this problem that has hung on for over 3 years, as Senator Dodd outlined. It started as a mess, the robo-signing. We want to figure out a way that it leaves the whole situation much better than when the mess started, and there are a number of things we are working on to try and make sure that this is never repeated again. That is, in a way, the simplest and very basic, that there is some redress to consumers that are harmed. But then how do we develop a way to change the paradigm and the whole system so that it works and works much more productively, because, as I said before, there is so much at stake for the homeowner, for the investor, for the community and the overall economy.

Chairman DODD. Thank you very much, General. I appreciate again your work on this effort and those of your colleagues around the country.

Barbara Desoer is the President of the Bank of America Home Loans. She oversees the business that currently accounts for almost one in five mortgage originations. Bank of America Home Loans has $2 trillion in a servicing portfolio that serves 13 million customers. She also manages the Bank's home equity business and insurance services organization. We thank you for joining us.

STATEMENT OF BARBARA J. DESOER, PRESIDENT, BANK OF AMERICA HOME LOANS

Ms. DESOER. Thank you, Chairman Dodd and Ranking Member Shelby and Members of the Committee. Thank you for the opportunity to testify.

The economic downturn and sustained high unemployment, coupled with the housing market collapse, have led to challenges far more profound and complex than anyone ever anticipated. Importantly, more than 86 percent of Bank of America's customers are current on their mortgage. Unfortunately, others are in distress. At foreclosure sale, one of three properties are vacant, and there are far too many abandoned properties in our communities that drive down home values in neighborhoods across the country.

Helping customers remain in their homes wherever possible remains Bank of America's number one priority, as evidenced by our over 700,000 completed loan modifications. We have reached a crossroads between modification efforts and the reality of foreclosure. Despite our best efforts and numerous programs, for some customers, foreclosure is unavoidable. That has driven an increase in the concerns that you and we are hearing from our customers.

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

We were the only servicer who stopped foreclosure sales nationwide to review our procedures. We know the concerns are not just technical issues. We have confirmed that the basis for our foreclosure decisions has been correct and accurate, but we did not find a perfect process and we are already moving forward with the needed improvements.

As a servicer, we have a responsibility to follow the guidelines established by our investors relating to modifications and other foreclosure alternatives. Where we can act to improve the process alone, we have and will continue to innovate. We also need to work with others, and we are committed to further improvements.

First, improve the communication with our customers. A frequent source of customer frustration is they cannot deal with the same person two times during the process, let alone three or four. We have redesigned our loan modification process to offer a single point of contact to our customers, and we have more than 140,000 customers who are experiencing this today. We are in discussions with key stakeholders, like the State Attorneys General, to determine how that approach can be expanded.

Second, we know we need to provide greater clarity to our customers who are going through the process, and Attorney General Miller referenced the parallel foreclosure or dual track process of modification and foreclosure. We want to partner with you and other key stakeholders to find a way to eliminate that dual track to significantly improve the understanding of where a customer is in the process.

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

Again, our commitment is to ensure that no property is taken to foreclosure sale until our customer is given a fair opportunity to be evaluated for all of the programs that exist under modification, or if that cannot be done, through a short sale or a deed execution. Foreclosure is the option of last resort. Thank you.

Chairman DODD. Thank you very much. We appreciate your testimony.

Mr. R.K. Arnold is the President and CEO of MERS Corporation and its subsidiary, Mortgage Electronic Registration, known as MERS. Most of you are familiar with it. MERS was created by the mortgage industry participants as a central electronic registry with the hopes of streamlining the mortgage process by eliminating the need to prepare and record paper assignments of mortgages. MERS now registers more than half of the mortgage loans originated in the United States. Mr. Arnold has been with MERS since its inception in 1996, and we thank you for joining us.

STATEMENT OF R.K. ARNOLD, PRESIDENT AND CHIEF EXECUTIVE OFFICER, MERSCORP, INC.

Mr. ARNOLD. Chairman Dodd, Ranking Member Shelby, Members of the Committee, I appreciate the opportunity to be here today. If it is all right with you, Mr. Chairman, I would submit my remarks for the record.

Chairman DODD. That is true of all of you, by the way, and any documentation that any of you want to add to your testimony, we will just include as part of the record, so consider that done.

ORAL STATEMENT OF R.K. ARNOLD, PRESIDENT AND CHIEF EXECUTIVE OFFICER, MERSCORP, INC.

Chairman Dodd, Ranking Member Shelby and Members of the Committee, my name is R.K. Arnold. I am President and CEO of MERSCORP, Inc. Thank you for this opportunity to appear today.

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

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

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

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

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

MERS also performs another key function: It serves as the mortgagee of record, or the holder of mortgage liens, on behalf of its members as a common agent. MERS is designated as the mortgagee in the mortgage document, and this designation is approved by the borrower at loan closing and then recorded in the appropriate local land records. Serving as the mortgagee enables MERS to receive and maintain updated information as loan servicers and noteholders change over time because we are the central clearinghouse for receipt of mail as mortgagee. One thing that is always clear in a mortgage document is that if the borrower defaults on his obligation, the lender can foreclose. If MERS holds the mortgage lien, foreclosures can occur in two ways: Either the MERS mortgage interest is reassigned in the land records to the lender holding the note and the lender initiates the action on its own, or MERS initiates the action as the mortgagee of record in the land records.

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

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

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

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

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

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

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

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

Mr. ARNOLD. Thank you, and I am ready for your questions.

Chairman DODD. Well, that was good testimony there. I appreciate it.

[Laughter.]

Chairman DODD. Professor, do you want to do the same?

[Laughter.]

Chairman DODD. Professor Levitin, we thank you very much for joining us. Professor Levitin is an Associate Professor of Law at Georgetown. He specializes in bankruptcy, commercial law, financial regulations. He has done extensive research on the role of financial institutions in consumer and business transactions, including mortgage finance payment systems and bankruptcy reorganizations. He also served as Special Counsel to the Congressional Oversight Panel, and is currently a Fellow at the Center of Law at George Washington University. We thank you for joining us.

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

Mr. LEVITIN. Well, I hope I can keep my comments as brief as Mr. Arnold.

I want to make clear that I am here today to testify only as an academic and not on behalf of the Congressional Oversight Panel.

Over the last few months, the mortgage world has been roiled by a number of seemingly unconnected issues: The discovery that major mortgage servicers were submitting thousands of faulty or fraudulent affidavits in foreclosure cases, the emergence of concerns over securitization chain of title, and mortgage-backed securities investors put-back demands. Although seemingly disparate, these issues are, in fact, connected by two common threads, the necessity of proving standing in order to maintain a foreclosure action, and the severe conflicts of interest between mortgage servicers and MBS investors.

It is axiomatic that in order to bring a foreclosure action, the plaintiff must have legal standing. Only the mortgagee has such standing. Many of the issues relating to foreclosure irregularities, ranging from procedural defects up to outright counterfeiting, relate to the need to show standing. Thus, problems like various types of false or faulty affidavits as well as backdated mortgage assignments and altered or wholly counterfeited notes, mortgages, and assignments all relate to the evidentiary need to prove standing.

Concerns about securitization chain of title also go to the standing question. If the mortgages were not properly transferred in the securitization process, then the party bringing the foreclosure does not, in fact, own the mortgage and therefore lacks standing to foreclose.

If the mortgage was not properly transferred, there are profound implications, too, for investors, as the mortgage-backed securities they believe they had purchased would, in fact, be non-mortgage-backed securities. If so, title on most properties in the United States would be clouded and there would also be a put-back liability that would greatly exceed the market capital of major U.S. banks.

Put-back claims underscore the myriad conflicts of interest between mortgage services and investors. Servicers are responsible for prosecuting violations of representations and warranties made to investors in securitization deals. Servicers are loath to bring such actions, however, not least because they would often be bringing them against their own affiliates. Thus, Countrywide Home Mortgage Servicing would be bringing those claims against Countrywide itself.

I am guessing that many of you received this morning a copy of the American Securitization Forum's White Paper on residential mortgage-backed security chain of transfer. It is a good document and I agree with most of the legal analysis within it, as far as it goes, but that is the problem. The problem is that the ASF White Paper neglects to address three rather important points.

First, it fails to address that parties can contract around the Uniform Commercial Code, which is what the ASF says governs transfers in securitization. Parties are allowed to contract around that by the terms of the Uniform Commercial Code, and arguably, that is exactly what mortgage securitization pooling and servicing agreements do. If that is correct, then the ASF White Paper is simply analyzing the wrong law.

Second, the ASF White Paper neglects to address the question of noncompliance with whatever the applicable law is, and there are a multitude of potential noncompliance problems, such as premature shredding of notes or the signing of assignments by purported agents of now-defunct companies. The scope of these problems is unclear, but noncompliance with transfer rules could void the transfers.

Third, the ASF White Paper neglects to address the trust law issues in securitization. Most residential mortgage securitization trusts are governed by New York trust law, and New York trust law imposes additional requirements on transfers. Arguably, these requirements are not met by many securitization deals. New York trust law provides that if a transfer does not comport with the trust documents, that transfer is void even if the transfer would otherwise comply with law. And if the transfer is void, that would mean that the trusts do not own the mortgages and therefore lack standing to foreclose.

I want to emphasize that I am not saying that this is the case, that there are many unresolved legal issues and there are also evidentiary questions. I am not predicting that there is a wholesale chain of title problem with residential mortgage-backed securities. Instead, my point is that there are unresolved questions and that the law is not as clear as either the American Securitization Forum or any law firm with outstanding securitization opinion letter liability would like you to believe.

We do not know how these questions are going to be resolved, but some of the potential resolutions have dire systemic consequences and Congress should be aware of that possibility, because we would do much better being ahead of the ball than behind it on systemic risk. When the systemic risk aspect is taken into consideration within the context of all the other problems in the mortgage securitization world, I think it makes a compelling case for early intervention and for a global settlement of the foreclosure crisis and investor litigation against servicers and securitizers. Only a global settlement will help revive the mortgage market, will remove the debt overhang from consumers and financial institutions, and will help restart the U.S. economy.

Thank you.

Chairman DODD. Thank you very, very much.

Mr. Lowman, we welcome you to the Committee, as well. Mr. Lowman is the Chief Executive Officer of Chase Home Lending, responsible for Chase's mortgage and home equity lending business, including loan origination servicing and default, as well as credit risk management and capital markets. Chase Home Lending originates $200 billion in residential markets and home equity per year. The company services some six million loan customers, and we thank you for joining us.

STATEMENT OF DAVID B. LOWMAN, CHIEF EXECUTIVE OFFICER FOR HOME LENDING, JPMORGAN CHASE

Mr. LOWMAN. Thank you, Chairman Dodd, Ranking Member Shelby, and Members of the Committee. Thank you for inviting me to appear before you today.

We are committed to ensuring that all borrowers are treated fairly and with respect, that all appropriate measures short of foreclosure are considered, and that if foreclosure is necessary, the process complies with all applicable laws and regulations. We take these issues seriously. We regret the errors in our affidavit processes and we have worked hard to correct these issues.

I want to emphasize that Chase strongly prefers to work with borrowers to reach a solution that permits them to keep their homes. Foreclosures cause significant hardship to borrowers and communities. Foreclosures——

[Interruption.]

Chairman DODD. Officers? All right.

[Interruption.]

Chairman DODD. OK. Because of disruption subject to arrest, I ask that you——

[Interruption.]

Chairman DODD. We stand in recess here for a few minutes.

[Recess.]

Chairman DODD. I would invite those who would like to hear the rest of the hearing to join us by sitting down so we can hear the rest of the witnesses, and I will just make a point here that those who engage in that kind of an outburst, we will have to ask you to clear the room. We will ask the officers to clear the room. I hope that is not necessary. We are delighted to have you here in the room to hear the testimony. It is an important hearing.

With that, now we will go back to Mr. Lowman, your testimony.

Mr. LOWMAN. Foreclosures cause significant hardship to borrowers and their communities. Foreclosures also inevitably result in severe losses for lenders and investors. Therefore, we always consider whether there are viable alternatives to foreclosure.

Chase adopted its own modification programs in early 2007. Since 2009, Chase has offered almost one million modifications to struggling borrowers and has completed over 250,000 permanent modifications.

Sustainable modifications are not always possible. There are some borrowers who simply cannot afford to stay in the homes or they have vacated their homes. While we make repeated efforts to modify a delinquent loan, sometimes we must proceed to foreclosure. A property does not go to foreclosure if a modification is in progress. But if the foreclosure has begun and a borrower later begins the modification process, our investors, including the GSEs, have instructed us to allow the two processes to run at the same time. However, we will not allow a foreclosure sale if a modification is in progress.

I understand the focus of the Committee today is our recent decision to temporarily suspend foreclosures in a number of States. To be clear, we service millions of loans and we make mistakes. But when we find them, we fix them. It is important to note that the issues that have arisen in connection with the foreclosure proceedings do not relate to whether the foreclosures were warranted. We have not found issues that would have led to foreclosures on borrowers who were current.

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

We take these issues seriously. Our process did not live up to our standards. While foreclosures have been halted, we have thoroughly reviewed our procedures and undertaken a complete review of our document execution policies. We have also rolled out extensive additional training for all personnel involved.

I would be happy to answer any questions that you might have.

Chairman DODD. Thank you very much.

Our last witness, and certainly not the least, is Diane Thompson, who is a familiar face to many of us here. She is Counsel to the National Consumer Law Center. She has written numerous publications dealing with the integrity of the lending and foreclosure process. She worked from 1994 to 2007 at the Land of Lincoln Legal Assistance Foundation representing low-income homeowners in East St. Louis. She testified at our hearing on loan modifications in July of 2009 before this Committee, and I will be particularly interested to hear if she believes enough progress has been made since our last hearing in July of last year. I thank you again for joining us.

STATEMENT OF DIANE E. THOMPSON, COUNSEL, NATIONAL CONSUMER LAW CENTER

Ms. THOMPSON. Thank you, Chairman Dodd, Ranking Member Shelby, and Members of the Committee. Thank you for inviting me to testify today, and to answer your question, Chairman Dodd, no, enough progress has not been made. I was shocked, actually, when I took out my testimony from last July to look at it as I was getting ready for this, how much of that testimony was still relevant.

I am an attorney with NCLC, and in my work at NCLC I provide training and support to hundreds of attorneys representing homeowners from all across the country. So I hear what is going on in Alaska and in Mississippi on a daily basis, as well as in New York and Illinois.

The recent robo-signing scandal reveals the contempt that servicers have long exhibited for rules—the rules of court procedure flouted in the robo-signing scandal, the contract rules breached by servicers' common misapplication of payments and imposition of illegal payments, and the rules for HAMP modifications honored, unfortunately, more often in the breach than in reality.

Servicers do not believe that the rules that apply to everyone else apply to them. This lawless attitude, created in part by financial incentives and too often tolerated by regulators, is the root cause of the robo-signing scandal, the failure of HAMP, and the wrongful foreclosure of countless American families.

In my written testimony, I provided dozens of examples of the harm caused to homeowners by servicers. Many of the foreclosure cases that have come to national attention involving robo-signing allegations originated due to the unnecessary forced placement of insurance, sometimes at more than ten times the actual cost of the homeowner's existing insurance policy.

Often, servicers' misrepresentations lead directly to foreclosure. In one case cited in my written testimony, a North Carolina woman was placed in foreclosure by Chase after 15 months of timely and full trial modification payments when she made the mistake of following the advice of a Chase representative to make a partial payment in the 16th month.

In another case, Bank of America employees told a California attorney that the relevant pooling and servicing agreement prohibited all loan modifications. Bank of America employees went so far as to provide the attorney with what appeared to be an electronic snapshot of the relevant section of the PSA, but that snapshot converted a comma to a period and removed the immediately following clause which provided for loan modifications in most circumstances after default.

These abuses occur because servicers have strong financial incentives to deny permanent modifications and in many cases to proceed with foreclosure. The illegal fees that push many homeowners into foreclosure are profit centers for servicers. Servicers usually recover their costs faster in a modification than in a foreclosure and servicers and their affiliates also profit from post-foreclosure REO sales. Ultimately, these actions by servicers strip wealth from investors as well as homeowners.

Unless and until servicers are held to account for their behavior, we will continue to see fundamental flaws in mortgage servicing with cascading costs throughout our society. The lack of restraint on servicer abuses has created a moral hazard juggernaut that at best prolongs and deepens the current foreclosure crisis, and at worst threatens our global economic security.

Solutions must address the affidavit and ownership issues raised most recently, but much more is urgently needed. We must require servicers to evaluate homeowners for loan modifications before foreclosure, offer modifications where doing so will provide a net benefit to the investors, and provide that the failure to do so is a defense to foreclosure. Funding for mediation and representation of low-income homeowners is desperately needed. Principal reduction must be mandated. Both Congress and Federal regulators must rein in servicer abuse and move toward restoring rationality to our mortgage markets.

Thank you for the opportunity to testify here today. I am happy to answer any questions you may have.

Chairman DODD. Thank you very much, Ms. Thompson. I appreciate your testimony.

[Applause.]

Chairman DODD. All right, please. Audience, please. This is not a rally here, it is a hearing.

Let me turn to Senator Shelby. As I said earlier, I know my Republican colleagues have a caucus and so I have invited Senator Shelby and Senator Johanns to go ahead of us here, so I will defer any questions I have. Senator Shelby.

Senator SHELBY. Mr. Chairman, I have a number of written questions that I would like to be made part of the record for the panel.

Chairman DODD. Consider it done.

Senator SHELBY. And I have something I want to ask. I will start with you, Mr. Arnold, and Ms. Thompson maybe will chime in here, I hope. As I understand—I used to do some of this many years ago—let us say a bank anywhere in America—we will just use my home town of Tuscaloosa, Alabama—a bank makes a loan on a home, or a mortgage banker or whoever, and that mortgage, that note is signed and the mortgage is recorded at the courthouse and the bank owns the mortgage. That is the security for the loan.

Now, it used to be, and correct me if it has changed, that they would sell that loan and then they would do an assignment of record, say X Bank would assign the record to Y Bank or whoever, or pension fund, and that would be recorded and they would own the mortgage of record. There would be a record of that in the courthouse there. And then if somebody missed four or five payments and they foreclosed, you would recite all of this in the foreclosure notice, of the default made in certain mortgage, dated so and so, to X Bank and subsequently assigned, or three or four times, and you would have to do that.

What has changed? Electronically, what is the problem and what has caused it? Did you get away from the basic property laws of the State? I do not know. And has that caused some of the problem? I realize that in the securitization you might take a thousand of these mortgages that I have just talked about and you pool them, you securitize them. But still, the fundamentals of each one of those homeowners remains: They are in debt and the record of their indebtedness. Am I wrong or right, and what has changed? I will ask Ms. Thompson next.

Mr. ARNOLD. Well, Senator, there has been a great deal that has changed.

Senator SHELBY. Tell the Committee.

Mr. ARNOLD. Part of that is that the sheer velocity of the transactions that you are talking about began to jam up the recorders' offices. There would be mistakes in those assignments. They would be filed in the wrong order.

Senator SHELBY. Wait a minute. Excuse me. You are saying there were mistakes in the courthouses?

Mr. ARNOLD. No, Senator.

Senator SHELBY. Well, where were the mistakes?

Mr. ARNOLD. Mistakes in the assignments that the banks were preparing.

Senator SHELBY. OK. The banks made the mistakes.

Mr. ARNOLD. Yes. And that would ultimately cause title problems, breaks in the chain of title. It was unnecessary that those assignments would be recorded every time——

Senator SHELBY. Why would it be unnecessary to show who owned the mortgage before you foreclosed on it? Because heretofore you always foreclosed in the name of the holder of record, did you not? I guess. Is that right, Ms. Thompson?

Ms. THOMPSON. Yes, that is the general rule in most States.

Senator SHELBY. Go ahead, sir.

Mr. ARNOLD. And that still happens today even with the advent of MERS. What MERS is is a common agent for all of those banks, and that way when servicing changes hands, which is covered under the Truth In Lending Act, there is a hello/goodbye letter. Anytime that that changes, that is reflected on the MERS system. The MERS——

Senator SHELBY. But is it reflected—excuse me. It might be reflected on your computer, but is it reflected in the courthouse where the mortgage is recorded.

Mr. ARNOLD. MERS is reflected in the courthouse at all times, and then if——

Senator SHELBY. Wait a minute. Do they record the assignment there at the courthouse? I could go look it up and see who owned the mortgage?

Mr. ARNOLD. There is no assignment if MERS is the mortgagee.

Senator SHELBY. That is what I am getting at. You just said there were, so you are correcting yourself. So actually what you are doing with the electronic transfer, you have taken the place of historically the property laws of the States. Is that wrong or right, Ms. Thompson?

Ms. THOMPSON. That is correct, and it is true that MERS has the case from New York, Romaine; there have been several cases where clerks challenged the MERS recordation because it removes from the public record any chain of title, and it does complicate homeowners' attempts to discover who the current holder of their mortgage is.

Senator SHELBY. Well, isn't this part of the problem in the foreclosure process? People are saying—I am asking you, Mr. Arnold—that you do not really own this mortgage; you have no—there is no record of you owning it, how can you foreclose on it? Is that part of it?

Mr. ARNOLD. If there is a foreclosure in the name of MERS, which might happen as few as one in ten——

Senator SHELBY. Can you do that legally? Is that the law of the land?

Mr. ARNOLD. The MERS mortgage can be foreclosed.

Senator SHELBY. No, I asked you a question. Was that the law of the land—in other words, you can do this? Because you used to could not do that. You had to have the property assignment properly recorded in X county to show, would you not?

Ms. THOMPSON. Whether or not MERS can foreclose in its own name is a hotly contested issue.

Senator SHELBY. That is what I am raising.

Ms. THOMPSON. It varies State by State. Some States have passed legislation allowing MERS to do that. In other States, there has been litigation that has allowed MERS to do that. In other States, there has been litigation that has forbidden MERS from foreclosing in its own name.

Senator SHELBY. So MERS is part of the problem.

Ms. THOMPSON. MERS certainly complicates determining who the actual ownership and what the correct standing is, and it can have the effect of concealing from the public the role of major lending institutions in foreclosures.

Senator SHELBY. I do not know if you have answered my question correctly or like I want you to, but I am looking for the truth of what the problem is. I think that when you deviated from the basic property laws of the country, you got yourself in trouble. Maybe I am wrong.

Ms. THOMPSON. I think that MERS is one piece of the problem. I think there are more serious and more complicated pieces of the problem.

Senator SHELBY. OK. Thank you, Mr. Chairman.

Chairman DODD. Thank you, Senator Shelby.

I am going to turn, Bob, with your permission, to Senator Johanns. He has to go to that caucus.

Senator JOHANNS. Well, thank you. I appreciate the courtesy from both Senators.

Ms. Thompson, help me understand this, if you will. All of the abuses that you have described, somebody altering a document and trying to mislead someone, I do not think there is anybody in the room, probably anybody in the country, that would try to claim that that is right. It is not right. I mean, fundamentally it is just not right. But I want to kind of drill down on the mortgage foreclosure issue itself and try to get your help in me understanding this.

I have done many mortgages through my life. My first mortgage was probably when I was in my 20s and bought my first house. And my understanding is, complex as those documents are—and, you know, they give you a stack about that thick to sign. My understanding was that somebody was giving me money that would at least partially buy the house—these days maybe buy most of the house—and that if I failed to repay that in a timely way, they would take the house. I mean, as sad and unfortunate as that is, that was kind of the bottom line.

How many instances have you run into or is it a common practice that these foreclosure people are foreclosing on properties where, in fact, somebody has not failed to pay? Do you see what I am getting to?

Ms. THOMPSON. I do, and in my written testimony I believe I have three examples of cases where people were not actually in default when the foreclosure was initiated.

Senator JOHANNS. And let me say again, that is not right. But I am trying to figure out if it is 3 million or 3,000 or three, because——

Ms. THOMPSON. I think it is very—it is certainly more than three. I certainly had many examples like that in the course of my practice. It is a complicated question because sometimes the person is absolutely not in default and they initiate foreclosure; sometimes the wrong bank initiates foreclosure. And sometimes there is a placement of fees that then makes the payment double or triple, and at that point the person does go into default. Now, I submit that in that case it is the placement of the improper fees that causes the foreclosure, even though the person does technically go into default.

Senator JOHANNS. Well, let me just say again I do not think that is right. And, again, I do not think you are going to get much debate from anybody about that. I just do not think that is right, and I want to make that clear.

But, again, for the purposes of this Banking Committee, in this area it is so important that we understand what we are dealing with. And so at least today you can give me three cases where a default was initiated in a situation where the person was not in default. Three.

Ms. THOMPSON. There are about 26 examples in the written testimony, and I believe three of them involve cases where there was no default; three of them involve cases where the homeowner submitted a partial payment in reliance on a representation by the servicer, and the servicer then declared a default; and at least three or four of them involve cases where people went into default solely because of the placement of improper fees.

It is not uncommon—I think it is very difficult for us to assess the magnitude of it, in part because there is no meaningful verification of the affidavits that servicers submit in a foreclosure process.

Senator JOHANNS. Well, you are going to have to——

Ms. THOMPSON. To determine whether or not the fees are actually correct and the default is correct requires hours, often, analysis of the payment histories.

Senator JOHANNS. Ms. Thompson, I will make this request to you. Again, I am trying to get a notion of the scope of what we are dealing with here so we can understand what we are to fix. But if this is truly a case where you are telling me out of all of the work you have done in this area that you can bring to mind three cases where somebody was default—or sued and foreclosed upon, that is a whole different dynamic for me than if there are 300,000 of them.

Ms. THOMPSON. Out of all of the cases that I took, out of the hundreds of homeowners that I represented, in virtually every case I believe the homeowner was not in default when you looked at the surrounding facts.

Senator JOHANNS. Would you be able to provide us with some information to back up that statement? You just made a statement: Out of all of these cases, in virtually every one the homeowner was not in default. That really—I find that troubling that there would be people out there foreclosing when the homeowner is not in default when there are—do you see how that does not——

Ms. THOMPSON. Yes, and as a legal services attorney, I had precious little time, and I only took cases where I believed that there was a meritorious defense to the foreclosure. I represented in court hundreds of homeowners. Every single one of those cases, I believed there was a strong defense that would defeat the foreclosure. You can only defeat the foreclosure ultimately if you establish that there is not a legal default. It is a widespread problem throughout the country.

Senator JOHANNS. I am a lawyer myself, and although I did a little bit of this work in my career, I did not do a lot, so I start with that deficiency. But I will tell you there are legal defenses and then there are defenses to the fact that, look, my client is not in default. And that is what I am trying to get to here. How many of those are in defense where you actually filed an answer to the foreclosure petition saying you made a mistake, my client is fully in compliance, at least in terms of the payment of this mortgage?

Ms. THOMPSON. Well, again, I do not think that is a simple yes or no, because if you have these improper fees, that can cause a technical default under the note. But if we are looking at the cases where somebody was absolutely not in default, that would have been—you know, there is absolutely no question, no controversy about their payments, maybe 10 percent of the cases that I handled. If we are looking at cases where it was something that the servicer did, just the servicer, that triggered the default, maybe about 50 percent of the cases.

Senator JOHANNS. OK. I will wrap up with this because I am over my time. You have even caused me more concern by your testimony because, again, if people are doing things that are not right, we should stop those things. We all agree to that. But what I am trying to get to is this issue of if you have not paid and somebody is suing you because you have not paid, then I need to know the scope of that problem. And if it is 10 percent, then, again, that causes me a great deal of concern about your testimony.

So hopefully you can provide more information to this Committee to try to clarify what you are saying here, and I would welcome that.

I thank the Chair. I have gone 3 minutes over, and I appreciate it.

Chairman DODD. No, no, that is fine, Senator. Thank you.

I would just note again—and then I will turn to Senator Bennett and then turn to my colleagues on the Democratic side. I had noted in the testimony of Ms. Desoer that 86 percent of homeowners are in compliance. Obviously, the number that is troubling to me is not the 86 percent, but the 14 percent who are not. Normally, as I understand it—and we have talked about this. Today, in fact, it is less than 1 percent or something around 1 percent under current underwriting standards and the like. Normally, though, in normal times, it would be around 2 percent, people in default. The fact that it is at 14 percent speaks of another larger—coming down to the point where whether or not someone is in default or not, that is the end of the process. There is a lot that occurs before that particular moment that really causes so much concern as well. But I would just make that point generally.

Senator Bennett.

Senator BENNETT. Thank you very much, Mr. Chairman.

Unlike Senator Johanns, I am not a lawyer. My experience with mortgages, like his, started with getting one. I have defaulted on payments at various times in my career when I simply did not have the money. Fortunately, I got it in time to make up the payment before any legal proceedings were made. I was 60 days late, or whatever it might be. But I know the angst that comes with having missed a mortgage payment, worrying about what is going to happen if you cannot get the money to make it up with sick children and a foster child at home and a situation where your own economic circumstance is not good. So I have all kinds of emotional reactions to the testimony and to the emotional reactions to the testimony. But let me try to follow up on Senator Johanns with some of the things he was trying to get a hold of.

We have two people here who are in the business of home loans: the president of the Bank of America Home Loans and the CEO of Chase Home Lending. I would like your response to the testimony we got from Ms. Thompson.

Ms. Thompson, either deliberately or otherwise, you gave us the impression that it was the policy of the servicers—that there is a built-in conflict of interest so that it is their policy to try to pile on extra fees, to try to force people into bankruptcy so they can make more money. And I would like those who were on the receiving end of that implication to have an opportunity to respond.

As a businessman—I am not a lawyer, but I am a businessman—I would say to the business people in the room, if that is indeed your policy, it is a really stupid policy, because while you may make a little short-term revenue out of such a circumstance, you build in very serious long-term consumer resistance to dealing with you. And I do not suggest that there are not businessmen and women who are stupid and, therefore, that there are not businessmen and women who do that. I think there are some who are stupid and who do do that. But if I were an employee of any company that was involved with this or serving on the board of any company that was involved with this and found out that you were deliberately trying to maximize short-term profits with these kinds of fees, I would say that is about as dumb a thing as you could possibly be doing from a business point of view.

So we have two business people here, and I would like to hear your response to this. Ladies first.

Ms. DESOER. OK, thank you. Senator, we absolutely do not sacrifice the long-term brand of Bank of America for the opportunity to have short-term gains in fees. At the same time, and for what Ms. Thompson referenced relative to our inaccurately portraying a PSA that resulted in a bad consumer experience, that is an error on our part. We take errors very seriously. We do make them. We are not perfect. When they are brought to our attention, we work to resolve them just as quickly as we can. So I apologize for any error there may have been. But, when we do make them, we work quickly to correct them because our best financial outcome is aligned with keeping homeowners in their homes. And so we have been as creative as we can under the circumstances, and unfortunately there are 14 percent of customers who are delinquent on their mortgages, to attempt to reach out, to make offers of Government programs, of our own programs, of working with others to try to do everything that we can to keep customers in their homes. And where that has been possible, we have succeeded 700,000 times with permanent modifications that have enabled customers to stay in their homes. We continue to work to do that by expanding programs, being one of the first in the industry to offer a principal reduction program, as an example, under a proprietary program to participate in the hardest-hit States of the Government funds and to participate in the principal reduction portion of that where it is important in States that have experienced the most severe depression in home prices.

At the same time, there is no question that we have to balance interests. We put the interests of the customer front and center. That is part of the core value of Bank of America. But we have to also consider the interests of the investors, whether that be Government agencies or private investors, as well as our role and responsibility of servicer. We take that balancing very seriously. We do not always get it right, but we certainly focus on trying to keep the customer in their home, and that is where our financial incentives are aligned.

Senator BENNETT. Mr. Lowman.

Mr. LOWMAN. Yes, I would echo Ms. Desoer. The fact is we do not make money when we foreclose on customers. It is in our best interest to figure out ways to make loans perform again. And as a result of that we have invested significant effort and resources to beef up our modification efforts. We have 6,000 customer-facing employees. We have 1,900 people that are the single point of contact for troubled borrowers. We go through an extensive analysis to determine whether or not a borrower is eligible for a modification, and as a result, modifications are in our best interest and in the interest of the investor.

Like Ms. Desoer mentioned, we have a balancing act to do. We have to do what is right for the borrower, and at the same time do what is right for the investor who we have a duty to minimize their losses.

Senator BENNETT. Yes, one last comment, Mr. Chairman.

Chairman DODD. Yes.

Senator BENNETT. Ms. Thompson, I am sure your information is accurate when you say employees of these companies have misled people and given them improper advice. If you call an IRS agent for advice on your taxes, there is a very good chance you will get wrong advice and end up in tax court. Human beings do make mistakes, and I would just say to the two representatives of the two banks, I hope you are checking your training at all times to make sure those kinds of mistakes are not made, because as I say, the IRS is a Government agency, but it has a history of misleading taxpayers, and they act on the basis of the advice they are getting, and then they end up in tax court. And it is not a defense to say, "Well, I did what the IRS agent told me." That does not matter. You are still—did you want to comment?

Mr. LEVITIN. Yes, Mr. Bennett, I think it is also important to actually hear the words of another servicer, and this is a public document, Countrywide's third quarter 2007 earnings call. Countrywide's president, David Sambol, this is what he said, and I quote:

> Now, we are frequently asked what the impact on our servicing costs and earnings will be from increased delinquencies and loss mitigation efforts and what happens to costs. And what we point out is, as I will now, that increased operating expenses in times like this tend to be fully offset by increases in ancillary income from our servicing operation: greater fee income from items like late charges and, importantly, from in-sourced vendor functions that represent part of our diversification strategy.

In 2010, Countrywide settled with the FTC for $108 million on charges that it overcharged delinquent homeowners for default management services, including mark-ups on some of these services that were in-sourced by over 100 percent. So that is the head of Countrywide in 2007 basically admitting, Yeah, we do sacrifice long term for short term.

Senator BENNETT. As I say, there are some people who are stupid.

Ms. THOMPSON. Mr. Bennett, if I may, Mortgage Daily News, hardly a radical publication, reported in June of this year that servicers generally, their profit per loan had increased over the previous year despite the fact that foreclosures were rising. Servicers' business model is not based on the long-term profitability of the loan. It is based on the fees. The fees make up a large chunk of their profits because they are allowed to retain the fees under the current business models. And that is a structural problem with the existing business model that incents them to charge and retain the fees.

Senator BENNETT. I think that is something we ought to look at.

Chairman DODD. Well, I was going to say, I am going to turn to Tim Johnson, then Senator Tester, and I am going to forgo any questions I have. But I am going to ask to include in the record a letter from the New York Fed to, I think it was, Bank of America, Bank of New York, and others on October 18th of this year.

Chairman DODD. This one paragraph goes to the very question that Senator Bennett has asked. I will preface it by saying that the PSAs, the pooling and service agreements, provides that the master servicers shall be entitled to recover servicing advances that are:

> customary, reasonable, and necessary out-of-pocket costs and expenses incurred in the performance by the master servicer of its servicing obligation, including, but not limited to, the cost of preservation, restoration, and protection of the mortgaged property.

That is the section of the law.

The letter from the New York Fed goes on to say:

> Despite the requirements that servicing advances were to be incurred only for reasonable and necessary out-of-pocket costs, the master servicer instead utilized affiliated vendors who marked up their services to a level of 100 percent or more above the market price to provide services related to the preservation, restoration, and protection of the mortgaged property in a fraudulent, unauthorized, and deceptive effort to supplement its servicing income.

That is from the New York Fed. That is not from—you know, with all due respect, this is—so this whole letter, by the way—it is a lengthy letter but very worthy, and I think it ought to be part of the record because it goes to the heart of these issues as well.

Senator Johnson.

Senator JOHNSON. Mr. Levitin, we have heard criticism that laws regarding documentation have not evolved quickly enough to address innovations in business. Does the law need to be changed to ensure proper documentation throughout the mortgage process?

Mr. LEVITIN. No, sir, I do not believe that is the case. I do not think the problem is the law. The law is actually pretty good. The problem is really one of compliance with the law, and there are, I think, two potential problems.

According to the American Securitization Forum—and I would agree with them, there are two generic ways in which you would transfer the notes and the mortgages in a securitization. One is that you would negotiate the notes through the procedures set out in Article 3 of the Uniform Commercial Code. Just the way you would sign the back of the check to negotiate it to the bank when you deposit it, similarly, you could sign it, endorse it to someone else. That way is fine.

Alternatively, Article 9 of the Uniform Commercial Code allows for promissory notes and mortgages to be transferred as part of just a regular—under just a regular contract of sale.

That system works fine. The first question is whether that system was actually the one that governed securitization. The answer, I believe—but I cannot say for certain, but I certainly believe the answer is now. Instead, I believe that what was governing securitization was private contractual law. The parties are allowed under Section 301 of Article 1 of the Uniform Commercial Code to contract around Article 3 or Article 9. And I believe that is exactly what they did in the pooling and servicing agreements. Pooling and servicing agreements are trust documents that create a trust, have a transfer of assets to the trust, set for the rights of the mortgage-backed security holders, because the trust pays for those assets by issuing mortgage-backed securities, and sets forth the rights and duties of the servicer.

The securitization documents themselves, the pooling and servicing agreement, call for a rather specific method of transferring of mortgage notes. My understanding—and this is a secondhand understanding. I want to emphasize this because I have not seen more than a handful of loan files. My understanding is that generally the requirements set forth in the pooling and servicing agreements were not followed, and they were not followed in the following way:

The pooling and servicing agreement says that there has to be—when the notes are transferred to the trust, there needs to be an endorsement in blank to the trust as well as a complete chain of endorsements for all preceding transfers. That means that the originator of the loan has to have a specific endorsement transferring it to the securitization sponsor, the sponsor to the depositor, and then the depositor in blank to the trust.

What I am told is that in the majority of cases that chain of endorsements is not there. There is simply a single endorsement in blank. That creates a problem because it does not comply with the trust documents. That is a severe problem because most pooling and servicing agreements are trusts that are governed by New York law, and New York law says if you are not punctilious in following the trust documents for a transfer, the transfer is void. It does not matter if you intended it. It is void.

In addition, there is a very good business reason for having that particular form of transfer. A critical concern in securitization is to ensure that the assets placed in the trust are bankruptcy remote, meaning that if any of the upstream transfers to the trust were itself to end up in bankruptcy, they could not claw the assets out of the trust. This is to protect the mortgage-backed security holders.

If you do not have that specific chain of endorsements, you just have an endorsement in blank turning the note into bearer paper, it is going to be very difficult to prove that you have that chain of transfers necessary for bankruptcy remoteness. So this is the concern.

Now, I want to emphasize, this is not a problem with the law. This is a problem with following the law. So I do not think that there is a need to change the law to catch up with the market. I think this is, rather, a problem with the market. The law itself would have been fine, and historically, these procedures were followed. But as volumes grew during the housing bubble, securitization volumes, it just became easier to disregard the requirements. And you know, just as the underwriting standards fell, similarly the transfer diligence fell.

Senator JOHNSON. Attorney General Miller, given that foreclosure is a judicial crisis in many States, what were the barriers to recognizing the documentation problems that existed?

Mr. MILLER. Well, I think what happened was that recently in some litigation people that did the robo-signing were deposed and admitted that. And, you know, once that happened, then this investigation started in earnest.

I do not think there was any way for the banking regulators just looking at the documents to know that they were robo-signed as opposed to done properly, as the affidavit said. So I think it was really sort of people coming forward, I think, in some foreclosure actions that were being defended in an aggressive, very capable way, that these disclosures became public, and then, you know, I think the Attorneys General, the banking regulators, the Federal authorities, class action lawyers, and the companies have been energized.

So I think that what was sort of an unusual occurrence or maybe even a happenstance, if we can convert that problem into multiple solutions like the ones I talked about earlier, you know, we can come out of this much better than we came in. I just agree wholeheartedly with Senator Dodd saying that what we need is a broad brush, a broadly based look at all the problems that he described and I described and try and work with the companies and the investors and the Federal regulators to come up with a comprehensive resolution that gets us back on track and corrects as many problems as we can of those that are on the table.

Senator JOHNSON. One last question for Ms. Desoer and Mr. Lowman. There have been serious questions, concerns raised that it is in the best interest not to modify—there have been serious concerns raised that it is in the servicer's best interest not to modify a loan given the fee structure and potential conflict of interest regarding second liens owned by a servicer's parent company. Can you address that criticism?

Ms. DESOER. Certainly, I would be happy to start. We are a large servicer of first mortgages and also we have a large servicing portfolio, most of which we own, of second lien home equity loans and lines of credit at Bank of America, and in that context, we do not even take the second mortgage into consideration when modifying the first. So it is absolutely not an obstacle that stands in our way. We do modifications on second liens. We have done 95,000 of them independently of the first lien. Also, we were the first servicer to sign up for participation in the HAMP 2MP program, which is the second lien modification program that now others in the industry, as well, are participating in. So the second lien is not an obstacle, and has not been an obstacle and does not get taken into consideration when we look at modifying a first lien. So it does not stand in our way.

Senator JOHNSON. Mr. Lowman?

Mr. LOWMAN. I would echo Barbara Desoer's comments. The second liens do not stand in the way of modifying the first. We, too, are participants in Treasury's 2MP program, which has just recently been rolled out, which will allow for an automatic modification of the second when the first is modified and that first is held by another servicer.

Senator JOHNSON. My time has expired.

Chairman DODD. Thank you very much, Senator.

Because we have a good number of our colleagues here, if we can try and keep it down to about 5 or 6 minutes. Senator Tester?

Senator TESTER. I will do my best, Mr. Chairman. Thank you very much.

I want to say, first of all, thank you all for being here. I very much appreciate your time. I am very deeply troubled about some of the allegations that have been made about improper fraudulent servicing and foreclosure processing, and what compounds this is the first-hand reports that my office has received in Montana. I have reached out to many foreclosure counseling agencies in Montana. I have read through some of the cases that my staff have worked on in recent months, and I will tell you, it is not a pretty picture. There is mismanagement that goes far beyond robo-signing and the chain of title issues.

Since the foreclosure crisis began, we have urged constituents in danger of foreclosure to be proactive and to reach the servicer before they were in trouble. The foreclosure process is daunting, to say the least. It is a maze of paperwork, computer systems, conflict information. So it is a big deal. And the misalignment of the servicer incentives with homeowners and investors, I think, is a recipe for disaster.

I have got a couple of examples and then I want to get to a couple of questions. In one example, a constituent of mine from Whitehall seeking a modification from Bank of America was told by a servicing associate that while the loan modification was in review, the homeowner should not make any mortgage payments. Let me repeat that. He was told by their servicer, Bank of America, not to make any payments, and that if they did, they would not qualify for modification. Ultimately, as a result of following the directions of their servicer, they were hit with interest and penalties and lapse in payments in addition to badly damaged credit.

Then there is a case of a gentleman from Helena who has been fighting with BOA for over a year to prove that he should not be in foreclosure, despite having the paperwork to prove that his modification was approved. He never missed a payment, never late with his mortgage. After being told in August, this last August, that the bank has confirmed his modification, he received a letter 2 weeks later telling him that he was in foreclosure along with a foreclosure notice in the paper.

Now, I do appreciate Bank of America's work to resolve the issue. Unfortunately, not everybody calls their U.S. Senator when they have a problem. And I am still trying to understand how this could go on for a year, in the case of the gentleman in Helena, to receive an erroneous foreclosure notice, and this was received at a time when, Ms. Desoer, there was a self-imposed pause of foreclosures in Montana. So I need to know how this can happen.

There are far, far, far too many stories out there, and it does not have anything to do with Ms. Thompson's testimony, although I very much appreciate it. This is stuff that I am getting in my office. We have a State with 950,000 people and I have got staff members that are spending a ton of time on this issue. I think it is more than an isolated case. If it was the folks who were not paying their bills, I get that. I have empathy for them and I understand it and we will do what we can do to help them. But in this particular case, these folks never missed a payment and they are getting hammered. Can you tell me how a servicer could ever tell a homeowner not to pay their mortgage?

Ms. DESOER. Thank you for bringing those to my attention, and I think our staff has met with your staff to get those details and to follow up. We apologize. That is not part of what we should be telling homeowners. Of course, homeowners who are current who are facing imminent default can be considered for the HAMP and other programs if they can demonstrate that their payments are at risk, and we take those into consideration and do those modifications and we should never be advising anyone to——

Senator TESTER. Do you attribute this to an employee who screwed up?

Ms. DESOER. An employee who somehow—yes, unfortunately, and—after conversations with your staff, we have gone back and reinforced that aspect of our communication to our teammates. It is a critical part of our training.

Senator TESTER. I think it is absolutely critical. If I take myself and put myself in that position, I mean, in these economic times, it is tough enough, and then you have something like this happen, it is pretty wild to even think it is possible.

The gentleman from Helena, how is it possible he did not receive a letter indicating that he is in foreclosure before foreclosure processing has restarted in the State of Montana?

Ms. DESOER. This goes back to what I referenced in my written testimony and my oral testimony about the dual track of if someone being delinquent and they go into the start of a foreclosure process, and then subsequently we engage in a conversation about a modification, the foreclosure sale will not take place, but that customer continues to get notices, and that is a requirement by certain investors that we do that on a parallel path. That is where we think there is an opportunity if we work together—and we are talking to the State Attorneys General under Attorney General Miller's leadership, to try to amend that process because we understand how confusing it is. But a customer would not go to a foreclosure sale——

Senator TESTER. OK. And I have run out of time and I am just going to make a real quick statement, and I appreciate everybody being here today. These particular hearings are not particularly enjoyable for me, and I know they cannot be enjoyable for you. The fact is that why we are here is not an isolated incident, like the Senators before talked about. There is no doubt in my mind this is not isolated. Montana is not a State where people come to the

U.S. Senator just willy nilly. They end up in trouble and think they have been wronged, and I do not know how many people out there did not come to me and end up on the street and they never did anything wrong, and so it is crazy.

So I just want to say in closing, I am going to remain very concerned about the scope of this problem, the impact it can have on our financial system and on the housing market. I know that the Fed is very much focused on it and I hope it is something that the Financial Stability Oversight Council will take a closer look at. It strikes me that some of the biggest servicers have been a little bit glib about their potential magnitude of these risks, particularly the risks to their own balance sheets. At a minimum, we need to understand these risks before the Fed moves forward with guidance on banks to increase dividends, because quite frankly, there are not going to be any more bailouts. And so it is important that we get this squared away simply from a fairness standpoint. I think both sides of the aisle can agree on that.

Mr. Miller, you had a question or a comment?

Mr. MILLER. Just one very quick comment. I agree with you. We hear about it more often than it be just isolated, and one of the things that is difficult that we hope we can do is get to the bottom of how often it happens, why it happens, and how it can be stopped. It is a daunting challenge but one that we want to work with the banks and with the Feds to figure out why this happens and how can be——

Senator TESTER. I just appreciate that. I think if you go to what Mr. Levitin said about what the Countrywide CEO said—I think it was the CEO that said that—this could be taken care of pretty quickly by the servicers, I mean, really quickly by the servicers. I mean, to be honest with you, some heads have to roll if they are giving that kind of advice. That is just the way it is.

[Applause.]

Chairman DODD. Senator Merkley.

Senator MERKLEY. Thank you very much, Mr. Chair.

Mr. Lowman, you made a comment that, if I understood it correctly, I wanted to restate it, and that is that GSEs say if foreclosure has begun before the modification starts, the servicer should continue foreclosure proceedings while underway with the modification. Did I catch that correctly?

Mr. LOWMAN. You did.

Senator MERKLEY. OK. So we have so many folks coming to our office in Oregon who over here are working with the servicer to modify their loan, but then they are getting foreclosure notices, phone calls, agents coming to their door, and they keep calling up the servicer and saying, "I thought we had a loan modification underway." Is this the result of these dual processes going forward together?

Mr. LOWMAN. Yes, it is a result of the dual processes, and as I mentioned, at Chase, what we have put in place is a process that makes sure that if there is a modification in process and—if there is a foreclosure in process and you initiate a modification during that period of time, that we will not allow a foreclosure sale to happen. So we stop the foreclosure sale.

Senator MERKLEY. So you do not take the final step, but you continue kind of the steps leading up to that?

Mr. LOWMAN. Correct.

Senator MERKLEY. It is just short. This is a story from one of my constituents:

> My husband and I signed a loan modification. We were approved September of 2009. It was a steep loan rate and every year our interest went up. We sent in a payment of $577 in certified funds for the modification to become effective. We began making our new payment each time we called in, but there was confusion.
>
> We got a foreclosure notice in the mail. When we called to ask about it, they would assure us everything is OK. Keep on making your payment, is what they would tell us. We have made our new payment for over a year and are still receiving foreclosure notices. The bank told us our account has not been updated and not to worry.
>
> We went out of town in October 2010, so last month, and received a 'Notice of Foreclosure' on our door. When my husband called the bank, they told him the lender never signed off on our modification, so it was not valid. They were going to try and figure out something and let us know. When I called to check on the account in November, of course, this month, the bank said we are now delinquent. I told them what had happened and asked what we should do. She told me we may qualify for a loan modification. I said, we did that. I told the woman we were approved and had been paying our new payment for over a year. I asked her if she had seen this happen before. The woman said yes. I then asked what happened to the money we paid every month. She told me that it went toward our account, but only as a partial payment.
>
> Now my husband and I do not know what to do. We want to make a payment, but not if it is just a partial payment. We need help and advice but cannot afford an attorney. It is embarrassing to have your neighbor tell you you have a foreclosure notice on your door. We also had a man come to our house telling us that he was from the mortgage company and wanting to know if we were occupying the property. I said, yes, we live here. This has created a huge strain in our family and caused an enormous amount of stress. Our children have been affected by this, as well.

I have stacks of these stories of this conflict between foreclosure—can't we just change this policy and suspend the foreclosure proceedings when a modification is underway, not keep it going forward and create this enormous confusion and stress for America's families?

Mr. LOWMAN. So the new process prescribed by HAMP that was instituted this summer would necessitate that we enter into the modification process and engage with the customer to initiate a modification prior to the commencement of foreclosure. So that is the process that is happening today.

The other major key difference today from in the past is at the beginning of the onset of the program, the HAMP program and other modification programs, we did things based on the statements from the borrower. So we entered into trial modification plans based on what they told us over the phone. And then we got into the game of collecting documents, not getting the documents, I am sure in many cases misplacing the documents. But at the end of the day, this period of time just took way too long. So the new process is such now that we collect the documents before we enter in the trial—set up a trial payment. And really the only thing that has to happen in order to make that——

Senator MERKLEY. Let me cut you off——

Mr. LOWMAN.——a permanent modification.

Senator MERKLEY. My time is almost out. Have you changed your practice to suspend the foreclosure proceedings, not the final step, but the whole stream of events?

Mr. LOWMAN. We have not.

Senator MERKLEY. I just want to put that forward.

Ms. Desoer, how about with Bank of America? Would that be possible, to set aside the foreclosure operation while you are in the modification process?

Ms. DESOER. That is what we are proposing to consider, but we cannot do it independently except on our own portfolio of loans, and that is why we are working with the State Attorneys General on a suggestion to do that.

Senator MERKLEY. Well, I think that is one substantial, simple step that would have substantial positive consequences, because this—the homeowners are completely confused and completely stressed by these foreclosure notices, and then suddenly in some cases people find out the foreclosure has actually gone through, which leads us then to talk about MERS.

In common law, if you had a stake in a house, you could put a lien against the house because you had that stake, and that is captured in our modern law with a contract that is a promissory note on the contract side and a mortgage lien on the property rights side, and the idea is that if your contract right is violated, you have a property right to go back and reclaim your damages, essentially. But the separation that has occurred in MERS between the property law and the contract law is creating a lot of court cases.

We are trying to get the details, but we think there has been a case in Oregon that has said, in fact, MERS does not have standing if they are not in a situation where they actually have damage, and I have your testimony, Mr. Arnold, from last year, your deposition where you said MERS suffers no damages. They have no economic stake in these mortgages.

I am very concerned about the legal issues getting resolved, in part because this poses a huge systemic risk to our banking system as a whole. We are talking here both about the rights of the homeowner being honored, but we are also talking about confusion that can throw shock waves through an already challenged system of home finance in our country that is important to all of our homeowners.

Can any of you kind of comment on what needs to be done to make sure both homeowner rights are honored and we do not send shock waves through our entire economy with this question?

Mr. ARNOLD. Well, Senator, I would say that one thing that MERS does is make all of that more clear. The public can look at the MERS system and, free of charge, find out who the servicer is and who the note holder was. That was never available in the public records prior to MERS. So that gives a homeowner the two key players that they would have to negotiate with for a modification. So with MERS and the land records and the MERS system keeping track of the servicers free of charge, consumers can get that information and go straight to a modification. With regard to the foreclosure, MERS, if the foreclosure is done in the name of MERS, we have a nationwide requirement that the promissory note be presented at the time of foreclosure. That is more strict than most

States. Likewise, there can be no lost note affidavit in a MERS foreclosure.

Senator MERKLEY. So the person who represents MERS at the foreclosure proceeding is normally someone you have designated as a certifying officer of the company. How many folks have you designated as certifying officers, essentially temporarily made them members of your company in order to execute this process?

Mr. ARNOLD. Well, it is not temporary. It is limited. They are limited to seven specific items that they can do for MERS. There are 20,000 of those nationwide.

Senator MERKLEY. OK. I am sorry. I am out of time. But it has created legal confusion and that is an issue and I am sorry. Thank you all very much.

Chairman DODD. Thank you, Senator.

Senator Bennet.

Senator BENNET. Thank you. Thank you, Mr. Chairman. Thank you for holding this hearing, although I have to say it is so depressing how little we have moved in the last 3 years on these questions.

I wanted to just clear something up because I did not understand the answers to the question. On the HAMP program, I wrote in February to the Administration suggesting that servicers that were part of the HAMP program ought to not be able to pursue foreclosure while they were working on modifying loans, and it was my understanding that last June the Administration put forward a policy like that, and you just spoke to that. I am confused about what the status is from the servicers' perspective. Are you in a position now to be able to say, we are not going to pursue foreclosures while we are doing modifications, or it sounds to me like it is not as simple as I may have imagined it was, or straightforward.

Ms. DESOER. We are not in a position to say that we are not going to follow the foreclosure process in parallel to a modification. If there is a modification in the process of being considered, we will not proceed with the foreclosure sale. So the work that I suggested that we consider doing, which is eliminating that parallel process, has not yet taken place.

Senator BENNET. What are the gating items there preventing you from being able to do that, or what——

Ms. DESOER. Investor requirements.

Senator BENNET. OK, which brings me actually to my second point——

Ms. THOMPSON. Senator Bennet?

Senator BENNET. Yes?

Ms. THOMPSON. May I address the question about the HAMP?

Senator BENNET. Sure.

Ms. THOMPSON. That would be Supplemental Directive 10–02, which for HAMP does halt the foreclosure process, but only, in most circumstances, only for loans that are not yet in foreclosure at the time that the modification review is initiated, so that if the foreclosure process has already started proceeding for one reason or another, that process is allowed to continue to the point of sale while the loan modification review goes on. So while Supplemental Directive 10–02 was helpful, it did not relate back to cover loans that were already in the foreclosure process.

Senator BENNET. You have heard the stories here today, and I want to say that my office is facing exactly the same thing Senator Tester's office is facing. I have had 22 months of town hall meetings, people bringing their documents and the transcripts of voice mails and e-mails from servicers telling them that what they are doing is OK, that they are in compliance with the loan, and then they find out that they have been hit by a penalty of some kind or another.

Mr. Chairman, there was an article in Sunday's Denver Post that I would ask to be included in the record, and I will not go through the two stories, but one of the people that were affected by all this sort of "through the looking glass" business, Wendy Diers, she said, "We did everything we were supposed to do. This is such a boondoggle of a mess," she described.

Senator BENNET. And it is a boondoggle of a mess, and I think there is some—and the thing that I cannot understand is where the misalignment of interest is here, because we have millions of people in this country that are underwater in their mortgages. We know that. I, for one, do not believe that it is possible to prop up the value of all of these houses. That is impossible and it would be foolish public policy to do that.

But it seems it is clearly in the interest of people that can pay on their loans at a reduced value and who want to stay in their home, it is clearly in their interest to do that, right?

For investors in these securities, it would seem to me that it is clearly in their interest to have the homeowner be able to do that, because the value of the modified mortgage is worth more than the proceeds from a foreclosure sale would be, it would seem to me, and I could be wrong. Any of this that you want to correct, please correct.

The third piece is that it is clearly in the interest of the adjacent homeowners that that loan be modified and that that person remain in their house, because if they do not, the value of their house is just going to go down, and that can be repeated over and over and over again until the neighborhood is actually the entire United States of America, not just one place or a State that has been particularly hard hit, but the entire economic recovery in many respects rests on our being able to get this sorted out. That is a self-interest that would seem to be present.

So the question I have is, and we have had this hearing and other hearings and here I am at the end still completely unclear where the misalignment is. Why can we not get all of the self-interest aligned in a way that will allow us to proceed expeditiously so that—not just so that my constituents can get on with their lives, which they desperately want to do, but so that we can get this economy moving again. Professor?

Mr. LEVITIN. I think there are at least two problems. One problem is mortgage servicers, and I think you have heard a fair amount of testimony already at this hearing about the incentive alignment problem. Simply put, foreclosure is either less costly or more profitable than modification in many cases.

The second problem——

Senator BENNET. Not as far as the investors are concerned, right?

Mr. LEVITIN. No. This is the servicers——

Senator BENNET. Right.

Mr. LEVITIN.——representing their own financial interests, which are—the servicers' financial interests do not match the investors'.

The second problem comes with loans that are not being serviced by a third-party servicer but with loans that are actually on bank books. There is a strong disincentive for banks to recognize losses on mortgages quickly.

Senator BENNET. What percentage would you say of——

Mr. LEVITIN. Around 40 percent of mortgages in this country are not securitized. We do not actually know how many mortgages there are in the United States, which is just kind of an astounding failure, regulatory failure to gather information. No one knows the number. Somewhere between 50 and 60 million.

But of the mortgages that are on bank books, if the bank—if the loan defaults, the bank can stretch out the period of time before foreclosure. That means that the bank is stretching out the time before it has to recognize the loss. If the bank modifies the loan now, and let us say it writes down principal now, it is taking an immediate loss and this is particularly a problem with second liens because almost all second lien mortgages are on banks' books. There are around $400 billion in second lien mortgages out there. That is roughly equal to—they are held by the four largest banks, Bank of America, Chase, Citi, and what am I forgetting—Wells. That is roughly equal to the market capitalization of those four banks. So if they started writing off their second lien mortgages, they would have no capital left. They would be insolvent. And that creates a strong incentive not to recognize losses and to just try and pretend that they are not there.

Senator BENNET. Mr. Attorney General, did you want to respond?

Mr. MILLER. Just briefly. First of all, you gave my speech, although you gave it better than I give it. I just agree with you completely on the fundamental alignment of interests that you describe.

And I think there is a series of factors. Some were just mentioned, including the second lien and the recognition of loss. In addition, I think there is a question of putting enough resources into the servicing process. There has been an enormous demand on what they need to do. They have added a lot of people. I think they have to add more and add more resources.

And then I think, additionally, the quality of decisionmaking that—it is hard to tell, and we hope to get to the bottom of this, as well, but I think that in the decisionmaking they make on modifications, they are not making some of the modifications that they should for a whole variety of reasons. In some cases, I think competency. In some cases, I am not sure.

Also, there is a culture here to get over that servicers traditionally—their job was to collect money and turn it over to investors, and now they are being asked to do something totally different, to make these judgments, really to underwrite loans maybe for the first time. For someone that is used to collecting the full amount, to write off part of it, there is a hurdle there. And I think they are getting over that hurdle more and more all the time.

But our belief, the State Attorney Generals' belief is that, like yours, that a lot more modifications should be made that are not being made. We are going to try and find out why that is happening, and as I say, we are working a lot with the servicers to figure out what the solution is. But I just—I could not agree more with the fundamentals of your question and your statement.

Senator BENNET. Ms. Thompson?

Chairman DODD. Could I, just quickly, I appreciate the Attorney General's comment on that. But just quickly, I just want quick yeses or noes, or very brief answers. Do you disagree with what Senator Bennet has said, beginning with Barbara?

Ms. DESOER. No. We are the largest U.S. consumer bank and our financial interests are aligned with consumers being healthy and the economy recovering. So I agree absolutely, when you look at a community and the impact that a foreclosure has on a community versus a household being able to stay together, a family being able to send their kids to school——

Chairman DODD. That is longer than a sentence, Barbara, but I appreciate it.

Ms. DESOER. I am sorry, but we are very aligned. I agree. Yes.

Chairman DODD. Just quickly, yes or no. I suspect everyone is going to agree with what Senator Bennet said. Is that true?

Mr. ARNOLD. Yes, sir.

Mr. LEVITIN. Yes.

Mr. LOWMAN. Yes.

Ms. THOMPSON. Yes.

Chairman DODD. Again, here we are——

Ms. THOMPSON. If I may, we spent at the Center a lot of time last year trying to answer that question, why it is that servicers have failed to modify, and produced this report looking very carefully at the legal and financial incentives that they face, and the key charts from that are reproduced in the testimony submitted today.

There are three key recommendations that we believe would do a great deal to align servicer incentives with homeowners, investors, and the American public at large, and those three are what both Senator Merkley and Senator Bennet have talked about, ending the two-track system and requiring in all cases that evaluation for a loan modification be performed before the foreclosure process is initiated and requiring that a loan modification be offered to the homeowner if, in fact, it is going to provide a net benefit to the investor. So if the investor will profit from a loan modification, it should be offered to the homeowner before fees start getting tacked on and the foreclosure process starts down the road.

Chairman DODD. I agree with that.

Ms. THOMPSON. That is one. Two is there are complicated rules imposed by the credit rating agencies and in the pooling and servicing agreements that make it—that reduce repayment of servicer expenses when there is a modification. So when there is a foreclosure, servicers get repaid off the top before the investors get anything, all of their fees and advances, all of those broker price opinions, their title work, their foreclosure fees, all of that gets paid back directly to the servicers when the home is sold in a post-foreclosure sale. The repayment of those advances is delayed and much less clear if there is a modification, and so that is almost certainly a significant disincentive in many cases to perform modifications and there ought to be guidance issued that would clarify that you can get repaid from the pool when you do a modification for your advances so that servicers would get their legitimate advances repaid.

The third thing is we have talked about the role of fees in pushing people into foreclosure and encouraging servicers to have people in default because then there are these extra fees that they can tack on that they can then put in their pocket to offset the costs of foreclosure. And so we believe that you need to regulate those default fees to reduce the incentives to put homeowners into foreclosure.

Chairman DODD. Thank you very much.

Senator Akaka.

Senator AKAKA. Thank you very much, Mr. Chairman.

Too many homeowners in our country, they face the threat of——

Chairman DODD. Is your microphone on?

Senator AKAKA. Thank you very much, Mr. Chairman.

Too many homeowners in our country have faced the threat of foreclosures, and hearing our witnesses here, I think of Hawaii as suffering from this. At this time, the foreclosure rate in October was the 12th highest in the nation. In September of this year, families in Hawaii faced 67 percent more foreclosures than in September 2009, and 172 percent more than in September 2 years ago. This underlines how alarming the reported problems among mortgage service providers are, and so without question, we must do more than we are doing now, and our business here really is legislation. Mr. Levitin did mention it is not the law. It is not being complied to, and so that is not the problem. Many problems have been addressed here, and this issue is very complex.

So let me cut this down to asking three of you, and that is Mr. Miller and Mr. Levitin and Ms. Thompson to help us in what we are trying to do, and that is what recommendations do you have to protect homeowners in foreclosure proceedings from abuse of legal practices?

Chairman DODD. Ms. Thompson, you just answered that question, I thought, pretty well in your last three things you said.

Ms. THOMPSON. Yes.

Senator AKAKA. Do you have something to add to that?

Ms. THOMPSON. I do. We have more recommendations in our testimony. One key point about compliance is that you can get much better compliance if you fund quality mediation programs and you fund legal services attorneys. The mediation programs in New York City and Philadelphia are reducing the foreclosures there by about 50 percent. People that participate in the mediation programs, about 50 percent of those avoid foreclosure. So if you can get the servicers into a program where they are forced to focus on that particular loan and get it out of the automated processes, you are very likely to avoid many foreclosures and reduce the numbers dramatically. But those programs need to be funded.

The other thing is that the Dodd-Frank Wall Street Reform Act authorized $35 million in funding for legal services for legal services programs to assist low-income homeowners and tenants facing foreclosure, but that money has not been appropriated. All of the robo-signing allegations were only discovered, brought to light by aggressive, competent attorneys working very diligently to represent their clients. Homeowners cannot negotiate these kinds of issues without lawyers. Low-income homeowners particularly need the lawyers. Funding for legal services in foreclosure defense has taken several hits in recent years. We urgently need that funding.

Senator AKAKA. Thank you for that.

Mr. Miller.

Mr. MILLER. I would underscore the funding set of issues. We have Federal funding for our hotline in Iowa that is working very well to try and help people modify loans and the whole system that supports that. Legal services also is terribly underfunded by the Congress for, I know, a variety of reasons. I am also a former legal services attorney.

In terms of the substantive legislation, you know, it might depend on how we come out with our investigation and our resolution and what we find. Hopefully, we can solve these issues, but if we can't, you might want to think about regulation on the fees——

Chairman DODD. Tom, can I jump in there? How long do you anticipate you Attorneys General are going to take on this?

Mr. MILLER. It is hard to tell, Mr. Chairman, but we are thinking in terms of months rather than a year or longer. But it depends really on how far we get, how the negotiations get, and as we expand the scope, like you and I believe strongly we should, that expands the time somewhat, as well.

Chairman DODD. Excuse me, Dan. I apologize.

Senator AKAKA. Sure.

Mr. MILLER. But maybe something on the fees that are allowed. I agree that the forced insurance, there has been a huge abuse there that need to either be corrected by agreement or by legislation. The same thing with the dual track of foreclosure and modification at the same time. If you all could solve the second lien problem, which I think is a daunting problem, we would all appreciate that. You might want to take a look at that, as well.

Senator AKAKA. Thank you.

Mr. Levitin.

Mr. LEVITIN. All right. I would certainly support everything that Ms. Thompson and Attorney General Miller have suggested, but I would also suggest that you might want to consider an alternative that would go a bit farther, namely taking servicers out of the loan modification process altogether. Servicers were never in the loan modification business. They are in the transaction processing business and we are trying to get them to enter a business line that they are not used to doing, and to expect them to succeed in that is really asking too much.

And the way to get them out of that would be having some federally administered loan modification program where—you could do this under the bankruptcy power. It would not necessarily have to be done through bankruptcy courts, even though that would certainly be one way, and it would not necessarily have to be a repeat of the Chapter 13 cram-down legislation that the Senate failed to pass a couple of years back.

You could do this instead through something like a mortgage-only bankruptcy chapter where you have an immediate triage between homeowners who can pay and those who cannot, and if they cannot, have an expedited foreclosure proceeding. So if it is an empty house, move it back on the market as fast as you can. But if the homeowner can pay, give them a cookie cutter modification, including principal reduction, and if you did something like that, that would certainly get rid of the second lien problem altogether. I mean, you would have another problem potentially, which is that you might have four very large insolvent banks, but that is a problem that exists whether or not you recognize the losses now or later.

Senator AKAKA. Thank you. My time has expired.

Chairman DODD. Thank you very much, Senator.

Senator Reed.

Senator REED. You anticipated my question, Professor Levitin, which is basically how do we deal with millions of individualized cases given the general model of the HAMP program, which applied to a specific case requires someone to weigh the ability of a borrower to pay, the job prospects, *etc.,* which all comes down to some type of impartial—both sides respecting the impartiality of the decisionmaker saying, well, this is what we are going to do.

You might be aware that I became aware through Senator Whitehouse's hearings in Rhode Island that the Southern District of New York, their bankruptcy judges are participating in a program like this under their mediation procedures. They have taken a step forward, and apparently it is working in that they are quickly, as you suggest, finding debtors who in no way can pay given their job circumstances, and the pain and the uncertainty is over. The pain might linger, but at least the foreclosure is completed. But for others, the modifications go into effect, they get on with their lives, *etc.* So I think that suggestion is excellent.

You mentioned previously, and I will get comments from others, too, that you were talking about some type of global settlement, because of the suggested implications on the balance sheets of the banks and the overall economy. What are the components, in addition to this bankruptcy-type approach, which you suggest should be in this global settlement?

Mr. LEVITIN. You need to make sure that there is quiet title on real estate in the United States. That is also something that bankruptcy can do. That is something that bankruptcy courts routinely do, is award quiet title. So that is one way of sorting through any of the chain of title problems.

I think, ultimately, our real problem is that there are losses in the system and we have to figure out how to allocate them. There is not a solution where everyone walks away happy with no losses. Right now, those losses are being put on mortgage-backed security holders and, frankly, on average homeowners, not just the ones in foreclosure but the ones who live next door and have the vacant property next to them where the lawn is not being watered and so forth.

The losses have to go somewhere. They can go on the banks. They can go on the investors. They can go on the homeowners. Or they can go on the Government. Those are the four choices. I certainly do not like the losses going on the Government. We made a move that way in 2008 and I do not think there is a lot of appetite to see that expand. The homeowners——

Chairman DODD. Very perceptive of you.

[Laughter.]

Mr. LEVITIN. That might get me tenure.

[Laughter.]

Mr. LEVITIN. I do not think anyone wants to see these losses borne by the homeowners, but that is where it is falling right now. So really, this is kind of a question between the investors and the banks, and frankly, I think the investors have really the—are the more innocent party in that they did not originate. There were a lot of problems on the origination end. That was not the investors' fault. I mean, certainly they bought the stuff and they made a market for it, but in many cases, the investors are saying now, we thought we were buying better paper than you sold us. You said you were selling us B-plus paper and it turns out this was actually C-plus paper. We want our money back.

But we need to recognize that we have to allocate the losses, and we can either just avoid that for a time, but recognize that as long as we do not specifically address the loss allocation, we are making a choice, and that choice is stick all the losses on the homeowners and the investors and that is really not where they should be.

Senator REED. Let me just make one point, and I do want to ask the Attorney General about his comments regarding the direction his investigation is going and his recommendations and also give the opportunity for the financial representatives to respond. This phenomenon, and Ms. Thompson said it here, if you look back, it is deja vu. This situation was bad a year ago. It is worse today, and it might get worse. If the strategy is to just try to hope for a recovery independent of anything we do here of solving a problem, we could find ourselves coming back here in months or years from now with even a worse situation, and investors being more frustrated and more willing to sue the banks, *etc.* So there is, I think, a problem for all the institutions, the homeowners, the financial institutions, and we have to start moving toward a solution, not simply waiting, because it seems to be getting worse in my mind. I hope I am wrong, but that is the impression.

Just quickly, General Miller, will your recommendations touch upon some of these discussions we have had in terms of a bankruptcy-like approach to settle these individual disputes between individual homeowners and banks, take the servicers out of the middle, if you will? Will it talk about some type of distribution or sharing of the losses, which Professor Levitin suggests could be substantial? Just give me an idea of where you think you are headed with your recommendations, not specifically, but what categories.

Mr. MILLER. You know, there could be some recommendations, but the core of what we are trying to do will be an agreement with the servicers, with the banks that are servicers, and, you know, we are trying to figure out ways to change the paradigm with them staying in place. They are not going to agree to the kinds of fundamental change that you have talked about.

So our goal is to change the paradigm within the current system so that it functions, and ideally, I think, from our point of view, so it functions the way Senator Bennet described that it should function. That is certainly our goal, and what we want to do is have some provisions—what we are talking about now are some provisions, some requirements that they would have to live up to—only one contact person, deal with the dual track, and other issues, as well.

And then I think there would have to be some way that it would be enforced, maybe a monitor is something we have talked a little bit about, maybe some penalties if they do not comply. But where we are at right now is to try and change the paradigm within the current system of the bank servicers that you see in front of you and the other large three.

We talk about and we struggle with sort of the dysfunction of the system. We have not gotten to the point of the resolutions you have talked about, but it is a system that was designed, as I mentioned, to collect money and turn it over to investors and now it is a much different system that has some issues concerning reliance on fees to pay for some of the new resources they have to bring in that we talked a little bit about earlier. The conflict of the second liens are involved there.

But I guess what we are still trying to do is have enough change within the current players to resolve some of the issues so that we have a much better system, the best system that we can have so that when that person comes before them and asks for a modification and the calculation is done quickly and fairly and accurately and the modification they are requesting produces more money for the investor than foreclosing, then that happens. I do not think it does happen that often now. I think there are some fundamental problems.

So we are trying to do what I am trying to say. We are struggling with how to do that, and if the Committee and the Committee staff have any suggestions to us, we would love to hear from you. We are talking to the investors. Last week, Patrick Madigan, our Assistant who is the lead of this, talked to the consumer groups and said what we should do. This is a very serious attempt to solve a very difficult problem. We are going to do the best we can and let the chips fall where they may from that. We will need, ultimately, agreement from the banks, and so far, our discussions, as I said, have been productive.

Senator REED. Well, I appreciate what you and your colleagues are doing. It is very important. But just again, your process, because of the negotiations, because of the complexity, we expect—you expect months from now to have recommendations which might take even further time to implement, and there is a real question, I think, of do we have that time, and not just in terms of the individual homeowners but the economy. And if the economy gets worse for reasons not directly related to this, such as the sovereign debt crisis overseas, *etc.,* then the foreclosure problem we face today, you know, the bottom keeps slipping down, down, down, down, down, and this problem becomes really tremendous.

I want to give an opportunity to——

Mr. MILLER. Yes, and we feel all that pressure, by the way.

Senator REED. Good. So do we.

Mr. MILLER. I know you do. And again, there will not be recommendations. If there is an agreement, there will be an agreement and we will go forward right from there.

Senator REED. But let me ask Ms. Desoer and then also Mr. Lowman this. Implicit in, I think, the comments, and I do not want to put words in your mouth, of Professor Levitin is that there could be potentially significant losses here, and the question really is are efforts being made to minimize your losses, which, frankly, if I was a business person, that might be my first goal on behalf of the shareholders, or to effectively deal with these home mortgage modifications to follow the HAMP guidelines, *etc.*? And I suspect in reality there is probably a constant tension and conflict to that. But I just want to give you an opportunity fairly to comment on this whole discussion with that.

Ms. DESOER. Thank you for the opportunity. There is not conflict in our company. Any dollar, any resource, any capability that is needed, our business has the support of that. There is nothing more important to recovery of Bank of America's brand than doing this right, listening to people like Ms. Thompson, understanding the Senators' individual situations, dedicating people, training people to do it.

We have moved people. As General Miller indicated, we have had to build a brand new capability, people, process, technology, to deliver it. We have moved as many resources, experienced underwriters, others who have experience into the servicing space to build that. We have made progress, but there is no question there is still great inconsistency that we are dedicated to eliminating. But it is not a constraint, or it is not that someone is saying, no, that will mean a lack of profit for the company. This is the most important issue in the company and there is no constraint on dollars that we will put against it.

Senator REED. Mr. Lowman?

Mr. LOWMAN. We have sustained billions of dollars of losses in this whole crisis as a bank, and I believe our interests are, in fact, aligned with other investors. The fact is, the best outcome is to keep a person in their home and to keep them paying, and we are all advantaged by doing that. We do not have anything to gain by having someone go into foreclosure. And so I would just echo Barbara's comments. Our interests are aligned and we are doing everything we can.

Senator REED. Just a final point, and I think this echoes one of the recommendations that Ms. Thompson has made and which is included in the legislation I have, which is basically to require that a full attempt to modify a loan be made prior to pursuing foreclosure. That might require renegotiating your agreements with the servicers and with the trusts. I do not know. But is that something that you would consider as a policy initiative for the bank to take immediately?

Mr. LOWMAN. Well, I would say that as we have described in the HAMP program, it is a requirement today. So we have to offer a modification to a customer before we commence with the foreclosure process. So by definition, as time goes on, it will have to have happened before foreclosure.

Senator REED. Ms. Thompson, any comments?

Ms. THOMPSON. As I said earlier to Mr. Bennet—first of all, Senator Reed, thank you so much for your work on supporting servicing reform. We greatly appreciate it and your bill, if enacted, would be a very important step forward.

As I said in response to Mr. Bennet's concerns earlier, in our view, the HAMP program—what Mr. Lowman just said is, over time, we will see that a modification will be offered, and the problem is that "over time" means that there are going to be tens and hundreds and perhaps millions of foreclosures that occur until you get to that point where a loan modification is, in fact, offered before a foreclosure, and over time, if you are waiting for over time, you are going to see millions of dollars of fees piled onto homeowners' accounts, which makes a modification much more difficult.

Senator REED. A final word. The Chairman has been very gracious here.

Mr. LEVITIN. I think it is important just to remember that HAMP—that requirement that the modification be offered only applies to HAMP-eligible loans, and only about one in six loans that is currently 60-plus days delinquent is HAMP-eligible. So we have a problem of HAMP being a problem that just had too narrow of a focus and that really does not solve the problem.

Senator REED. Thank you, Mr. Chairman. You are most kind.

Chairman DODD. Thank you. Let me just—because these are important. Attorney General Miller, at the outset of my opening comments, I talked about the importance of getting this Financial Stability Council that we established in the financial reform bill to anticipate systemic risk and to collectively work as a body chaired by the Secretary of the Treasury, along with the FDIC and the OCC. There are 10 members of that, an independent member, and five others are part of it. This seems to me like a classic example, one that we did not anticipate necessarily when we drafted the legislation, but exactly—I mean, we are in a crisis with this. Now, you could argue that it is not yet a systemic crisis that poses the kind of risk we saw in the fall of 2008. But no one can argue we are not in the middle of a crisis.

Now, the idea of this, of course, was to minimize crises so that they do not grow into the large systemic crises. Have you had any contact with the Secretary of the Treasury or is there any communication going on between the Attorneys General and this Council or the Chairman of it, the Secretary of the Treasury, or their office to begin to talk about what the role of the Federal Government might be in formulating an answer to all of this?

Mr. MILLER. We have not had any contact with the Council. We have repeated contact with the Department of Treasury, with Assistant Secretary Michael Barr and his staff. We have developed a terrific ongoing relationship with them. We talk about these issues and try and help and support each other on these issues. So we have had a lot of discussions with Treasury, but not with that particular Council.

Chairman DODD. Again, I talked privately with Senator Warner and others. I do not know if Senator Merkley has a similar thought. I am going to use this forum here obviously in a very public setting to urge the Secretary of the Treasury and others to convene that Council, to begin to work with you and others so that there is a role here to examine this question in seeking broad solutions to this question. So my hope is they will hear this request to pick up that obligation that we have, I think, laid out in that legislation.

I want to ask, if I can, also as well both you, Ms. Desoer and Mr. Lowman, to respond, if you could, to the suggestions that Ms. Thompson made regarding the three that were raised. And anyone else can jump in on this, but I would like to get your response to them.

First, she argues the elimination of the two-track system, which we just discussed, and as Mr. Levitin pointed out, only one in six— and, again, having been very involved in the crafting of HAMP, you know, we were trying to put together a bill here in this Committee, and it was very awkward and obviously trying to get a majority, getting 60 votes and doing the best we could to have some answer to all of this at the time. It is not exactly what I would have written if I could have written it alone and passed it. But it is what we were able to get done through a very difficult mine field politically here in the institution.

But I want to get your response to the elimination of the two-track system. Forget whether HAMP requires it or not. What is in your interest, what would you like to see happen here in all of this, regarding that homeowners are fully evaluated for loan modification before the foreclosure is initiated?

Second, she proposes that failure to offer loan modification where such a modification is net present positive—in other words, where the modification had a better return for investors than foreclosure, it would be allowed to be used as a defense against foreclosure?

And, third, the principal reduction should be mandatory under HAMP. I have been advocating that for almost 4 years, that principal reduction would really address this issue very directly. But I would like to get—Mr. Lowman, why don't we start with you? We always have Ms. Desoer going first. We will have you go first here. Give me your answer to these three. Are you in favor of them or not? And why?

Mr. LOWMAN. So, first of all, with respect to the two-track system——

Chairman DODD. Right.

Mr. LOWMAN. You know, as I mentioned, the HAMP program already requires——

Chairman DODD. I know, but forget that for a second. What would you like? Would you be willing to accept what she has argued for here?

Mr. LOWMAN. I think we have to be careful with that, and I just believe that, you know, we have now a process inside of our company where every defaulted borrower gets linked up with a single person and there is single accountability——

Chairman DODD. Well, how do you address the point she raised earlier? If you are going through and you have got a foreclosure process going and all of these costs are mounting up, it seems to me you are working against yourself. In fact, if you are trying to get some modification here, would it not be wiser to go with the modification? Then if that falls apart, then go to foreclosure.

Mr. LOWMAN. Right. So that is currently what we——

Chairman DODD. But it is a dual track. You are going both at the same time.

Mr. LOWMAN. We actually start the modification process much sooner than when a borrower goes—you know, is referred to foreclosure. We start the modification process literally with the first talk-off.

Chairman DODD. OK. So you reject that. Tell me about number two.

Mr. LOWMAN. So to make sure I understand number two, can you repeat it?

Chairman DODD. Number two, she proposes—and correct me if I misspoke here. She points out that the modification has a better return for investors, to investors than foreclosure, they be allowed to use that as a defense against foreclosure.

Mr. LOWMAN. So today, the way the process works is we, you know, run the net present value models that we use to determine whether or not we should foreclose or modify. And in the cases of where it is in the best interest of the investor to modify, we offer a modification.

Chairman DODD. Well, if there is a net present value that makes it more valuable than foreclosure—I mean, using a model is one thing. But, I mean, in these individual cases, if that turns out to be the result——

Mr. LOWMAN. That we should modify the loan, then it should be modified.

Chairman DODD. How about number three, principal reduction mandatory?

Mr. LOWMAN. So principal reduction, first of all, we are participating in the HAMP principal reduction program which was recently rolled out. All of our analysis indicates that what is most important is that borrowers have affordable mortgage payments, and we have got lots of experience, having done many mods. And we do that by reducing the interest rate, by extending the term, and by deferring principal where necessary with, you know, no interest attached to that. We as a servicer have a duty to our investors to minimize losses, and obviously principal forgiveness potentially increases losses.

And then, last, I think if we want to rebuild the U.S. mortgage market and continue to have investors and banks have confidence in the market, we need to ensure that the collateral values are there.

Chairman DODD. Now, I understand that, but going back—and I recall 4 years ago making the case. There was a study done on a square block in the city of Chicago. One foreclosure in that square block immediately caused the lowering of value of every other property on that block immediately by 5 percent. You end up with two and three foreclosures in a city block, and you get, obviously, a larger impact.

Why wouldn't it make more sense just to go directly at that principal issue which makes a greater possibility that homeowner will be able to afford that mortgage and avoid the kind of cascading effect we see in these neighborhoods, which obviously can work to your interests?

Mr. LOWMAN. We are able to achieve affordability with the tool set that we have today, which includes the deferment of principal. So you get to the same end state.

Chairman DODD. I wish that were the case.

Ms. Desoer, how about responding to those three points?

Ms. DESOER. As I have discussed, we are very open to discussing changes for the existing pipeline that is going through the dual track to take it away. I agree with Mr. Lowman that with everything we have done, hopefully nobody who is eligible for a modification ever gets to the start of a foreclosure, but we know we have got a pipeline to work through, and so we are amenable to that.

On the second issue, I agree. And then on the third issue of principal reduction, we do have a proprietary program that we are now executing with 40 States on a principal reduction program, and we are participating in the principal reduction program of the hardest-hit States with Government funding, and those are the places where it is the largest issue.

Thank you.

Chairman DODD. Senator Merkley, do you have any additional questions you would like to raise?

Senator MERKLEY. Yes.

Chairman DODD. I am going to leave the record open, by the way, for a few days—this is awkward, obviously, with caucuses around here and everything else—for other Members to submit questions to the panel.

Senator MERKLEY. Thank you very much, Mr. Chair. I just wanted to clarify a couple of points.

One is I know that we sought to create a safe harbor for the servicers from the investors so that they were following the HAMP program, that they would be in that safe harbor and not subject to suits. That is a real concern. Did the safe harbor not provide enough protection to disconnect the foreclosure track from the modification track? And do we need to take action here to provide an expanded safe harbor?

Because of the constituents streaming in our doors with the enormous stress connected with working on a modification and yet some other group of folks somewhere within the same servicer are pursuing aggressively every single step on foreclosure, people are—it just seems like the two parts are not talking to each other, and they are enormously stressed over this. And it seems like if there is a good-faith modification effort under way, the foreclosure process ought to be shut down until it becomes clear that modification will not work, and then, OK, well, it gears up again.

What do we need to do to help create the ability—and, Ms. Desoer, since you referred to that you are working on this, what do we need to do to—do we need to do anything? What needs to be done to help create the legal framework that will allow you to take a step that would be a tremendous step forward for American families?

Ms. DESOER. Well, first, the safe harbor has enabled us to get to some of those 700,000 permanent modifications that we have done and certainly the 85,000 that we have done under HAMP, because without that not all of our investors would have agreed to those modifications as many do today. So that has been beneficial.

On the dual track, for about 23 percent of our servicing portfolio where Bank of America is the investor on those mortgages, we have the ability to do something about that because we have the authority as investor as well as servicer. But for the rest of the investors, it would take their approval to make a change, and that would include, you know, the Government-sponsored enterprises and other private investors as well.

Senator MERKLEY. So that is a process you are actively pursuing? You are requesting those changes in the servicing contract?

Ms. DESOER. That is what we are in the early discussions of with the State Attorneys General, seeing if we can use that forum to get investors to the table as well for consideration in that.

Senator MERKLEY. So I did not hear you mention anything that we need to do here to provide an additional legal framework. Mr. Lowman, your sense, do you need additional legal authority to be able to set the foreclosure track aside while you are in good-faith modification——

Mr. LOWMAN. I am not certain that we have the right safe harbor, but, frankly, I would like to follow up on that question.

Senator MERKLEY. That would be great. This is the last question I will ask, though everything we talk about is so complex and interrelated, I have 100 questions, but I will stick with this one. That is, Mr. Lowman, you noted that your services, your interests are aligned, and, Ms. Desoer, that as a community bank you have a huge stake in the success of families and so forth. But is it different when you are contracted to be the servicer but you do not own the loan? You do not have a stake in the success of the loan, if you will. You have a stake only in the fees generated by the servicing unit. In that situation, is it really the case, as Ms. Thompson has been laying out, that there are enormous financial incentives as a servicer to pursue this foreclosure track? She has all these charts and information that she has analyzed. Is her testimony fair? Or if it is not, what is she missing?

Ms. DESOER. As I referenced, we are not perfect. We have inconsistencies as we have built our capabilities out, and there have been customer issues. I do not deny those, and we work every day and we have significantly increased the staff to support all of our customers who have those issues while we get to the point where we can eliminate the issues that we do have.

What you have to remember is the financial cost is one aspect of it, but the reputation cost to the Bank of America brand is a very powerful driver of why we are working as hard as we are to get this right and why we listen to customers, community groups, yourselves, and certainly working with the State Attorneys General. Our interests are aligned in working to get this right, that is for a homeowner who has some ability to pay and a desire to stay in their primary residence, to stay there. It is in all of our best interests to get to a solution that enables them to do that by taking advantage of all the programs and capabilities and resources that are available. And that is what we are committed to make happen.

Senator MERKLEY. If I can summarize what I just heard, you are not contesting her analysis of the financial incentives that certainly favor foreclosure, but that because the reputation of the bank is at stake, that balances that out.

Ms. DESOER. I have not looked at all of the analysis that I would need to so I can confirm or deny that with you.

Senator MERKLEY. Yes, Professor.

Mr. LEVITIN. I would just like to point out that many servicers are in a very different situation than Bank of America. Bank of America has a major lending business in its own name and servicing in its own name. There are plenty of servicers, though, that are a servicing unit of a major bank but service under a completely different name, and the consumer is unlikely to make any connection between any misdeeds brought by the servicer and the lending unit.

Senator MERKLEY. So, Professor, in that case the financial incentives to pursue foreclosure are not offset by, if you will, defense of the reputation of the banking institution?

Mr. LEVITIN. There would be no—you could not even make such a claim. That is correct.

Senator MERKLEY. Mr. Lowman, do you want to share your thoughts on that?

Mr. LOWMAN. Yes. As a servicer, the calculation that is used to determine whether to foreclose or to modify does not take into account our remuneration as a servicer. And I think it is important to note that, as I said earlier, we make money, we earn fees on performing loans. And when we modify a loan, we get the servicing stream because we have made it a performing loan. And to the extent it is a HAMP loan, we get an income stream as a result of payment from the Government for having successfully modified the loan.

So I guess I do not agree that we are incented to foreclose. We, in fact, I believe, are incented to modify.

Senator MERKLEY. Well, I just want to thank you all for addressing these complicated issues. I do not think we really got into the other big piece of this, which the Chair referred to, which is kind of the systemic risk that comes from some of the legal issues that are being raised and how we can really get our hands around that, which is important to both homeowners in terms of their rights and to our economy in terms of the availability of credit. But certainly I have learned a lot, and thank you very much.

Chairman DODD. Let me just say that would hopefully be the subject matter of the next hearing on the subject matter because I think it is a critical point that we have to address. I say this respectfully of others—and I know the Oversight Panel made suggestions somehow this was much larger than a technical issue. And I am not disagreeing. That may be the conclusion. But it is just as premature to make that conclusion as it is to suggest it is only a technical problem. So in either case, language like that can cause its own distortions, and I get a little uneasy without knowing the implications of what we are doing, making predictions along those lines.

I had a chance to talk to Ms. Desoer and just share—and correct me if I am wrong on some of these numbers, but I thought it was interesting. Thirty percent of all foreclosures nationwide are in the judicial States, I think it is 23 of the judicial States. Of that 30 percent, 68 percent of the foreclosures are in the State of Florida. Is that correct?

Ms. DESOER. Of the 23 judicial States in Bank of America's portfolio of foreclosures, over 60—close to 60 percent are in Florida.

Chairman DODD. And 70 percent of the foreclosures nationwide are in the non-judicial—the 27 States that are non-judicial States. And, of course, in the non-judicial, the burden is on the homeowner as opposed to—I mean, I am simplifying this. The Attorney General is probably rolling his eyes as I make that kind of broad, sweeping statement. But as I read it, basically the burdens shift in a non-judicial and a judicial State. And you correct me, Tom, if I am wrong on this, but in the non-judicial the burden is on the homeowner to make the case they are not able to make their payments and so forth; whereas, in the judicial, the burden is more on the servicing side of the equation? Am I oversimplifying that?

Mr. MILLER. I think that is right, yes.

Chairman DODD. So is there any indication to draw from these statistics that 70 percent of the foreclosures are in the non-judicial, that there is something about that equation that places the burden on the homeowners, why we are seeing so much more of the foreclosures occurring in the non-judicial States as opposed to the judicial States? Or am I just reading too much into these numbers?

Ms. DESOER. Senator, I think it is more related to economic factors like unemployment or housing price declines as to the States that are experiencing the greatest level of foreclosures. So I do not think Florida is related to the fact that it is a judicial or a non-judicial State, but to the extent of the economy——

Chairman DODD. Well, I agree with that. That would make some sense. But, otherwise, where that is not the case, does the judicial framework have any strong implication on the outcome in terms of a modification versus a foreclosure?

Ms. THOMPSON. Senator?

Chairman DODD. Yes.

Ms. THOMPSON. One point is that, of course, California and Nevada are non-judicial foreclosure States.

Chairman DODD. Right.

Ms. THOMPSON. So that makes a big difference. There are some studies that show that being in a judicial foreclosure State increases—delays the time to foreclosure, that is obvious, and increases slightly the likelihood that you will end up with a modification. There is some evidence that being in a judicial——

Chairman DODD. But not the 37 numbers.

Ms. THOMPSON. I would not think the numbers would be that high.

Chairman DODD. One other point—and, again, I want to thank Ms. Desoer for her sharing this information with me. And, again, it is a separate subject matter but one that concerns me, and that is that when you are getting—the foreclosed homes that are bought—it was not 40 percent. They gave me some numbers—30 percent. But 30 percent of the foreclosed homes that are bought are bought with cash.

Ms. DESOER. Thirty percent of all U.S. home sales are cash purchases, not just the foreclosed.

Chairman DODD. I thought it was just foreclosed.

Ms. DESOER. No.

Chairman DODD. Of all.

Ms. DESOER. Of all U.S. home sales, 30 percent are purchased with cash, and I can give you the study that is produced monthly that shows the mix of how many new homes purchased are purchased for cash or financed with a conventional mortgage or financed with an FHA mortgage as an example. But 30 percent of last month's—and it has been running about that for several months—entire home purchases are cash purchases.

Chairman DODD. And further—and, again, you correct me if I am interpreting these numbers in too broad a context. Of that number bought with cash, these are not owner-occupied; these are investment properties.

Ms. DESOER. The vast majority of those purchases are investors as opposed to primary homeowners. That is correct.

Chairman DODD. And any implications of what that means in terms of neighborhoods and so forth, as opposed to having owner-occupied versus rental properties?

Ms. DESOER. If it is concentrated in terms of the mix of investors coming into a community, it could mean a shift from primary homeownership to rental. But I think the primary indication that I was trying to say is that there are investors with cash who think that the price of the property is right for them to earn a good return as a rental property. And I think in certain communities where, as we acquire the real estate for our own portfolio after a foreclosure sale, those properties do sell relatively quickly.

Chairman DODD. And, again, I am a great advocate that we need to increase rental stock in the country. One of the problems is we have had so much of an emphasis on homeownership that we find a limitation of increasing rental stock, and that has created its own set of problems. So I would state that. But is there any correlation between having less owner-occupied properties and the value of other properties in that neighborhood?

Ms. DESOER. I do not know the answer to that.

Chairman DODD. Do you have any idea on that, Mr. Levitin?

Mr. LEVITIN. No.

Chairman DODD. Ms. Thompson, any idea?

Ms. THOMPSON. No.

Chairman DODD. OK. Well, thank you very, very much. This has been—it is a long time but I am glad we—sorry for starting late, but otherwise it would have been very difficult to hold all of you here. So let me thank all of you for your testimony. I will leave the record open so that Members can provide some additional questions. But it has been very, very helpful to hear what you have had to say, and I am very grateful to all of you for coming and sharing your thoughts with us.

Tom Miller, the Attorney General, we thank you for what you are doing and how hard you are working at this. And I hope you might make that call to the Treasury Department and say you would like to be hearing what this Systemic Council is also—what their thoughts might be on this as well.

The Committee will stand adjourned.

[Whereupon, at 6:03 p.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF SENATOR RICHARD C. SHELBY

Thank you Mr. Chairman.

On October 6th, I called for an investigation into the growing controversy surrounding home foreclosures. This hearing represents what I understand will be the only examination the Committee intends to conduct. I hope that isn't the case.

At this point, there appear to be a number of key issues that need to be examined thoroughly.

First, we need to determine the extent of the problem. It appears that thousands of so-called "robo-signers" working on behalf of banks that service loans, signed foreclosure related court documents swearing that they had "personal knowledge" of the facts of each foreclosure case. It now appears that few, if any, of these people had such knowledge.

Second, we need to determine whether the flaws in the process led to improper results. In other words, were any homeowners foreclosed upon when they shouldn't have been.

Third, we need to examine the activities of the law firms that worked for the servicers. Many questions have been raised regarding the conduct of these firms during their engagement in foreclosure proceedings.

Fourth, what role did the GSEs and the larger securitization market play in this debacle. Did their actions contribute to the problem? Were Fannie and Freddie complicit in any way?

Finally, we need to examine the role of the regulators. Where were they in this process? What were they supposed to be doing and were they doing it? If not, why not?

In order to determine the extent of the problem we need to speak with all of the major servicers. Unfortunately, we only have a small subset present today. For example, Ally Financial was the first major servicer to recognize that it had problems with its process. That firm, among others, is not here today.

Mr. Chairman, it is my understanding that many, if not all, of the law firms under investigation were selected by the housing GSEs. In order to best understand how and why these firms were chosen, I believe we need to hear from Fannie and Freddie.

Unfortunately, they also didn't make the witness list.

Perhaps the most complex facet of this examination involves securitization. As highlighted in the Congressional Oversight Panel's most recent report, the most severe potential fallout from this will be found in the securitization market. According to that report, this could have a devastating affect on our broader financial system.

On this critical topic we have a professor from Georgetown University, the Iowa Attorney General, and finally the CEO of MERS.

Each witness has an important view point to share with the Committee, but none of them represent the views or expertise of the securitizers. Given the complexity of this issue, perhaps the Committee should have invited someone from the broader securitization community to answer our questions.

Finally, the regulators are also significant players in this examination. Each of the major servicers have regulators onsite in their operations.

How did those regulators miss the wide-spread foreclosure problems at the firms they were regulating? We could ask them, but, unfortunately they are not here today.

Mr. Chairman, I expected this hearing to be focused on the foreclosure process. As I have already stated, there is a great deal to examine on this topic alone.

It appears, however, that this hearing has also become a foreclosure mitigation hearing. Mortgage modification is an important topic to be sure, and certainly one that warrants its own hearing.

Nonetheless, if we are also going to examine the issue of foreclosure mitigation, we should study the extent to which borrower fraud has distorted the modification process and inflated overall foreclosure numbers.

This is a critical issue considering that the U.S. taxpayer has spent more than $50 billion on foreclosure mitigation programs. We need to know where our mitigation efforts are best directed and where our money is being wasted as a result of fraud. I understand that there are no witnesses here today that can address the topic of borrower fraud.

Mr. Chairman, I called for a full investigation on this matter in early October because I believed that those who face foreclosure should, at the very least, know that the process is being handled fairly and according to the law. While I believe that we will learn a great deal from this hearing, I hope that it does not represent the Committee's complete examination of this important issue.

Thank you.

PREPARED STATEMENT OF SENATOR DANIEL K. AKAKA

Thank you, Mr. Chairman, for holding this timely hearing. Too many homeowners continue to lose their homes to foreclosure. For approximately one in five borrowers, the value of their home is less than what they owe on it. And, high unemployment rates suggest that even more families face difficult financial situations and even more borrowers may be at risk of foreclosure now or in the future. These challenges are not just isolated to the largest housing markets. Hawaii's foreclosure rate in October was the 12th highest in the nation.

Homeowners are under a tremendous amount of financial stress right now, which is what makes the recent reports of problems within the mortgage servicing industry all the more troubling. The "robo-signing" issue has shed light on other questionable mortgage servicing practices that my colleagues on this Committee and I have been hearing about from homeowners in our States for quite some time. They have reported that servicers are unresponsive, uncooperative, and disingenuous throughout the loan modification and foreclosure processes.

Borrowers should expect mortgage lenders and servicers to put forth a good faith effort to help them keep their homes. Foreclosure should be servicer's last resort, not its preferred outcome. However, servicers' decisions to flaunt their protocols and contractual agreements indicate that this is not the case.

We must do more to help distressed borrowers and preserve homeownership. This begins with ensuring that servicers are properly adhering to modification, refinance, and foreclosure procedures. Borrowers should expect servicers to be accessible and to refrain from obstructing homeowner assistance efforts. Mortgage modifications and refinances must be significant and meaningful so that homeowners do not find themselves in the same situation several months later. We also have a responsibility to those who have lost their homes—to ensure that they have access to alternative housing opportunities, that they have the knowledge and resources to meet their other debt obligations, and that they are able to rebuild their credit.

Finally, these failures among mortgage service providers once again highlight the need for greater financial literacy. Homeowners are borrowers and consumers—they should be able to understand the terms of their mortgage agreements and the consumer protection resources available to them. They should also have the knowledge and skills to overcome foreclosure and other unforeseen financial obstacles.

Mr. Chairman, I thank you for this opportunity for the Committee to examine the prevalence of foreclosures and the actions of mortgage service providers. I also thank the witnesses for appearing today, and I look forward to your testimonies. Thank you, Mr. Chairman.

PREPARED STATEMENT OF SENATOR SHERROD BROWN

Thank you, Mr. Chairman.

The predatory practices of the mortgage servicing industry are remarkably similar to the predatory practices that led to the subprime crisis.

The biggest mortgage servicers have poorly maintained, lost, or forged documentation. They ignored the interests of homeowners in exchange for outsized profits.

Each day Ohioans are failed by the modification process. Last month, my State had the **eighth most foreclosures in the nation—**and the most of any States represented on this Committee.

Ohioans interested in ***merely attempting to*** modify mortgages often end up owing more principal on their loans or having their credit scores lowered.

Instead of trying to stay in their homes, they are saddled with back payments, penalties, and late fees.

And it's happening across Ohio—in large cities and small towns, and urban and rural counties that are hit hard by the housing crisis.

In **Perry County,** a homeowner was outraged to learn that her temporary modification was accompanied by late fees and negative marks on her credit report.

It's the tragic truth that she was luckier than other Ohioans because her servicer stopped collection efforts.

In **Cuyahoga County—**which had the most foreclosures of any county in the State last month—a senior living on Social Security disability received collection notices while she was in her trial period.

When my office contacted the bank about these notices, we were told that the mortgage department could not make the collection department stop until she got a permanent modification.

We were told that she should just ignore their collection notices.

But this same constituent also had her first trial payment double-billed, causing the bank to tack on $136 in overdraft fees.

In **Geauga County** one family asked about her servicer, ***"How is it possible for a bank, its computers, departments and representatives to be so out of touch with one another?"***

Another constituent from Geauga County told my office, ***"In 1999, I was diagnosed with cancer . I endured two surgeries and a brutal year of chemotherapy . . . My experiences with [my servicer] have been worse than having cancer."***

Indifference, foreclosed homes, and broken neighborhoods shouldn't be a formula for record profits.

By far the most complaints that I receive from frustrated Ohioans relate to the four largest servicers, who account for **more than 55 percent** of all servicing contracts.

After acquiring big subprime player like Countrywide, Wachovia, and Washington Mutual, the four biggest banks are now so large that their executives apparently don't know what's happening deep in their own securitization and servicing departments.

In July, I sent these four largest servicers a letter describing Ohioans' frustrations with their failed attempts at mortgage modifications.

I received a response letter from one of the banks on September 29, affirming its commitment to keeping homeowners in their homes and out of foreclosure.

But that very same day, that bank announced a moratorium on **56,000 foreclosures in 23 States—including Ohio—because of deficiencies with their foreclosure affidavits.**

These big banks tell us that mistakes are isolated and harmless. But these problems are not new. They are well documented and are part of a longstanding, ugly pattern of homeowner abuse.

It's a cycle of mistrust and misinformation that deprives families of their homes and neighborhoods of their vitality.

According to a **survey of foreclosure counselors** released last month by the **Cleveland Federal Reserve,** most **modifications take between 120–240 days to work out.**

In that period paperwork errors like multiple requests, incorrect evaluations, and poor internal communications are common.

It's common enough that last year, a bankruptcy judge in Ohio wrote in a decision that mortgage servicers are **"unconcerned with the accuracy of records and information."**

The Department of Treasury's report on the **Home Assistance Modification Program (HAMP)** found compliance problems at three of the four biggest servicers.

Yesterday, the **GAO** released a report that I had requested on **bank walkaways.**

The report found that as a result of poor communication from servicers, **between 14,000 and 34,000 families** in cities like Cleveland, Akron, and Columbus have been unnecessarily forced out of their homes.

Vacant and abandoned homes not only diminish surrounding properties values, they drain city resources and present a series of public safety concerns and risks.

Why are so many homeowners being kicked out of their houses—even when it is not economically beneficial to anyone?

That's why today's hearing is so important—and why reform to the mortgaging servicing industry is long overdue.

We've seen how "robo-signings" are a serious abuse of court processes—the Cuyahoga County courts are now asking lawyers to confirm that the information in their filings is true.

Courts are considering whether banks have standing to foreclose or whether promissory notes were properly transferred and conveyed.

There are strong possibilities that banks have wrongfully taken homes to which they had no secured claim.

These are all symptoms of a mortgage servicing industry that is broken.

Servicers claim that homeowners didn't meet their legal obligations, so they don't deserve to stay in their homes—that homeowners lack "personal responsibility."

But what about institutional responsibility? Should we not hold the banks to the same standards they impose on homeowners?

A Federal judge in Cleveland pointed out 3 years ago, **"Neither the fluidity of the secondary mortgage market, nor monetary or economic considerations of the parties, nor the convenience of the [banks,]"** overrides the banks' duty to follow the law.

Money and profits should not trump the law.

And while the courts are playing a role in checking abuse, it is Congress's responsibility to empower regulators to oversee the mortgage servicing industry.

As the newly confirmed Fed Governor Sarah Bloom Raskin said last week, ***"Until a better business model is developed that eliminates the business incentives that can potentially harm consumers, there will be a need for close regulatory scrutiny of these issues and for appropriate enforcement action that addresses them."***

The new **Bureau of Consumer Financial Protection (CFPB)** is a perfect illustration of how to empower regulatory scrutiny and appropriate enforcement.

Instead of helping homeowners, regulators' responses appear crafted to protect the balance sheets of the "too big to fail" servicers.

The CFPB is designed to ensure someone serves American families and confronts abusive mortgage servicing practices.

And stronger oversight means streamlined modification procedures and meaningful penalties when servicers fail to comply.

We should be trying to find ways to keep people in their homes, not forcing more houses onto an already depressed housing market.

This foreclosure crisis affects all of us—homeowners, families, neighbors, and State and local governments.

It is clear that the current system isn't working.

And it's clear that we won't have economic recovery if our neighborhoods are full of foreclosed or vacant homes.

Thank you, Mr. Chairman.

PREPARED STATEMENT OF THOMAS J. MILLER

ATTORNEY GENERAL, STATE OF IOWA

NOVEMBER 16, 2010

Chairman Dodd, Ranking Member Shelby and the other Members of the Committee, thank you for the opportunity to address you today on this important subject.

I. Background and History of the States' Efforts

While the issues of foreclosures, mortgage loan servicing, and loss mitigation efforts are currently receiving substantial attention in the press, they are not new to the Attorneys General. Starting over a decade ago, the Attorneys General and our partners in the State banking departments began numerous enforcement efforts regarding fraudulent behavior by lenders in the origination of subprime mortgages. Beginning with First Alliance Mortgage Company (better known as FAMCO), then followed by the $484 million settlement with Household Finance, and finally the $325 million settlement with Ameriquest Mortgage Company, at that time the largest subprime lender, the States have had a front row seat to the fraud and misconduct in subprime originations.

This fraud, however, was concealed for years by the unprecedented home price appreciation that many areas of the country were experiencing. Due to the race to the bottom in underwriting standards, as soon as borrowers got into trouble they would simply refinance, masking their inability to perform. Accordingly, we knew that as soon as the rapid and unprecedented home price appreciation began to stall, the fraudulent and fragile underpinnings of the market would be exposed and more loans than we could imagine would begin to fail.

Knowing this, my staff began to explore servicing and foreclosure issues in the Spring of 2007. The more we learned, the more concerned we grew as it became apparent that servicers were not in any way prepared to deal with even a moderate volume of foreclosures. Accordingly, in July 2007 my office put out an invitation to every Attorney General in the country to attend a summit on foreclosures. The purpose was to warn our colleagues that a tidal wave was coming and they needed to begin to prepare.

Out of this meeting, a working group of Attorneys General and State bank regulators was formed. This group was later named the State Foreclosure Prevention Working Group ("State Working Group"). At the beginning, a policy decision was made that this would not be a litigation based group, but rather the group would attempt to work collaboratively with the mortgage servicing industry in order to find solutions to the myriad problems standing in the way of effective loss mitigation. Because the problem was mostly contained to subprime loans at that point in time, we set up a meeting with the top 10 largest subprime servicers in September 2007 and another meeting with the next 10 largest in November 2007. At these meetings, we were assured by many of the servicers that they were adequately staffed and prepared for what was coming. Obviously, this did not turn out to be the case.

In addition, it became clear to the States that we wanted to base our decisions on empirical data, not anecdotal stories. Thus, in October 2007, the State Working Group became the first governmental entity—state or Federal—to collect data on the servicers' loss mitigation efforts and results. We used this data to publish five reports which provide analysis and commentary on a variety of issues. Reports were published in February 2008, April 2008, September 2008, January 2010, and August 2010. Unfortunately, our data collection was not as robust as it could have been due to the extremely short-sighted direction of the Office of the Comptroller of the Currency which forbad national banks from providing loss mitigation data to the States.

II. The Impact of Securitization on Servicing

Many people still talk about "banks" generically when discussing foreclosure issues. Of course, the old model of a local bank making a loan and then keeping that loan on its books has largely disappeared. Instead, mass securitization of mortgage loans has become the norm. This has produced a radical change in the structure of loan servicing and a misalignment of incentives. Many pages can and have been written on this subject, and I will not attempt to repeat that discussion hear. Described in its simplest form, in most cases ownership of the mortgage loan is no longer aligned with the servicing of that loan. This change has introduced enormous complexity and has made the task of modifying loans and avoiding preventable foreclosures much more difficult.

III. Common Loan Servicing Problems

In order to understand what has been happening with mortgage loan servicing over the last 3 years, it is essential to understand one basic truth: the current mortgage servicing system was not designed for any of the tasks it is being asked to perform, and it certainly is not equipped to perform such tasks at anywhere near the scope and scale of the foreclosure crisis. Modern loan servicing was designed to be a no-touch or low-touch money collection system. Instead, servicers have been asked to re-underwrite, or in many cases underwrite for the first time, a massive number of loans. Asking servicers to solve the foreclosure crisis is akin to putting a square peg in a round hole. The servicers, no matter how good their intentions, were simply not designed for this problem. Put on top of that the unprecedented scope and scale of the foreclosure crisis, and the servicers have become completely overwhelmed.

From this premise flow all of the problems which our office and other Attorneys General hear about on a regular basis. For example, we are constantly hearing about borrowers who are asked to resubmit their paperwork because it was lost multiple times. Because servicers are overwhelmed, loss mitigation requests are often delayed and stretched out over long periods of time. As a result, the financial documents originally submitted by the borrower become stale, triggering multiple requests for resubmission. While the servicer is free to lose documents as many times as they want or to take as long as they want, the servicer often demands strict compliance from the borrower. Thus, no matter how many times the borrower has previously submitted his or her paperwork, if the borrower fails one time, the loan modification is denied. Similarly, many borrowers report that after not hearing from their servicer for several months, they will receive a proposed loan modification but will be given a very short timeframe (several days) to sign and return the document (along with any required financial contribution). Again, strict compliance is enforced.

Perhaps the biggest problem is that loss mitigation and foreclosure exist simultaneously on parallel tracks. This leads to problems when the left hand does not know what the right hand is doing. Thus, we all hear stories of borrowers who thought they were approved for a loan modification receiving a notice of a foreclosure sale. In short, the fundamental fact that servicing systems are being asked to perform a task for which they were not designed has predictably led to a wide range of problems in implementing loss mitigation solutions.

IV. The Mortgage Foreclosure Multistate Group

In a classic example of why it is wise to continue to support our constitutional framework of federalism, the States were able to react very quickly to the recent robo-signing reports. In very short order, all 50 Attorneys General and a committee of State banking regulators representing all 50 States formed a multistate group to address this problem. We were able to do this for several reasons. First, State officials are much closer to the problems in loan origination and servicing than our Federal counterparts. Quite simply, citizens know who their State Attorney General or banking department is and are much more likely to contact us than a 1–800 number in some far away location, particularly when it comes to real estate and foreclosures, both of which are inherently local issues. Second, the long standing relationships formed over the past decade in our mortgage origination enforcement actions and more recently, the work of the State Foreclosure Prevention Working Group, allowed us to mobilize quickly. As in our previous efforts, we are continuing our valuable partnership with our State bank regulator counterparts.

Because we are in the midst of our investigation, I am necessarily constrained as to how much I can comment on the specifics. However, I can make some general comments.

First, some have attempted to describe the issue of "robo-signing" as being a mere technicality. This argument shows a certain type of arrogance. The home is not only the centerpiece of family life, but it is by far the biggest purchase that many people will make in their life, and for many their biggest asset. The State foreclosure laws are the official method by which the family home can be taken away. Given such high stakes, strict compliance is expected. Others have suggested that the only relevant facts are that the borrower owes the money and has to pay it back. Such statements miss the point entirely. We do not say in a criminal prosecution that it is ok for the prosecutor to fabricate evidence, so long as the defendant is in fact guilty. The outrage over robo-signing is about due process, protection of private property rights, and the rule of law. In judicial foreclosure States, robo-signing is a fraud on the court. Such issues are of the highest importance.

That being said, I would like to make it clear that the multistate investigation is about more than robo-signing. After all, robo-signing is only a symptom of the much larger problems with the mortgage servicing system. Thus, the multistate group intends to look at issues regarding the accuracy of the information used by servicers in the foreclosure process, as well as issues such as the imposition of various servicing related fees and force placed insurance. The multistate group is also interested in some of the issues that are being raised regarding the ability or inability of servicers and investors to show proper chain of title.

However, the biggest issue is fixing the loan modification system. In many ways, there is not currently a coherent loss mitigation system. Instead, there exists a system of "Russian roulette" where whether or not a borrower receives a modification that will save the family home depends in large part on who picks up the phone on the other end. In essence, those who are lucky enough or persistent enough to get to the right person are the ones who receive quality modifications, regardless of the facts of their case. This has to change.

To be clear, the States do not believe that every foreclosure is a tragedy that must be avoided. To the contrary, we have consistently stated over the last 3 years that we are only interested in modifications where the cash-flow from the modification exceeds the expected proceeds from a foreclosure sale. In industry parlance, this is a net present value positive modification. Such a modification is a win for the servicer, the investors who own the loan, the borrower, and the community at large. We strongly believe, however, that many borrowers, who under a strict *economic analysis* should receive a modification, are falling through the cracks. We must find a way to make sure that all borrowers who have the desire to keep the home and qualify for a modification, receive that modification.

V. Conclusion

In recent weeks, many have opined that the temporary halt on foreclosures and foreclosure sales by several servicers was greatly damaging the economy. With all due respect, it is the foreclosures in the first instance that pose the greatest threat to the economy. While certainly it does not make sense to allow vacant properties to linger, and such properties should be sold if possible, the looming shadow inventory of homes that will become real estate owned and the millions of foreclosures yet to come is the true threat that must be avoided. Foreclosures at the scale we are currently experiencing, and unfortunately will continue to experience for some time, are a public policy issue. It is well past time to once and for all tackle the issue of foreclosures and loan modifications with the resources and urgency it deserves.

As set forth above, the Attorneys General and the State banking regulators have been discussing various issues and quite frankly warning the servicing industry for over 3 years. Unfortunately, the mortgage servicing industry has been slow to recognize the problems and instead responded with a series of half-steps, based on the hope that a recovery in the market was just around the corner. Instead, the situation has become worse and worse, forcing servicers and secondary market investors to take steps that a relatively short time earlier were off the table. We believe that there have been many missed opportunities over the past few years and are deeply disappointed that our many previous attempts at working with the servicers have not been as successful as we had hoped. However, the States are determined that this time, we will find lasting solutions to the foreclosure crisis.

PREPARED STATEMENT OF BARBARA J. DESOER

PRESIDENT, BANK OF AMERICA HOME LOANS

NOVEMBER 16, 2010

Introduction

Chairman Dodd, Ranking Member Shelby, and Members of the Committee, thank you for the opportunity to discuss Bank of America's loan modification performance and foreclosure process.

The prolonged economic downturn and sustained high unemployment, coupled with the collapse of the U.S. housing market, have led to challenges that are more profound and complex than anyone anticipated. For a borrower, the prospect of falling behind on mortgage payments due to loss of income would be a wrenching personal situation in normal times. But these are not normal times, and the traditional solutions of the refinance of debt or the sale of a home at sufficient value to repay the debt, do not exist for many, which causes great anxiety and frustration for borrowers under economic stress. We know you are hearing from your constituents, because in many cases your constituents are also our customers.

These customers depend on us—Treasury, GSE's, lenders, and servicers to have a solution for their unprecedented needs. The good news: we have worked together at extraordinary speed to create solutions—like HAMP—and to retool mortgage servicing; adding new people, new processes, and new technology capabilities to meet the ever increasing needs. Unfortunately, those solutions have not met all of the needs nor have they been executed well in some cases.

It's important to note that despite the hardships most Americans are facing, more than 86 percent of Bank of America customers remain current and are making their mortgage payment each month. Others are unfortunately in distress. Helping these customers remain in their homes where possible is a top priority for Bank of America—as evidenced by our 700,000 completed loan modifications since 2008.

Whether one of our customers has just missed his or her first mortgage payment or is many months delinquent and at the point of foreclosure—Bank of America believes the customer's experience with us, from start to finish, must be consistent, accurate, and understandable. Our customers are entitled to an experience that gives them confidence they are being treated fairly.

We have, however, reached a crossroads between loan modification efforts and the reality of foreclosure. Fortunately, early stage delinquencies are stabilizing. The majority of initial volume and backlog of customers seeking solutions have been evaluated for available programs. We're reaching a peak where some customers will be dealing with the reality that despite the myriad of programs and our best efforts, foreclosure is unavoidable. That has driven an increase in the concerns you and we hear from distressed homeowners, and our increases in staffing and foreclosure alternative programs are directed at moving through this difficult period. We believe that these efforts are working, as every day we reduce the backlog in both modification decisions and customer complaints.

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

We also fully understand our obligation to evaluate customers for every way to make their payment more affordable, and we are continually improving our processes for working with customers.

When industry concerns arose with the foreclosure affidavit process, we took the step to stop foreclosure sales nationwide and launch a voluntary review of our foreclosure procedures. Thus far, we have confirmed the basis for our foreclosure decisions has been accurate. At the same time, however, we have not found a perfect process. There are areas where we clearly must improve, and we are committed to making needed changes.

We've also used this opportunity to further evaluate our modification program and identify additional enhancements we can make. We have done this based on feedback from you, our customers, community groups, investors, and from our regulators. We also are committed to a constructive dialogue with State Attorneys General, who have taken a leadership role on these issues.

Role of the Servicer

Before I describe the changes we have made in the foreclosure and modification processes, I would like to provide some context regarding the role of mortgage servicers, the complexity of our portfolio and loan modification performance. This context relates directly to the changes we are making.

Traditionally, a mortgage servicer's primary function is to collect loan payments from customers and to distribute payments to the investors who own the loan. Until recent years, foreclosures were ancillary and loan modifications were essentially non-existent. Economic conditions—including the loss of income, inability of many consumers to pay their mortgages or, when in distress, to sell their property—have dramatically increased the volume of modifications and foreclosures, severely straining industry systems and resources designed around much lower volumes of activity.

Moreover, Bank of America is constrained by our duties to investors; of the nearly 14 million loans in our servicing portfolio:

- 23 percent of the portfolio is owned by Bank of America;
- 77 percent of the portfolio we service for the investors who own the loans—Fannie Mae and Freddie Mac are the investors on 60 percent of these loans, for example.

Many investors limit Bank of America's discretion to take certain actions. When working with delinquent customers, we aim to achieve an outcome that meets customer and investor interests, consistent with whatever contractual obligations we have to the investor.

Duties to investors add complexities to the execution of modification programs and can result in confusion for customers. For example, Treasury, investors, and other constituencies often change the requirements of their modification programs. HAMP alone has had nearly 100 major program changes in the past 20 months. Fannie and Freddie, as investors, have layered on additional requirements, conditions and restrictions for HAMP processing. When these changes occur, we and other servicers have to change our process, train our staff, and update technology. These changes can also affect what is required of the customer, for example the need for new or different documentation.

Basic Facts of the Bank of America Portfolio

With the Countrywide acquisition, Bank of America became the nation's largest mortgage servicer—with a servicing portfolio that more than tripled post-acquisition to nearly 14 million customer loans—1 in 5 of all U.S. mortgages.

The majority—86 percent—of our customers are current and making their mortgage payments on time every month. Fortunately, that number is stabilizing. But the segments of the portfolio that are distressed include large numbers of customers who are seriously delinquent. Nearly 600,000 customers have not made a mortgage payment in more than a year; of these 195,000 have not made a mortgage payment in 2 years.

Servicer Implementation of Loan Modification Solutions

To address these drastic economic and industry changes, Bank of America has had to undertake a massive retooling since our acquisition of Countrywide in 2008 to shift our servicing organization from one that simply services loans, to one that also manages customer requests for aid as the housing downturn and high unemployment persist. We also have built new processes, tools and partnerships with community organizations to reach customers who do not respond to loan modification offers.

We've hired and trained more than 10,000 new employees—and now have a team of more than 26,000 helping customers who are delinquent. To reach customers we've opened bricks and mortar customer assistance centers; gone door to door with modification solicitations, and participated in more than 500 housing rescue fairs across the country.

We have completed more than 614,000 proprietary modifications and 85,000 HAMP modifications. Given the majority of our delinquent borrowers are not eligible for HAMP today, proprietary solutions have been critical to provide meaningful options for those who fall outside the requirements of HAMP. We have completed over 95,000 second lien modifications and were the first servicer to implement the Treasury's second lien program—2MP.

We have provided innovative solutions to meet evolving customer needs, including the launch of an industry-leading principal reduction program earlier this year. Bank of America is also a leader in the Hardest Hit Fund program development and is working with Treasury, the State Housing Finance Authorities, and others as we attempt to find solutions and design programs including principal reduction in the most severely impacted States.

If all home retention options are exhausted, and there is not a viable alternative to create an affordable payment, we offer short sale and deed-in-lieu solutions that allow customers to avoid foreclosure and ease the transition to alternative housing. Earlier this year, we launched a proprietary cooperative short sale program that proactively solicits customers in late stage delinquency to provide assistance. We are also fully operational with Treasury's Home Affordable Foreclosure Alternatives (HAFA) program, which streamlines the short sale process for borrowers who have been considered for HAMP and offers customers relocation assistance of $3,000. We've completed nearly 70,000 short sales through the first three quarters of this year.

We also provide deed in lieu programs that do provide an increased cash allotment for expenses such as moving and rental security deposits in exchange for the deed to the property in which the customer currently resides.

Our intent is to exhaust all modification, short sale and other disposition options before foreclosure. Despite those efforts, far too many customers have been impacted by an economy that has left them unemployed or severely underemployed to a point that leaves even a modified mortgage payment out of reach.

With that background in mind, I would like to inform you of some key decisions and commitments we have made to address concerns we have heard from our customers, your constituents and other stakeholders:

Single Point of Contact

A frequent source of frustration for customers is when they feel they are being passed around the system, seemingly never talking to the same person twice. We are addressing this by redesigning our modification process to offer a single point of contact for every eligible borrower. We are in the midst of implementation and more than 140,000 customers have already been assigned a single case manager to whom they can always turn with questions or concerns that arise throughout the process. We are also in discussions with key stakeholders, like the State Attorneys General, about how this approach can be expanded, and refined, to improve the customer experience and reduce borrower anxiety during the time they are being considered for modifications. We know this goes to the heart of many customer complaints that you have heard.

Reform of Dual Track System

Parallel foreclosure and modification processes are required by many investors, and reflect an industry-wide servicing practice. This so-called "dual track" process has been a source of confusion for customers. We want to be a partner with you, State Attorneys General, other servicers, and investors in looking for ways to change industry practice with respect to evaluation of borrowers for modifications after they have been referred to foreclosure to mitigate the very real concerns we have heard about that practice.

Customer Status Checklist

Customers are understandably frustrated when they are unsure where they are in the process of modification or foreclosure. To address this and provide greater clarity, we are working to create a Customer Status Checklist, so that customers will have a document in hand to understand their status, the steps they have completed, reasons decisions have been made and what additional steps remain.

Housing Rescue Fairs and Outreach

By establishing a presence in the community, we've had greater success reaching customers who have not been responsive to more traditional contact methods. We've deployed Customer Assistance Centers in areas most impacted by the housing downturn. We've also launched mobile home retention teams who travel around the country meeting with customers.

We've had considerable success in working with non-profit partners such as Neighborhood Assistance Corporation of America (NACA), National Urban League, National Council of La Raza and the National Association of Asian Pacific Americans for Community Development. We established the Alliance for Stabilizing our Communities—the first national multicultural outreach and home retention effort to address foreclosure prevention in diverse communities. Through the Alliance, 34 home rescue fairs have been completed serving more than 9,800 families. We find that the opportunity for customers to work with a trusted non-profit and get the chance to meet with their servicer face-to-face can enhance the response rates of borrowers and the chance for a successful modification, and we are committed to increasing the resources committed to face to face contact in 2011—including doubling our outreach staff.

Enhanced Transition Services:

When we cannot change the foreclosure outcome, we can ensure the process is respectful. We have been in extensive conversations with the Neighborhood Preservation Foundation, the United Way, other non-profit agencies, and with HUD to determine how we can most effectively engage them to help customers in the transition of households to alternative, more affordable housing. We are working with these and other community partners to expand support services—relocation assistance, credit counseling, and other aid to help customers and rejuvenate neighborhoods.

Other Reforms

Additional reforms and process enhancements may be identified through our constructive and continuing conversations with State Attorney General Miller and the Executive Committee of the National Association of Attorneys General.

Foreclosure Process

Our commitment at Bank of America and its subsidiaries is to ensure that no property is taken to foreclosure sale until our customer is given a fair opportunity to be evaluated for a modification to an affordable payment or, if that cannot be done, a short sale or deed in lieu solution. Foreclosure is the option of last resort.

We voluntarily launched a foreclosure hold in October 2008 and have participated in several others—as new programs were developed and launched, in order to ensure no customer goes to foreclosure who has a reasonable option to stay in their home.

We re-evaluate borrowers for home retention options throughout the foreclosure process and check to determine whether a borrower is being evaluated for a modification all the way up until the day before the foreclosure sale. Subject to investor guidelines and the rules of the applicable court, we defer the sale dates of borrowers who are being evaluated for modifications.

When a customer is referred to foreclosure sale, the process and requirements vary significantly among States. Courts have jurisdiction over foreclosures in 23 States (called judicial States). In both judicial and non-judicial cases, it is our policy to refer a loan to foreclosure only after we have completed a review for modification eligibility, assessment of foreclosure alternatives and compliance with applicable State law requirements. Also included are several checks to ensure the data supporting the foreclosure is both accurate and accurately recorded.

On average, it takes nearly a year from the time a customer receives a foreclosure notice until the actual foreclosure sale is completed; and for customers in judicial States like Florida that timeline can be closer to 2 years. This is not a process that is rushed and there are multiple checkpoints and controls along the way to prevent wrongful foreclosure—controls that have now been further strengthened.

Foreclosure Review and Improvements

After concerns emerged at other lenders regarding the foreclosure affidavit in judicial foreclosure States, Bank of America and its servicing subsidiary initiated a review of our foreclosure procedures. On October 1, we voluntarily suspended foreclosure judgments in the 23 judicial foreclosure States while we completed this review.

One week later, we paused foreclosure sales nationwide as we launched a voluntary review of our foreclosure process in all 50 States. We believe this step was appropriate and responsible in order to give our customers confidence they are being treated fairly in the process. I would like to share some conclusions we've reached following our review, as well as some of our plans to improve our process going forward. Let me first offer a quick overview of the typical foreclosure process in a judicial foreclosure State. If the internal foreclosure review process concludes all other options are exhausted and that foreclosure is necessary, the loan is referred to our foreclosure operation and to outside foreclosure counsel, who prepare affidavits of indebtedness where required and ultimately handle the local foreclosure process.

The decision to refer a loan to foreclosure is made by Bank of America after a foreclosure review process that is based on an evaluation of our servicing records. This evaluation precedes and is independent from the process used to create and execute affidavits of indebtedness. The foreclosure affidavit is a summary of the basic facts in the foreclosure case (for example, the borrower's name, address and delinquent amount). For all GSE loans, we select the outside counsel from pre-approved lists created by each of Fannie Mae and Freddie Mac.

Once Bank of America receives the affidavit from outside counsel, we conduct a multi-step quality assessment process to verify the key facts underlying the affidavit. After this quality check, the verified affidavits are sent to a bank officer for a notarized signature and then returned to foreclosure counsel for filing.

Even though our review has indicated the basis for our foreclosure decisions has been accurate, we have identified areas for improvement as a result of our intensive review. We are taking the need for improvement very seriously and are implementing changes accordingly. These changes in the foreclosure process include, among other things, a new affidavit form and additional quality control checks.

Every affidavit will be individually reviewed by the signer, properly executed, and promptly notarized. We are carefully restarting the affidavit process with these controls in place. We are working to replace previously filed affidavits in as many as 102,000 pending foreclosure cases that have not yet gone to judgment. Further, with regard to both judicial and non-judicial States, we are implementing new procedures for selecting and monitoring outside counsel.

Conclusion

If a Bank of America customer is eligible for a modification, we'll help him or her stay in their home. That is in our interest as a mortgage servicer and as an owner of loans. And, when foreclosure is the necessary outcome, we will pursue it through a respectful process. As the loan servicer, the decision is not always in our hands, but ensuring a process that is fair, accurate and consistent is our accountability. We have worked for 2 years since our acquisition of Countrywide to aggressively respond to more than a million customers in distress. We don't claim perfection, but we believe we have led with innovative ideas and continue to put forward solutions that respond to customer needs. That's a responsibility that comes with being America's leading consumer bank—and a responsibility every associate at Bank of America is working diligently to uphold.

Thank you and I look forward to your questions.

PREPARED STATEMENT OF R.K. ARNOLD

PRESIDENT AND CHIEF EXECUTIVE OFFICER OF MERSCORP, INC.

NOVEMBER 16, 2010

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

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

BACKGROUND

MERS is owned by the mortgage industry[1] and operated as a membership organization. Almost all mortgage lenders (about 3,000) are members of MERS, though not all members register all the loans they originate on the MERS® System.[2] MERS derives its revenue solely from its members.[3] MERS charges no fees and makes no money from mortgages, from the securitization or transfer of mortgages, or from foreclosures done in its name.

MERS serves two important functions. First, it maintains a database or registry of mortgage loans, keeping track of changes in servicing rights and beneficial ownership interests over the life of the loan. Second, it can be designated by its members

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

[2] Members tend to register only loans they plan to sell. Wells Fargo and JPMorgan Chase are the principal members in this regard. They service most of the loans they originate themselves, so registering their retail business on the MERS® System is of less practical value to them. However, when these institutions purchase loans from others, known as their correspondent business, they do require that those loans be registered on the MERS® System.

[3] MERS makes its money through an annual membership fee (ranging from $264 to $7,500) based on organizational size, and through loan registration and servicing transfer fees. MERS charges a one-time $6.95 fee to register a loan and have Mortgage Electronic Registration Systems, Inc. serve as the common agent (mortgagee) in the land records. For loans where Mortgage Electronic Registration Systems, Inc. will not act as the mortgagee, there is only a small one-time registration fee ($0.97). This is known as an iRegistration. Transactional fees (ranging from $1.00 to $7.95) are charged to update the database when servicing rights on the loan are sold from one member to another.

to serve as the mortgagee, or the holder of the mortgage lien, in the public land records. This designation is what enables MERS to maintain its accurate database.

MERS AND YOUR MORTGAGE

The mortgage loan process can be confusing and complex to consumers. There is a lot of paperwork generated and many documents to be signed. However, two pieces of paper stand out from the rest as the most important pieces needed so that the consumer can get a mortgage loan. They are: (1) the promissory note, which is a promise by the borrower to repay the loan amount to the lender or noteholder; and (2) the mortgage (also referred to as the "deed of trust" in some States), which establishes a lien against the property as collateral for the loan and allows the lender (or noteholder) to foreclose on the property if the borrower does not repay the loan according to the terms of the promissory note. The person who borrows the money is called the "mortgagor" and the holder of the mortgage is called the "mortgagee." Once the borrower signs both pieces of paper, the borrower receives the money to buy the house. To obtain a mortgage loan, the borrower must agree that the mortgagee has the right to foreclose in the event of a default.

Another important party in the life of a mortgage loan is the loan servicer. The servicer is a company named (by the note-owner) to be the interface between the note-owner and the borrower to collect payments and remit them to the note-owner. It may become the noteholder for purposes of enforcing the terms of the note on behalf of the note-owner.[4]

MERS acts as the designated "common agent" for the MERS member institutions in the land records, which means that MERS holds the mortgage lien on behalf of its members and acts on their behalf as mortgagee. To accomplish this, at the time of the closing, the borrower and lender appoint MERS to be the mortgagee. The designation of MERS is prominently displayed on the mortgage document and is affirmatively approved by the borrower at closing.[5] After the borrower executes the mortgage document, it is recorded in the public land records with Mortgage Electronic Registration Systems, Inc. noted in the index prepared by the recorder (or clerk) as the mortgagee. Mortgage loan information is then registered on the MERS database.

These two key pieces of paper in a mortgage transaction follow very different paths after they are signed. The mortgage (or deed of trust) is recorded in the county land records where an imaged copy is stored.[6] The original mortgage document, with recording data added by the county recorder, is returned to the servicer and goes into the servicer's master loan file. The note is sent to a custodian (usually a regulated depository institution) and is typically bought and sold (and thus trades hands) in the normal course of financial activity.[7] The servicer undertakes the obligations to service the loan, but servicing rights also may move from one servicing business to another because servicing rights are contract rights, which are bought and sold independent of any sale of the promissory note. MERS does not receive or maintain either the mortgage or the promissory note.

Every time a note or servicer changes hands, a notation of that change is made (electronically) on the MERS® System by the members involved in the sale. In this way, changes in servicing rights and beneficial ownership interest in the promissory note are tracked over the life of the loan.[8]

A fundamental legal principle is that the mortgage follows the note, which means that as the note changes hands, the mortgage remains connected to it legally even though it is not physically attached. In other words, the promissory note is enforceable against the property because of the mortgage, but the mortgage instrument itself is not independently enforceable as a debt. This principle is not changed when MERS is the mortgagee because of the agency relationship between MERS and the lender. An agency relationship arises where one party is specifically authorized to act on behalf of another in dealings with third persons, and the legal definition of

[4] The originating lender may be the servicer in some cases.

[5] A copy of a sample mortgage document can be found in Attachment One. A short summary of MERS prepared by the Mortgage Bankers Association can be found in Attachment Two.

[6] This action tells the world that there is a lien against the property. This is done to protect the lender's interest. The recording of the mortgage puts future purchasers on notice of any outstanding claims against the property.

[7] The promissory note is not (and never has been) recorded or stored with the county land records office. The note is a negotiable instrument that can be bought and sold by endorsement and delivery from the seller to the note purchaser. This activity is governed in all fifty States by the Uniform Commercial Code (UCC) Article 3.

[8] The MERS® System is the database; MERSCORP, Inc is the operating company that owns the database; and Mortgage Electronic Registration Systems, Inc ("MERS") a subsidiary of MERSCORP, Inc., which serves as mortgagee in the land records for loans registered on the MERS® System. For discussion purposes, "MERS" may be used in this testimony to refer to all three entities unless specifically stated otherwise.

a "nominee" is a "party who holds bare legal title for the benefit of others." Here, the language of the mortgage appoints MERS as nominee, or agent, for the lender and its successors and assigns for the purposes set forth therein. The mortgage also grants MERS broad rights, again as nominee for the lender and the lender's successors and assigns, "to exercise any or all" of the interests granted by the borrower under the mortgage, "including but not limited to, the right to foreclose and sell the property; and to take any action required of the lender." Thus, the language of the recorded mortgage authorizes MERS to act on behalf of the lender in serving as the legal titleholder under the mortgage and exercising any of the rights granted to the lender there under.

MERS members affirm this agency relationship with MERS in their membership agreements, which provide that MERS "shall serve as mortgagee of record" with respect to each mortgage loan that the MERS member registers on the MERS® System and provide that "MERS shall at all times comply with the instructions of the holder of mortgage loan promissory notes."

THE MECHANICS OF MERS

MERS tracks mortgage loans through an 18-digit identification number called the Mortgage Identification Number (MIN). With one notable exception, the MIN is to a specific home loan what the VIN (Vehicle Identification Number) is to an individual automobile. Like the VIN, the MIN can be assigned at the earliest stage of the product's creation and stays with it for its entire life. However, unlike cars which all get a VIN, not all loans get MINs and are registered on the MERS® System. This is because some loan originators do not use MERS when they do not intend to sell the servicing rights. About half of all loans active in the United States are registered on the MERS® System.

As the mortgagee of record, MERS receives all notices including legal pleadings on actions pertaining to the property such as foreclosure notices and complaints, tax sales and eminent domain actions, among the many other types of mail. MERS forwards those documents electronically to the relevant servicer who will then take the appropriate action to respond on behalf of the note-owner and MERS.

MERS plays an important role for borrowers as the permanent link between borrowers and their servicers. If servicers change or if they declare bankruptcy, the borrower always has a knowledgeable point of contact in MERS. A toll free number, the unique Mortgage Identification Number (MIN) and mailing address are prominently included on the first page of the mortgage document. MERS also maintains a Web site, which serves as another resource for borrowers. MERS is also a means by which the borrower can easily identify the note-owner.[9]

MERS is not part of the decisionmaking process as to which mortgage loans the lenders make to borrowers, nor is MERS part of how mortgage loans get securitized. It is the note-owner who decides whether a note should be sold, or transferred to a trust, or ultimately securitized with a pool of other loans.[10] Loans were securitized long before MERS became operational, and in fact, there are loans in securities today that do not name Mortgage Electronic Registration Systems, Inc. as the mortgagee. What MERS does is eliminate the expense of repeated assignments, resulting in lower cost for lenders when they sell the loans (represented by the promissory note) to investors. When the note is sold, MERS continues to act as the mortgagee for the new noteholder because the mortgage interest follows the note when it changes hands.

OTHER FACTS ABOUT MERS

The number of loans registered on the MERS® System is substantial. Since its establishment in 1997, about 66 million loans have been registered and tracked on the MERS® System. About half of those loans (about 31 million) are active mortgage loans.

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[9] The design of the MERS® System always anticipated and required that borrowers would be able to access the system to determine the servicer of their loans. Providing such information to MERS is a requirement of membership and loan registration. When Congress acted last year to require that borrowers be told when their note is sold and the identity of the new note-owner, MERS established, within a matter of weeks, a new service called Investor ID. Of the 3,000 members of MERS, 97 percent agreed to disclose the identity of the note-owner through the MERS® System. Fannie Mae opted to be disclosed. Freddie Mac chose not to be disclosed.

[10] The issue of whether transfers of residential mortgage loans made in connection with securitizations are sufficient to transfer title and foreclosure rights is the subject of a "View Point" article entitled "Title Transfer Law 101" by Karen Gelernt that appeared in the October 19, 2010 edition of the *American Banker.* A copy can be found in Attachment Three.

Measured by direct employment, MERS is a relatively small organization. About 50 people work for MERSCORP, Inc. in our Reston, VA, office. Hewlett-Packard is the MERS technology partner and runs the database with an additional 150 people.

In significant ways, MERS is analogous to the Depository Trust and Clearing Corporation (DTCC) that electronically records the assignment of stock and bond certificates, thus eliminating the need to create a new certificate each time a security is bought or sold. The benefit of MERS is similar to that of the DTCC: It reduces the errors associated with paper processes and increases system efficiency.[11] Also like the DTCC, MERS is adjacent to the systems that create the data it tracks; it is integrated with, but independent of, its member organizations. The two primary differences between the organizations are that the DTCC holds title to the financial instrument and that it clears trades between its participants (including the exchange of funds between the counter-parties).

MERS CERTIFYING OFFICERS

Mortgage Electronic Registration Systems, Inc. takes the majority of its actions as the mortgagee through the use of officers commonly referred to as "certifying officers." From inception, the concept of certifying officers has always been fundamental to the operations of MERS. In the white paper calling for the creation of MERS (referenced in footnote 11), it was recognized that members would need to have a form of authority to act on behalf of MERS when MERS is the mortgagee on their behalf. That authority took the form of electing persons (designated by the member) as officers with limited authority to take certain actions. The offices to which each of these individuals are officially appointed are vice president and assistant secretary. The authority granted to these officers is limited to: (1) executing lien releases, (2) executing mortgage assignments, (3) initiating foreclosures, (4) executing proofs of claims and other bankruptcy related documents (*e.g.,* motions for relief of the automatic stay), (5) executing modification and subordination agreements needed for refinancing activities, (6) endorsing over mortgage payment checks made payable to MERS (in error) by borrowers, and (7) taking such other actions and executing documents necessary to fulfill the member's servicing duties.

It is important to note that the certifying officers are the same officers whom the lenders and servicers use to carry out these functions even when MERS is not the mortgagee. MERS has specific controls over who can be identified by its members as a certifying officer. To be a MERS certifying officer, one must be a company officer of the member institution, have basic knowledge of MERS, and pass a certifying examination administered by MERS.

Under the corporate law in Delaware (where MERS is incorporated), there is no requirement that an officer of a corporation also be an employee of that corporation. A corporation is allowed to appoint individuals to be officers without having to employ those individuals or even pay them. This concept is not limited to MERS. Corporations cannot operate without officers; they can and often do operate without employees. It is not uncommon for large organizations to have all its employees employed by an operating company and for those employees to be elected as officers of affiliated companies that are created for other purposes (all corporations are required by law to have officers to act for it). Even for loans where MERS is not the mortgagee, employees of the servicer are generally delegated the power to take actions (*e.g.,* initiate foreclosures) and execute documents (*e.g.,* lien releases and assignments) on behalf of the owner of the loan (and the servicer, in turn, may further delegate such authority to a third-party vendor).

MERS AND FORECLOSURE

When Mortgage Electronic Registration Systems, Inc. is the mortgagee of record, and the borrower is in default on the mortgage, and the note-owner decides to foreclose, foreclosure can be undertaken in one of two ways: Either in the name of MERS, or in the name of the noteholder (which is usually the servicer).

If the noteholder chooses to foreclose in its own name, under the MERS rules, it must be named as mortgagee in the land records. MERS, through the MERS member's designated certifying officer, will execute an assignment to the foreclosing company and the assignment will be recorded in the land records. At this point, MERS no longer holds any legal interest in the mortgage, and it plays no further role in the foreclosure process. Most loans are assigned out of MERS in this way and not foreclosed in the name of MERS.

[11] A 1993, 36-page white paper entitled "Whole Loan Book Entry Concept for the Mortgage Finance Industry" addresses the concepts underlying MERS and the problems it was designed to address. It is available upon request.

If the note-owner chooses to have Mortgage Electronic Registration Systems, Inc. foreclose, then the note-owner endorses the note in blank (if it has not already done so), making it bearer paper, and grants possession of the note to a MERS certifying officer. This makes MERS the noteholder. Since MERS is already the mortgagee in the land records, MERS is now able to legally begin the foreclosure process on behalf of the note-owner. The foreclosure is managed entirely by the member institution's MERS certifying officer. This person typically works in the default department within the MERS member institution so they are familiar with the various State foreclosure requirements. The member manages the relationship with the law firm that is handling the foreclosure. The member retains the law firm on behalf of MERS and the member provides the necessary documents and information to the law firm. The member obtains these documents and information from the servicing files and system, which are maintained by the member.

As noted earlier, the MERS certifying officers are the same employee officers who handle foreclosure functions for the MERS member institutions. Whether a foreclosure is initiated in the name of MERS and handled by the certifying officers, or by the lender in its own name, the same people would be doing the work. Likewise, the loan file remains with the servicer as it did before MERS existed. MERS is not a repository for mortgage documents or promissory notes.

It is important to note that Mortgage Electronic Registration Systems, Inc. only initiates foreclosure when it has been instructed to do so by the servicer (acting on behalf of the note-owner) or directly by the note-owner. MERS has strict rules and procedures governing foreclosure, most notably a requirement that the certifying officer be in possession of the mortgage note when foreclosing in the name of MERS. In addition, pursuant to a 2006 MERS membership rule, no foreclosures in the name of MERS are allowed in the State of Florida. In the event a MERS member contracts out foreclosure operations to a vendor or a law firm, a separate contract is entered into by MERS, the MERS member and the contracted firm for the purpose of establishing our understanding of the obligations of the parties and for the purposes of designating certifying officers. The specific, authorized functions of MERS certifying officers are enumerated in a corporate resolution by which MERS makes the appointment.

Because there is a choice whether a foreclosure is done in the name of the servicer, note-owner or MERS, one might wonder if there is an advantage in choosing one way or the other. The advantage to institutions by foreclosing in the name of MERS is that they do not need to record an assignment from MERS to themselves, saving them time and money. The advantage that some lenders see in not foreclosing in the name of MERS is that the MERS rules are strict and require that the note be produced. If the lender does not want to do this, the MERS member cannot commence a foreclosure action in the name of MERS, but must assign the mortgage out of MERS. This is a major reason why most loans are not foreclosed in the name of MERS.

In 2005, when it became apparent to us that foreclosures undertaken in Florida were relying excessively on lost note affidavits, MERS adopted a rule forbidding the use of lost note affidavits when foreclosures were done in the name of MERS in Florida. That rule was extended nationally in 2006 and is still in effect today. MERS believes that borrowers are entitled to know that the company foreclosing has all of the necessary paperwork and rights to do so. Showing up with the original note provides the borrower and the court with proof that the foreclosing company is the proper party to foreclose.

COMMON QUESTIONS ABOUT MERS STRUCTURE AND ROLE IN MORTGAGE MARKETS

When servicing rights or promissory notes are sold for loans where MERS is not the mortgagee, the usual practice is for the seller to execute and record an instrument assigning the mortgage lien to the purchaser (commonly referred to as an "assignment"). Assignments are not required by law to be recorded in the land records. The primary reason assignments are recorded (in cases where MERS is not the mortgagee), stems from the appointment of servicers to administer the loan on behalf of the mortgage loan owner. In which case, the servicer will be assigned the mortgage lien (thus becoming the mortgagee) in order to receive the service of process related to that mortgage loan. When Mortgage Electronic Registration Systems, Inc. is the mortgagee (*i.e.,* holds the legal title to the mortgage lien), there is no need for an assignment between its members because MERS is the common agent for them. It is not the case that the assignments are now being done electronically through the MERS® System instead of being recorded in the land records. The need for an assignment is eliminated because title to the mortgage lien has been grounded in MERS. Moreover, transfers of mortgage notes and servicing rights are not recordable transactions (and have never been reflected in the land records) because they are not a conveyance of an interest in real property that is entitled to be recorded; only the transfer of the lien is a conveyance. A promissory note is sold by endorsing the note, and delivering it to the purchasers. Servicing rights are non-recordable contracts rights. Mortgage Electronic Registration Systems, Inc. remains the mortgagee regardless of the number of these non-recordable transfers that may occur during the life of the loan. Upon such sales, the seller and purchaser update the MERS® System of the transfer with an "electronic handshake." If the purchaser does not confirm the transaction, it is flagged by the MERS® System for follow-up. MERS also audits its members for the accuracy of the information they provide to the MERS® System.

The only reason servicers needed to appear in the county land records before MERS was so they could receive legal notices pertaining to the property. That role is now played by MERS as their common agent. MERS runs a massive mailroom and help desk operation to handle millions of legal notices for its members, which makes it far more efficient and certain that mail will go to the correct place. Today, if a servicer "boxes up" in the middle of the night and disappears, the homeowner can have confidence that legal notices will be delivered to the correct successor company without delay.

The chain of title starts and stops with Mortgage Electronic Registration Systems, Inc. as the mortgagee. MERS, as the agent for the note-owner, can hold legal title for the note-owner in the land records.[12] The basic concept of a recording statute is that a person or company claiming an interest in land protects its interest by recording that interest at the county recorder of deeds office. The recorded document provides constructive notice to the world of the claim. In many States, there is no requirement that a conveyance of real estate must be recorded in the land records. The concept of nominees appearing in the land records on behalf of the true owner has long been recognized. It has never been the case that the true owners of interests in real estate could be determined using the land records.

The use of MERS is in compliance with the statutory intent of the State recording acts. When MERS is the mortgagee, the mortgage is recorded at the county land records, thereby putting the public on notice that there is a lien on the property. As the 1993 white paper describing MERS makes clear, at certain time periods, the flow of assignments were overwhelming the county recorder system, resulting in long backlogs, and in some cases, taking the county recorder over a year to record an assignment. Now that assignments are eliminated because a common agent like MERS is holding the mortgage lien, the land records can operate more efficiently. Multiple assignments can lead to errors and uncertainty in the chain of title because assignments were often missing, incomplete, inaccurate, or misfiled. In situations where the recorded assignment identified the wrong property, the lender had not perfected its lien on the right property but had clouded the title for some unrelated third party.

The MERS® System also complements the county land records by providing additional information that was never intended to be recorded at the county level, namely the information about the mortgage loan servicer, and now, with the addition of MERS® InvestorID, the name of the investor.

Some have raised questions about the reduction of recording fees that has accompanied the elimination of the need to record assignments, and there have been suggestions that these fees are somehow owed or outstanding. Fees are paid for a service performed, and if a document is eliminated because it is no longer legally necessary, no fee is due and owing because there is nothing to record. Another way to look at it is that, because MERS greatly reduces the workload of county recorders, the lower operating expenses of the county recorder's office offsets the loss in fee income. Moreover, it would be the borrower, and not the lender, who ultimately pays the costs of recording assignments, either directly or indirectly.[13]

The use of MERS is based on sound legal principles. Its legal validity has been upheld as it was in the Cervantes, Jackson and In re Tucker cases, to just name a few. While there is much support by courts for the MERS role as a common agent, there have been cases where there have been evidentiary issues, which have resulted in outcomes that do not always let MERS, or its members, foreclose without

[12] The essential elements of the legal principles underlying MERS can be found in "MERS Under Attack: Perspective on Recent Decisions from Kansas and Minnesota," an article by Barkley and Barbara Clark in the February 2010 edition of *Clark's Secured Transactions Monthly.* A copy of this article can be found in Attachment Four.

[13] On loans originated by correspondent lenders or brokers (where MERS is not the mortgagee), the costs of preparing assignments and the associated filing fees are listed on the HUD–1 and paid directly by the borrower.

going back and proving up the right to take action. States have laws that govern foreclosures [14] and when the process is not followed, it can, and should result in a court not allowing it to go forward. In some of these cases, judges wanting more evidence or information about MERS have made comments about MERS. In light of the recent foreclosure crisis, it is probable that MERS will continue to be challenged. But we are confident that when courts are provided with all of the facts, MERS will continue to prevail.[15] A MERS case law outline (current through October 20, 2010) is available upon request.[16]

MERS CONTINUES TO IMPROVE ITS PROCESSES

In 2009, when it came to our attention that some employees designated by member institutions to serve as MERS certifying officers were not entrusted by their own institutions with signing authority, MERS enhanced its procedures to require that each MERS certifying officer be a company officer of the member institution. In addition, MERS has developed a primer containing information to be reviewed by each prospective MERS certifying officer. To test this knowledge, MERS instituted an online examination to make sure prospective certifying officers had a basic knowledge of MERS and of their roles and responsibilities as MERS certifying officers. MERS requires that these certifications be renewed annually, and we also instituted a recertification process for current certifying officers who had been designated prior to establishment of the online examination. MERS will continue to enforce these policies and refine its testing and certification program in recognition of the responsibility involved in initiating a foreclosure on someone's home.

When we saw actions were being undertaken to accelerate foreclosure document processing, we became concerned that certifying officers might be pressured to perform their responsibilities in a manner inconsistent with the MERS rules. When we did not receive the assurances we thought appropriate that this would not happen, we suspended relationships with some prominent players involved in the foreclosure process.

When we discovered that some "robo-signers" were MERS certifying officers, we contacted those certifying officers and suspended their authority. They will not be recertified until they retrain and submit to reexamination, and the members who employed them provide MERS with a plan on what will be changed within their companies to prevent this from happening again.

The MERS management team is committed to the highest standards; we believe that MERS adds great value to our nation's system of housing finance in a way that benefits financial institutions, borrowers and the Government. There are many benefits derived from the MERS database:

- The MERS database is available to borrowers to locate their servicers, and in many cases, to identify note-owners.

[14] Individual States handle real estate foreclosures differently. In some States the foreclosure process is judicial, and in some States it is non-judicial. Under both systems, timeframes and terms vary widely from State to State. A brief, general, description of both processes prepared by the Mortgage Bankers Association can be found in Attachment Five.

[15] Some important recent cases upholding the rights of MERS include:

In re Mortgage Electronic Registration Systems (MERS) Litigation, a multi-district litigation case in Federal court in Arizona where the court issued a favorable opinion, stating that "The MERS System is not fraudulent, and MERS has not committed any fraud."

In re Tucker (9/20/2010), where a Missouri bankruptcy judge found that the language of the deed of trust clearly authorizes MERS to act on behalf of the lender in serving as the legal title holder.

Mortgage Electronic Registration Systems, Inc. v. Bellistri, 2010 WL 2720802 (E.D. Mo. 2010), where the court held that Bellistri's failure to provide notice to MERS violated MERS' constitutional due process rights.

Taylor v. Deutsche Bank Nat'l Trust Co., So. 3d, 2010 WL 3056612 (Fla. 5th DCA 2010), where the court held the MERS mortgage to be valid under Florida law, and held that MERS may assign its rights in the mortgage to the foreclosing company who holds the note. The Florida court also held that where MERS is described as the "mortgagee under the Security Instrument" the document grants to MERS legal status under the UCC, which MERS can assign to the foreclosing bank.

Deutsche Bank Natl. Trust Co. v. Traxler, 2010–Ohio–3940, where the Ohio Court of Appeals recognizes MERS' authority to assign a mortgage when designated as both a nominee and mortgagee.

King v. American Mortgage Network, *et al.,* United States District Court, District of Utah, Northern Division (Case No. 1:09–CV–125 TS), where the court, interpreting the language of the deed of trust, held that MERS had the authority to initiate foreclosure proceedings, appoint a trustee, and to foreclose and sell the property.

[16] A review of the use of MERS in all 50 States was done by Covington and Burling in 1996 and 1997 as part of the due diligence associated with the creation of MERS. It is available upon request.

- For local communities, MERS has become a much-needed link between code enforcement officers and the servicing community to help combat the blight that vacant properties bring to neighborhoods. Over 600 government institutions (cities, municipalities and States) utilize the MERS® System for free to look up the property preservation contacts for loans registered on the system. This helps save the code enforcement officers much needed time in searching for the company directly responsible for the upkeep of that vacant property.
- For law enforcement agencies, MERS aids in combating mortgage fraud through the detection of undisclosed multiple liens taken out by fraudsters for the same social security number or property.

Also, with MERS, lien releases occur quickly at the time of payoff for borrowers because there can be no break in the chain of title with MERS. And finally, foreclosures in the name of MERS are not allowed without the note.

IDEAS FOR THE FUTURE

The MERS database, coupled with the Mortgage Identification Number, is a powerful tool that can be harnessed by the Congress and the industry to improve the mortgage finance system. There are a number of ideas that are worth considering so that when we emerge from this current crisis we have a housing finance system that meets our needs.

1. All residential home loans should be uniquely identified and tracked on a national database, which should include:

a. Who is the borrower?

b. What/Where is the property?

c. Who is the owner of the loan's promissory note (the originator/investor)?

d. Who is the servicer of the loan (the mortgage company)?

2. The cost of registration for the loan should be included with the other origination fees and disclosed on the HUD–1 at closing.

3. The national database should also track who has physical custody of the original promissory note (the mortgages are always available in the county land records).

4. The database should reflect both current and historical information regarding the home loan.

5. The national unique identifier should be a full life-of-loan identifier, from origination through final satisfaction (payoff) and lien release.

6. All Federal data systems that deal with home loans should be required to integrate the unique national identification number, so that information regarding loans can be linked across multiple data sources, *e.g.,* the FHA should be able to look at HUD data, and FDIC should be able to look at SEC information, always knowing that they are comparing apples to apples. State and local government agencies should also be encouraged to adopt the number.

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

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

ATTACHMENTS:

1) Sample mortgage document
2) MBA Fact Sheet on MERS
3) "Title Transfer Law 101," by Karen Gelernt, American Banker, October 19, 2010
4) "MERS Under Attack: Perspective on Recent Decisions from Kansas and Minnesota," by Barkley and Barbara Clark, Clark's Secured Transactions Monthly, February 2010
5) "Judicial Versus Non-Judicial Foreclosure," Mortgage Bankers Association, October 2010

ATTACHMENT 1:

SAMPLE MORTGAGE DOCUMENT

This is an Example of a Mortgage which names MERS as the Original Mortgagee (MOM Document).

Prepared by or under the supervision of:

[Name of Natural Person]

[Street Address]

[City, State Zip Code]

The MERS 18-digit MIN must be visible on the Security Instrument. Place the MIN to the right of the form title, but not within the top recording margin or on the right margin.

[Space Above This Line For Recording Data]

MORTGAGE **MIN: 1000XXX-XXXXXXXXXX-X**

DEFINITIONS

Words used in multiple sections of this document are defined below and other words are defined in Sections 3, 11, 13, 18, 20 and 21. Certain rules regarding the usage of words used in this document are also provided in Section 16.

(A) **"Security Instrument"** means this document, which is dated , together with all Riders to this document.

(B) **"Borrower"** is

MERS as the Original Mortgagee language. See page 3 of this document to note further reference to MERS as Mortgagee.

. Borrower is the mortgagor under this Security Instrument.

(C) **"MERS"** is Mortgage Electronic Registration Systems, Inc. MERS is a separate corporation that is acting solely as a nominee for Lender and Lender's successors and assigns. **MERS is the mortgagee under this Security Instrument.** MERS is organized and existing under the laws of Delaware, and has an address and telephone number of P.O. Box 2026, Flint, MI 48501-2026, tel. (888) 679-MERS.

(D) **"Lender"** is .

Lender is a organized and existing under the laws of . Lender's address is .

(E) **"Note"** means the promissory note signed by Borrower and dated . The Note states that Borrower owes Lender Dollars (U.S. $) plus interest. Borrower has promised to pay this debt in regular Periodic Payments and to pay the debt in full not later than .

Initials: _____ _____ _____ _____

This is an Example of a Mortgage which names MERS as the Original Mortgagee (MOM Document).

(F) **"Property"** means the property that is described below under the heading "Transfer of Rights in the Property."

(G) **"Loan"** means the debt evidenced by the Note, plus interest, any prepayment charges and late charges due under the Note, and all sums due under this Security Instrument, plus interest.

(H) **"Riders"** means all Riders to this Security Instrument that are executed by Borrower. The following Riders are to be executed by Borrower *[check box as applicable]*:

☐ Adjustable Rate Rider
☐ Balloon Rider
☐ 1-4 Family Rider
☐ Other(s) *[specify]*
☐ Condominium Rider
☐ Planned Unit Development Rider
☐ Revocable Trust Rider
☐ Second Home Rider
☐ Biweekly Payment Rider

(I) **"Applicable Law"** means all controlling applicable federal, state and local statutes, regulations, ordinances and administrative rules and orders (that have the effect of law) as well as all applicable final, non-appealable judicial opinions.

(J) **"Community Association Dues, Fees, and Assessments"** means all dues, fees, assessments and other charges that are imposed on Borrower or the Property by a condominium association, homeowners association or similar organization.

(K) **"Electronic Funds Transfer"** means any transfer of funds, other than a transaction originated by check, draft, or similar paper instrument, which is initiated through an electronic terminal, telephonic instrument, computer, or magnetic tape so as to order, instruct, or authorize a financial institution to debit or credit an account. Such term includes, but is not limited to, point-of-sale transfers, automated teller machine transactions, transfers initiated by telephone, wire transfers, and automated clearinghouse transfers.

(L) **"Escrow Items"** means those items that are described in Section 3.

(M) **"Miscellaneous Proceeds"** means any compensation, settlement, award of damages, or proceeds paid by any third party (other than insurance proceeds paid under the coverages described in Section 5) for: (i) damage to, or destruction of, the Property; (ii) condemnation or other taking of all or any part of the Property; (iii) conveyance in lieu of condemnation; or (iv) misrepresentations of, or omissions as to, the value and/or condition of the Property.

(N) **"Mortgage Insurance"** means insurance protecting Lender against the nonpayment of, or default on, the Loan.

(O) **"Periodic Payment"** means the regularly scheduled amount due for (i) principal and interest under the Note, plus (ii) any amounts under Section 3 of this Security Instrument.

(P) **"RESPA"** means the Real Estate Settlement Procedures Act (12 U.S.C. §2601 et seq.) and its implementing regulation, Regulation X (24 C.F.R. Part 3500), as they might be amended from time to time, or any additional or successor legislation or regulation that governs the same subject matter. As used in this Security

Initials: _____ _____ _____ _____

This is an Example of a Mortgage which names MERS as the Original Mortgagee (MOM Document).

Instrument, "RESPA" refers to all requirements and restrictions that are imposed in regard to a "federally related mortgage loan" even if the Loan does not qualify as a "federally related mortgage loan" under RESPA.

(Q) **"Successor in Interest of Borrower"** means any party that has taken title to the Property, whether or not that party has assumed Borrower's obligations under the Note and/or this Security Instrument.

TRANSFER OF RIGHTS IN THE PROPERTY

This Security Instrument secures to Lender: (i) the repayment of the Loan, and all renewals, extensions and modifications of the Note; and (ii) the performance of Borrower's covenants and agreements under this Security Instrument and the Note. For this purpose, Borrower does hereby mortgage, grant and convey to **MERS (solely as nominee for Lender and Lender's successors and assigns) and to the successors and assigns of MERS, the following described property located in the**

[Type of Recording Jurisdiction]

of :

[Name of Recording Jurisdiction]

MERS noted as lender's nominee in the transfer/due on sale clause.

which currently has the address of

[Street]

, Florida ("Property Address"):

[City] *[Zip Code]*

TOGETHER WITH all the improvements now or hereafter erected on the property, and all easements, appurtenances, and fixtures now or hereafter a part of the property. All replacements and additions shall also be covered by this Security Instrument. All of the foregoing is referred to in this Security Instrument as the "Property." Borrower understands and agrees that MERS holds only legal title to the interests granted by Borrower in this Security Instrument, but, if necessary to comply with law or custom, MERS (as nominee for Lender and Lender's successors and assigns) has the right: to exercise any or all of those interests, including, but not limited to, the right to foreclose and sell the Property; and to take any action required of Lender including, but not limited to, releasing and canceling this Security Instrument.

BORROWER COVENANTS that Borrower is lawfully seised of the estate hereby conveyed and has the right to mortgage, grant and convey the Property and that the Property is unencumbered, except for encumbrances of record. Borrower warrants and will defend generally the title to the Property against all claims and demands, subject to any encumbrances of record.

Initials: ____ ____ ____ ____

This is an Example of a Mortgage which names MERS as the Original Mortgagee (MOM Document).

THIS SECURITY INSTRUMENT combines uniform covenants for national use and non-uniform covenants with limited variations by jurisdiction to constitute a uniform security instrument covering real property.

UNIFORM COVENANTS. Borrower and Lender covenant and agree as follows:

1. Payment of Principal, Interest, Escrow Items, Prepayment Charges, and Late Charges. Borrower shall pay when due the principal of, and interest on, the debt evidenced by the Note and any prepayment charges and late charges due under the Note. Borrower shall also pay funds for Escrow Items pursuant to Section 3. Payments due under the Note and this Security Instrument shall be made in U.S. currency. However, if any check or other instrument received by Lender as payment under the Note or this Security Instrument is returned to Lender unpaid, Lender may require that any or all subsequent payments due under the Note and this Security Instrument be made in one or more of the following forms, as selected by Lender: (a) cash; (b) money order; (c) certified check, bank check, treasurer's check or cashier's check, provided any such check is drawn upon an institution whose deposits are insured by a federal agency, instrumentality, or entity; or (d) Electronic Funds Transfer.

Payments are deemed received by Lender when received at the location designated in the Note or at such other location as may be designated by Lender in accordance with the notice provisions in Section 15. Lender may return any payment or partial payment if the payment or partial payments are insufficient to bring the Loan current. Lender may accept any payment or partial payment insufficient to bring the Loan current, without waiver of any rights hereunder or prejudice to its rights to refuse such payment or partial payments in the future, but Lender is not obligated to apply such payments at the time such payments are accepted. If each Periodic Payment is applied as of its scheduled due date, then Lender need not pay interest on unapplied funds. Lender may hold such unapplied funds until Borrower makes payment to bring the Loan current. If Borrower does not do so within a reasonable period of time, Lender shall either apply such funds or return them to Borrower. If not applied earlier, such funds will be applied to the outstanding principal balance under the Note immediately prior to foreclosure. No offset or claim which Borrower might have now or in the future against Lender shall relieve Borrower from making payments due under the Note and this Security Instrument or performing the covenants and agreements secured by this Security Instrument.

2. Application of Payments or Proceeds. Except as otherwise described in this Section 2, all payments accepted and applied by Lender shall be applied in the following order of priority: (a) interest due under the Note; (b) principal due under the Note; (c) amounts due under Section 3. Such payments shall be applied to each Periodic Payment in the order in which it became due. Any remaining amounts shall be applied first to late charges, second to any other amounts due under this Security Instrument, and then to reduce the principal balance of the Note.

If Lender receives a payment from Borrower for a delinquent Periodic Payment which includes a sufficient amount to pay any late charge due, the payment may be applied to the delinquent payment and the late charge. If more than one Periodic Payment is outstanding, Lender may apply any payment received from Borrower to the repayment of the Periodic Payments if, and to the extent that, each payment can be paid in full. To the extent that any excess exists after the payment is applied to the full payment of one or more Periodic Payments, such excess may be applied to any late charges due. Voluntary prepayments shall be applied first to any prepayment charges and then as described in the Note.

Any application of payments, insurance proceeds, or Miscellaneous Proceeds to principal due under the Note shall not extend or postpone the due date, or change the amount, of the Periodic Payments.

3. Funds for Escrow Items. Borrower shall pay to Lender on the day Periodic Payments are due under the Note, until the Note is paid in full, a sum (the "Funds") to provide for payment of amounts due for: (a) taxes and assessments and other items which can attain priority over this Security Instrument as a lien or encumbrance on the Property; (b) leasehold payments or ground rents on the Property, if any; (c) premiums for any and all insurance required by Lender under Section 5; and (d) Mortgage Insurance premiums, if any, or any sums payable by

Initials: ____ ____ ____ ____

This is an Example of a Mortgage which names MERS as the Original Mortgagee (MOM Document).

Borrower to Lender in lieu of the payment of Mortgage Insurance premiums in accordance with the provisions of Section 10. These items are called "Escrow Items." At origination or at any time during the term of the Loan, Lender may require that Community Association Dues, Fees, and Assessments, if any, be escrowed by Borrower, and such dues, fees and assessments shall be an Escrow Item. Borrower shall promptly furnish to Lender all notices of amounts to be paid under this Section. Borrower shall pay Lender the Funds for Escrow Items unless Lender waives Borrower's obligation to pay the Funds for any or all Escrow Items. Lender may waive Borrower's obligation to pay to Lender Funds for any or all Escrow Items at any time. Any such waiver may only be in writing. In the event of such waiver, Borrower shall pay directly, when and where payable, the amounts due for any Escrow Items for which payment of Funds has been waived by Lender and, if Lender requires, shall furnish to Lender receipts evidencing such payment within such time period as Lender may require. Borrower's obligation to make such payments and to provide receipts shall for all purposes be deemed to be a covenant and agreement contained in this Security Instrument, as the phrase "covenant and agreement" is used in Section 9. If Borrower is obligated to pay Escrow Items directly, pursuant to a waiver, and Borrower fails to pay the amount due for an Escrow Item, Lender may exercise its rights under Section 9 and pay such amount and Borrower shall then be obligated under Section 9 to repay to Lender any such amount. Lender may revoke the waiver as to any or all Escrow Items at any time by a notice given in accordance with Section 15 and, upon such revocation, Borrower shall pay to Lender all Funds, and in such amounts, that are then required under this Section 3.

Lender may, at any time, collect and hold Funds in an amount (a) sufficient to permit Lender to apply the Funds at the time specified under RESPA, and (b) not to exceed the maximum amount a lender can require under RESPA. Lender shall estimate the amount of Funds due on the basis of current data and reasonable estimates of expenditures of future Escrow Items or otherwise in accordance with Applicable Law.

The Funds shall be held in an institution whose deposits are insured by a federal agency, instrumentality, or entity (including Lender, if Lender is an institution whose deposits are so insured) or in any Federal Home Loan Bank. Lender shall apply the Funds to pay the Escrow Items no later than the time specified under RESPA. Lender shall not charge Borrower for holding and applying the Funds, annually analyzing the escrow account, or verifying the Escrow Items, unless Lender pays Borrower interest on the Funds and Applicable Law permits Lender to make such a charge. Unless an agreement is made in writing or Applicable Law requires interest to be paid on the Funds, Lender shall not be required to pay Borrower any interest or earnings on the Funds. Borrower and Lender can agree in writing, however, that interest shall be paid on the Funds. Lender shall give to Borrower, without charge, an annual accounting of the Funds as required by RESPA.

If there is a surplus of Funds held in escrow, as defined under RESPA, Lender shall account to Borrower for the excess funds in accordance with RESPA. If there is a shortage of Funds held in escrow, as defined under RESPA, Lender shall notify Borrower as required by RESPA, and Borrower shall pay to Lender the amount necessary to make up the shortage in accordance with RESPA, but in no more than 12 monthly payments. If there is a deficiency of Funds held in escrow, as defined under RESPA, Lender shall notify Borrower as required by RESPA, and Borrower shall pay to Lender the amount necessary to make up the deficiency in accordance with RESPA, but in no more than 12 monthly payments.

Upon payment in full of all sums secured by this Security Instrument, Lender shall promptly refund to Borrower any Funds held by Lender.

4. Charges; Liens. Borrower shall pay all taxes, assessments, charges, fines, and impositions attributable to the Property which can attain priority over this Security Instrument, leasehold payments or ground rents on the Property, if any, and Community Association Dues, Fees, and Assessments, if any. To the extent that these items are Escrow Items, Borrower shall pay them in the manner provided in Section 3.

Borrower shall promptly discharge any lien which has priority over this Security Instrument unless Borrower: (a) agrees in writing to the payment of the obligation secured by the lien in a manner acceptable to Lender, but only so long as Borrower is performing such agreement; (b) contests the lien in good faith by, or

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defends against enforcement of the lien in, legal proceedings which in Lender's opinion operate to prevent the enforcement of the lien while those proceedings are pending, but only until such proceedings are concluded; or (c) secures from the holder of the lien an agreement satisfactory to Lender subordinating the lien to this Security Instrument. If Lender determines that any part of the Property is subject to a lien which can attain priority over this Security Instrument, Lender may give Borrower a notice identifying the lien. Within 10 days of the date on which that notice is given, Borrower shall satisfy the lien or take one or more of the actions set forth above in this Section 4.

Lender may require Borrower to pay a one-time charge for a real estate tax verification and/or reporting service used by Lender in connection with this Loan.

5. **Property Insurance.** Borrower shall keep the improvements now existing or hereafter erected on the Property insured against loss by fire, hazards included within the term "extended coverage," and any other hazards including, but not limited to, earthquakes and floods, for which Lender requires insurance. This insurance shall be maintained in the amounts (including deductible levels) and for the periods that Lender requires. What Lender requires pursuant to the preceding sentences can change during the term of the Loan. The insurance carrier providing the insurance shall be chosen by Borrower subject to Lender's right to disapprove Borrower's choice, which right shall not be exercised unreasonably. Lender may require Borrower to pay, in connection with this Loan, either: (a) a one-time charge for flood zone determination, certification and tracking services; or (b) a one-time charge for flood zone determination and certification services and subsequent charges each time remappings or similar changes occur which reasonably might affect such determination or certification. Borrower shall also be responsible for the payment of any fees imposed by the Federal Emergency Management Agency in connection with the review of any flood zone determination resulting from an objection by Borrower.

If Borrower fails to maintain any of the coverages described above, Lender may obtain insurance coverage, at Lender's option and Borrower's expense. Lender is under no obligation to purchase any particular type or amount of coverage. Therefore, such coverage shall cover Lender, but might or might not protect Borrower, Borrower's equity in the Property, or the contents of the Property, against any risk, hazard or liability and might provide greater or lesser coverage than was previously in effect. Borrower acknowledges that the cost of the insurance coverage so obtained might significantly exceed the cost of insurance that Borrower could have obtained. Any amounts disbursed by Lender under this Section 5 shall become additional debt of Borrower secured by this Security Instrument. These amounts shall bear interest at the Note rate from the date of disbursement and shall be payable, with such interest, upon notice from Lender to Borrower requesting payment.

All insurance policies required by Lender and renewals of such policies shall be subject to Lender's right to disapprove such policies, shall include a standard mortgage clause, and shall name Lender as mortgagee and/or as an additional loss payee. Lender shall have the right to hold the policies and renewal certificates. If Lender requires, Borrower shall promptly give to Lender all receipts of paid premiums and renewal notices. If Borrower obtains any form of insurance coverage, not otherwise required by Lender, for damage to, or destruction of, the Property, such policy shall include a standard mortgage clause and shall name Lender as mortgagee and/or as an additional loss payee.

In the event of loss, Borrower shall give prompt notice to the insurance carrier and Lender. Lender may make proof of loss if not made promptly by Borrower. Unless Lender and Borrower otherwise agree in writing, any insurance proceeds, whether or not the underlying insurance was required by Lender, shall be applied to restoration or repair of the Property, if the restoration or repair is economically feasible and Lender's security is not lessened. During such repair and restoration period, Lender shall have the right to hold such insurance proceeds until Lender has had an opportunity to inspect such Property to ensure the work has been completed to Lender's satisfaction, provided that such inspection shall be undertaken promptly. Lender may disburse proceeds for the repairs and restoration in a single payment or in a series of progress payments as the work is completed. Unless an agreement is made in writing or Applicable Law requires interest to be paid on such insurance proceeds, Lender shall not be

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required to pay Borrower any interest or earnings on such proceeds. Fees for public adjusters, or other third parties, retained by Borrower shall not be paid out of the insurance proceeds and shall be the sole obligation of Borrower. If the restoration or repair is not economically feasible or Lender's security would be lessened, the insurance proceeds shall be applied to the sums secured by this Security Instrument, whether or not then due, with the excess, if any, paid to Borrower. Such insurance proceeds shall be applied in the order provided for in Section 2.

If Borrower abandons the Property, Lender may file, negotiate and settle any available insurance claim and related matters. If Borrower does not respond within 30 days to a notice from Lender that the insurance carrier has offered to settle a claim, then Lender may negotiate and settle the claim. The 30-day period will begin when the notice is given. In either event, or if Lender acquires the Property under Section 22 or otherwise, Borrower hereby assigns to Lender (a) Borrower's rights to any insurance proceeds in an amount not to exceed the amounts unpaid under the Note or this Security Instrument, and (b) any other of Borrower's rights (other than the right to any refund of unearned premiums paid by Borrower) under all insurance policies covering the Property, insofar as such rights are applicable to the coverage of the Property. Lender may use the insurance proceeds either to repair or restore the Property or to pay amounts unpaid under the Note or this Security Instrument, whether or not then due.

6. Occupancy. Borrower shall occupy, establish, and use the Property as Borrower's principal residence within 60 days after the execution of this Security Instrument and shall continue to occupy the Property as Borrower's principal residence for at least one year after the date of occupancy, unless Lender otherwise agrees in writing, which consent shall not be unreasonably withheld, or unless extenuating circumstances exist which are beyond Borrower's control.

7. Preservation, Maintenance and Protection of the Property; Inspections. Borrower shall not destroy, damage or impair the Property, allow the Property to deteriorate or commit waste on the Property. Whether or not Borrower is residing in the Property, Borrower shall maintain the Property in order to prevent the Property from deteriorating or decreasing in value due to its condition. Unless it is determined pursuant to Section 5 that repair or restoration is not economically feasible, Borrower shall promptly repair the Property if damaged to avoid further deterioration or damage. If insurance or condemnation proceeds are paid in connection with damage to, or the taking of, the Property, Borrower shall be responsible for repairing or restoring the Property only if Lender has released proceeds for such purposes. Lender may disburse proceeds for the repairs and restoration in a single payment or in a series of progress payments as the work is completed. If the insurance or condemnation proceeds are not sufficient to repair or restore the Property, Borrower is not relieved of Borrower's obligation for the completion of such repair or restoration.

Lender or its agent may make reasonable entries upon and inspections of the Property. If it has reasonable cause, Lender may inspect the interior of the improvements on the Property. Lender shall give Borrower notice at the time of or prior to such an interior inspection specifying such reasonable cause.

8. Borrower's Loan Application. Borrower shall be in default if, during the Loan application process, Borrower or any persons or entities acting at the direction of Borrower or with Borrower's knowledge or consent gave materially false, misleading, or inaccurate information or statements to Lender (or failed to provide Lender with material information) in connection with the Loan. Material representations include, but are not limited to, representations concerning Borrower's occupancy of the Property as Borrower's principal residence.

9. Protection of Lender's Interest in the Property and Rights Under this Security Instrument. If (a) Borrower fails to perform the covenants and agreements contained in this Security Instrument, (b) there is a legal proceeding that might significantly affect Lender's interest in the Property and/or rights under this Security Instrument (such as a proceeding in bankruptcy, probate, for condemnation or forfeiture, for enforcement of a lien which may attain priority over this Security Instrument or to enforce laws or regulations), or (c) Borrower has abandoned the Property, then Lender may do and pay for whatever is reasonable or appropriate to protect Lender's interest in the Property and rights under this Security Instrument, including protecting and/or assessing the value of the Property, and securing and/or repairing the Property. Lender's actions can include, but are not limited to:

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(a) paying any sums secured by a lien which has priority over this Security Instrument; (b) appearing in court; and (c) paying reasonable attorneys' fees to protect its interest in the Property and/or rights under this Security Instrument, including its secured position in a bankruptcy proceeding. Securing the Property includes, but is not limited to, entering the Property to make repairs, change locks, replace or board up doors and windows, drain water from pipes, eliminate building or other code violations or dangerous conditions, and have utilities turned on or off. Although Lender may take action under this Section 9, Lender does not have to do so and is not under any duty or obligation to do so. It is agreed that Lender incurs no liability for not taking any or all actions authorized under this Section 9.

Any amounts disbursed by Lender under this Section 9 shall become additional debt of Borrower secured by this Security Instrument. These amounts shall bear interest at the Note rate from the date of disbursement and shall be payable, with such interest, upon notice from Lender to Borrower requesting payment.

If this Security Instrument is on a leasehold, Borrower shall comply with all the provisions of the lease. If Borrower acquires fee title to the Property, the leasehold and the fee title shall not merge unless Lender agrees to the merger in writing.

10. Mortgage Insurance. If Lender required Mortgage Insurance as a condition of making the Loan, Borrower shall pay the premiums required to maintain the Mortgage Insurance in effect. If, for any reason, the Mortgage Insurance coverage required by Lender ceases to be available from the mortgage insurer that previously provided such insurance and Borrower was required to make separately designated payments toward the premiums for Mortgage Insurance, Borrower shall pay the premiums required to obtain coverage substantially equivalent to the Mortgage Insurance previously in effect, at a cost substantially equivalent to the cost to Borrower of the Mortgage Insurance previously in effect, from an alternate mortgage insurer selected by Lender. If substantially equivalent Mortgage Insurance coverage is not available, Borrower shall continue to pay to Lender the amount of the separately designated payments that were due when the insurance coverage ceased to be in effect. Lender will accept, use and retain these payments as a non-refundable loss reserve in lieu of Mortgage Insurance. Such loss reserve shall be non-refundable, notwithstanding the fact that the Loan is ultimately paid in full, and Lender shall not be required to pay Borrower any interest or earnings on such loss reserve. Lender can no longer require loss reserve payments if Mortgage Insurance coverage (in the amount and for the period that Lender requires) provided by an insurer selected by Lender again becomes available, is obtained, and Lender requires separately designated payments toward the premiums for Mortgage Insurance. If Lender required Mortgage Insurance as a condition of making the Loan and Borrower was required to make separately designated payments toward the premiums for Mortgage Insurance, Borrower shall pay the premiums required to maintain Mortgage Insurance in effect, or to provide a non-refundable loss reserve, until Lender's requirement for Mortgage Insurance ends in accordance with any written agreement between Borrower and Lender providing for such termination or until termination is required by Applicable Law. Nothing in this Section 10 affects Borrower's obligation to pay interest at the rate provided in the Note.

Mortgage Insurance reimburses Lender (or any entity that purchases the Note) for certain losses it may incur if Borrower does not repay the Loan as agreed. Borrower is not a party to the Mortgage Insurance.

Mortgage insurers evaluate their total risk on all such insurance in force from time to time, and may enter into agreements with other parties that share or modify their risk, or reduce losses. These agreements are on terms and conditions that are satisfactory to the mortgage insurer and the other party (or parties) to these agreements. These agreements may require the mortgage insurer to make payments using any source of funds that the mortgage insurer may have available (which may include funds obtained from Mortgage Insurance premiums).

As a result of these agreements, Lender, any purchaser of the Note, another insurer, any reinsurer, any other entity, or any affiliate of any of the foregoing, may receive (directly or indirectly) amounts that derive from (or might be characterized as) a portion of Borrower's payments for Mortgage Insurance, in exchange for sharing or modifying the mortgage insurer's risk, or reducing losses. If such agreement provides that an affiliate of Lender

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takes a share of the insurer's risk in exchange for a share of the premiums paid to the insurer, the arrangement is often termed "captive reinsurance." Further:

(a) Any such agreements will not affect the amounts that Borrower has agreed to pay for Mortgage Insurance, or any other terms of the Loan. Such agreements will not increase the amount Borrower will owe for Mortgage Insurance, and they will not entitle Borrower to any refund.

(b) Any such agreements will not affect the rights Borrower has – if any – with respect to the Mortgage Insurance under the Homeowners Protection Act of 1998 or any other law. These rights may include the right to receive certain disclosures, to request and obtain cancellation of the Mortgage Insurance, to have the Mortgage Insurance terminated automatically, and/or to receive a refund of any Mortgage Insurance premiums that were unearned at the time of such cancellation or termination.

11. Assignment of Miscellaneous Proceeds; Forfeiture. All Miscellaneous Proceeds are hereby assigned to and shall be paid to Lender.

If the Property is damaged, such Miscellaneous Proceeds shall be applied to restoration or repair of the Property, if the restoration or repair is economically feasible and Lender's security is not lessened. During such repair and restoration period, Lender shall have the right to hold such Miscellaneous Proceeds until Lender has had an opportunity to inspect such Property to ensure the work has been completed to Lender's satisfaction, provided that such inspection shall be undertaken promptly. Lender may pay for the repairs and restoration in a single disbursement or in a series of progress payments as the work is completed. Unless an agreement is made in writing or Applicable Law requires interest to be paid on such Miscellaneous Proceeds, Lender shall not be required to pay Borrower any interest or earnings on such Miscellaneous Proceeds. If the restoration or repair is not economically feasible or Lender's security would be lessened, the Miscellaneous Proceeds shall be applied to the sums secured by this Security Instrument, whether or not then due, with the excess, if any, paid to Borrower. Such Miscellaneous Proceeds shall be applied in the order provided for in Section 2.

In the event of a total taking, destruction, or loss in value of the Property, the Miscellaneous Proceeds shall be applied to the sums secured by this Security Instrument, whether or not then due, with the excess, if any, paid to Borrower.

In the event of a partial taking, destruction, or loss in value of the Property in which the fair market value of the Property immediately before the partial taking, destruction, or loss in value is equal to or greater than the amount of the sums secured by this Security Instrument immediately before the partial taking, destruction, or loss in value, unless Borrower and Lender otherwise agree in writing, the sums secured by this Security Instrument shall be reduced by the amount of the Miscellaneous Proceeds multiplied by the following fraction: (a) the total amount of the sums secured immediately before the partial taking, destruction, or loss in value divided by (b) the fair market value of the Property immediately before the partial taking, destruction, or loss in value. Any balance shall be paid to Borrower.

In the event of a partial taking, destruction, or loss in value of the Property in which the fair market value of the Property immediately before the partial taking, destruction, or loss in value is less than the amount of the sums secured immediately before the partial taking, destruction, or loss in value, unless Borrower and Lender otherwise agree in writing, the Miscellaneous Proceeds shall be applied to the sums secured by this Security Instrument whether or not the sums are then due.

If the Property is abandoned by Borrower, or if, after notice by Lender to Borrower that the Opposing Party (as defined in the next sentence) offers to make an award to settle a claim for damages, Borrower fails to respond to Lender within 30 days after the date the notice is given, Lender is authorized to collect and apply the Miscellaneous Proceeds either to restoration or repair of the Property or to the sums secured by this Security Instrument, whether or not then due. "Opposing Party" means the third party that owes Borrower Miscellaneous Proceeds or the party against whom Borrower has a right of action in regard to Miscellaneous Proceeds.

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Borrower shall be in default if any action or proceeding, whether civil or criminal, is begun that, in Lender's judgment, could result in forfeiture of the Property or other material impairment of Lender's interest in the Property or rights under this Security Instrument. Borrower can cure such a default and, if acceleration has occurred, reinstate as provided in Section 19, by causing the action or proceeding to be dismissed with a ruling that, in Lender's judgment, precludes forfeiture of the Property or other material impairment of Lender's interest in the Property or rights under this Security Instrument. The proceeds of any award or claim for damages that are attributable to the impairment of Lender's interest in the Property are hereby assigned and shall be paid to Lender.

All Miscellaneous Proceeds that are not applied to restoration or repair of the Property shall be applied in the order provided for in Section 2.

12. Borrower Not Released; Forbearance By Lender Not a Waiver. Extension of the time for payment or modification of amortization of the sums secured by this Security Instrument granted by Lender to Borrower or any Successor in Interest of Borrower shall not operate to release the liability of Borrower or any Successors in Interest of Borrower. Lender shall not be required to commence proceedings against any Successor in Interest of Borrower or to refuse to extend time for payment or otherwise modify amortization of the sums secured by this Security Instrument by reason of any demand made by the original Borrower or any Successors in Interest of Borrower. Any forbearance by Lender in exercising any right or remedy including, without limitation, Lender's acceptance of payments from third persons, entities or Successors in Interest of Borrower or in amounts less than the amount then due, shall not be a waiver of or preclude the exercise of any right or remedy.

13. Joint and Several Liability; Co-signers; Successors and Assigns Bound. Borrower covenants and agrees that Borrower's obligations and liability shall be joint and several. However, any Borrower who co-signs this Security Instrument but does not execute the Note (a "co-signer"): (a) is co-signing this Security Instrument only to mortgage, grant and convey the co-signer's interest in the Property under the terms of this Security Instrument; (b) is not personally obligated to pay the sums secured by this Security Instrument; and (c) agrees that Lender and any other Borrower can agree to extend, modify, forbear or make any accommodations with regard to the terms of this Security Instrument or the Note without the co-signer's consent.

Subject to the provisions of Section 18, any Successor in Interest of Borrower who assumes Borrower's obligations under this Security Instrument in writing, and is approved by Lender, shall obtain all of Borrower's rights and benefits under this Security Instrument. Borrower shall not be released from Borrower's obligations and liability under this Security Instrument unless Lender agrees to such release in writing. The covenants and agreements of this Security Instrument shall bind (except as provided in Section 20) and benefit the successors and assigns of Lender.

14. Loan Charges. Lender may charge Borrower fees for services performed in connection with Borrower's default, for the purpose of protecting Lender's interest in the Property and rights under this Security Instrument, including, but not limited to, attorneys' fees, property inspection and valuation fees. In regard to any other fees, the absence of express authority in this Security Instrument to charge a specific fee to Borrower shall not be construed as a prohibition on the charging of such fee. Lender may not charge fees that are expressly prohibited by this Security Instrument or by Applicable Law.

If the Loan is subject to a law which sets maximum loan charges, and that law is finally interpreted so that the interest or other loan charges collected or to be collected in connection with the Loan exceed the permitted limits, then: (a) any such loan charge shall be reduced by the amount necessary to reduce the charge to the permitted limit; and (b) any sums already collected from Borrower which exceeded permitted limits will be refunded to Borrower. Lender may choose to make this refund by reducing the principal owed under the Note or by making a direct payment to Borrower. If a refund reduces principal, the reduction will be treated as a partial prepayment without any prepayment charge (whether or not a prepayment charge is provided for under the Note). Borrower's acceptance of any such refund made by direct payment to Borrower will constitute a waiver of any right of action Borrower might have arising out of such overcharge.

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15. Notices. All notices given by Borrower or Lender in connection with this Security Instrument must be in writing. Any notice to Borrower in connection with this Security Instrument shall be deemed to have been given to Borrower when mailed by first class mail or when actually delivered to Borrower's notice address if sent by other means. Notice to any one Borrower shall constitute notice to all Borrowers unless Applicable Law expressly requires otherwise. The notice address shall be the Property Address unless Borrower has designated a substitute notice address by notice to Lender. Borrower shall promptly notify Lender of Borrower's change of address. If Lender specifies a procedure for reporting Borrower's change of address, then Borrower shall only report a change of address through that specified procedure. There may be only one designated notice address under this Security Instrument at any one time. Any notice to Lender shall be given by delivering it or by mailing it by first class mail to Lender's address stated herein unless Lender has designated another address by notice to Borrower. Any notice in connection with this Security Instrument shall not be deemed to have been given to Lender until actually received by Lender. If any notice required by this Security Instrument is also required under Applicable Law, the Applicable Law requirement will satisfy the corresponding requirement under this Security Instrument.

16. Governing Law; Severability; Rules of Construction. This Security Instrument shall be governed by federal law and the law of the jurisdiction in which the Property is located. All rights and obligations contained in this Security Instrument are subject to any requirements and limitations of Applicable Law. Applicable Law might explicitly or implicitly allow the parties to agree by contract or it might be silent, but such silence shall not be construed as a prohibition against agreement by contract. In the event that any provision or clause of this Security Instrument or the Note conflicts with Applicable Law, such conflict shall not affect other provisions of this Security Instrument or the Note which can be given effect without the conflicting provision.

As used in this Security Instrument: (a) words of the masculine gender shall mean and include corresponding neuter words or words of the feminine gender; (b) words in the singular shall mean and include the plural and vice versa; and (c) the word "may" gives sole discretion without any obligation to take any action.

17. Borrower's Copy. Borrower shall be given one copy of the Note and of this Security Instrument.

18. Transfer of the Property or a Beneficial Interest in Borrower. As used in this Section 18, "Interest in the Property" means any legal or beneficial interest in the Property, including, but not limited to, those beneficial interests transferred in a bond for deed, contract for deed, installment sales contract or escrow agreement, the intent of which is the transfer of title by Borrower at a future date to a purchaser.

If all or any part of the Property or any Interest in the Property is sold or transferred (or if Borrower is not a natural person and a beneficial interest in Borrower is sold or transferred) without Lender's prior written consent, Lender may require immediate payment in full of all sums secured by this Security Instrument. However, this option shall not be exercised by Lender if such exercise is prohibited by Applicable Law.

If Lender exercises this option, Lender shall give Borrower notice of acceleration. The notice shall provide a period of not less than 30 days from the date the notice is given in accordance with Section 15 within which Borrower must pay all sums secured by this Security Instrument. If Borrower fails to pay these sums prior to the expiration of this period, Lender may invoke any remedies permitted by this Security Instrument without further notice or demand on Borrower.

19. Borrower's Right to Reinstate After Acceleration. If Borrower meets certain conditions, Borrower shall have the right to have enforcement of this Security Instrument discontinued at any time prior to the earliest of: (a) five days before sale of the Property pursuant to any power of sale contained in this Security Instrument; (b) such other period as Applicable Law might specify for the termination of Borrower's right to reinstate; or (c) entry of a judgment enforcing this Security Instrument. Those conditions are that Borrower: (a) pays Lender all sums which then would be due under this Security Instrument and the Note as if no acceleration had occurred; (b) cures any default of any other covenants or agreements; (c) pays all expenses incurred in enforcing this Security Instrument, including, but not limited to, reasonable attorneys' fees, property inspection and valuation fees, and other fees incurred for the purpose of protecting Lender's interest in the Property and rights under this Security Instrument; and

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(d) takes such action as Lender may reasonably require to assure that Lender's interest in the Property and rights under this Security Instrument, and Borrower's obligation to pay the sums secured by this Security Instrument, shall continue unchanged. Lender may require that Borrower pay such reinstatement sums and expenses in one or more of the following forms, as selected by Lender: (a) cash; (b) money order; (c) certified check, bank check, treasurer's check or cashier's check, provided any such check is drawn upon an institution whose deposits are insured by a federal agency, instrumentality or entity; or (d) Electronic Funds Transfer. Upon reinstatement by Borrower, this Security Instrument and obligations secured hereby shall remain fully effective as if no acceleration had occurred. However, this right to reinstate shall not apply in the case of acceleration under Section 18.

20. Sale of Note; Change of Loan Servicer; Notice of Grievance. The Note or a partial interest in the Note (together with this Security Instrument) can be sold one or more times without prior notice to Borrower. A sale might result in a change in the entity (known as the "Loan Servicer") that collects Periodic Payments due under the Note and this Security Instrument and performs other mortgage loan servicing obligations under the Note, this Security Instrument, and Applicable Law. There also might be one or more changes of the Loan Servicer unrelated to a sale of the Note. If there is a change of the Loan Servicer, Borrower will be given written notice of the change which will state the name and address of the new Loan Servicer, the address to which payments should be made and any other information RESPA requires in connection with a notice of transfer of servicing. If the Note is sold and thereafter the Loan is serviced by a Loan Servicer other than the purchaser of the Note, the mortgage loan servicing obligations to Borrower will remain with the Loan Servicer or be transferred to a successor Loan Servicer and are not assumed by the Note purchaser unless otherwise provided by the Note purchaser.

Neither Borrower nor Lender may commence, join, or be joined to any judicial action (as either an individual litigant or the member of a class) that arises from the other party's actions pursuant to this Security Instrument or that alleges that the other party has breached any provision of, or any duty owed by reason of, this Security Instrument, until such Borrower or Lender has notified the other party (with such notice given in compliance with the requirements of Section 15) of such alleged breach and afforded the other party hereto a reasonable period after the giving of such notice to take corrective action. If Applicable Law provides a time period which must elapse before certain action can be taken, that time period will be deemed to be reasonable for purposes of this paragraph. The notice of acceleration and opportunity to cure given to Borrower pursuant to Section 22 and the notice of acceleration given to Borrower pursuant to Section 18 shall be deemed to satisfy the notice and opportunity to take corrective action provisions of this Section 20.

21. Hazardous Substances. As used in this Section 21: (a) "Hazardous Substances" are those substances defined as toxic or hazardous substances, pollutants, or wastes by Environmental Law and the following substances: gasoline, kerosene, other flammable or toxic petroleum products, toxic pesticides and herbicides, volatile solvents, materials containing asbestos or formaldehyde, and radioactive materials; (b) "Environmental Law" means federal laws and laws of the jurisdiction where the Property is located that relate to health, safety or environmental protection; (c) "Environmental Cleanup" includes any response action, remedial action, or removal action, as defined in Environmental Law; and (d) an "Environmental Condition" means a condition that can cause, contribute to, or otherwise trigger an Environmental Cleanup.

Borrower shall not cause or permit the presence, use, disposal, storage, or release of any Hazardous Substances, or threaten to release any Hazardous Substances, on or in the Property. Borrower shall not do, nor allow anyone else to do, anything affecting the Property (a) that is in violation of any Environmental Law, (b) which creates an Environmental Condition, or (c) which, due to the presence, use, or release of a Hazardous Substance, creates a condition that adversely affects the value of the Property. The preceding two sentences shall not apply to the presence, use, or storage on the Property of small quantities of Hazardous Substances that are generally recognized to be appropriate to normal residential uses and to maintenance of the Property (including, but not limited to, hazardous substances in consumer products).

Initials: ____ ____ ____ ____

This is an Example of a Mortgage which names MERS as the Original Mortgagee (MOM Document).

Borrower shall promptly give Lender written notice of (a) any investigation, claim, demand, lawsuit or other action by any governmental or regulatory agency or private party involving the Property and any Hazardous Substance or Environmental Law of which Borrower has actual knowledge, (b) any Environmental Condition, including but not limited to, any spilling, leaking, discharge, release or threat of release of any Hazardous Substance, and (c) any condition caused by the presence, use or release of a Hazardous Substance which adversely affects the value of the Property. If Borrower learns, or is notified by any governmental or regulatory authority, or any private party, that any removal or other remediation of any Hazardous Substance affecting the Property is necessary, Borrower shall promptly take all necessary remedial actions in accordance with Environmental Law. Nothing herein shall create any obligation on Lender for an Environmental Cleanup.

NON-UNIFORM COVENANTS. Borrower and Lender further covenant and agree as follows:

22. Acceleration; Remedies. Lender shall give notice to Borrower prior to acceleration following Borrower's breach of any covenant or agreement in this Security Instrument (but not prior to acceleration under Section 18 unless Applicable Law provides otherwise). The notice shall specify: (a) the default; (b) the action required to cure the default; (c) a date, not less than 30 days from the date the notice is given to Borrower, by which the default must be cured; and (d) that failure to cure the default on or before the date specified in the notice may result in acceleration of the sums secured by this Security Instrument, foreclosure by judicial proceeding and sale of the Property. The notice shall further inform Borrower of the right to reinstate after acceleration and the right to assert in the foreclosure proceeding the non-existence of a default or any other defense of Borrower to acceleration and foreclosure. If the default is not cured on or before the date specified in the notice, Lender at its option may require immediate payment in full of all sums secured by this Security Instrument without further demand and may foreclose this Security Instrument by judicial proceeding. Lender shall be entitled to collect all expenses incurred in pursuing the remedies provided in this Section 22, including, but not limited to, reasonable attorneys' fees and costs of title evidence.

23. Release. Upon payment of all sums secured by this Security Instrument, Lender shall release this Security Instrument. Borrower shall pay any recordation costs. Lender may charge Borrower a fee for releasing this Security Instrument, but only if the fee is paid to a third party for services rendered and the charging of the fee is permitted under Applicable Law.

24. Attorneys' Fees. As used in this Security Instrument and the Note, attorneys' fees shall include those awarded by an appellate court and any attorneys' fees incurred in a bankruptcy proceeding.

25. Jury Trial Waiver. The Borrower hereby waives any right to a trial by jury in any action, proceeding, claim, or counterclaim, whether in contract or tort, at law or in equity, arising out of or in any way related to this Security Instrument or the Note.

BY SIGNING BELOW, Borrower accepts and agrees to the terms and covenants contained in this Security Instrument and in any Rider executed by Borrower and recorded with it.

Signed, sealed and delivered in the presence of:

____________________________   ____________________________ (Seal)

-Borrower

[Printed Name]

Printed Name:____________________   Mailing Address:

[Please Complete]

____________________________   ____________________________ (Seal)

-Borrower

Initials: ____ ____ ____ ____

This is an Example of a Mortgage which names MERS as the Original Mortgagee (MOM Document).

[Printed Name]

Printed Name:____________________ Mailing Address:
[Please Complete]

________________________________ (Seal)
-Borrower
[Printed Name]
Mailing Address:

________________________________ (Seal)
-Borrower
[Printed Name]
Mailing Address:

——————— *[Acknowledgment on Following Page]* ———————

This is an Example of a Mortgage which names MERS as the Original Mortgagee (MOM Document).

State of §
§
County of §

The foregoing instrument was acknowledged before me this , ,
[date] by

[name of person acknowledging],
who is personally known to me or who has produced
[type of identification] as identification.

Signature of Person Taking Acknowledgment

Name Typed, Printed or Stamped

Title or Rank

Serial Number, if any

After recording please return to:

[Company Name]

[Name of Natural Person]

[Street Address]

[City, State Zip Code]

ATTACHMENT 2:

MBA FACT SHEET ON MERS

MORTGAGE BANKERS ASSOCIATION®
Investing in communities

MBA Fact Sheet
The Role of Electronic Mortgage Registrations

The Need for Electronic Registration

Recent events in the mortgage loan servicing industry have prompted questions about how mortgages are recorded and their ownership tracked. These questions are important for a number of reasons. In today's mortgage finance system, a loan is often sold one or more times after origination and then securitized as part of a pool of similar mortgages. Additionally, the overwhelming majority of mortgage loans are paid off through refinancing or sale of a property long before their terms (such as 15, 30 or 40 years) expire. These facts make tracking the servicer and ownership of every mortgage challenging and, at the same time, absolutely critical to the efficient operation of the mortgage market.

To understand the purpose of a registry of mortgage rights, it is important to understand the nature of mortgage loans. Mortgage loans are complex financial products that come with piles of paperwork (actual and electronic) at every step of the process – from borrower application to the ultimate marketing of a security backed by that loan. Two instruments are fundamental to virtually every mortgage loan today and rise above the rest in terms of legal importance – the promissory note and the security instrument, which is generally a mortgage or deed of trust. The security instrument establishes the note holder's right to the property, securing repayment of the borrower's promissory note upon the borrower's default.

The legal principle governing the right to receive payment under a mortgage note is that "possession" of the note determines ownership and the security instrument follows the note. The security instrument is recorded in the local (usually county) land records office to provide "public notice" of the mortgage lien.

The American process for allowing a borrower to possess real estate while paying the debt, and requiring the lender to record a notice of lien so that subsequent creditors and other interested parties can be aware of the lender's security interest in the real property, has been in place since the early 17th century. For hundreds of years, it worked pretty much the same way in counties across the country.

In more recent history, it also has been common practice to divide up the rights in a mortgage into "legal" rights and "equitable" or "beneficial" rights. Going back to the launch of FHA-insured mortgages in the 1930's, when a loan was made, the mortgage originator was identified in the public records as "mortgagee of record" on behalf of a life insurance company that would purchase the mortgage obligation. All rights to receive payment were sold to the insurance company which would become the equitable owner of the promissory note. To the world, the mortgage originator/servicer would be the mortgagee of record, but the entity would hold only "bare legal title" in order to service the mortgage on behalf of its investor. "Servicing" includes collecting mortgage payments, remitting them to investors, and handling mortgage delinquencies and defaults on behalf of an investor. As the secondary mortgage market evolved, this model was adopted by Fannie Mae and Freddie Mac, Ginnie Mae, and private label securitizers.

Under this model, every time servicing obligations changed hands as the mortgage moved through the mortgage business chain, the new servicer was generally required by the investor to record the assignment of its bare legal title in the local land records office. The records also had to be updated and liens released, as they do still today, any time a mortgage was paid off through a refinance or sale of the property.

By the early 1990s, with homeownership continuing to grow and interest rates falling to new lows, it was apparent that the mortgage recordation system that had been in use for nearly 400 years could not keep up with the modern volume of residential real property finance transactions. In fact, the 1993 mortgage refinance boom, still one of the largest in American history, was hampered by a severe backlog of paperwork (which included the assignments between servicers) at land records offices in many areas of the country, often delaying lien releases and related home purchase and mortgage refinance transactions to the detriment of consumers trying to benefit from falling interest rates and compromising the chain of record title. Borrowers, lenders and government officials all became frustrated by this situation which was exacerbated by the growing volume of investor-required mortgage assignments.

The mortgage recordation backlog of the early 1990s was somewhat analogous to Wall Street's "paperwork crisis" of the late 1960s, where clerks were buried in so many paper stock certificates that they could not process them fast enough. To solve this crisis, Wall Street turned to technology and a system of book-entry accounting to track stock ownership. Mortgage companies, banks, investors and government officials saw the positive results of this evolution in the stock market and began to discuss how to apply a similar concept to tracking mortgage ownership rights, servicing rights and warehouse loans (short-term security interests in mortgage obligations prior to their sale into the secondary mortgage market). Out of these discussions was born an industry utility that came to be called MERS, or Mortgage Electronic Registration Systems, Inc.

MERS Today

Today, MERS is an integral part of modern mortgage finance. MERS has dramatically improved the quality and availability of information in the residential mortgage process since its operations began in 1997.

The MERS® System is a database of information provided by mortgage lenders, servicers and investors. It is owned and operated by MERSCORP, Inc., the parent company of Mortgage Electronic Registration Systems, Inc. Using a standard Mortgage Identification Number (MIN), the MERS® System tracks changes in holders of loan servicing rights, owners of the mortgage note and holders of warehouse loans.

On the majority of mortgage loans today, borrowers agree at settlement to allow Mortgage Electronic Registration Systems, Inc. to be the mortgagee of record – as "nominee" for the promissory note holder – as the note is sold, aggregated and securitized. The mortgage lien and its priority position are properly established in the county recorder's office, while the ownership of the note and other mortgage rights move through the modern system of banking and capital markets, all the time being tracked closely by the MERS® System.

Allowing Mortgage Electronic Registration Systems, Inc. to serve as the mortgagee of record has relieved the pressures on the public land records caused by repeated transfers of mortgage rights (such as servicing and ownership rights), and thereby helps protect the accuracy and integrity of the chain of title. MERS also maintains a centralized "mailroom" on behalf of its members to receive and disseminate legal notices it receives as mortgagee of record.

The MERS® System supports the mortgage securitization process by giving banks, brokers, loan originators, servicers, investors and regulators the ability to track key information on every mortgage loan registered on the MERS® System. Since its inception, over 3,000 such market participants have registered more than 65 million loans with on the MERS® System. Today, over half of all outstanding mortgages are registered on the MERS® System.

MERS is also useful to borrowers, both directly and indirectly. MERS, for the first time, created a way for borrowers to track the servicer (and sometimes the investor) for their loan. This service is free online at http://www.mersinc.org/homeowners/ or by calling (888) 679-6377. Through the reduction of paperwork and other efficiencies, MERS has helped significantly reduce the costs of a mortgage which helps keep the mortgage market liquid and ultimately reduces costs to borrowers. In addition, MERS has decreased the time it takes to refinance a loan which can be a significant benefit to borrowers attempting to lower their interest rate or move from a variable interest rate loan to one with a fixed rate.

As the mortgagee of record, it is common for MERS to play a role in foreclosures. If Mortgage Electronic Registration Systems, Inc. is the mortgagee of record with the county land records, and the borrower is in default on the mortgage, foreclosure can be legally commenced either by Mortgage Electronic Registration Systems, Inc. on behalf of the note owner, or by servicer or other entity if the note owner instructs MERS to assign the mortgage to the servicer or other entity. The process varies in these two ways due to state laws and/or the preference of the servicer or investor. It is important to note that Mortgage Electronic Registration Systems, Inc. only initiates foreclosure when it has been instructed to do so by the owner of the mortgage and possesses the mortgage note.

For more information on MERS, go to www.mersinc.org.

October 29, 2010

ATTACHMENT 3:

"Title Transfer Law 101," by Karen Gelernt

***American Banker*, October 19, 2010**

AMERICAN BANKER®
THE FINANCIAL SERVICES DAILY
Tuesday, October 19, 2010

VIEWPOINT

Title Transfer Law 101

BY KAREN GELERNT

Recently, commentators have raised questions about whether certain transfers of residential mortgage loans (made in connection with secondary market transactions such as securitizations) were sufficient to transfer title to the new owner of the mortgage loans and whether such transfers of rights were sufficient to allow the new owner of the mortgages to commence foreclosure, where appropriate.

To better understand these issues, they must be put in their proper perspective based upon the law that underlies transfers of mortgage loans. The underlying tenet, however, is that residential mortgage notes are negotiable instruments which, by their nature, are intended to be liquid and easily transferable by certain key actions outlined in the law. Challenging this notion, irresponsibly questions a well-established body of law affecting trillions of dollars of mortgage loans as well as trillions of dollars of other types of negotiable instruments.

A mortgage loan consists of two important documents: the mortgage note, which constitutes the obligation of the mortgagor to pay its loan; and the mortgage, that constitutes the lien on the real property that secures the note. The note is a promissory note and notes secured by homes are typically negotiable instruments under law. Negotiable instruments have certain special characteristics under law. First, they are easily transferable (typically by endorsement).

Second, a holder in due course of a negotiable instrument takes the instrument free of most defenses to payment, thereby permitting the holder prompt payment. The intent behind the law of negotiable instruments was to enable such instruments to be as liquid as possible, to encourage commerce and lending. As such, residential mortgage loans are intended to be relatively liquid assets, easily transferred and easily realized upon.

In this way, a residential mortgage note is analogous to a check. In the case of the mortgage note, it is payable to the order of a mortgagee. Similar to a check, which is transferred by endorsement, a mortgage note is also transferred by endorsement. An endorsement can be specific (such as "Pay to the order of Joe Smith") or can be blank (such as "Pay to the order of______"). When a note is endorsed in blank, it becomes bearer paper (in other words, the bearer, or holder, is presumed to be the owner). The analogy would be a check made out to "cash." In both instances, the instrument can be physically transferred multiple times without the requirement of additional endorsements. If you presented a bank with a check made out to "cash" the bank should not question your ownership. Similarly, the ownership by an entity of a mortgage note endorsed in blank should not, in the ordinary course, be challenged.

In other words (and aside from the separate issue of whether the circumstances that are required to commence foreclose exist with respect to the mortgage loan), mere possession of a promissory note endorsed in blank (whether a check or a mortgage note) should provide the presumption of ownership of that promissory note by the current holder. So for example, a trustee for a securitization that has physical possession of the mortgage note, should be the presumed owner of that note. Any other outcome would put at risk the entire premise and foundation of negotiable instruments law.

In the end, an endorsement in blank does not, and should not, raise a question of ownership of the instrument.

The second component of a mortgage loan is the mortgage. The mortgage and the transfer of mortgage is governed by real property law. The mortgage must be recorded to put third parties on notice of the lienholder. This protects the mortgagee as well as other parties that might assert an interest in the property, like other lenders, judgment creditors or potential purchasers of the property. It protects the mortgagee because, if a third party were to assert an interest in the real property it would be required to give notice to all the interested parties of record, including the mortgagee of record under the mortgage. If an assignee did not record an assignment of mortgage, then the assignee would not be put on notice. However, this would be a risk borne by the assignee.

Historically, when a mortgage loan was transferred it was accompanied by an assignment of mortgage, oftentimes in blank. Because the secondary market was so active, buyers of mortgage loans frequently did not record the assignments in blank and merely delivered the assignments with the related mortgage notes endorsed in blank to the subsequent buyer. Frequently, the servicer of the mortgage loans remained the mortgagee of record and would receive any important notices regarding the related mortgaged properties. However, in order to facilitate easy transfers of mortgage loans, and to ease the burden of multiple recordations of assignments of mortgage in an active secondary market, MERS systems was developed. MERS is basically an agent for the mortgagee of record. So while a mortgage note may be transferred several times the mortgagee of record remains MERS and MERS tracks the intended mortgagee in its systems.

But at the end of the day, it is the owner of the mortgage note that dictates ownership of the mortgage (a premise commonly referred to as "the mortgage follows the note") as evidenced by Article 3 and Article 9 of the Uniform Commercial Code, in effect in all states.

Ideally, at foreclosure, the mortgagee of record should correspond to the holder of the note. However, any disparity should not be an acceptable basis to bar foreclosure, since the mortgage should not be the document that is dispositive of title to the mortgage loan. The holder of the note should be deemed the owner of the mortgage loan with standing and right to foreclose.

The chain of assignment of the mortgage may for various reasons be defective, or in the case of MERS, an agent for the holder may be identified as the mortgagee, but the principles of commercial law and negotiable instruments, if applied correctly, should ultimately prevail and allow the holder of the note to foreclose to the extent permitted by the mortgage loan documents and applicable state law. Any other outcome would call into question the foundations and liquidity of negotiable instruments and severely obstruct what was always intended as a relatively liquid market.

Karen Gelernt is a partner in the capital markets department at Cadwalader, Wickersham & Taft.

ATTACHMENT 4:

"MERS Under Attack:
Perspective on Recent Decisions from Kansas and Minnesota,"
by Barkley and Barbara Clark
Clark's Secured Transactions Monthly
February 2010

CLARKS'
SECURED TRANSACTIONS MONTHLY
Documentation • Bankruptcy • Regulation

MERS Under Attack:
Perspective on Recent Decisions from Kansas and Minnesota

by Barkley and Barbara Clark

February 2010

Due to the economic downtown, the business of securitizing loans into secondary markets has come under intense scrutiny. This is particularly true in the real estate area, where loans are routinely bundled into mortgage-backed securities and sold to investors. Since the original lender contemplates the immediate sale of the loan, it is common practice for originators to appoint a nominee, as third-party agent, who remains as mortgagee in the land records throughout the life of the loan. MERSCORP, INC., a privately held shareholder Delaware Corporation, operates the nationwide electronic registry for tracking interests in mortgage loans as they move through the securitization pipeline.

Mortgage Electronic Registration Systems, Inc. (MERS), a wholly owned subsidiary of MERSCORP, Inc. that serves as mortgagee in a nominee capacity for the lender and subsequent assignees—upfront and for the life of the loan---is generating nationwide litigation. Distressed borrowers are seizing on the fact that the name of the recorded mortgagee, and the identity of the investor as the beneficial owner of the mortgage loan, do not match. Borrowers (and some bankruptcy judges) are using the mismatch as ammunition for challenging foreclosure actions and avoiding mortgage obligations.

The legal issues have recently come to a head in significant decisions by the Kansas and Minnesota supreme courts. These cases are high-stakes challenges to the MERS registration system. We think the Kansas Supreme Court misconstrued the law in reaching its decision, but the Minnesota Supreme Court got it right.

MERS loses in Kansas. The Kansas case, decided on August 28, is *Landmark National Bank v. Kesler*, 216 P.3d 158 (Kan. 2009). The Kansas high court recently denied motions for reconsideration. There is a possibility that MERS will take the case to the U.S. Supreme Court in an effort to bolster its position as mortgagee and the mortgage showed an address for MERS on millions of recorded mortgages.

In *Landmark*, MERS was the mortgagee as the nominee for the beneficial owner of the junior mortgage loan. When the first mortgagee foreclosed, it did not notify MERS even though MERS was the recorded mortgagee. A default judgment wiped out the second mortgage and the property sold to a third party. The court did not decide the issue of whether MERS was entitled to notice and service of process in the initial foreclosure action, an issue fundamental to the MERS business model. Instead, it narrowly held that the trial court did not abuse its discretion in denying MERS' motion to vacate a default judgment and require joinder of MERS. Under the court's analysis, even if MERS was technically entitled to notice and service in the initial foreclosure action, MERS would not have had a "meritorious defense."

MERS is interpreting the Kansas court's holding narrowly, based on its procedural posture (the difficulty of overturning a judgment under the "abuse of discretion standard"), and is suggesting that the holding is limited because the court did not want to vacate a default judgment. Nevertheless, consumer advocates and some commentators are reading the decision as challenging MERS' basic right to notice of foreclosure actions. For example, Dan Schechter, a law professor at Loyola Law School in Los Angeles, suggests that the case "deprives the assignee of all economic benefit from the mortgage due to the involvement of MERS." He finds it "hard to quarrel with Kansas law" and posits that the law of "most states would be similar." Ominously, Professor Schechter concludes that dicta in the decision call into question "whether millions of MERS-administered mortgages are really enforceable." See 2009 Comm. Fin. News 72 (available on Westlaw).

MERS wins in Minnesota. *Jackson v. MERS*, 770 N.W. 2d 487 (August 13, 2009) is the Minnesota case. It came to the supreme court of Minnesota by way of a certified question from the federal district court. Borrowers facing foreclosure brought the lawsuit. Purporting to act on behalf of a class, they challenged MERS' right to proceed under Minnesota's foreclosure-by-advertisement statute, arguing that MERS had failed to comply with the statutory provisions requiring recording of an assignment of the underlying indebtedness. Minn. Stat. §§ 590.02 and 580.04 (2006). MERS serves as mortgagee for the lender as well as lender's assigns.

The Minnesota case turned on the legal question of what constitutes an assignment of a mortgage within the meaning of the foreclosure statute. The court answered the certified question in MERS' favor, holding that "transfers of the underlying indebtedness do not have to be recorded to foreclose a mortgage" under the foreclosure-by-advertisement statute. Therefore, MERS had no reason to re-record, and MERS was the proper mortgagee, with standing to bring the non-judicial foreclosure. Although the certified question focused on Minnesota's non-judicial foreclosure statute, the court's interpretation of the general law applicable to assignments of beneficial ownership interests is important.

How MERS works. Some background about how MERS works helps to put into context the legal issues before both courts. MERSCORP, Inc. tracks changes in the beneficial interests in mortgage loans in the secondary markets. MERSCORP, Inc. is similar to the book-entry systems used by the securities industry since the 1970s. A consortium of key players in the real estate financing industry developed MERSCORP, Inc. and MERS, including the GSEs (Fannie Mae, Freddie Mac, and Ginnie Mae) and the Mortgage Bankers Association; their purpose was to facilitate the operation of the mortgage markets. MERS registers about two-thirds of all residential loans in the secondary market--approximately 62 million mortgages. In a nutshell, MERS is mega.

Typically, the parties use the Fannie Mae/Freddie Mac Uniform Security Instrument. It is a three-party agreement among the borrower, lender, and MERS. The mortgage form names MERS as mortgagee of record in a nominee capacity for the original lender and lender's successors and assigns. The interest conveyed to MERS is "legal title." The document explicitly grants MERS the right to act on behalf of the lender as required by law or custom, including the right to foreclose and sell the property. Under the mortgage, the lender (and its assigns) retain "beneficial" title.

Put another way, the MERS' system intentionally names MERS as the original mortgagee while the originating lender remains as the payee on the note. When beneficial ownership interests transfer in the secondary market from one MERS member to another, (e.g. the note is negotiated and servicing rights are sold), MERSCORP, Inc. tracks these transfers electronically. The idea behind MERS is that the efficiency of the mortgage markets is vastly improved by maintaining MERS as the mortgagee on public records (in a nominee capacity for the lender and assigns) when transfers of mortgage interests (for mortgage loan sellers, warehouse lenders, mortgage investors, documents custodians, and mortgage servicers) are transacted privately pursuant to clearinghouse rules.

The MERS operating agreement also stipulates that MERS will act on behalf of the beneficial owner according to instructions from that member. Rules governing these agency relationships are set forth in member agreements. As a matter of contract, MERS becomes the agent for a new principal, the next purchasing member, each time there is a transfer. Special rules govern situations where parties that are not members of MERS purchase loans. Under these circumstances, the non-member can choose to keep using the MERS system if the servicer is a MERS member, or de-register the loan. When a non-member removes the loan from the MERS system, there is a recorded assignment of the mortgage to the new note holder.

MERS model relies on fundamental legal principles. Looking at the MERS system as a whole, it relies on well-recognized principles of real property law, the law of negotiable instruments, and basic contracts law. Important analogies in the UCC rules governing security interests in personal property also support the legal model. Here are the essential elements:

- **Use of a nominee on a security instrument is well established**: Both real estate law and the UCC recognize the validity of using a nominee. UCC § 9-502 (a) (2) states that a financing statement is sufficient if it provides the name of the secured party "or a representative of the secured party." This section codifies the holding of *In re Cushman Bakery*, 526 F2d 23 (1st Cir. 1975), cert. denied, 425 U.S. 937 (1976). That case also recognizes the validity of using a nominee as mortgagee on the mortgage for recording purposes on behalf of the note holder. See generally, 59 C.J.S. Mortgages § 80 at 116 (mortgages are valid even if the mortgagees of record are nominees or straw persons); 2 Milton R. Friedman, Friedman on Contracts & Conveyances of Real Property, § 6:1:3 (James Charles Smith ed., 7th ed. 2007). In addition, by private contract parties can establish agency relationships. UCC § 1-103(b) provides that common law agency principles may always supplement the rules governing secured transactions.

- **Article 9 rules apply even though note is secured by a mortgage.** UCC § 9-109(b) provides that "the application of this article to a security interest in a secured obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which this article does not apply." In other words, perfection of a security interest or the outright transfer of a note is not affected by the fact that the note is secured by a mortgage. The comments clearly state that "the security interest in the promissory note is covered" by Article 9 "even though the note is secured by a real-property mortgage."

- **Under Article 9, there is no need to record a mortgage assignment when the note is transferred.** The clear rules of Article 9 provide that when a note transfers, the security interest in the real estate securing the note also transfers. The principle that the "mortgage follows the note" is a common law principle that is codified in UCC § 9-203(g). UCC § 9-308(e) is the analogous rule for perfection. A promissory note evidences the underlying indebtedness. Negotiation occurs when the new note holder takes possession. There are complicated UCC rules that apply regarding the rights of holders, but the basic rule is that there is no requirement to file assignments of the document evidencing the debt.

- **A mortgagee can remain in place even though there are subsequent assignments of the note in accordance with private contractual agreements.** Under UCC § 9-310(c), if a secured party assigns a perfected security interest, an Article 9 filing is not required to continue the perfected status of the security interest against creditors from the original debtor. The original filing provides sufficient notice that there is a lien. Under real estate law, legal title can remain in a mortgagee without invalidating the security instrument even though the beneficial note holder is another party. Here again, the original mortgage does the trick. Both the UCC filing system and real property recordation statutes provide notice to creditors of the original debtor that there is a security interest or lien on the property. Even if the assignee takes no steps to record a new assignment of the mortgage so that it reflects the name of the new assignee, the security interest remains perfected against creditors and transferees of the original debtor. The comments to UCC § 9-310(c) and longstanding case law support this basic principle.

The basic legal model for MERS is a sound one. MERS' operational model relies on the rules set forth in so-called member agreements. In order for MERS to operate as a reliable and accurate registry, members are responsible for notifying MERS each time there is an event that occurs involving a registered loan in accordance with member rules. For detailed discussion of the relevant law, see Clark and Clark, *The Law of Secured Transactions under the UCC*, ¶¶ 1.08[10][a][iv] and 2.09[2].

A closer look at the Kansas case. The Kansas dispute dates back to 2004, when a borrower named Boyd Kesler took out a first mortgage on a piece of real property in Kansas. Landmark was the original lender on a $50,000 first mortgage. About a year later, Kesler took out a second mortgage. The second mortgage secured a loan for $93,100 from Millennia Mortgage Corp. Millennia was a MERS member; the parties used a MERS mortgage form identifying MERS as mortgagee. The structure of the deal indicates that Millennia contemplated selling the loan but intended to retain MERS as the mortgagee of record. The court assumes that this is exactly what happened. In hindsight, we know that the original lender on the second mortgage did, indeed, sell the loan to Sovereign Bank. Subsequently, the borrower filed for bankruptcy. Landmark got relief from the stay, and then filed a foreclosure action, eventually obtaining a default judgment.

Crucial facts turn on notice. The first-mortgage lender notified the original second-mortgage lender, named as lender in the mortgage and a MERS member. In other words, Landmark notified Millennia; however, Landmark did not notify MERS even though MERS was on the mortgage as nominee for the lender. Millennia failed to appear as a party, and apparently failed to notify MERS of the lawsuit. Compounding the notice problems, Millennia did not notify Sovereign, even though Sovereign purchased the loan from Millennia.

MERS tries to intervene after new buyers purchased the property. Landmark sold the property without anyone appearing to enforce the second lien. The sales price was enough to pay off Landmark's first lien and left a surplus of $37,000. The borrower tried to grab these funds, thinking it had the right to the money since the default judgment had effectively wiped out the second mortgage. At some point, Sovereign, as the beneficial owner of the second mortgage, learned what was happening and attempted to assert its rights. MERS also learned about the mess and filed motions to intervene, contending that it was a necessary party to the foreclosure action.

The district court denied both parties the right to intervene. The Kansas Court of Appeals affirmed the district court. 40 Kan.App.2d. 325, 192 P23d 177 (2008). The Supreme Court took the case on a petition to review, as a matter of first impression in Kansas. The question before the court came down to a determination of whether the trial court had "abused its discretion" by refusing to permit MERS to join the litigation as a necessary party. Did MERS have a "meritorious defense" or a sufficient property interest to require joinder?

Reading between the lines: the court had trouble with the facts. Reflecting back on the court's description of the factual scenario, a couple of points jump out:

- The court spends a lot of time wrestling with the language used in the mortgage document and grapples with its terms, finding the document confusing and conflicting with respect to how it described MERS' role. Under the terms of the mortgage, the lender retains the right to enforce the mortgage but if "necessary to comply with law or custom," the mortgage provides that MERS can enforce the interests of the lender and assigns.

- Even though the mortgage gave MERS the right to foreclose, the mortgage directed that Millennia, as lender, receive notice. The court had a hard time reconciling the notice provision with MERS' argument that it was entitled to notice as mortgagee of record.

- The court seems to have trouble sympathizing with MERS, given the facts. MERS is trying to set aside a default judgment after the sale of the property. The way the court tells the story, there are hints that MERS waited too long to object because MERS' own rules and procedures malfunctioned.

Kansas court misapplies the law. Notwithstanding the tough facts, we think the court should have ruled in MERS favor on the law. The court ruled that MERS, as straw man nominee, essentially lost the power to act for the lender when the note transferred to a new note holder. The court mistakenly failed to recognize that a mortgagee, holding "legal" title under the terms of the mortgage, retains a sufficient interest in the property to act on behalf of a subsequent assignee of the note. Essentially, the court lost sight of long-standing principles regarding the use of nominees on security instruments and ignored fundamental common law principles of agency law. It misconstrued the principle that "the mortgage follows the note." It wrongly interpreted the maxim as standing for the proposition that when a separation occurs between the note and holder of the legal title to the mortgage, the mortgage lien is wiped out. To the contrary, under Article 9, a new assignment of the mortgage is not required and the original mortgagee continues to act as a vehicle for the purpose of notice for recording purposes. The mortgage remains in place and is just fine.

A closer look at the Minnesota case. This principle that "the mortgage follows the note," construed correctly, saved the day for MERS in the Minnesota case. In Jackson, the borrowers facing foreclosure argued that the assignees of their mortgage interests were required to record new mortgage assignments in the land records before they had the authority to foreclose under the Minnesota foreclosure-by-advertisement statute. According to the borrowers, subsequent assignments of the underlying debt required recording of new mortgage assignments under Minnesota law.

The Minnesota supreme court properly rejected these arguments, relying on: (a) longstanding rules sanctioning the use of nominees; (b) the principle that since "the mortgage followed the note," new mortgage assignments were not required in order to keep the mortgage alive and perfected; and (c) a literal reading of the plain language used in Minnesota's non-judicial foreclosure statutes. This language requires recording of mortgage assignments when there is a change in mortgagees. Since the parties had retained MERS as mortgagee down the assignment line, the court was able to conclude that there had been no assignment of mortgage rights. We agree with the court's decision and its reasoning.

Damage control. Without doubt, MERS is unhappy with the Kansas situation, both the Supreme Court decision and the way notice of the foreclosure suit escaped detection in the MERS system for too long. To prevent another fiasco, MERS is reminding its members:

- Notify MERS when it is named as a defendant in a foreclosure case even though the member no longer has any ownership interest in the mortgage loan.

- In the situation where there are multiple mortgage holders and the mortgage holders are MERS members, MERS will be wearing multiple hats in any foreclosure action, acting as nominee for the plaintiff and nominee for the defendant. Under these circumstances, the foreclosing party should notify MERS and name it as a defendant. This creates the strange situation where MERS is both plaintiff and defendant.

- Be certain that recorded mortgages reflect MERS as mortgagee and the indexing system reflects MERS as mortgagee.

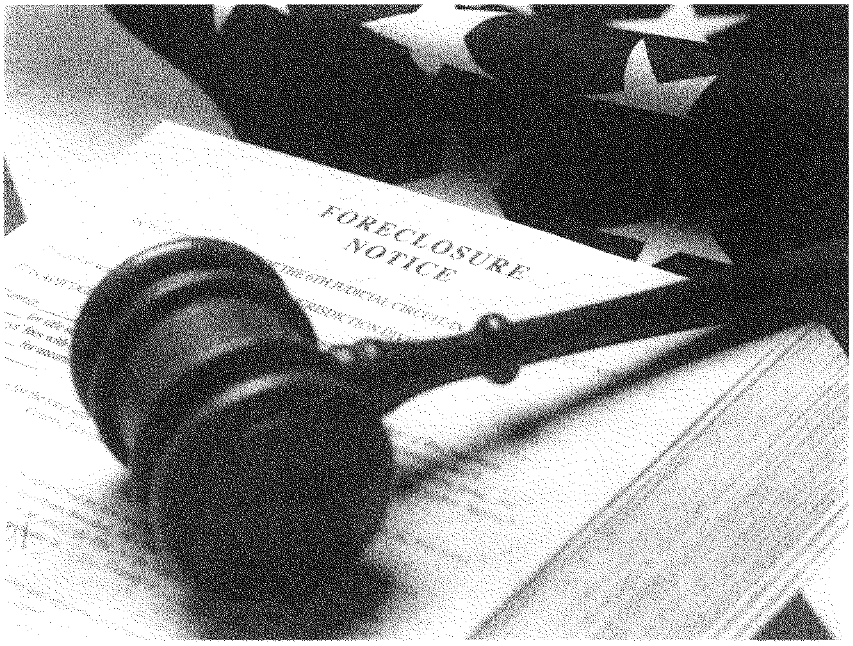
(MERS Announcement Number 2009-06, dated October 1, 2009, posted on the MERS website).

Bottom line. Given the fallout from the Kansas case, it is not surprising that MERS is looking seriously at an appeal to the United States Supreme Court. We suspect that borrowers will rely inappropriately on *Landmark* as authority for wiping out mortgage liens in foreclosure cases and will use the case to challenge MERS' ability to enforce liens in bankruptcy court using standing and real party in interest arguments. *Jackson* is the better precedent. Even with *Jackson* in hand, there may be times when the simple fact that MERS is the mortgagee of record is not enough. Depending on the jurisdiction and posture of the litigation, MERS may need to connect the dots for the court by coming prepared with evidence documenting its agency relationship with the investor as owner of the underlying debt. Documenting the link, however, is an evidentiary matter. It does not change the law.

Note: One of the editors of this newsletter, Barkley Clark, is a partner in the firm of Stinson Morrison Hecker LLP, which represented MERS in the Kansas case. He did not participate in the case.

ATTACHMENT 5:

"Judicial Versus Non-Judicial Foreclosure"
Mortgage Bankers Association
October 2010



Judicial Versus Non-Judicial Foreclosure

MORTGAGE
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Investing in communities

Judicial Versus Non-Judicial Foreclosure

In many discussions about mortgage foreclosures the terms **judicial** and **non-judicial** foreclosure are used. They involve very different processes. These terms refer to how individual states handle real estate foreclosure. Under both systems, time frames and terms vary widely from state to state. The following is a brief, general, description of both processes. The accompanying chart (see last page) depicts the varying time frames involved in the judicial foreclosure process.

Judicial Foreclosures

A judicial foreclosure is a court proceeding that begins when the lender files a complaint and records a notice in the public land records announcing a claim on the property to potential buyers, creditors and other interested parties. The complaint describes the debt, the borrower's default and the amount owed. The complaint asks the court to allow the lender to foreclose its lien and take possession of the property as a remedy for non-payment.

The homeowner is served notice of the complaint, either by mail, direct service or publication of the notice. The defendant (borrower) is permitted to dispute the facts (such as show that payments were made), offer defenses or present counterclaims by answering the complaint, filing a separate suit, and/or by attending a hearing arranged by the court. If the defendant shows there are differences of material facts, a trial will be held by the court to determine if foreclosure should occur. In the vast majority of cases, however, the foreclosure action is undisputed because the borrower is in default and cannot offer facts to the contrary. If the court determines the homeowner did default and that the debt is valid, it will issue a judgment in favor of the servicer for the total amount owed, including costs for the foreclosure process. In order for the judge to determine the amount of the judgment, the servicer submits paperwork through an affidavit that itemizes the amounts due.

Twenty two states use judicial procedures as the primary way to foreclose. These include: Connecticut, Delaware, Florida, Hawaii, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, New Jersey, New Mexico, New York, North Dakota, Ohio, Oklahoma, Pennsylvania, South Carolina, South Dakota, Vermont and Wisconsin.

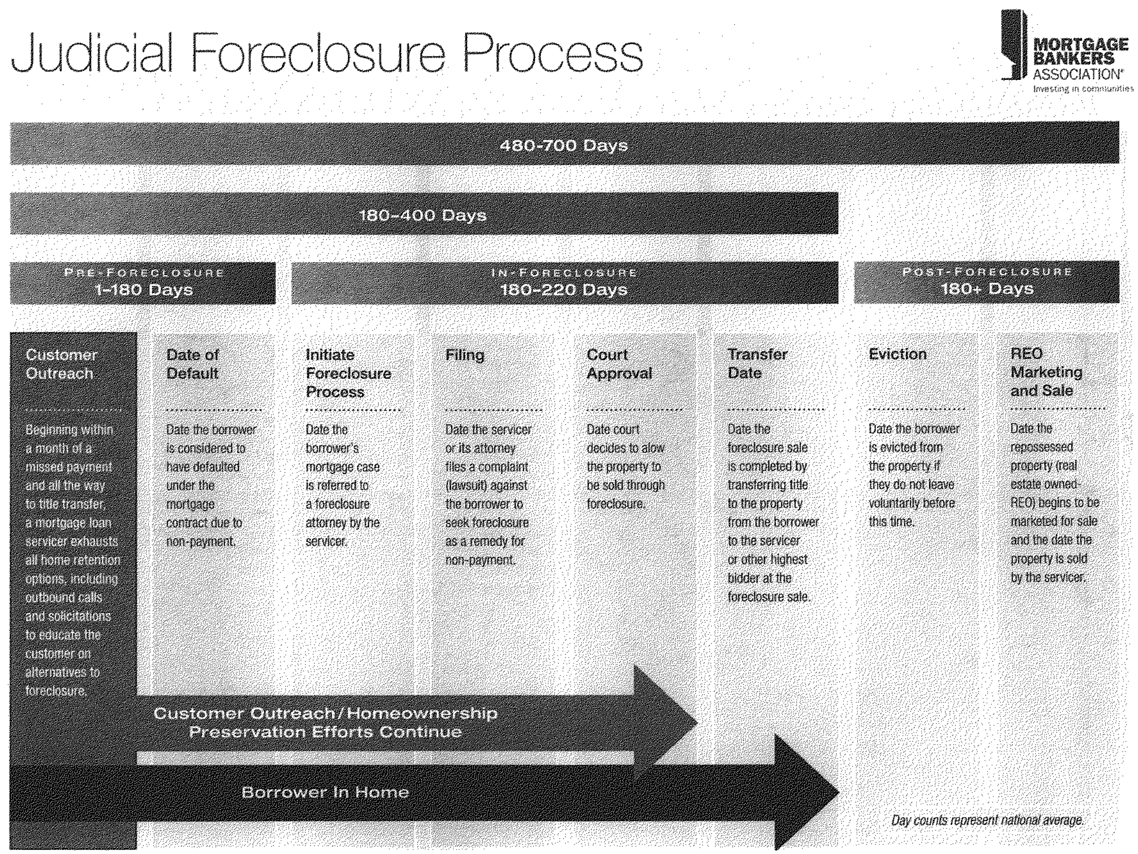
In all other states, foreclosure is usually handled by attorneys who follow a state-provided process. In the mortgage documents, borrowers give lenders the "power of sale" outside of judicial process in the event of an uncured default. Documentation or affidavit issues are not common in these states because of the non-judicial nature of the process.

Next, the court will authorize a sheriff's sale. The sale is an auction of the property open to anyone, and must be held in a public place. Procedures for a sheriff's sale in each locality differ, but the individual with the highest bid is granted the property. After the sale is confirmed by the court, the deed, which transfers ownership, is prepared, recorded and the highest bidder becomes the owner of the property. In most cases, the highest bidder is the servicer, who takes title of the property. The servicer then can sell the property. At this point, it is called **real estate owned (REO).**

Non-Judicial Foreclosures

The requirements for non-judicial foreclosure are established by state statue; there is no court intervention. When the default occurs, the homeowner is mailed a default letter and in many states a Notice of Default is recorded, at or about the same time. The homeowner may cure the debt during a prescribed period; if not, a Notice of Sale is mailed to the homeowner, posted in public places, recorded at the county's recorder's office, and published in area newspapers/legal publications. When the legally required notice period (determined by each state) has expired, a public auction is held and the highest bidder becomes the owner of the property, subject to recordation of the deed. Prior to the sale, if the borrower disagrees with the facts of the case, he or she can try to file a lawsuit to enjoin the trustee's sale.

Judicial Foreclosure Process



PREPARED STATEMENT OF ADAM J. LEVITIN *

ASSOCIATE PROFESSOR OF LAW, GEORGETOWN UNIVERSITY LAW CENTER
NOVEMBER 16, 2010

Executive Summary

The mortgage foreclosure process is beset by a variety of problems. These range from procedural defects (including, but not limited to robosigning) to outright counterfeiting of documents to questions about the validity of private-label mortgage securitizations that could mean that these mortgage-backed securities are not actually backed by any mortgages whatsoever. While the extent of these problems is unknown at present, the evidence is mounting that it is not limited to one-off cases, but that there may be pervasive defects throughout the foreclosure and securitization processes.

The problems in the mortgage market are highly technical, but they are extremely serious. At best they present problems of fraud on the court, clouded title to property, and delay in foreclosures that will increase the shadow housing inventory and drive down home prices. At worst, they represent a systemic risk of liabilities in the trillions of dollars, greatly exceeding the capital of the United State's major financial institutions.

Congress would do well to ensure that Federal regulators are undertaking a thorough investigation of foreclosure problems and to consider the possibilities for a global settlement of foreclosure problems, loan modifications, and the housing debt overhang that stagnate the economy and pose potential systemic risk.

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. I also serve as Special Counsel to the Congressional Oversight Panel for the Troubled Asset Relief Program. The views I express today are my own, however.

We are now well into the fourth year of the foreclosure crisis, and there is no end in sight. Since mid-2007 around 8 million homes entered foreclosure,[1] and over three million borrowers lost their homes in foreclosure.[2] As of June 30, 2010, the Mortgage Bankers Association reported that 4.57 percent of 1–4 family residential mortgage loans (roughly 2.5 million loans) were currently in the foreclosure, process a rate more than quadruple historical averages. (See Figure 1.) Additionally, 9.85 percent of mortgages (roughly 5 million loans) were at least a month delinquent.[3]

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Before joining the Georgetown faculty, Professor Levitin practiced in the Business Finance & Restructuring Department of Weil, Gotshal & Manges, LLP in New York, and served as law clerk to the Honorable Jane R. Roth on the United States Court of Appeals for the Third Circuit.

Professor Levitin holds a J.D. from Harvard Law School, an M.Phil and an A.M. from Columbia University, and an A.B. from Harvard College.

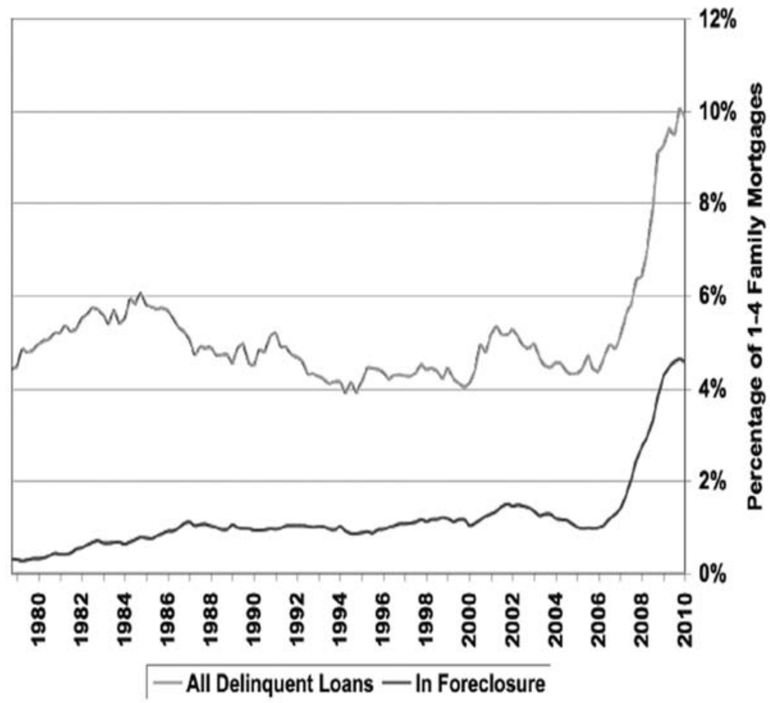
Professor Levitin has not received any Federal grants nor has he received any compensation in connection with his testimony. The views expressed in Professor Levitin's testimony are his own and do not represent the positions of the Congressional Oversight Panel.

[1] HOPE Now Data Reports.

[2] *Id.*

[3] Mortgage Bankers Association, National Delinquency Survey.

Chart 1: Percentage of 1–4 Family Residential Mortgages in Foreclosure[4]



Private lenders, industry associations, and two successive Administrations have made a variety of efforts to mitigate the crisis and encourage loan modifications and refinancings. A series of much hyped initiatives, such as the FHASecure refinancing program and the Hope4Homeowners have all met what can charitably be described as limited success. FHASecure, predicted to help 240,000 homeowners,[5] assisted only a few thousand borrowers before it wound down,[6] while Hope4Homeowners, originally predicted to help 400,000 homeowners,[7] had closed only 130 refinancings as of September 30, 2010.[8] The Home Affordable Modification (HAMP) has also failed, producing 495,898 permanent modifications through September 2010. This number is likely to be a high water mark for HAMP, as new permanent modifications are decreasing rapidly while defaults on permanent modifications rise; if current trends continue, by year's end the number of active permanent HAMP modifications will actually decline.

A number of events over the past several months have roiled the mortgage world, raising questions about:

(1) Whether there is widespread fraud in the foreclosure process;

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[4] Mortgage Bankers Association, National Delinquency Surveys.

[5] *See, e.g.,* Press Release, U.S. Dept. of Housing and Urban Development, Bush Administration to Help Nearly One-Quarter of a Million Homeowners Refinance, Keep Their Homes; FHA to implement new "FHASecure" refinancing product (Aug. 31, 2007), available at *http://www.hud.gov/news/release.cfm?content=pr07-123.cfm;* Press Release, U.S. Dept. of Housing and Urban Development, FHA Helps 400,000 Families Find Mortgage Relief; Refinancing on pace to help half-million homeowners by year's end (Oct. 24, 2008), available at *http://www.hud.gov/news/release.cfm?content=pr08-167.cfm.*

[6] Michael Corkery, *Mortgage 'Cram-Downs' Loom as Foreclosures Mount,* Wall St. J., Dec. 31, 2008.

[7] Dina ElBoghdady, *HUD Chief Calls Aid on Mortgages a Failure,* Wash. Post. Dec. 17, 2008, at A1.

[8] *See* FHA Single Family Outlook, Sept. 2010, at *http://www.hud.gov/offices/hsg/rmra/oe/rpts/ooe/olcurr.xls-2010-11-02,* Row 263 (note that FHA fiscal years begin in October, so that Fiscal Year 2009 began in October 2008).

(2) Securitization chain of title, namely whether the transfer of mortgages in the securitization process was defective, rendering mortgage-backed securities into non-mortgage backed securities;

(3) Whether the use of the Mortgage Electronic Registration System (MERS) creates legal defects in either the secured status of a mortgage loan or in mortgage assignments;

(4) Whether mortgage servicers' have defaulted on their servicing contracts by charging predatory fees to borrowers that are ultimately paid by investors;

(5) Whether investors will be able to "putback" to banks securitized mortgages on the basis of breaches of representations and warranties about the quality of the mortgages.

These issues are seemingly disparate and unconnected, other than that they all involve mortgages. They are, however, connected by two common threads: the necessity of proving standing in order to maintain a foreclosure action and the severe conflicts of interests between mortgage servicers and MBS investors.

It is axiomatic that in order to bring a suit, like a foreclosure action, the plaintiff must have legal standing, meaning it must have a direct interest in the outcome of the legislation. In the case of a mortgage foreclosure, only the mortgagee has such an interest and thus standing. Many of the issues relating to foreclosure fraud by mortgage servicers, ranging from more minor procedural defects up to outright counterfeiting relate to the need to show standing. Thus problems like false affidavits of indebtedness, false lost note affidavits, and false lost summons affidavits, as well as backdated mortgage assignments, and wholly counterfeited notes, mortgages, and assignments all relate to the evidentiary need to show that the entity bringing the foreclosure action has standing to foreclose.

Concerns about securitization chain of title also go to the standing question; if the mortgages were not properly transferred in the securitization process (including through the use of MERS to record the mortgages), then the party bringing the foreclosure does not in fact own the mortgage and therefore lacks standing to foreclose. If the mortgage was not properly transferred, there are profound implications too for investors, as the mortgage-backed securities they believed they had purchased would, in fact be non-mortgage-backed securities, which would almost assuredly lead investors to demand that their investment contracts be rescinded, thereby exacerbating the scale of mortgage putback claims.

Putback claims underscore the myriad conflicts of interest between mortgage servicers and investors. Mortgage servicers are responsible for prosecuting on behalf of MBS investors, violations of representations and warranties in securitization deals. Mortgage servicers are loathe to bring such actions, however, not least because they would often be bringing them against their own affiliates. Servicers' failure to honor their contractual duty to protect investors' interest is but one of numerous problems with servicer conflicts of interest, including the levying of junk fees in foreclosures that are ultimately paid by investors and servicing first lien loans while directly owning junior liens.

Many of the problems in the mortgage securitization market (and thus this testimony) are highly technical, but they are extremely serious.[9] At best they present problems of fraud on the court and questionable title to property. At worst, they represent a systemic risk of liabilities in the trillions of dollars, greatly exceeding the capital of the United State's major financial institutions. While understanding the securitization market's problems involves following a good deal of technical issues, it is critical to understand from the get-go that securitization is all about technicalities.

Securitization is the legal apotheosis of form over substance, and if securitization is to work it must adhere to its proper, prescribed form punctiliously. The rules of the game with securitization, as with real property law and secured credit are, and always have been, that dotting "i's" and crossing "t's" matter, in part to ensure the fairness of the system and avoid confusions about conflicting claims to property. Close enough doesn't do it in securitization; if you don't do it right, you cannot ensure that securitized assets are bankruptcy remote and thus you cannot get the ratings and opinion letters necessary for securitization to work. Thus, it is important not to dismiss securitization problems as merely "technical;" these issues are no more technicalities than the borrower's signature on a mortgage. Cutting corners

[9] I emphasize, however, that this testimony does not purport to be a complete and exhaustive treatment of the issues involved and that many of the legal issues discussed are not settled law, which is itself part of the problem; trillions of dollars of mortgage securitization transactions have been done without a certain legal basis.

may improve securitization's economic efficiency, but it undermines its legal viability.

Finally, as an initial matter, let me also emphasize that the problems in the securitization world do not affect the whether homeowners owe valid debts or have defaulted on those debts. Those are separate issues about which there is no general controversy, even if debts are disputed in individual cases.[10]

This written testimony proceeds as follows: Part I presents an overview of the structure of the mortgage market, the role of mortgage servicers, the mortgage contract and foreclosure process. Part II presents the procedural problems and fraud issues that have emerged in the mortgage market relating to foreclosures. Part III addresses chain of title concerns. Part IV considers the argument that the problems in foreclosures are mere technicalities being used by deadbeats to delay foreclosure. Part V concludes.

I. BACKGROUND ON SECURITIZATION, SERVICING, AND THE FORECLOSURE PROCESS

A. MORTGAGE SECURITIZATION

Most residential mortgages in the United States are financed through securitization. Securitization is a financing method involving the issuance of securities against a dedicated cash flow stream, such as mortgage payments, that are isolated from other creditors' claims. Securitization links consumer borrowers with capital market financing, potentially lowering the cost of mortgage capital. It also allows financing institutions to avoid the credit risk, interest rate risk, and liquidity risk associated with holding the mortgages on their own books.

Currently, about 60 percent of all outstanding residential mortgages by dollar amount are securitized.[11] The share of securitized mortgages by number of mortgages outstanding is much higher because the securitization rate is lower for larger "jumbo" mortgages.[12] Credit Suisse estimates that 75 percent of outstanding first-lien residential mortgages are securitized.[13] In recent years, over 90 percent of mortgages originated have been securitized.[14] Most second-lien loans, however, are not securitized.[15]

Although mortgage securitization transactions are extremely complex and vary somewhat depending on the type of entity undertaking the securitization, the core of the transaction is relatively simple.[16]

First, a financial institution (the "sponsor" or "seller") assembles a pool of mortgage loans. The loans were either made ("originated") by an affiliate of the financial institution or purchased from unaffiliated third-party originators. Second, the pool of loans is sold by the sponsor to a special-purpose subsidiary (the "depositor") that has no other assets or liabilities. This is done to segregate the loans from the spon-

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[10] A notable exception, however, is for cases where the default is caused by a servicer improperly force-placing insurance or misapplying a payment, resulting in an inflated loan balance that triggers a homeowner default.

[11] Inside Mortgage Finance, 2010 Mortgage Market Statistical Annual.

[12] *Id.*

[13] Ivy L. Zelman *et al., Mortgage Liquidity du Jour: Underestimated No More,* 28 exhibit 21 (Credit Suisse, Equity Research Report, Mar. 12, 2007).

[14] Inside Mortgage Finance, 2010 Mortgage Market Statistical Annual.

[15] Inside Mortgage Finance, 2010 Mortgage Market Statistical Annual. From 2001–2007, only 14 percent of second lien mortgages originated were securitized. *Id.* Second lien mortgages create a conflict of interest beyond the scope of this paper. In many cases, second lien loans are owned by financial institutions that are servicing (but do not own) the first lien loan. See Hearing Before the House Financial Services Committee, Apr. 13, 2009, "Second Liens and Other Barriers to Principal Reduction as an Effective Foreclosure Mitigation Program" (testimony of Barbara DeSoer, President, Bank of America Home Loans) at 6 (noting that Bank of America owns the second lien mortgage on 15 percent of the first lien mortgages it services); Hearing Before the House Financial Services Committee, Apr. 13, 2009, "Second Liens and Other Barriers to Principal Reduction as an Effective Foreclosure Mitigation Program" (testimony of David Lowman, CEO for Home Lending, JPMorgan Chase) at 5 (noting that Chase owns the second lien mortgage on around 10 percent of the first lien mortgages it services). The ownership of the second while servicing the first creates a direct financial conflict between the servicer qua servicer and the servicer qua owner of the second lien mortgage, as the servicer has an incentive to modify the first lien mortgage in order to free up borrower cash flow for payments on the second lien mortgage.

[16] The structure illustrated is for private-label mortgage-backed securities. Ginnie Mae and GSE securitizations are structured somewhat differently. The private-label structure can, of course, be used to securitize any asset, from oil tankers to credit card debt to song catalogues, not just mortgages.

sor's assets and liabilities.[17] Third, the depositor sells the loans to a passive, specially created, single-purpose vehicle (SPV), typically a trust in the case of residential mortgages.[18] The SPV issues certificated securities to raise the funds to pay the depositor for the loans. Most of the securities are debt securities—bonds—but there will also be a security representing the rights to the residual value of the trust or the "equity."

The securities can be sold directly to investors by the SPV or, as is more common, they are issued directly to the depositor as payment for the loans. The depositor then resells the securities, usually through an underwriting affiliate that then places them on the market. (*See* Figure 2, below.) The depositor uses the proceeds of the securities sale (to the underwriter or the market) to pay the sponsor for the loans. Because the certificated securities are collateralized by the residential mortgage loans owned by the trust, they are called residential mortgage-backed securities (RMBS).

A variety of reasons—credit risk (bankruptcy remoteness), off-balance sheet accounting treatment, and pass-through tax status (typically as a REMIC [19] or grantor trust)—mandate that the SPV be passive; it is little more than a shell to hold the loans and put them beyond the reach of the creditors of the financial institution.[20] Loans, however, need to be managed. Bills must be sent out and payments collected. Thus, a third-party must be brought in to manage the loans.[21] This third-party is the servicer. The servicer is supposed to manage the loans for the benefit of the RMBS holders.

Every loan, irrespective of whether it is securitized, has a servicer. Sometimes that servicer is a first-party servicer, such as when a portfolio lender services its own loans. Other times it is a third-party servicer that services loans it does not own. All securitizations involve third-party servicers, but many portfolio loans also have third-party servicers, particularly if they go into default. Third-party servicing contracts for portfolio loans are not publicly available, making it hard to say much about them, including the precise nature of servicing compensation arrangements in these cases or the degree of oversight portfolio lenders exercise over their third-party servicers. Thus, it cannot always be assumed that if a loan is not securitized it is being serviced by the financial institution that owns the loan, but if the loan is securitized, it has third-party servicing.

Securitization divides the beneficial ownership of the mortgage loan from legal title to the loan and from the management of the loans. The SPV (or more precisely its trustee) holds legal title to the loans, and the trust is the nominal beneficial owner of the loans. The RMBS investors are formally creditors of the trust, not owners of the loans held by the trust.

The economic reality, however, is that the investors are the true beneficial owners. The trust is just a pass-through holding entity, rather than an operating company. Moreover, while the trustee has nominal title to the loans for the trust, it is the third-party servicer that typically exercises legal title in the name of the trustee. The economic realities of securitization do not track with its legal formalities; securitization is the apotheosis of legal form over substance, but punctilious respect for formalities is critical for securitization to work.

Mortgage servicers provide the critical link between mortgage borrowers and the SPV and RMBS investors, and servicing arrangements are an indispensable part of securitization.[22] Mortgage servicing has become particularly important with the growth of the securitization market.

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[17] This intermediate entity is not essential to securitization, but since 2002, Statement of Financial Accountings Standards 140 has required this additional step for off-balance-sheet treatment because of the remote possibility that if the originator went bankrupt or into receivership, the securitization would be treated as a secured loan, rather than a sale, and the originator would exercise its equitable right of redemption and reclaim the securitized assets. Deloitte & Touche, *Learning the Norwalk Two-Step,* Heads Up, Apr. 25, 2001, at 1.

[18] The trustee will then typically convey the mortgage notes and security instruments to a "master document custodian," who manages the loan documentation, while the servicer handles the collection of the loans.

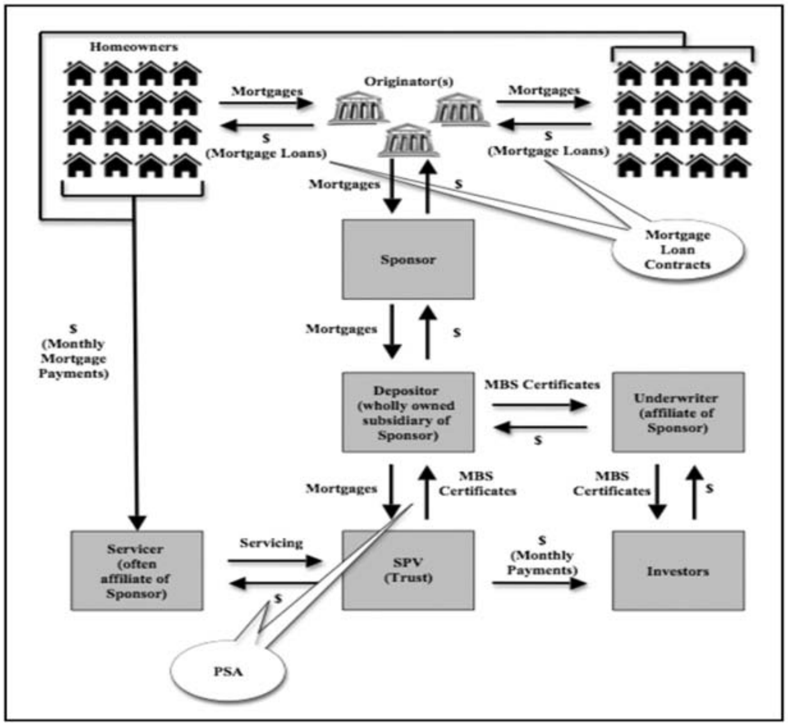
[19] A REMIC is a real estate mortgage investment conduit, as defined under I.R.C. §§ 860A–860G.

[20] *See* Anna Gelpern & Adam J. Levitin, *Rewriting Frankenstein Contracts: Workout Prohibitions in Residential Mortgage Backed Securities,* 82 S. Cal. L. Rev. 1075, 1093–98. (2009).

[21] *See* Kurt Eggert, *Limiting Abuse and Opportunism by Mortgage Servicers,* 15 Housing Pol'y Debate 753, 754 (2004).

[22] The servicing of nonsecuritized loans may also be outsourced. There is little information about this market because it does not involve publicly available contracts and does not show up in standard data.

Figure 2. Private-Label Mortgage Securitization Structure [23]



B. THE MORTGAGE SERVICING BUSINESS [24]

The nature of the servicing business in general militates toward economies of scale and automation. Servicing combines three distinct lines of business: transaction processing, default management, and loss mitigation. Transaction processing is a highly automatable business, characterized by large economies of scale. Default management involves collections and activities related to taking defaulted loans through foreclosure. Like transaction processing, default management can be automated,[25] as it does not require any negotiation with the homeowner, insurers, or junior lienholders.[26]

Loss mitigation is considered an *alternative to foreclosure,* and includes activities such as repayment plans, loan modifications, short sales and deeds in lieu of foreclosure. Loss mitigation is always a negotiated process and is therefore labor-intensive and expensive. Not only must the homeowner be agreeable to any loss mitigation solution, but so too must mortgage insurers and junior lienholders if they are parties on the loan. Because each negotiation is separate and requires a trained employee, there are very few opportunities for automation or economies of scale. Labor expenses are also considered overhead, which are all non-reimbursable expenses to servicers. And, to the extent that loss mitigation is in the form of a loan modification, redefault and self-cure risk always lurk in the background. Moreover, loss miti-

[23] See ACE Sec. Corp. Home Equity Loan Trust, Series 2006–NC3, Prospectus Supplement (Form 424B5) S–11 (Nov. 21, 2006), *available at http://www.sec.gov/Archives/edgar/data/1380884/000114420406049985/v058926__424b5.htm.*

[24] This section of my testimony comes from Adam J. Levitin & Larry Cordell, *What RMBS Servicing Can Learn from CMBS Servicing,* working paper, November 2010.

[25] *See In re Taylor,* 407 B.R. 618 (Bankr. E.D. Pa. 2009), *rev'd* 2010 WL 624909 (E.D. Pa. 2010).

[26] Arguably servicers have a fourth line of business—the management of real estate owned (REO). REO are foreclosed properties that were not purchased by third-parties at the foreclosure sale. REO management involves caring for and marketing the REO. It does not require negotiations with the homeowner (who is evicted) or junior lienholders (whose liens are generally extinguished by the foreclosure).

tion, redefault and self-cure risk always lurk in the background. Moreover, loss mitigation must generally be conducted in addition to default management; the servicer must proceed with foreclosure even if attempting to find an alternative, so the cost of loss mitigation is additive. Yet, while taking a loan through foreclosure is likely to involve lower costs than pursuing loss mitigation, it may not ultimately maximize value for RMBS investors because loss severities in foreclosure can easily surpass those on a re-performing restructured loan.

The balance between these different parts of a servicer's business changes over the course of the housing cycle. When the housing market is strong, the transaction processing dominates the servicing business, but when the housing market is weak, default management and loss mitigation become more important.

The very short weighted average life (WAL) of RMBS trusts combined with very low defaults in most economic environments encouraged servicers to place disproportionate weight on performing loan servicing, which historically has been characterized by small servicing fees and enormous economies of scale. Thus, on a typical loan balance of $200,000 today, a servicer might earn between $500 and $1,000 per year.[27] Given the low-level of annual income per loan, the short WAL of each loan, and low default rates in most economic environments before 2006, servicers had few incentives to devote resources to loss mitigation, but large incentives to invest in performing loan automation to capture the large economies of scale. This left servicers wholly unprepared for the elevated level of defaults that began in 2007.

C. RMBS SERVICER COMPENSATION

RMBS servicers' duties and compensation are set forth in a document called a "Pooling and Servicing" agreement (PSA) also governs the rights of the RMBS certificate holders. RMBS servicers are compensated in four ways. First, they receive a "servicing fee," which is a flat fee of 25–50 basis points (bps) and is a first priority payment in the RMBS trust.[28] This is by far the greatest portion of servicer income. This fee is paid out proportionately across all loans regardless of servicer costs through the economic cycle.

Second, servicers earn "float" income. Servicers generally collect mortgage payments at the beginning of the month, but are not required to remit the payments to the trust until the 25th of the month. In the interim, servicers invest the funds they have collected from the mortgagors, and they retain all investment income. Servicers can also obtain float income from escrow balances collected monthly from borrowers to pay taxes and insurance during the course of the year.

Third, servicers are generally permitted to retain all ancillary fees they can collect from mortgagors. This includes things like late fees and fees for balance checks or telephone payments. It also includes fees for expenses involved in handling defaulted mortgages, such as inspecting the property. Finally, servicers can hold securities themselves directly as investors, and often hold the junior-most, residual tranche in the securitization.

Servicers face several costs. In addition to the operational expenses of sending out billing statements, processing payments, maintaining account balances and histories, and restructuring or liquidating defaulted loans, private label RMBS servicers face the expense of "servicing advances."[29] When a loan defaults, the servicer is responsible for advancing the missed payments of principal and interest to the trust as well as paying taxes and insurance on the property. They continue to pay clear through liquidation of the property, unless these advances are not deemed recoverable.

The servicer is able to recover advances it has made either from liquidation proceeds or from collections on other loans in the pool, but the RMBS servicer does not receive interest on its advances. Therefore, advances can be quite costly to servicers in terms of the time value of money and can also place major strains on servicers' liquidity, as the obligation to make advances continues until the loan is liquidated or the servicer believes that it is unlikely to be able to recover the advances. In some cases, servicers have to advance years' worth of mortgage payments to the trust.

While RMBS servicers do not receive interest on servicing advances, they are compensated for their "out-of-pocket" expenses. This includes any expenses spent on

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[27] Servicing fees are generally 25–50 bps, which translates into $500–$1,000 per year in servicing fees.

[28] Generally the servicing fee is 25 bps for conventional fixed-rate mortgages, 37.5 bps for conventional ARM loans, 44 bps for Government loans and 50 bps for subprime.

[29] In Agency securities, servicers generally stop advancing after borrowers owe their fifth payment, at 120 days past due. For GSE loans, they are then removed from the securities and taken on balance sheet. Servicer advances for the four payments are typically not reimbursed until termination.

preserving the collateral property, including force-placed insurance, legal fees, and other foreclosure-related expenses. Large servicers frequently "in-source" default management expenses to their affiliates.

D. MONITORING OF RMBS SERVICERS

RMBS servicing arrangements present a classic principal-agent problem wherein the agent's incentives are not aligned with the principal and the principal has limited ability to monitor or discipline the agent.

1. Investors

Investors are poorly situated to monitor servicer behavior because they do not have direct dealings with the servicer. RMBS investors lack information about servicer loss mitigation activity. Investors do not have access to detailed servicer expense reports or the ability to examine loss mitigation decisions. Investors are able to see only the ultimate outcome. This means that investors are limited in their ability to evaluate servicers' performance on an ongoing basis. And even if investors were able to detect unfaithful agents, they have little ability to discipline them short of litigation.[30]

2. Trustees

RMBS feature a trustee, but the name is deceptive. The trustee is not a common law trustee with general fiduciary duties. Instead, it is a limited purpose corporate trustee whose duties depend on whether there has been a default as defined U.N. the PSA. A failure to pay all tranches their regularly scheduled principal and interest payments is *not* an event of default. Instead, default relates to the financial condition of the servicer, whether the servicer has made required advances to the trust, whether the servicer has submitted its monthly report, and whether the servicer has failed to meet any of its covenants under the PSA.

Generally, before there is an event of default, the trustee has a few specifically assigned ministerial duties and no others.[31] These duties are typically transmitting funds from the trust to the RMBS investors and providing investors performance statements based on figures provided by the servicer. The trustee's pre-default duties do *not* include active monitoring of the servicer.

Trustees are generally entitled to rely on servicers' data reporting, and have little obligation to analyze it.[32] Indeed, as Moody's has noted, trustees lack the ability to verify most data reported by servicers; at best they can ensure that the reported data complies with any applicable covenant ratios:

> The trustee is not in a position to verify certain of the numbers reported by the servicer. For example, the amount of delinquent receivables and the amount of receivables charged off in a given month are figures that are taken from the servicer's own computer systems. While these numbers could be verified by an auditor, they are not verifiable by the trustee.[33]

[30] Investors also arguably lack a strong incentive to care about servicer performance. *See* Levitin & Twomey, *supra* note ____. (Noting that resecuritization and investor optimism bias means that investors are likely to either be invested only derivatively in subordinated tranches or believe that they have selected a tranche that will be "in-the-money" and therefore unaffected by marginal changes in servicer behavior).

[31] *See, e.g.,* Wells Fargo Mortgage Backed Securities 2006–AR10 Trust § 8.01 ("Prior to the occurrence of an Event of Default of which a Responsible Officer of the Trustee shall have actual knowledge and after the curing of all such Events of Default which may have occurred, the duties and obligations of the Trustee shall be determined solely by the express provisions of this Agreement, the Trustee shall not be liable except for the performance of such duties and obligations as are specifically set forth in this Agreement, no implied covenants or obligations shall be read into this Agreement against the Trustee and, in the absence of bad faith on the part of the Trustee, the Trustee may conclusively rely, as to the truth of the statements and the correctness of the opinions expressed therein, upon any certificates or opinions furnished to the Trustee, and conforming to the requirements of this Agreement."). *See also* Moody's Investor Service, Structured Finance Ratings Methodology: Moody's Re-examines Trustees' Role in ABS and RMBS, Feb. 4, 2003, at 4. (noting "Some trustees have argued that their responsibilities are limited to strictly administrative functions as detailed in the transaction documents and that they have no "fiduciary" duty prior to an event of default.").

[32] MBIA Ins. Corp. v. Royal Indem. Co., 519 F. Supp. 2d 455 (2007), *aff'd* 321 Fed. Appx. 146 (3d Cir. 2009) ("Royal argues that Wells Fargo [the trustee] had the contractual obligation to analyze data using certain financial accounting principles and to detect any anomalies that analysis might have uncovered. As Royal suggests, this analysis may not have been very labor-intensive. Yet, the contract did not call for any analysis at all. It simply required Wells Fargo to perform rote comparisons between that data and data contained in various other sources, and to report any numerical inconsistencies. Wells Fargo did just that.").

[33] Moody's Investor Service, *supra* note 31, at 4.

Likewise, as attorney Susan Macaulay has observed:

> In most cases, even if the servicer reports are incorrect, or even fraudulent, absent manifest error, the trustee simply has no way of knowing that there is a problem, and must allocate the funds into the appropriate accounts, and make the mandated distributions, in accordance with the servicer reports."[34]

Similarly, trustees usually wait for servicers to notify them of defaults,[35] and Moody's has noted that trustees are often unresponsive to information from third parties indicating that an unreported default might have occurred.[36] Thus, trustees enforce servicer representations and warranties largely on the honor system of servicer self-reporting.

For private-label securities, trustees also lack the incentive to engage in more vigorous monitoring of servicer loss mitigation decisions. The trustee does not get paid more for more vigorous monitoring. The trustee generally has little ability to discipline the servicer except for litigation. Private-label RMBS trustees have almost no ability to fire or discipline a servicer. Servicers can only be dismissed for specified acts, and these acts are typically limited to the servicer's insolvency or failure to remit funds to the trust. Occasionally servicers may be dismissed if default levels exceed particular thresholds.

Trustees also have no interest in seeing a servicer dismissed because they often are required to step in as back-up servicer.[37] In the event of a servicer default, the trustee takes over as servicer (which includes the option of subcontracting the duties), and assumes the duty of making servicing advances to the trust. The back-up servicer role is essentially an insurance policy for investors, and activation of that role is equivalent to payment on a claim; a trustee that has to act as a back-up servicer is likely to lose money in the process, especially when some of the trustees do not themselves own servicing operations.

Trustees also often have close relationships with particular servicers. For example, Professor Tara Twomey and I have shown that Bank of America/Countrywide accounts for nearly two-thirds of Deutsche Bank's RMBS trustee business.[38] In such circumstances, trustees are unlikely to engage in meaningful monitoring and disciplining of servicers.[39] Amherst Securities points out that early payment default provisions are not effectively enforced by trustees, to the point where in cases where borrowers did not make a single payment on the mortgage, only 37 percent were purchased out of the trust, much smaller amounts for loans making only one to six payments.[40] Thus, for private-label RMBS, there is virtually no supervision of servicers.[41]

GSE and Ginnie Mae securitization have greater oversight of servicers. The GSEs serve as master servicers on most of their RMBS; they therefore have a greater ability to monitor servicer compliance. The GSEs require servicers to foreclose according

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[34] Susan J. Macaulay, *U.S.: The Role of the Securitisation Trustee,* Global Securitisation and Structured Finance 2004. Macaulay further notes that:

> It is almost always an event of default under the indenture if the trustee does not receive a servicer report within a specified period of time, and the trustee must typically report such a failure to the investors, any credit enhancement provider, the rating agencies and others. However, the trustee generally has no duties beyond that with respect to the contents of the report, although under the TIA, the trustee must review any reports furnished to it to determine whether there is any violation of the terms of the indenture. Presumably this would include verifying that any ratios represented in any reports conform to financial covenants contained in the indenture, *etc.* It would not however, require the trustee to go beyond the face of the report, *i.e.,* to conduct further investigation to determine whether the data underlying the information on the reports presented to it were, in fact, true. Virtually all indentures, whether or not governed by the TIA, explicitly permit the trustee to rely on statements made to the trustee in officers' certificates, opinions of counsel and documents delivered to the trustee in the manner specified within the indenture.

Id.

[35] Moody's Investor Service, *supra* note 31, at 4.

[36] *Id.*

[37] Eric Gross, Portfolio Management: The Evolution of Backup Servicing, Portfolio Financial Servicing Company (PFSC) (July 11, 2002) at *http://www.securitization.net/knowledge/article.asp?id=147&aid=2047.*

[38] Levitin & Twomey, *supra* note ____.

[39] *See* Ellington Credit Fund, Ltd. v. Select Portfolio, Inc., No. 1:07-cv-00421-LY, W.D. Tex., Plaintiffs' First Amended Complaint, July 10, 2007 (RMBS residual tranche holder alleging that trustee was aware that servicer was in violation of PSA and failed to act).

[40] *See* Amherst Mortgage Insight, *supra* note ____, at 15.

[41] For MBS with separate master and primary servicers, the master servicer may monitor the primary servicer(s), but often the master and primary servicers are the same entity.

to detailed timelines, and servicers that fail to comply face monetary penalties. Recognizing the benefits inherent in effective loss mitigation, Fannie Mae places staff directly in all of the largest servicer shops to work alongside loss mitigation staff at their servicers.[42] Freddie Mac constructed servicer performance profiles to directly monitor servicers, sharing results directly with servicers and rating agencies. Since each GSE insures against credit losses on the loans, their ongoing monitoring provides consistent rules and a single point of contact to approve workout packages and grant exceptions, something absent in private label RMBS.

3. Ratings and Reputation

Like any repeat transaction business, servicers are concerned about their reputations. But reputational sanctions have only very weak discipline on servicer behavior.

While Regulation AB requires servicers to disclose information about their experience and practices,[43] they are not required to disclose information about performance of past pools they have serviced. In any event, reputational sanctions are ineffective because loss severities are more likely to be attributed to underwriting quality than to servicing decisions. Rating agencies also produce servicer ratings, but these ratings are a compilation of the evaluation of servicers on a multitude of characteristics. Rating agencies have been known to incorporate features of Freddie Mac's servicer performance profiles in their servicer assessments and to incorporate loss mitigation performance into their ratings. But details of their methodology used to measure these assessments are not disclosed. They give no indication of whether a servicer is likely to make loss mitigation decisions based solely on the interests of the securitization trust. Ratings are also combined with other criteria, such as the servicer's own financial strength and operational capacity. In other words, servicer ratings go to the question of whether a servicer will have to be replaced because it is insolvent or lacks the ability to service the loans, with much less weight given to whether the servicer acts in the investors' interests.

C. THE MORTGAGE CONTRACT AND FORECLOSURE PROCESS

The mortgage contract consists of two documents, a promissory note (the "note" or the "mortgage loan") and a security instrument (the "mortgage" or the "deed of trust").[44] The note is the IOU that contains the borrower's promise to repay the money loaned. If the note is a negotiable instrument, meaning that it complies with the requirements for negotiability in Article 3 of the Uniform Commercial Code,[45] then the *original physical note* is itself the right to payment.[46]

The mortgage is the document that connects the IOU with the house. The mortgage gives the lender a contingent right to the house; it provides that *if* the borrower does not pay according to the terms of the note, then the lender can foreclose and have the property sold *according to the terms of the mortgage and applicable State and Federal law.* The applicable law governing foreclosures is State law.[47]

State real estate law, including foreclosure law, is non-uniform, making it difficult to State what the law is as a generic matter; there is always the possibility that some jurisdictions may deviate from the majority rule. That said, no State requires a borrower's note to be recorded in local land records for the note to be valid, and, as a general matter, State law does not require the mortgage to be recorded either in order for the mortgage to be enforceable against the borrower. Recording of the mortgage is necessary, however, to establish the mortgage's priority relative to the claims of other parties, including other mortgagees, judgment lien creditors and tax and workmen's liens against the property. The basic rule of priority is first in time, first in right; the first mortgage to be recorded has senior priority. An unrecorded mortgage will thus, generally have junior priority to a subsequently issued, but recorded mortgage. The difference between enforceability and priority is an important one, discussed in more detail below, in the section of this testimony dealing with MERS.

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[42] PMI insurers have recently started to embed staff in servicer shops to monitor loss mitigation efforts. Harry Terris & Kate Berry, *In the Trenches,* Am. Banker, Aug. 27, 2009.

[43] 17 C.F.R. § 229.1108.

[44] The note and the mortgage can be combined in a single document, but that is not common practice, both because the mortgage can be granted subsequent to the creation of the debt and because of borrower privacy concerns about the terms of the note, which would become public if the note and mortgage were combined and recorded in local property records.

[45] *See* UCC 3–104.

[46] UCC 3–203, Cmt. 1 ("An instrument is a reified right to payment. The right is represented by the instrument itself.").

[47] There is a Federal foreclosure statute that can be utilized by FHA.

State law on foreclosures is also non-uniform. Roughly, however, States can be divided into two groups: those where foreclosure actions are conducted through the courts ("judicial foreclosure") and those where foreclosure actions are conducted by private sales ("non-judicial foreclosure"). This division maps, imperfectly, with whether the preferred security instrument is a mortgage or a deed of trust.[48]

Mortgage loans cost more in States that have judicial foreclosure; what this means is that borrowers in judicial foreclosure States are paying more for additional procedural rights and legal protections; those procedural rights are part of the mortgage contract; failure to honor them is a breach of the mortgage contract. Note, that a default on the mortgage note is not a breach of the contract per se; instead it merely triggers the lender's right to foreclose per the applicable procedure.

In a typical judicial foreclosure proceeding, the homeowner receives a notice of default and if that default is not cured within the required period, the mortgagee then files a foreclosure action in court. The action is commenced by the filing of a written complaint that sets forth the mortgagee's allegations that the homeowner owes a debt that is secured by a mortgage and that the homeowner has defaulted on the debt. Rules of civil procedure generally require that legal actions based upon a writing include a copy of the writing as an attachment to the complaint, although there is sometimes an exception for writings that are available in the public records. While the mortgage is generally filed in the public records, assignments of the mortgage are often not (an issue complicated by MERS, discussed below), and the note is almost never a matter of public record.

It is important to understand that most judicial foreclosures do not function like the sort of judicial proceeding that is dramatized on television, in which all parties to the case appear in court, represented by attorneys and judgment only follows a lengthy trial. Instead, the norm in foreclosure cases is a default judgment. Most borrowers do not appear in court or contest their foreclosures, and not all of those who do are represented by competent counsel, not least because of the difficulties in paying for counsel. Most borrowers that the borrower does not contest the foreclosure or appear in court. In most cases, only the lender's attorney appears, and judges routinely dispatch dozens or hundreds of foreclosure cases in a sitting. Homeowners in foreclosure actions are among the most vulnerable of defendants, the least able to insist up on and vindicate their rights, and accordingly the ones most susceptible to abuse of legal process.

II. PROCEDURAL PROBLEMS AND FRAUD

The first type of problems in the mortgage market are what might generously be termed "procedural defects" or "procedural irregularities." There are numerous such problems that have come to light in foreclosure cases. The extent and distribution of these irregularities is not yet known. No one has compiled a complete typology of procedural defects in foreclosures; there are, to use Donald Rumsfeld's phrase, certainly "known unknowns" and well as "unknown unknowns."

A. AFFIDAVITS FILED WITHOUT PERSONAL KNOWLEDGE (ROBOSIGNING)

Affidavits need to be based on personal knowledge to have any evidentiary effect; absent personal knowledge an affidavit is hearsay and therefore generally inadmissible as evidence. Accordingly, affidavits attest to personal knowledge of the facts alleged therein.

The most common type of affidavit is an attestation about the existence and status of the loan, namely that the homeowner owes a debt, how much is currently owed, and that the homeowner has defaulted on the loan. (Other types of affidavits are discussed in sections II.B. and II.C., *infra*). Such an affidavit is typically sworn out by an employee of a servicer (or sometimes by a law firm working for a servicer). Personal knowledge for such an affidavit would involve, at the very least, examining the payment history for a loan in the servicer's computer system and checking it against the facts alleged in a complaint.

The problem with affidavits filed in many foreclosure cases is that the affiant lacks any personal knowledge of the facts alleged whatsoever. Many servicers, including Bank of America, Citibank, JPMorgan Chase, Wells Fargo, and GMAC, employ professional affiants, some of whom appear to have no other duties than to sign affidavits. These employees cannot possibly have personal knowledge of the facts in

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[48] Mortgages sometimes also include a power of sale, permitting non-judicial foreclosure. In a deed of trust, the deed to the property is transferred in trust for the noteholder to a deed of trust trustee, often a local attorney. The note remains the property of the lender (the deed of trust beneficiary). When there is a default on the note, the lender notifies the deed of trust trustee and the lender or its agent is typically appointed as substitute deed of trust trustee to run the foreclosure sale.

their affidavits. One GMAC employee, Jeffrey Stephan, stated in a deposition that he signed perhaps 10,000 affidavits in a month, or approximately one a minute for a 40-hour work week.[49] For a servicer's employee to ascertain payment histories in a high volume of individual cases is simply impossible.

When a servicer files an affidavit that claims to be based on personal knowledge, but is not in fact based on personal knowledge, the servicer is committing a fraud on the court, and quite possibly perjury. The existence of foreclosures based on fraudulent pleadings raises the question of the validity of foreclosure judgments and therefore title on properties, particularly if they are still in real estate owned (REO).

B. LOST NOTE AFFIDAVITS FOR NOTES THAT ARE NOT LOST

The plaintiff in a foreclosure action is generally required to produce the note as evidence that it has standing to foreclose. Moreover, under the Uniform Commercial Code, if the note is a negotiable instrument, only a holder of the note (or a subrogee)—that is a party in possession of the note—may enforce the note, as the note is the reified right to payment.[50]

There is an exception, however, for lost, destroyed, or stolen notes, which permits a party that has lost possession of a note to enforce it.[51] If a plaintiff seeks to enforce a lost note, it is necessary "to prove the terms of the instrument" as well as the "right to enforce the instrument."[52] This proof is typically offered in the form of a lost note affidavit that attests to the prior existence of the note, the terms of the note, and that the note has been lost.

It appears that a surprisingly large number of lost note affidavits are filed in foreclosure cases. In Broward County, Florida alone, over 2000 such affidavits were filed in 2008–2009.[53] Relative to the national population, that translates to roughly 116,000 lost note affidavits nationally over the same period.[54]

There are two problems with the filing of many lost note affidavits. First, is a lack of personal knowledge. Mortgage servicers are rarely in possession of the original note. Instead, the original note is maintained in the fireproof vault of the securitization trustee's document custodian. This means that the servicer lacks personal knowledge about whether a note has or has not been lost.[55] Merely reporting a communication from the document custodian would be hearsay and likely inadmissible as evidence.

The second problem is that the original note is frequently not in fact lost. Instead, it is in the document custodian's vault. Servicers do not want to pay the document custodian a fee (of perhaps $30) to release the original mortgage, and servicers are also wary of entrusting the original note to the law firms they hire. Substitution of counsel is not infrequent on defaulted mortgages, and servicers are worried that the original note will get lost in the paperwork shuffle if there is a change in counsel. When pressed, however, servicers will often produce the original note, months after filing lost note affidavits. The Uniform Commercial Code (UCC) requires that a party seeking to enforce a note be a holder (or subrogee to a holder) or produce evidence that a note has been lost, destroyed, or stolen; the UCC never contemplates an "inconvenience affidavit" that states that it is too much trouble for a servicer to bother obtaining the original note. But that is precisely what many lost note affidavits are effectively claiming.

Thus, many lost note affidavits are doubly defective: they are sworn out by a party that does not and cannot have personal knowledge of the alleged facts and the facts being alleged are often false as the note is not in fact lost, but the servicer simply does not want to bother obtaining it.

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[49] *See* Deposition of Jeffrey Stephan, GMAC Mortgage LLC v. Ann M. Neu a/k/a Ann Michelle Perez, No. 50 2008 CA 040805XXXX MB, (15th Judicial Circuit, Florida, Dec. 10, 2009) at 7, *available at http://api.ning.com/files/s4SMwlZXvPu4A7kq7XQUsGW9xEcYtqNMPCm0a2hISJu88PoY6ZNqanX7XK41Fyf9gV8JIHDme7KcFO2cvHqSEMcplJ8vwnDT/091210gmacmortgagevs-annmneu1.pdf* (stating that Jeffrey Stephan, a GMAC employee, signed approximately 10,000 affidavits a month for foreclosure cases).

[50] UCC 3–301; 1–201(b)(21) (defining "holder").

[51] UCC 3–309. Note that UCC 3–309 was amended in the 2001 revision of Article 3. The revision made it easier to enforce a lost note. Not every State has adopted the 2001 revisions. Therefore, UCC 3–309 is non-uniform law.

[52] UCC 3–309(b).

[53] Cite NY Times.

[54] According to the U.S. Census Bureau, Broward County's population is approximately 1.76 million, making it .57 percent of the total U.S. population of 307 million. Broward does have a significantly higher than average foreclosure rate, roughly 12 percent over the past 2 years, according to Core Logic Loan Performance data, making it approximately 3 times the national average.

[55] The 2001 version of UCC 3–309 permits not only a party that has lost a note but a buyer from such a party to enforce a lost note.

C. JUNK FEES

The costs of foreclosure actions are initially incurred by servicers, but servicers recover these fees off the top from foreclosure sale proceeds before MBS investors are paid. This reimbursement structure limits servicers' incentive to rein in costs and actually incentives them to pad the costs of foreclosure. This is done in two ways. First, servicers charge so-called "junk fees" either for unnecessary work or for work that was simply never done. Thus, Professor Kurt Eggert has noted a variety of abusive servicing practices, including "improper foreclosures or attempted foreclosures; imposition of improper fees, especially late fees; forced-placed insurance that is not required or called for; and misuse of escrow funds."[56] Servicers' ability to retain foreclosure-related fees has even led them to attempt to foreclose on properties when the homeowners are current on the mortgage or without attempting any sort of repayment plan.[57] Consistently, Professor Katherine Porter has documented that when mortgage creditors file claims in bankruptcy, they generally list amounts owed that are much higher than those scheduled by debtors.[58]

There is also growing evidence of servicers requesting payment for services not performed or for which there was no contractual right to payment. For example, in one particularly egregious case from 2008, Wells Fargo filed a claim in the borrower's bankruptcy case that included the costs of two brokers' price opinions allegedly obtained in September 2005, on a property in Jefferson Parish, Louisiana when the entire Parish was under an evacuation order due to Hurricane Katrina.[59]

Similarly, there is a frequent problem of so-called "sewer summons" issued (or actually not issued) to homeowners in foreclosures. Among the costs of foreclosure actions is serving notice of the foreclosure (a court summons) on the homeowner. There is disturbing evidence that homeowners are being charged for summons that were never issued. These non-delivered summons are known as "sewer summons" after their actual delivery destination.

One way in which these non-existent summons are documented is through the filing of "affidavits of lost summons" by process servers working for the foreclosure attorneys hired by mortgage servicers. A recent article reports that in Duval County, Florida (Jacksonville) the number of affidavits of lost summons has ballooned from 1,031 from 2000–2006 to over 4,000 in the last 2 years, a suspiciously large increase that corresponds with a sharp uptick in foreclosures.[60]

Because of concerns about illegal fees, the United States Trustee's Office has undertaken several investigations of servicers' false claims in bankruptcy[61] and brought suit against Countrywide,[62] while the Texas Attorney General has sued American Home Mortgage Servicing for illegal debt collection practices.[63]

The other way in which servicers pad the costs of foreclosure is by in-sourcing their expenses to affiliates at above-market rates. For example, Countrywide, the largest RMBS servicer, force places insurance on defaulted properties with its captive insurance affiliate Balboa.[64] Countrywide has been accused of deliberately extending the time to foreclosure in order to increase the insurance premiums paid to its affiliate, all of which are reimbursable by the trust, before the RMBS investors' claims are paid.[65] Similarly, Countrywide in-sources trustee services in deed of trust foreclosures to its subsidiary Recon Trust.[66]

Thus, in Countrywide's 2007 third quarter earnings call, Countrywide's President David Sambol emphasized that increased revenue from in-sourced default management functions could offset losses from mortgage defaults.

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[56] Kurt Eggert, *Comment on Michael A. Stegman et al.'s "Preventive Servicing Is Good for Business and Affordable Homeownership Policy": What Prevents Loan Modifications?,* 18 Housing Policy Debate 279 (2007).

[57] Eggert, *Limiting Abuse, supra* note 21, at 757.

[58] Katherine M. Porter, *Mortgage Misbehavior,* 87 Tex. L. Rev. 121, 162 (2008).

[59] *In re* Stewart, 391 B.R. 327, 355 (Bankr. E.D. La. 2008).

[60] Matt Taibi, *Courts Helping Banks Screw Over Homeowners,* Rolling Stone, Nov. 25, 2010, *at http://www.rollingstone.com/politics/news/17390/232611?RS_show_page=7.*

[61] *Ashby Jones, U.S. Trustee Program Playing Tough With Countrywide, Others,* Law Blog (Dec. 3, 2007, 10:01 AM), *http://blogs.wsj.com/law/2007/12/03/us-trustee-program-playing-tough-with-countrywide-others.*

[62] Complaint, Walton v. Countrywide Home Loans, Inc. (*In re* Atchely), No. 05–79232 (Bankr. N.D. Ga. filed Feb. 28, 2008).

[63] Complaint, State v. Am. Home Mtg. Servicing, Inc., No. 2010–3307 (Tex. Dist. Ct. 448th Jud. Dist. filed Aug. 30, 2010).

[64] *Amherst Mortgage Securities, supra* note____, at 23.

[65] *Id.*

[66] Center for Responsible Lending, *Unfair and Unsafe: How Countrywide's irresponsible practices have harmed borrowers and shareholders,* CRL Issue Paper, Feb. 7, 2008, at 6–7.

> Now, we are frequently asked what the impact on our servicing costs and earnings will be from increased delinquencies and loss mitigation efforts, and what happens to costs. And what we point out is, as I will now, is that increased operating expenses in times like this tend to be fully offset by *increases in ancillary income in our servicing operation, greater fee income from items like late charges, and importantly from in-sourced vendor functions* that represent part of our diversification strategy, a counter-cyclical diversification strategy such as our businesses involved in foreclosure trustee and default title services and property inspection services.[67]

In June, 2010, Countrywide settled with the FTC for $108 million on charges that it overcharged delinquent homeowners for default management services. According to the FTC:

> Countrywide ordered property inspections, lawn mowing, and other services meant to protect the lender's interest in the property. But rather than simply hire third-party vendors to perform the services, Countrywide created subsidiaries to hire the vendors. The subsidiaries marked up the price of the services charged by the vendors—often by 100 percent or more—and Countrywide then charged the homeowners the marked-up fees.[68]

Among the accusations brought against Countrywide in a recent investor notice of default filed by the Federal Reserve Bank of New York along with BlackRock and PIMCO, is that Countrywide has been padding expenses via in-sourcing on the 115 trusts covered by the letter.[69]

Countrywide is hardly the only servicer accused of acting in its interests at the expense of investors. Carrington, another major servicer, also owns the residual tranche on many of the deals it services. Amherst Mortgage Securities has shown that Carrington has been much slower than other servicers to liquidate defaulted loans.[70] Delay benefits Carrington both as a servicer and as the residual tranche investor. As a servicer, delay helps Carrington by increasing the number of monthly late fees that it can levy on the loans. These late fees are paid from liquidation proceeds before any of the MBS investors.

As an investor in the residual tranche, Carrington has also been accused of engaging in excessive modifications to both capture late fees and to keep up the excess spread in the deals, as it is paid directly to the residual holders.[71] When loans were mass modified, Carrington benefited as the servicer by capitalizing late fees and advances into the principal balance of the modified loans, which increased the balance on which the servicing fee was calculated. Carrington also benefited as the residual holder by keeping up excess spread in the deals and delaying delinquency deal triggers that restrict payments to residual holders when delinquencies exceed specified levels. Assuming that the residual tranche would be out of the money upon a timely foreclosure, delay means that Carrington, as the residual holder, receives many more months of additional payments on the MBS it holds than it otherwise would.[72]

It is important to emphasize that junk fees on homeowners ultimately come out of the pocket of MBS investors. If the homeowner lacks sufficient equity in the property to cover the amount owed on the loan, including junk fees, then there is a deficiency from the foreclosure sale. As many mortgages are legally or functionally non-

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[67] Transcript, "Countrywide Financial Corporation Q3 2007 Earnings Call," Oct. 26, 2007 (emphasis added) (also mentioning "Our vertical diversification businesses, some of which I mentioned, are counter-cyclical to credit cycles, like the lender-placed property business in Balboa and like the in-source vendor businesses in our loan administration unit.").

[68] FTC, Press Release, June 7, 2010, *Countrywide Will Pay $108 Million for Overcharging Struggling Homeowners; Loan Servicer Inflated Fees, Mishandled Loans of Borrowers in Bankruptcy.*

[69] Kathy D. Patrick, Letter to Countrywide Home Loan Servicing LP and the Bank of New York, dated Oct. 18, 2010, *available at http://www.scribd.com/Bondholders-Letter-to-BofA-Over-Countrywide-Loans-inc-NY-fed/d/39686107.*

[70] Amherst Mortgage Insight, 2010, "The Elephant in the Room-Conflicts of Interest in Residential Mortgage Securitizations", pp. 22–24, May 20, 2010.

[71] See Amherst Mortgage Insight, "Why Investors Should Oppose Servicer Safe Harbors", April 28, 2009. Excess spread is the difference between the income of the SPV in a given period and its payment obligations on the MBS in that period, essentially the SPV's periodic profit. Excess spread is accumulated to supplement future shortfalls in the SPV's cash flow, but is either periodically released to the residual tranche holder. Generally, as a further protection for senior MBS holders, excess spread cannot be released if certain triggers occur, like a decline in the amount of excess spread trapped in a period beneath a particular threshold.

[72] Carrington would still have to make servicing advances on any delinquent loans if it stretched out the time before foreclosure, but these advances would be reimbursable, and the reimbursement would come from senior MBS holders, rather than from Carrington, if it were out of the money in the residual.

recourse, this means that the deficiency cannot be collected from the homeowner's other assets. Mortgage servicers recover their expenses off the top in foreclosure sales, before MBS investors are paid. Therefore, when a servicer lards on illegal fees in a foreclosure, it is stealing from investors such as pension plans and the U.S. Government.

D. COMPLAINTS THAT FAIL TO INCLUDE THE NOTE

Rule of civil procedure generally require that a compliant based on a writing include, as an attachment, a copy of a writing. In a foreclosure action, this means that both the note and the mortgage and any assignments of either must be attached. Beyond the rules of civil procedure requirement, these documents are also necessary as an evidentiary matter to establish that the plaintiff has standing to bring the foreclosure. Some States have exceptions for public records, which may be incorporated by reference, but it is not always clear whether this exception applies in foreclosure actions. If it does, then only the note, which is not a public record, would need to be attached.

Many foreclosure complaints are facially defective and should be dismissed because they fail to attach the note. I have recently examined a small sample of foreclosure cases filed in Allegheny County, Pennsylvania (Pittsburgh and environs) in May 2010. In over 60 percent of those foreclosure filings, the complaint failed to include a copy of the note. Failure to attach the note appears to be routine practice for some of the foreclosure mill law firms, including two that handle all of Bank of America's foreclosures.

I would urge the Committee to ask Bank of America whether this was an issue it examined in its internal review of its foreclosure practices.

E. COUNTERFEIT AND ALTERED DOCUMENTS AND NOTARY FRAUD

Perhaps the most disturbing problem that has appeared in foreclosure cases is evidence of counterfeit or altered documents and false notarizations. To give some examples, there are cases in which multiple copies of the "true original note" are filed in the same case, with variations in the "true original note;"[73] signatures on note allonges that have clearly been affixed to documents via Photoshop;[74] "blue ink" notarizations that appear in blank ink; counterfeit notary seals;[75] backdated notarizations of documents issued before the notary had his or her commission;[76] and assignments that include the words "bogus assignee for intervening asmts, whose address is XXXXXXXXXXXXXXXXX."[77]

Most worrisome is evidence that these frauds might not be one-off problems, but an integral part of the foreclosure business. A price sheet from a company called DocEx that was affiliated with LPS, one of the largest servicer support firms, lists prices for various services including the "creation" of notes and mortgages. While I cannot confirm the authenticity of this price sheet or date it, it suggests that document counterfeiting is hardly exceptional in foreclosure cases.

While the fraud in these cases is not always by servicers themselves, but sometimes by servicer support firms or attorneys, its existence should raise serious concerns about the integrity of the foreclosure process. I would urge the Committee to ask the servicer witnesses what steps they have taken to ascertain that they do not have such problems with loans in their servicing portfolios.

G. THE EXTENT OF THE PROBLEM

The critical question for gauging the risk presented by procedural defects is the extent of the defects. While Federal Reserve Chairman Bernanke has announced that Federal bank regulators are looking into the issue and will issue a report this month, I do not believe that it is within the ability of Federal bank regulators to

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[73] Brief of Antonio Ibanez, Defendant-Appellee, U.S. Bank Nat'l Assn, as Trustee for the Structured Asset Securities Corporation Mortgage Pass-Through Certificates, Series 2006–Z v. Ibanez; Wells Fargo Bank, N.A. as Trustee for ABFC 2005–Opt 1 Trust, ABFC Asset Backed Certificates Series 2005–OPT 1, No 10694, (Mass. Sept. 20, 2010), at 10 (detailing 3 different "certified true copies" of a note allonge and of an assignment of a mortgage); *http://4closurefraud.org/2010/04/27/foreclosure-fraud-of-the-week-two-original-wet-ink-notes-submitted-in-the-same-case-by-the-florida-default-law-group-and-jpmorgan-chase/* (detailing a foreclosure file with two different "original" wet ink notes for the same loan).

[74] *http://4closurefraud.org/2010/04/08/foreclosure-fraud-of-the-week-poor-photoshop-skills/.*

[75] *See* WSTB.com, *at http://www.wsbtv.com/video/25764145/index.html.*

[76] Deposition of Cheryl Samons, Deutsche Bank Nat'l Trust Co., as Trustee for Morgan Stanley ABS Capital 1 Inc. Trust 2006–HE4 v. Pierre, No. 50–2008–CA–028558–XXXX–MB (15th Judicial Circuit, Florida, May 20, 2009, *available at http://mattweidnerlaw.com/blog/wpcontent/uploads/2010/03/depositionsammons.pdf.*

[77] *http://www.nassauclerk.com/clerk/publicrecords/oncoreweb/showdetails.aspx?id=809395&rn=0&pi=0&ref=search.*

gauge the extent of procedural defects in foreclosure cases. To do so would require, at the very least, an extensive sampling of actual foreclosure filings and their examination by appropriately trained personnel. I am unaware of Federal bank regulators undertaking an examination of actual foreclosure filings, much less having a sufficient cadre of appropriately trained personnel. Bank examiners lack the experience or training to evaluate legal documents like foreclosure filings. Therefore, any statement put forth by Federal regulators on the scope of procedural defects is at best a guess and at worse a parroting of the "nothing to see here folks" line that has come from mortgage servicers.

I would urge the Committee to inquire with Federal regulators as to exactly what steps they are taking to examine foreclosure irregularities and how they can be sure that those steps will uncover the extent of the problem. Similarly, I would urge the Committee to ask the servicer witnesses what specific irregularities they examined during their self-imposed moratoria and by what process. It defies credulity that a thorough investigation of all the potential problems in foreclosure paperwork could be completed in a month or two, much less by servicers that have taken so long to do a small number of loan modifications.

III. CHAIN OF TITLE PROBLEMS

A second problem and potentially more serious problem relating to standing to foreclose is the issue of chain of title in mortgage securitizations.[78] As explained above, securitization involves a series of transfers of both the note and the mortgage from originator to sponsor to depositor to trust. This particular chain of transfers is necessary to ensure that the loans are "bankruptcy remote" once they have been placed in the trust, meaning that if any of the upstream transferors were to file for bankruptcy, the bankruptcy estate could not lay claim to the loans in the trust by arguing that the transaction was not a true sale, but actually a secured loan.[79] Bankruptcy remoteness is an essential component of private-label mortgage securitization deals, as investors want to assume the credit risk solely of the mortgages, not of the mortgages' originators or securitization sponsors. Absent bankruptcy remoteness, the economics of mortgage securitization do not work in most cases.

Recently, arguments have been raised in foreclosure litigation about whether the notes and mortgages were in fact properly transferred to the securitization trusts. This is a critical issue because the trust has standing to foreclose if, and only if it is the mortgagee. If the notes and mortgages were not transferred to the trust, then the trust lacks standing to foreclose. There are several different theories about the defects in the transfer process; I do not attempt to do justice to any of them in this testimony.

While the chain of title issue has arisen first in foreclosure defense cases, it also has profound implications for MBS investors. If the notes and mortgages were not properly transferred to the trusts, then the mortgage-backed securities that the investors' purchased were in fact *non-mortgage-backed securities.* In such a case, investors would have a claim for the rescission of the MBS,[80] meaning that the securitization would be unwound, with investors receiving back their original payments at par (possibly with interest at the judgment rate). Rescission would mean that the securitization sponsor would have the notes and mortgages on its books, meaning that the losses on the loans would be the securitization sponsor's, not the MBS investors, and that the securitization sponsor would have to have risk-weighted capital for the mortgages. If this problem exists on a wide-scale, there is not the capital in the financial system to pay for the rescission claims; the rescission claims

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[78] Chain of title problems appear to be primarily a problem for private-label securitization, not for agency securitization because even if title were not properly transferred for Agency securities, it would have little consequence. Investors would not have incurred a loss as the result of an ineffective transfer, as their MBS are guaranteed by the GSEs or Ginnie Mae, and when a loan in an Agency pool defaults, it is removed from the pool and the owned by the GSE or Ginnie Mae, which is then has standing to foreclose.

[79] Bankruptcy remote has a second meaning, namely that the trust cannot or will not file of bankruptcy. This testimony uses bankruptcy remote solely in the sense of whether the trust's assets could be clawed back into a bankruptcy estate via an equity of redemption. The Uniform Commercial Code permits a debtor to redeem collateral at face value of the debt owed. If a pool of loans bore a now-above-market interest rate, the pool's value could be above the face value of the debt owed, making redemption economically attractive.

It can be very difficult to distinguish true sales from secured loans. For example, a sale and repurchase agreement (a repo) is economically identical to a secured loan from the repo buyer to the repo seller, secured by the assets being sold.

[80] This claim would not be a putback claim necessarily, but could be brought as a general contract claim. It could not be brought as a securities law claim under section 11 of the Securities Act of 1933 because the statute of limitations for rescission has expired on all PLS.

would be in the trillions of dollars, making the major banking institutions in the United States would be insolvent.

The key questions for evaluating chain of title are what method of transferring notes and mortgages is actually supposed to be used in securitization and whether that method is legally sufficient both as a generic matter and as applied. There is a surprising degree of legal uncertainty over these issues, even among banks' attorneys; different arguments appear in different litigation. The following section outlines the potential methods of transfer and some of the issues that arise regarding specific methods. It is critical to emphasize that the law is not settled on most of the issues regarding securitization transfers; instead, these issues are just starting to be litigated.

A. TRANSFERS OF NOTES AND MORTGAGES

As a generic matter, a note can be transferred in one of four methods:

(1) the note can be sold via a contract of sale, which would be governed by the common law of contracts.

(2) if the note is a negotiable instrument, it could be negotiated, meaning that it would be transferred via endorsement and delivery, with the process governed by Article 3 of the Uniform Commercial Code (UCC). The endorsement.

(3) the note could be converted into an electronic note and transferred according to the provisions of the Federal E–SIGN Act.[81]

(4) The note could be sold pursuant to UCC Article 9. In 49 States (South Carolina being the exception), Article 9 provides a method for selling a promissory note, which requires that there be an authenticated (signed) agreement, value given, and that the seller have rights in the property being transferred.[82] This process is very similar to a common law sale.

There is general agreement that as a generic method, any of these methods of transfer would work to effectuate a transfer of the note. No method is mandatory. Whether or not the chosen process was observed in practice, is another matter, however.[83]

There are also several conceivable ways to transfer mortgages, but there are serious doubts about the validity of some of the methods:

(1) the mortgage could be assigned through the traditional common law process, which would require a document of assignment.
   a. There is general consensus that this process works.

(2) the mortgage could be negotiated.
   a. This method of transfer is of questionable effectiveness. A mortgage is not a negotiable instrument, and concepts of negotiability do not fit well with mortgages. For example, if a mortgage were negotiated in blank, it should become a "bearer mortgage," but this concept is utterly foreign to the law, not least as the thief of a bearer mortgage would have the ability to enforce the mortgage (absent equitable considerations). Similarly, with a bearer mortgage, a homeowner could never figure out who would be required to grant a release of the mortgage upon payoff. And, in many States (so-called title theory states), a mortgage is considered actual ownership of real property, and real property must have a definite owner (not least for taxation purposes).

(3) the mortgage could "follow the note" per common law.

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[81] 15 U.S.C. § 7021.

[82] UCC 9–203. The language of Article 9 is abstruse, but UCC Revised Article 1 defines "security interest" to include the interest of a buyer of a promissory note. UCC 1–201(b)(35). Article 9's definition of "debtor" includes a seller of a promissory note, UCC 9–102(a)(28)(B), and "secured party" includes a buyer of a promissory note, UCC 9–102(a)(72)(D). Therefore UCC 9–203, which would initially appear to address the attachment (enforceability) of a security interest also covers the sale of a promissory note. South Carolina has not adopted the revised Article 1 definition of security interest necessary to make Article 9 apply to sales of promissory notes.

[83] Note that common law sales and Article 9 sales do not affect the enforceability of the note against the obligor on the note. UCC 9–308, Cmt.6, Ex. 3 ("Under this Article, attachment and perfection of a security interest in a secured right to payment do not of themselves affect the obligation to pay. For example, if the obligation is evidenced by a negotiable note, then Article 3 dictates the person to whom the maker must pay to discharge the note and any lien security it."). UCC Article 3 negotiation and E–SIGN do affect enforceability as they enable a buyer for value in good faith to be a holder in due course and thereby cutoff some of the obligor's defenses that could be raised against the seller. UCC 3–305, 3–306; 15 U.S.C. § 7021(d).

a. Common law is not settled on this point. There are several instances where the mortgage clearly does not follow the note. For example, the basic concept of a deed of trust is that the security instrument and the note are separated; the deed of trust trustee holds the security, while the beneficiary holds the note. Likewise, the mortgage follows the note concept would imply that the theft of a note also constitutes theft of a mortgage, thereby giving to a thief more than the thief was able to actually steal. Another situation would be where a mortgage is given to a guarantor of a debt. The mortgage would not follow the debt, but would (at best) follow the guarantee. And finally, the use of MERS, a recording utility, as original mortgage (a/k/a MOM) splits the note and the mortgage. MERS has no claim to the note, but MERS is the mortgagee. If taken seriously, MOM means that the mortgage does not follow the note. While MERS might claim that MOM just means that the beneficial interest in the mortgage follows the note, a transfer of the legal title would violate a bankruptcy stay and would constitute a voidable preference if done before bankruptcy.

(4) the mortgage could "follow the note" if it is an Article 9 transfer.[84]

a. There is consensus that this process would work if Article 9 governs the transfer of the note.

Ultimately, there is lack of consensus as to the method of transfer that is actually employed in securitization transactions. In theory, the proper method should be UCC Article 9 transfer process was adopted as part of the 2001 revision of Article 9 with the apparent goal of facilitating securitization transactions. Parties are free, however, to contract around the UCC.[85] That is precisely what pooling and servicing agreements (PSAs) appear to do. PSAs provide a recital of a transfer of the notes and loans to the trust and then they further require that the as they set forth specific requirements regarding the transfer of the notes and mortgages, namely that there be a complete chain of endorsements followed by either a specific endorsement to the trustee or an endorsement in blank.[86] The reason for this additional requirement is to provide a clear evidentiary basis for all of the transfers in the chain of title in order to remove any doubts about the bankruptcy remoteness of the assets transferred to the trust. Absent a complete chain of endorsements, it could be argued that the trust assets were transferred directly from the originator to the trust, raising the concern that if the originator filed for bankruptcy, the trust assets could be pulled back into the originator's bankruptcy estate.

As PSAs are trust documents, they must be followed punctiliously. Moreover, most RMBS are issued by New York common law trusts, and well-established New York law provides that a transaction that does not accord with the trust documents is void.[87] Therefore, the key question is whether transfers to the trusts complied with PSAs. It appears that in recent years mortgage securitizers started to cut corners in order to deal with the increased deal volume they faced during the housing bubble, and they ceased to comply with the PSA requirements in many cases. Thus, in many cases, the notes contain either a single endorsement in blank or no endorsement whatsoever, rather than the chain of endorsements required by the PSA and critical for ensuring the trust's assets' bankruptcy remoteness.

It bears emphasis that the validity of transfers to the trusts is an unsettled legal issue. But if the transfers were invalid, they cannot likely be corrected because of various timeliness requirements in the PSAs.

IV. YES, BUT WHO CARES? THESE ARE ALL DEADBEATS

A common response from banks about the problems in the securitization and foreclosure process is that it doesn't matter as the borrower still owes on the loan and has defaulted. This "No Harm, No Foul" argument is that homeowners being foreclosed on are all a bunch of deadbeats, so who really cares about due process? As JPMorganChase's CEO Jamie Dimon put it "for the most part by the time you get to the end of the process we're not evicting people who deserve to stay in their house."[88]

Mr. Dimon's logic condones vigilante foreclosures: so long as the debtor is delinquent, it does not matter who evicts him or how. But that is not how the legal system works. A homeowner who defaults on a mortgage doesn't have a right to stay

[84] UCC 9–203(g). If the transfer is not an Article 9 transfer, then the Article 9 provision providing that the mortgage follows the note would not apply.

[85] UCC 1–203.

[86] This provision is general found in section 2.01 of PSAs.

[87] NY E.P.T.L. § 7–2.4.

[88] Tamara Keith & Renee Montaigne, *Sorting Out the Banks' Foreclosure Mess,* NPR, Oct. 15, 2010.

in the home if the proper mortgagee forecloses, but any old stranger cannot take the law into his own hands and kick a family out of its home. That right is reserved solely for the proven mortgagee.

Irrespective of whether a debt is owed, there are rules about who can collect that debt and how. The rules of real estate transfers and foreclosures have some of the oldest pedigrees of any laws. They are the product of centuries of common law wisdom, balancing equities between borrowers and lenders, ensuring procedural fairness and protecting against fraud.

The most basic rule of real estate law is that only the mortgagee may foreclosure. Evidence and process in foreclosures are not mere technicalities nor are they just symbols of rule of law. They are a paid-for part of the bargain between banks and homeowners. Mortgages in States with judicial foreclosures cost more than mortgages in States without judicial oversight of the foreclosure process.[89] This means that homeowners in judicial foreclosure States are buying procedural protection along with their homes, and the banks are being compensated for it with higher interest rates. Banks and homeowners bargained for legal process, and rule of law, which is the bedrock upon which markets are built function, demands that the deal be honored.

Ultimately the "No Harm, No Foul," argument is a claim that rule of law should yield to banks' convenience. To argue that problems in the foreclosure process are irrelevant because the homeowner owes *someone* a debt is to declare that the banks are above the law.

V. CONCLUSION

The foreclosure process is beset with problems ranging from procedural defects that can be readily cured to outright fraud to the potential failure of the entire private label mortgage securitization system.

In the best case scenario, the problems in the mortgage market are procedural defects and they will be remedied within reasonably quickly (perhaps taking around a year). Remedying them will extend the time that properties are in foreclosure and increase the shadow housing inventory, thereby driving down home prices. The costs of remedying these procedural defects will also likely be passed along to future mortgage borrowers, thereby frustrating attempts to revive the housing market and the economy through easy monetary policy.

In the worst case scenario, there is systemic risk, as there could be a complete failure of loan transfers in private-label securitization deals in recent years, resulting in trillions of dollars of rescission claims against major financial institutions. This would trigger a wholesale financial crisis.

Perhaps the most important lesson from 2008 is the need to be ahead of the ball of systemic risk. This means (1) ensuring that Federal regulators do a serious investigation as discussed in this testimony above and (2) considering the possible legislative response to a crisis. The sensible course of action here is to avoid gambling on unsettled legal issues that could have systemic consequences. Instead, we should recognize that stabilizing the housing market is the key toward economic recovery, and that it is impossible to fix the housing market unless the number of foreclosures is drastically reduced, thereby reducing the excess inventory that drives down housing prices and begets more foreclosures. Unless we fix the housing market, consumer spending will remain depressed, and as long as consumer spending remains depressed, high unemployment will remain and the U.S. economy will continue in a doldrums that it can ill-afford given the impending demographics of retirement.

This suggests that the best course of action is a global settlement on mortgage issues, the key elements of which must be (1) a triage between homeowners who can and cannot pay with principal reduction and meaningful modifications for homeowners with an ability to pay and speedier foreclosures for those who cannot, (2) a quieting of title on securitized properties, and (3) a restructuring of bank balance sheets in accordance with loss recognition.

I recognize that for many, the preferred course of action is not to deal with a problem until it materializes. But if we pursue that route, we may be confronted with an unmanageable crisis. We cannot rebuild the U.S. housing finance system until we deal with the legacy problems from our old system, and these are problems that are best addressed sooner, before an acute crisis, then when it is too late.

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[89] *See* Karen Pence, *Foreclosing on Opportunity: State Laws and Mortgage Credit,* 88 Rev. Econ. & Stat. 177 (2006) (noting that the availability—and hence the cost—of mortgages in States with judicial foreclosure proceedings is greater than in States with non-judicial foreclosures).

PREPARED STATEMENT OF DAVID B. LOWMAN

CHIEF EXECUTIVE OFFICER FOR HOME LENDING, JPMORGAN CHASE

NOVEMBER 16, 2010

Introduction

Chairman Dodd, Ranking Member Shelby, and Members of the Committee, thank you for inviting me to appear before you today. My name is David Lowman, and I am the Chief Executive Officer for Home Lending at JPMorgan Chase. I am grateful for the opportunity to discuss Chase's loan servicing business, our wide-ranging efforts to enable borrowers to keep their homes and avoid foreclosure where possible, and the recent issues that have arisen relating to affidavits filed in connection with certain foreclosure proceedings.

JPMorgan Chase is committed to ensuring that all borrowers are treated fairly; that all appropriate measures short of foreclosure are considered; and that, if foreclosure is necessary, the foreclosure process complies with all applicable laws and regulations. As I will discuss in detail later in my testimony, we regret the errors that we have discovered in our processes, and we have worked hard to correct these processes so that we get them right. We take these issues very seriously.

Chase services about 9 million mortgages across every State, representing over $1.2 trillion in loans to borrowers. In our role as servicer, we are responsible for administering loans on behalf of the owner of the loan, which sometimes is Chase itself, but more often is someone else—a Government-sponsored enterprise (GSE), a Government agency (such as the Federal Housing Administration or the Department of Veterans Affairs), a securitization trust, or another private investor.

I will first discuss Chase's extensive efforts to help borrowers avoid foreclosure and then discuss the issues that led to our temporary halt to some foreclosures, as well as Chase's enhanced procedures for the foreclosure process.

The past several years have been very difficult ones for many Americans. We have made extensive efforts during these difficult economic times to help borrowers who have fallen behind on their payments understand all of their options and, where feasible, to work with them in an effort to modify their loans and bring their accounts current so that they can keep their homes.

At the outset, I want to emphasize that Chase strongly prefers to work with borrowers to reach a solution that permits them to keep their homes rather than foreclose on their properties. As we discuss below, solutions may include modification, temporary forbearance, short sales or deeds-in-lieu of foreclosure. Foreclosures cause significant hardship to borrowers, harm their credit profiles, and depress property values in the communities where they occur. Foreclosures also inevitably result in severe losses for lenders and investors. Therefore, we always consider whether there are viable alternatives to foreclosure before proceeding with a foreclosure.

It is critical to note that the analysis we use in deciding whether to proceed with a modification or foreclosure does not take into account servicer compensation. Furthermore, if it were considered, servicer compensation would tend to favor modification over foreclosure. Indeed, the cost for servicers to take a loan to foreclosure generally is significantly greater than the cost of a modification. With a successful modification, Chase is able to continue to service the loan and earn servicer fees; but when a property is sold as a result of foreclosure, Chase's role as servicer ends and Chase receives no further fees.

Chase has established modification programs that collectively have allowed us to avoid many more foreclosures than we have completed. We established these programs starting in early 2007 in recognition of the difficult economic conditions that resulted in a growing number of our borrowers being unable to make their monthly payments. While we keep striving to do even better, our efforts to date have yielded significant results. Since January 2009, Chase has offered almost one million modifications to struggling borrowers and has completed over 250,000 permanent modifications under the Home Affordable Modification Program (HAMP), Chase's own proprietary modification programs, and modification programs offered by the GSEs and FHA/VA. Combined with other programs designed to avoid foreclosure, we have prevented over 429,000 foreclosures since January 2009. Over that same period, we have completed over 241,000 foreclosures. In other words: during the last 2 years, Chase has successfully prevented about two foreclosures for each one we have completed.

Sustainable modifications are not always possible; there are some borrowers who simply cannot afford to stay in their homes, notwithstanding the modification programs and other foreclosure prevention alternatives available. There are other borrowers who are not seeking modifications; in the majority of cases that went to foreclosure sale in the last quarter, the properties were vacant or not owner-occupied.

Our Investment in Foreclosure Prevention

Our progress in foreclosure prevention derives in part from early and significant investments since late 2008. Currently, Chase employs over 6,000 customer-facing staff whose focus is working with distressed borrowers, and we have more than doubled the number of employees in this area in the last 2 years. For more than 6 months, we have assigned each borrower a single point of contact who serves as a consistent touchpoint for the borrower as he/she seeks a loan modification. More than 1,900 dedicated relationship managers serve in this role for our borrowers.

In addition, Chase has made major efforts to reach out personally to borrowers and offer assistance with modifications. Since early 2009, our employees have met with 115,000 struggling borrowers at the 51 Homeownership Centers we have created in 15 States and the District of Columbia. The Chase Homeownership Centers are a notable example of our early efforts to reach borrowers in need. We also have a Homeownership Preservation Office, which maintains relationships with national groups like HOPE NOW and NeighborWorks, as well as with hundreds of local nonprofit organizations across the country. Our team works closely with Government and community leaders on initiatives that focus on affordable housing, foreclosure prevention and community revitalization. The team also travels across the country and directs national outreach events. Over 3.7 million letters have been sent to borrowers inviting them to attend these events. More than 54,000 borrowers have attended one of the hundreds of events held to date.

We expend great efforts to reach our borrowers and inform them about modification alternatives. In the last 2 years, Chase has made 341 million outbound calls to borrowers. Chase does not wait for borrowers to contact us; when we believe a borrower may be at risk, we affirmatively reach out to them early to discuss possible modification options. While requirements vary by State, generally our outreach to borrowers includes numerous calls from a customer service representative and letters detailing the nature of the delinquency and possible Government and other modification programs. Our borrowers also receive a Chase Homeownership and Outreach letter, including any information about local events that provide in-person help. When a loan becomes more delinquent, a Chase representative may visit the property; and generally at 90 days past due, the borrower receives notification of intent to foreclose. On average, we contact a borrower over 100 times before a foreclosure is completed. In addition, our loan counselors have fielded over 29 million inbound calls from borrowers seeking foreclosure prevention assistance in the last 2 years and 5 million calls to our dedicated loan modification hotline.

Loan Modification Programs

Chase's modification programs are focused on helping borrowers stay in their homes by making their monthly mortgage payments affordable.

HAMP Modifications

Chase has supported the Department of Treasury's efforts to increase mortgage modifications industry-wide through HAMP, and Chase was one of the first major servicers to begin implementing the program. Chase mails a HAMP application to every borrower whose loan meets the program's eligibility criteria at both 40 and 70 days delinquency. To date, we have sent HAMP applications to 900,000 borrowers.

Chase makes substantial efforts to help borrowers complete the necessary paperwork, and any decision denying a HAMP application is subject to a rigorous review. Chase also affords borrowers an opportunity to appeal denials of HAMP applications by supplementing the information in their file. When an application is pending, Chase suspends foreclosure sales; and if that application is denied, Chase ordinarily will not proceed with the foreclosure sale for a period of 30 days, provided that an investor does not instruct us to proceed sooner.

If a borrower is eligible for participation in HAMP and is approved for a trial modification, we adjust the mortgage payment to 31 percent of the borrower's total pretax income, as required by HAMP. To achieve this level, as a first step, the loan's interest rate is reduced to as low as 2 percent. If this is not sufficient, then the term of the loan is extended to 40 years. Finally, if necessary, a portion of the principal is deferred until the loan is paid off, and no interest is charged on the deferred principal.

The response to HAMP has been substantial. To date, we have offered HAMP trial plans to more than 270,000 borrowers and have over 60,000 borrowers in active permanent HAMP modification plans through October 2010. These modifications have benefited borrowers by reducing their monthly mortgage payments in most cases. Our borrowers who have taken advantage of HAMP modifications realized an average reduction of 28 percent in their monthly payment.

Modifications for Adjustable Rate Mortgages

Prior to the introduction of HAMP, Chase implemented several of its own proprietary loan modification programs, including several programs for adjustable rate mortgages (ARMs). Chase-owned subprime hybrid ARMs scheduled to reset for the first time are modified to remain at the initial interest rate for the life of the loan. Borrowers qualify for this program if they have a clean payment history on a hybrid ARM with an interest rate that adjusts after the first two or 3 years. Borrowers do not need to contact Chase to benefit from this program; Chase implements the rate lock automatically, and borrowers are so advised. In cases of hybrid ARM loans that we service but do not own, we use the American Securitization Forum (ASF) Fast Track program to reduce payment shock. Under this program, qualifying borrowers will have their initial ARM rate frozen for 5 years.

We also have taken action to help borrowers with Chase-owned Pay Option ARMs. Chase did not originate or purchase these loans, but assumed them through the 2008 acquisition of the mortgage assets of Washington Mutual. Chase has developed proactive programs to assist current Pay Option ARM borrowers who may be at higher risk of default due to factors such as credit score, loan-to-value ratio (LTV), and future payment shock. To eliminate any potential payment shock, we offer to modify the loan to a fixed payment, keeping the borrower's monthly payment at its current amount. For the majority of these modifications, the borrower's payment is fixed for the life of the loan. Since 2009, Chase has proactively completed about 22,000 Option ARM modifications on current loans, worth $8 billion in unpaid principal balance.

Chase Custom Modifications

Borrowers not eligible for HAMP are reviewed on a case-by-case basis to determine their suitability for an alternative modification. We evaluate these loans by developing an estimated target affordable payment of 31 percent to 40 percent of the borrower's gross income. We use the lowest percentage for borrowers with the lowest incomes. Once the target payment is calculated for the borrower, we test each modification option to see if it will get the borrower to an affordable payment. As in the HAMP program, we apply a net present value (NPV) analysis to each option to determine whether the value of the modification exceeds the value expected to be recovered through a foreclosure. Chase recommends a modification when that option produces both an affordable payment and a positive NPV result.

Despite our best efforts, not every loan can be modified, for a variety of reasons. Most of the mortgages we service are serviced on behalf of others; we do not own the loans. We generally owe those third parties, which include the GSEs, a contractual duty to maximize the return on the investment they made. As noted above, the high costs of foreclosure give them (and us) an incentive to consider meaningful payment reduction when necessary to effectively modify the loan, but modifications that do not maximize the return to investors are inconsistent with our duties as servicer. And even aside from our contractual duties, the U.S. mortgage market will never return to health if investors come to believe that the value of the collateral is unreliable.

Other Loss Mitigation Efforts

For a variety of reasons, loan modifications are not always a workable solution. Borrowers who cannot afford their homes, even if the payment is substantially reduced, need other solutions. So, in addition to loan modifications, Chase also offers borrowers other options to avoid foreclosure. These include:

- **Short Sales**—For borrowers who do not qualify for loan modification or would qualify, but do not wish to stay in their homes, Chase has a program that makes available a short sale in which Chase agrees to a sale to a third party, arranged by the borrower, at a price below the outstanding amount of indebtedness. Since April 2010, Chase has had a program to proactively contact borrowers who have listed their homes for sale and who would be good candidates for short sales. Chase provides these borrowers with a minimum offer that Chase would accept to approve a short sale. Since 2009, Chase has completed more than 83,000 short sales.
- **Deed in Lieu**—In cases where a short sale is not possible because a sale cannot be arranged within the prescribed period of time, Chase may offer borrowers the option of deeding the property to Chase in full satisfaction of their debt. Since 2009, Chase has completed more than 3,400 deeds-in-lieu.
- In addition to short sales and deeds-in-lieu, since 2009, Chase has implemented over 55,000 forbearance, extension and repayment plans to help with a hardship and avoid foreclosure.

Foreclosures

The decision to foreclose is always a difficult one, but there are unfortunately many cases where this alternative is unavoidable. In many cases, borrowers are unemployed or otherwise do not or cannot make any meaningful payment on their mortgages. In the average case where we foreclose, the borrower has not made any payment for 14 months; in Florida, where many of our foreclosures have occurred, the average period without payment prior to foreclosure sale is 22 months. In some cases, the borrower may not have an incentive to pursue a modification; of the properties on which we foreclose, a significant percentage is vacant or not the owner's primary residence, but rather an investment property. In cases where the property is vacant, foreclosure may not only be the right economic decision—it also transfers the property into a new owner's hands, improving community safety and stabilizing neighboring property values.

We recently announced that we had temporarily suspended foreclosures, foreclosure sales, and evictions in a number of States to allow for a review and enhancement of our procedures. It is important to note at the outset that the issues that have arisen in connection with foreclosure proceedings do not relate to whether foreclosure proceedings were appropriately commenced. We have not found errors in our systems or processes that would have led foreclosure proceedings to be commenced when the borrower was not in default.

Chase has substantial safeguards in place designed to ensure that foreclosures are both a last resort and instituted only in appropriate cases. A loan is referred to foreclosure only after Chase has made substantial attempts to provide the borrower with alternatives to foreclosure. Then, as part of the process that can ultimately lead to referring a loan to foreclosure, Chase policy requires that all delinquent loans be reviewed by its Independent Foreclosure Review team. The Independent Foreclosure Review confirms that the loan is past due and that Chase has complied with its pre-referral policies, including repeated efforts to contact the borrower to discuss alternatives. Under Chase's policies, only *after* the Independent Foreclosure Review is complete can a loan be referred for foreclosure proceedings. The Independent Foreclosure Review is repeated 2 to 3 weeks prior to any scheduled sale, and a final check also is performed 72 hours prior to the sale. If any of these subsequent reviews suggests that a loan should not have been referred to foreclosure, we do not proceed with the sale. Under our policies, if a loan modification process has begun after the commencement of a foreclosure, we do not engage in a foreclosure sale if the modification succeeds or until the modification process fails. That is not to say we are perfect—we service millions of loans, and we sometimes do make mistakes. But when we find an error, we fix it.

The Nature of the Affidavit Issues

Chase's recent temporary suspension of foreclosure operations in a number of States arose out of concerns about affidavits prepared by local foreclosure counsel, signed by Chase employees, and filed in certain mortgage foreclosure proceedings. Specifically, employees in our foreclosure operations area may have signed affidavits on the basis of file reviews and verifications performed by other Chase personnel, not by the affiants themselves. In addition, we discovered other related issues in connection with some of these affidavits, including instances in which notarized affidavits may not have been signed and affirmed in the physical presence of the notary. Nevertheless, the facts set forth in the affidavits with respect to the borrowers' indebtedness and the amount of the debt—the core facts justifying foreclosure—were verified prior to the execution of the affidavits by Chase employees consulting the company's books and records, which are themselves subject to extensive internal and external controls. Therefore, we believe the underlying information about default and indebtedness was materially accurate and the issues described above did not result in unwarranted foreclosures.

We take these issues very seriously. Our process was not what it should have been; quite simply, it did not live up to our standards. To begin to address these issues, we temporarily halted foreclosure and related proceedings in certain States because our procedures may not have complied with personal knowledge and notarization requirements. In late September, Chase temporarily halted all foreclosure proceedings and property sales in the 23 States where foreclosure primarily occurs through a judicial process and where affidavits are generally filed as part of the process. Shortly thereafter, Chase also temporarily halted foreclosure proceedings in certain States where foreclosure primarily occurs through a non-judicial process in order to assess whether similar documentation issues might exist in those jurisdictions. As an additional safeguard, Chase also temporarily halted evictions in the States in which it suspended foreclosures, as well as in other States where Chase-signed affidavits might be used as part of the eviction process.

While these proceedings have been halted, Chase has thoroughly reviewed its foreclosure procedures and enhanced them to resolve these issues. Briefly, the remedial actions undertaken by Chase include:

- A complete review of our document execution policies and procedures;
- The creation of model affidavits that will comply with all local law requirements and be used in every case, and that will limit factual assertions to those within the personal knowledge of the signer and eliminate any legal conclusions that are outside the signer's personal knowledge;
- Implementation of enhanced procedures designed to ensure that the employees who execute affidavits personally verify their contents and that the affidavits are executed only in the physical presence of a licensed notary;
- Extensive training for all personnel who will have responsibility for document execution going forward and certification of those personnel by outside counsel;
- Implementation of a rigorous quality control double-check review of affidavits completed by Chase employees; and
- Review and verification of our revised procedures by outside experts.

In addition to enhancing procedures for future foreclosure filings, Chase also is working to remedy any issues with affidavits on file in pending proceedings. Although Chase's approach will vary based on the procedures in individual States, in cases in which judgment has not yet been entered, Chase plans to re-verify the material information in filed affidavits and file replacement affidavits prepared under the new enhanced procedures to eliminate any possible defects in these affidavits. Chase is taking other appropriate measures in connection with foreclosure matters in which judgment has been entered but a sale has not yet occurred.

We have worked hard over the past month and a half to review and strengthen our procedures to remediate the affidavit issues we found. We are committed to addressing these issues as thoroughly and quickly as possible.

I hope that my testimony has explained our processes for dealing with cases of borrower default, as well as the issues surrounding the documentation filed in Chase's foreclosure proceedings and the steps we have taken to address them. Foreclosure is a last resort for Chase, but when we do foreclose, we are committed to making sure that we do so in compliance with applicable law and with respect for the borrower. I would be happy to answer questions from the Committee.

Problems in Mortgage Servicing From Modification to Foreclosure

Written Testimony

of

Diane E. Thompson
National Consumer Law Center

also on behalf of
National Association of Consumer Advocates

Before the United States Senate Committee on
Banking, Housing, & Urban Affairs

November 16, 2010

I. Introduction

Chairman Dodd, Ranking Member Shelby, and members of the Committee, thank you for inviting me to testify today regarding the problems occasioned by mortgage servicer abuse run rampant.

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 National Association of Consumer Advocates.[1]

I am an attorney, currently of counsel to the National Consumer Law Center (NCLC).[2] In my work at NCLC I provide training and support to hundreds of attorneys representing homeowners from all across the country. In that role, I hear many, many reports of the difficulties encountered by advocates and homeowners in working with loan servicers. For nearly 13 years prior to joining NCLC, I represented low-income homeowners at Land of Lincoln Legal Assistance Foundation in East St. Louis, Illinois. In that capacity, I became intimately familiar

[1] 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.
[2] 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.

with the various abuses committed by servicers, ranging from the excessive fees that force homeowners into foreclosure to the failure to negotiate a loan modification in good faith to preparation of false affidavits. Lamentably, nothing about the current crisis is new.

What robo-signing reveals is the contempt that servicers have long exhibited for rules, whether the rules of court procedure flouted in the robo-signing scandal or the contract rules breached in the common misapplication of payments or the rules for HAMP modifications, honored more often in the breach than in reality. Servicers do not believe that the rules that apply to everyone else apply to them. This lawless attitude, supported by financial incentives and too-often tolerated by regulators, is the root cause of the robo-signing scandal, the failure of HAMP, and the wrongful foreclosure of countless American families.

The falsification of judicial foreclosure documents is closely and directly tied to widespread errors and maladministration of HAMP and non-HAMP modification programs, and the forced-placed insurance and escrow issues. Homeowners for decades have complained about servicer abuses that pushed them into foreclosure without cause, stripped equity, and resulted, all too often, in wrongful foreclosure. In recent months, investors have come to realize that servicers' abuses strip wealth from investors as well.[3] Unless and until servicers are held to account for their behavior, we will continue to see fundamental flaws in mortgage servicing, with cascading costs throughout our society. The lack of restraint on servicer abuses has created a moral hazard

[3] *Cf.* Jody Shenn, *Mortgage Investors with $500 Billion Urge End of Practices, Lawyer Says,* Bloomberg News, July 23, 2010, http://www.bloomberg.com/news/2010-07-23/mortgage-investors-with-500-billion-urge-end-of-practices-lawyer-says.html (reporting on letters sent to trustees of mortgage pools on behalf of a majority of the investors in the pool); Letter from Kathy D. Patrick to Countrywide Home Loans Servicing, Oct. 18, 2010 (notifying a trust and master servicer of breaches in the master servicer's performance).

juggernaut that at best prolongs and deepens the current foreclosure crisis and at worst threatens our global economic security.

The current robo-signing scandal is a symptom of the flagrant disregard adopted by servicers as to the basic legal and business conventions that govern most transactions. This flagrant disregard has been carried through every aspect of servicer's business model. Servicers rely on extracting payments from borrowers as quickly and cheaply as possible; this model is at odds with notions of due process, judicial integrity, or transparent financial accounting. The current foreclosure crisis has exposed these inherent contradictions, but the failures and abuses are neither new nor isolated. Solutions must include but go beyond addressing the affidavit and ownership issues raised most recently. Those issues are merely symptoms of the core problem: servicers' failure to service loans, account for payments, limit fees to reasonable and necessary ones, and provide loan modifications where appropriate and necessary to restore loans to performing status.

In testimony before this committee in July 2009, I detailed widespread noncompliance with the Home Affordable Modification Program (HAMP). HAMP was a laudable attempt to overcome long standing reluctance by servicers to perform large numbers of sustainable loan modifications. While the permanent loan modifications offered under HAMP are performing well, with historically low redefault rates, only a very few of the potentially eligible borrowers have been able to obtain permanent modifications. Advocates continue to report that borrowers are denied improperly for HAMP, that servicers solicit opt-outs from HAMP, and that some servicers persistently disregard HAMP applications. HAMP sought 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. But, by failing to require that servicers perform modifications and by overlooking servicer accountability and transparency at every step of the process from application to evaluation to conversion, HAMP was set up to fail. HAMP failed to realign servicer incentives with the interests of homeowners, investors, and the American public.

When servicers wrongfully foreclose, or fail to modify, or undermine the judicial process and imperil the legality of a foreclosure, homeowners, investors, and the American public at large all lose. We are living through a period of historic levels of foreclosures. The foreclosure rate is now more than three times what it was in 1933, at the height of the Great Depression.[4] The crisis has impacted every part of our country and most of the world. As the chairman of the Federal Reserve Board has noted, the crisis threatens our national economy.[5] Losses to individual families foreclosed on are projected to exceed $2.6 trillion,[6] with spillover effects on neighbors and communities in the trillions of dollars.[7]

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[4] The U.S. foreclosure rate (percentage of outstanding mortgage loans in foreclosure) at the end of the second quarter of 2010 was 4.57%. Mortgage Banker's Ass'n, National Delinquency Survey Q2 2010, at 3. The foreclosure rate for non-farm mortgages peaked in 1933, below 1.4%. David C. Wheelock, *The Federal Response to Home Mortgage Distress: Lessons from the Great Depression*, 90 Federal Reserve Bank of St. Louis Rev. 133, 138–39 (2008).

[5] *See, e.g.*, Ben S. Bernanke, Chairman, Board 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) [hereinafter Bernanke, Speech at Federal Reserve], *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20081204a.htm ("Despite good-faith efforts by both the private and public sectors, the foreclosure rate remains too high, with adverse consequences for both those directly involved and for the broader economy.").

[6] Staff of the Joint Economic Comm., 110th Cong., 2d Sess., State by State Figures: Foreclosure and Housing Wealth Losses (2008), *available at* http://jec.senate.gov/index.cfm?FuseAction=Reports.Reports&ContentRecord_id=392cb915-9c45-fa0d-5a46-f61f6e619381&Region_id=&Issue_id=.

[7] *See, e.g.*, Ctr. for Responsible Lending, Soaring Spillover: Accelerating Foreclosures to Cost Neighbors $502 Billion in 2009 Alone; 69.5 Million Homes Lose $7,200 on Average (2009), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/soaring-spillover-accelerating-foreclosures-to-cost-neighbors-436-billion-in-2009-alone-73-4-million-homes-lose-5-900-on-average.html (estimating losses to

Servicers, however, do not lose when they foreclose. Servicers make money from force placed insurance and other excessive fees that push homeowners into default. Servicers are able to minimize staffing and other costs when they fail to modify, without imperiling their income. Servicers save money by engaging in robo-signing, and may even have been able to use robo-signing allegations to reduce their obligation to make advances—thus saving them even more money and shifting more of the risk of failure to the top-rated tranches held by pension funds and other large institutional investors.[8]

We are facing a foreclosure tsunami, which has destabilized our economy, devastated entire communities, and destroyed millions of families. Yet we have failed to take aggressive action to restore stability. Neither the government nor the private sector has responded to scale in addressing the crisis. Public and private response to the crisis has been anemic at best, causing millions of families to lose their homes unnecessarily, at great cost to all of us. Indeed, in 2009, foreclosures actually increased as a percentage of the outcomes for loans in default.[9]

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neighboring property values due to the foreclosure crisis at $1.86 trillion dollars); Staff of the Joint 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 Apgar & Mark Duda, Collateral Damage: The Municipal Impact of Today's Mortgage Foreclosure Boom, at 4 (May 11, 2005), *available at* www.hpfonline.org/PDF/Apgar-Duda_Study_Final.pdf (estimating costs to the City of Chicago per foreclosure upwards of $30,000 for some vacant properties).

[8] Kate Berry, *Pipeline: A Roundup of Credit Market News and Views*, Am. Banker, Nov. 11, 2010 (citing research by Amherst securities). The requirement to make advances can be suspended when the servicer judges that losses are irrecoverable. If exposure of robo-signing requires additional expense and time, servicers may claim that the losses are now irrecoverable. This is an exception to the usual rule that servicers never stop making advances.

[9] Diane Pendley et al., Fitch Ratings, U.S. RMBS Servicers' Loss Mitigation and Modification Efforts Update II at 1 (June 2010).

We must take immediate action to rein in servicer abuses and restore transparency to our mortgage markets.

To restore rationality to our market we must take the following steps:

- ❖ Eliminate the two-track system. Homeowners should be evaluated for a loan modification before a foreclosure is initiated, and that evaluation (and offer of a loan modification, if the homeowner qualifies for a loan modification) should be completed before any foreclosure fees are incurred. Such a requirement could be imposed by legislation or by regulation.
- ❖ The failure to offer loan modifications to homeowners, where doing so is predicted to save the investor money under the Net Present Value test, must be made a clear and absolute defense to foreclosure, in both judicial and non-judicial foreclosure states.
- ❖ Homeowners must be provided the tools to focus servicer attention on resolving individual cases.
    - ▪ Quality mediation programs should be funded in every community to provide an opportunity to resolve disputes outside of litigation.
    - ▪ Funding for legal services lawyers representing homeowners facing foreclosure must be increased to allow our adversarial justice system to function as designed.
- ❖ Principal reductions should be mandated in HAMP and provided for via judicial modification.
- ❖ Fees to servicers must be limited to those both reasonable and necessary for them to carry out their legitimate activities. Default-related fees should not remain an unconstrained profit center for servicers.

- Federal regulators should conduct random sample reviews of the servicing and payment history of all servicers, with special attention to the history of borrower contacts, the application of payments, and the legality of imposed fees.
- Where investor restrictions actually restrict modifications, they must be eased.
  - Servicers must be required to seek waivers.
  - Regulatory agencies should encourage investors to grant such waivers freely.
  - Borrowers should be provided with access to full documentation of any investor restrictions, as well as all servicer attempts to procure a waiver, upon any denial based on investor guidelines.
- HAMP must be improved.
  - Enforcement and compliance mechanisms under HAMP must be adopted, including the enactment of the Franken Amendment that gives homeowners the ability to appeal HAMP servicer decisions.
  - Principal forgiveness under HAMP must be mandated.
  - Coordination with the second lien program must be strengthened.
  - Homeowners suffering an involuntary drop in income should be eligible for a second HAMP loan modification.
  - For some homeowners, payments at 31% of family income are not affordable. For those homeowners, monthly payments below 31% should be offered.
  - Conversion from trial modifications to permanent modifications should be made automatic and self-executing.
  - The period of time for unemployment forbearance should be extended, no further trial modification period should be required after the unemployment forbearance

period ends, and no fees other than interest should accrue during the period of unemployment forbearance, consistent with the treatment of homeowners in trial modification plans.

II. Servicing Abuses Are Endemic Throughout the Industry

At every stage of the process, from modification evaluation through foreclosure, servicers have failed to serve either the interests of investors or to treat homeowners fairly and honestly. As the robo-signing scandal illustrates, servicers hold themselves above the law in ways large and small.

Bank of America recently refused to process a Chicago-area homeowner for a loan modification, saying that the investors forbid modification, but refused to provide the name of the holder of the loan—despite the fact that federal law[10] requires servicers to provide the name of the holder upon request. In communicating with a California attorney, Bank of America representatives similarly represented that a pooling and servicing agreement forbade all modifications, when, in fact, the Pooling and Servicing Agreement specifically provided for modifications in the event of the borrower's default. The Bank of America representative in that case went so far as to provide the homeowner's attorney with an electronic copy of the relevant sections of the PSA from which the clause permitting modifications in default had been excised, and a comma replaced with a period. Tens of thousands of homeowners have languished in trial modifications—facing growing loan principals and increasingly damaged credit—although they have met all requirements to obtain a permanent deal. The errors by servicers are systematic and widespread. In the aggregate, they cannot be explained as good faith mistakes.

[10] Truth in Lending Act, 15 U.S.C. § 1641(f)(2).

A. Servicers deny and delay loan modification requests improperly.

Examples abound of servicers refusing to evaluate homeowners for loan modification or delaying loan modifications until a loan modification is no longer feasible. A ProPublica survey found that the average length of time homeowners spend seeking a HAMP loan modification is 14 months.[11] Delay and deny is many servicers' standard response to loan modification requests, as recent examples from advocates around the country illustrate:

- SunTrust took over a year to process an Illinois homeowner for a loan modification. When the homeowner requested that she be reviewed for a HAMP modification, she was told she was not eligible for any modification and the offer of the non-HAMP modification was rescinded.
- A Brooklyn homeowner placed into a HAMP trial modification in June 2009 received, after making his timely trial modification payments, a verbal denial of the HAMP modification in December 2009, followed by the offers of three non-HAMP compliant modifications, which were less sustainable by their terms than a HAMP modification would have been.
- An Illinois homeowner has faxed her documents, and confirmed receipt dozens of times since 2008, and never yet received a complete loan modification application from her servicer, Chase - although she did once receive three pages of a ten page modification agreement, which she, in desperation, returned with a payment. Her payment was returned to her, and she was denied that modification, in part, for failure to make the required initial payment.
- In one all-too typical case from Ohio, getting to a permanent HAMP modification for a low-income and elderly woman took a skilled and determined attorney seventeen months. The attorney first submitted a completed HAMP application to Countrywide in April 2009 and resubmitted the complete application to Bank of America in June 2009. The attorney spent the next several months resending the same application and income documents, which Bank of America repeatedly claimed it had not received. In January 2010, the homeowner received a notice that she had completed a forbearance plan—not the trial modification she thought she was under. Four months elapsed between when Bank of America first acknowledged the homeowner was entitled to a permanent loan modification, in April 2010, and the final permanent HAMP modification sent to the homeowner in August 2010.

[11] *See* http://www.propublica.org/article/homeowner-questionnaire-shows-banks-violating-govt-program-rules.

- A Colorado advocate reports that at least twice Bank of America refused to process HAMP application requests submitted on the standard Request for Modification Agreement (RMA) forms. In one case, the borrower received back a non-compliant "special forbearance" offer. In another case, Bank of America replied to the RMA with a promise to send out a HAMP application form. (A California advocate reports similar experiences with Bank of America refusing to process modification applications submitted on the standard RMA).

- When an elderly Illinois man realized in January 2010 he would miss a mortgage payment due to an unexpected furnace repair, after 10 years of regular mortgage payments, he called his servicer, PNC, to see if he could make some payment arrangements. PNC suggested a loan modification, but told the homeowner to wait to apply and not to make his February payment because that would interfere with his ability to get a modification. After he submitted a modification application, PNC placed the homeowner into foreclosure and rejected his offer to sell his woodworking equipment to raise the cash to pay off the entire arrearage.

- In early 2010, Chase canceled, without explanation, the trial modification of an Illinois couple and then offered a non-HAMP modification that would have required an unaffordable payment at a 41% debt-to-income ratio. The homeowners requested that they be evaluated again for a HAMP modification, and Chase made assurances that the non-HAMP modification offer would remain outstanding while the HAMP evaluation was completed. But, several months later, Chase denied the HAMP modification because the homeowners had failed to accept the non-HAMP compliant modification.

- One New York couple initially requested a loan modification in 2009, and is still waiting for a response from Bank of America, despite having submitted a completed application packet at least twice. Worse, Bank of America placed them into foreclosure while they were awaiting evaluation of their HAMP request, and returned their payments. The day after a Bank of America employee told the homeowners that their payments were being rejected because they had been placed in foreclosure, they received a letter instructing them to continue making payments.

- One Indiana couple dealing with Bank of America discovered that they are no longer eligible for a loan modification because of the extent of their default—default that occurred, in part, due to reliance on Bank of America's representations that they could not be considered for a loan modification until they were further in default.

- A Brooklyn homeowner, who applied for a loan modification from Washington Mutual in 2009, was told to cease making payments for three months before getting the loan modification only to have Chase rescind the permanent modification because he was in default.

- An Illinois homeowner has spent the past two years attempting to get a loan modification from Chase, faxing her documents dozens of times and having numerous payments returned to her. She is now so far in default that she is ineligible for many loan modifications.

- Bank of America cancelled another Illinois homeowner's trial modification because he had allegedly withdrawn from the program. But the homeowner had never requested to be removed from the program and was in fact traveling away from home when Bank of America claimed to have received his opt-out notice.

As discussed more below, delay serves servicers' interests. During delay, fees and interest accrue. For example, a Brooklyn homeowner was placed into foreclosure by Ocwen after attempting to pay off her loan in August 2007. In the intervening three years, the amount Ocwen claims is due and owing to pay off the loan has more than tripled, due largely to the imposition of fees and costs.

These fees will ultimately be paid to the servicer, either by the homeowner or from the proceeds of a foreclosure sale. If, ultimately, the loan is modified, the servicer's monthly servicing fee will increase since it is calculated as a percentage of the outstanding principal, and the homeowner's principal balance will increase due to the capitalization of fees and back interest. For example, in the seven months it took First Franklin to process a Brooklyn woman's loan modification request, her principal balance increased by $30,000.

Of course, the servicer must also advance the borrower's principal and interest payments to the investors every month, and delay increases the servicer's overall costs to borrow funds to make these advances. But only when the costs of financing advances outstrip the additional accumulating fees do servicers have a meaningful incentive to end delay. At that point, the scales will often tilt toward a foreclosure rather than a modification—in part because investor restrictions on how long a loan can be in default before modification may have been exceeded, in part because the accumulated arrearages may make any modification unsustainable, and in part because the time to recover those fees and any legitimate advances will be much shorter in a foreclosure proceeding than in a modification.

To counteract these incentives to delay the process of evaluating homeowners for loan modifications, many advocates report taking extraordinary steps to document the delivery of complete document packages and monitor the timeline. One advocate in Indiana reports that she submitted the same documents three times, without change, as Bank of America employees first claimed that the documents were not signed, and then that they were not notarized. Fortunately, she had not only ensured that the original submission was complete, but retained copies. Not all homeowners attempting to navigate the loan modification maze are able to be as meticulous or as persistent, and many give up in confusion and frustration after they are asked for the same document four or five times or told that they did not submit documents they did submit.

Advocates have received little help from Treasury in enforcing the applicable timelines for processing loan modification requests under HAMP. One Florida attorney was told by the HAMP escalations center, the organization tasked by Treasury with fielding disputes regarding servicer compliance with HAMP, that a failure to evaluate the loan modification request within 30 days, as required under the HAMP handbook, was not a compliance issue.

Particularly offensive are servicers' failures to accept documentation of the death of a co-owner. One California advocate reports that his client submitted his wife's death certificate to Bank of America no fewer than six times. Bank of America sent a deceased Indiana homeowner a letter denying a loan modification because they had received no documents from her (unsurprising, since she had been dead for over two years at that point), although the co-owner had submitted a complete loan modification packet and a death certificate numerous times. Worse, a representative of Bank of America appeared at the home one day and demanded repeatedly to talk with the deceased homeowner and refused to talk to the remaining co-owner, despite her repeated explanation that she was the surviving joint tenant and a signatory to the note. A South Brooklyn woman whose husband died in 1999 has been attempting to negotiate a loan modification with Wells Fargo since 2008, but Wells refuses to modify the mortgage until and unless she brings the loan current, since only her husband was on the original note.

Other documentation requests may violate the terms of HAMP or federal anti-discrimination statutes. For example, Bank of America discounted a 65 year old woman's employment income, and then denied her for insufficient income, because they judged that at her age she was unlikely to continue working. When her attorneys challenged this denial, Bank of America asserted she had failed to provide necessary documentation of her income and continued employment.

B. Servicers' errors result in wrongful foreclosure.

We do not know—and cannot know—how many homeowners have been improperly foreclosed on. Poor documentation by servicers is not merely a "technical" error. Reported cases abound where servicers are unable to establish the amount of default[12] or where a servicer misapplication of payments leads to default.[13] Servicer errors can and do lead to foreclosure.

As discussed below, servicers have substantial incentives to impose significant fees on homeowners because they are usually permitted under the pooling and servicing agreements to

[12] *See, e.g.,* Maxwell v. Fairbanks Capital Corp. (*In re* Maxwell), 281 B.R. 101 (Bankr. D. Mass. 2002).
[13] *See, e.g.,* Chu v. Green Point Sav. Bank, 628 N.Y.S. 2d 527 (2nd App. Dist. 1995) (finding servicers' conduct in foreclosing "frivolous" and imposing sanctions).

retain all of those fees. Forceplaced insurance in particular is often a locus of abuse.[14] The result of the abusive placement of forceplaced insurance frequently leads to default and foreclosure. For example, a servicer billed a Maine homeowner twice for force-placed insurance at $8,500 per year, when the homeowner had in place coverage at $550 per year. The resulting increase in his monthly payments eventually forced the homeowner into default and foreclosure, and the lender dropped the foreclosure only after several years of active litigation. Similar examples have been reported around the country.[15] Mortgage insurance may also be a source of profit for a servicer or its affiliates and hence a frequent locus for improper placement and upcharging of fees. One New York advocate reports that her client—who had never before paid mortgage insurance and for whom there was no apparent contract authority to require mortgage insurance—was suddenly required to make a monthly payment to support mortgage insurance, increasing the cost of her loan and providing her no benefit.

Other "technical" errors can push homeowners into foreclosure. An Illinois homeowner ended up deeply in default and on the verge of foreclosure when there was a problem processing an on-line payment because his servicer, American Home Mortgage Servicing, Inc. (AHMSI), changed his loan number—without notice to him. It took three months of repeated calling before AHMSI located his loan and provided the home owner with the new loan number, but, by then, his loan had been referred to foreclosure as 90 days delinquent. The desperate homeowner agreed to make payments of twice his monthly payment for several months until he paid off the claimed arrearage (twice what he in fact owed), but AHMSI nonetheless instituted foreclosure payments

[14] *See, e.g.,* Jeff Horwitz, *Ties to Insurers Could Land Mortgage Servicers in More Trouble: Force-Placed Polices Impose Costs on Both Homeowner, Investor*, Am. Banker, Nov. 10, 2010.
[15] *See, e.g.,* Kate Berry, *Pipeline: A Roundup of Credit Market News and Views*, Am. Banker, Nov. 11, 2010 (citing research by Amherst securities) (reporting on a Florida case)

and returned his check. Only the intervention of a legal services attorney saved this homeowner from losing his home—despite the fact that the initial arrearage was entirely due to a "technical" error by AHMSI.

In a more extreme case, Countrywide sold a North Carolina woman's home at a foreclosure sale, even though she was making the timely payments required under a consent order entered in bankruptcy court, perhaps because the bankruptcy consent order permitting the modified payments was not entered into the servicer's computer system.

Not infrequently, servicers return borrowers' payments for obscure reasons and then proceed to foreclose on the basis of the default. For example, after an Illinois couple sent in a triple payment to catch up two missing payments on their mortgage (and after consulting with their servicer), Bank of America returned the payment and initiated foreclosure proceedings. A North Carolina woman made payments under a trial modification agreement with Chase for 15 months, and then, on the advice of a Chase representative, sent in a partial payment in the 16th month of her trial modification. Chase promptly returned the partial payment and initiated foreclosure proceedings, without ever processing her for a permanent modification.

Servicers have yet, more than three years into the crisis, to figure out staffing, with sometimes disastrous results for homeowners. One Illinois advocate was told by an employee at Chase's Homeownership Preservation office, after she called to determine why her client had been denied a modification she never applied for, that when the loss mitigation department gets too busy, the collections department answers the phone. Once collections takes that call, the employee reported, the homeowner's file with loss mitigation is transferred to collections and no further loan modification work goes on. Neither the homeowner nor her counsel had requested that transfer or even been informed of it.

When I was representing clients, I more than once arrived at an agreement in principle in a foreclosure defense case only to be told by opposing counsel that his client no longer owned the loan, that they were unsure who owned the loan, but that they were still willing to settle with my client. Not infrequently, servicers will bring foreclosure actions in the name of the wrong trust. In one recent case involving a homeowner in Long Island, after protracted litigation, including denial of a motion to dismiss a foreclosure complaint filed in the name of Deutsche Bank for Deutsche Bank's failure to prove ownership, and multiple transfers of ownership, the attorney for the holder acknowledged that Deutsche Bank had never had an interest in the loan. This uncertainty about ownership complicates settlement, frustrates loan modification, and can, occasionally, expose homeowners to double jeopardy on their mortgage loans.

The problems establishing ownership and chain of title demonstrated in the robo-signing scandal can make obtaining a loan modification impossible. One North Carolina homeowner was advised by BAC Home Loans Servicing in 2009 that she was not eligible for a modification since her loan was an FHA loan, and she did not meet the FHA loan modification requirements. A year later, after the woman found her way to a legal services attorney, FHA disclaimed any interest in the loan. Until this question is resolved, no loan modification can be processed, and the accumulating arrearage makes any loan modification increasingly unlikely. In another case, after offering a Brooklyn homeowner two separate permanent HAMP modifications over a period of seven months, and after the homeowner had completed the terms of her trial modification, the servicer determined that investor restrictions prohibited modifications, apparently because the servicer had previously incorrectly identified the holder.

The cause may be a technical error, or a mistake by the servicer, but if the homeowner is pushed into default, denied a loan modification, or induced not to make payments in reliance on a loan modification, the result is the same: a wrongful foreclosure, at incalculable cost to the homeowners and likely loss to the investors. [16]

C. All safety fuses limiting servicer abuses have been blown.

Most of the major servicers have acknowledged their failure to follow standard legal procedures for documenting transfer of the note and mortgage and failure to document correctly the amount and extent of the borrowers' default. While servicers claim to have remedied or be in the process of remedying these defects, no existing external mechanism will reliably prevent a recurrence. Indeed, we have long since abrogated the two traditional checks to ensure that homeowners cannot be deprived of their home by a stranger: the requirement that the original note be produced and the public recording of assignments. Without the public availability of those documents, it is impossible for most homeowners or any independent third party to verify a servicer's representations as to ownership. There are even fewer checks on the servicer's declaration of default.

Only about half the states follow a judicial foreclosure process, where a judge reviews the documents. In the other states, foreclosure is conducted extra-judicially, with few if any

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[16] *Cf.* Jody Shenn, *Mortgage Investors with $500 Billion Urge End of Practices, Lawyer Says,* Bloomberg News, July 23, 2010, http://www.bloomberg.com/news/2010-07-23/mortgage-investors-with-500-billion-urge-end-of-practices-lawyer-says.html (reporting on letters sent to trustees of mortgage pools on behalf of a majority of the investors in the pool); Letter from Kathy D. Patrick to Countrywide Home Loans Servicing, Oct. 18, 2010 (notifying a trust and master servicer of breaches in the master servicer's performance).

verifications of a servicer's representation as to default and ownership. Even the extra protection afforded by judicial process is spotty, at best, however, particularly in this era of historically high volumes of foreclosure cases. Judges, in foreclosure cases as in other cases, rely on the adversarial process to bring to light problems in either party's case. Where one side is systematically unrepresented, as the vast majority of homeowners are, the process skews away from a balanced review of the equities. Judges are unlikely to detect errors in a servicer's documentation where the homeowner goes unrepresented, as most do. In many courtrooms, the foreclosure process resembles a factory assembly line far more than our images of a court of law.

During the years I represented homeowners—from 1994 through June 2007, before the massive levels of foreclosures we are currently experiencing—the judge hearing foreclosure cases would often dispose of one to two hundred cases in no more than an hour and a half. A few minutes before court opened, paralegals from the two firms representing lenders would wheel trolleys stacked with bankers' boxes into the courtroom. The paralegals would then empty the boxes onto the counsel tables, with the prepared orders paper clipped on top. Stacks of cases would then be handed to the judge, the judge would call out the homeowner's name, and if no one answered, sign the order and hand it to the courtroom clerk for file stamping. Those homeowners who did show up were told to go talk with the bank's lawyer out in the hallway, to see if something could be worked out. By and large, if the homeowner said, as many did, "The bank told me we could work something out," the judge would nonetheless sign the order for foreclosure, relying on the attorney's representation that their client had not communicated any instructions for ceasing the foreclosure but that, if they did work something out, the bank would come back and set the foreclosure aside. I sometimes appeared on as many as ten cases, but only one or two other homeowners were typically represented on those Thursday morning foreclosure docket calls, leaving often a hundred or more unrepresented.

That experience was not atypical, and the numbers have only gotten worse. The numbers of foreclosures have overwhelmed the already limited judicial resources. We cannot count on activist judges to find the time to independently review the filings in the hundreds of cases presented to them on each foreclosure docket. Fundamentally, our legal system relies on an adversarial model. Currently, that adversarial model is lacking in the vast majority of cases: lenders are represented by attorneys while homeowners go unrepresented. Only when homeowners are represented by competent and engaged attorneys are judges likely to confront the gross inadequacies found in many foreclosure filings. Homeowners facing foreclosure need increased access to attorneys.

We know from the success of the New York City and Philadelphia mediation programs that where servicers and their lawyers are compelled to treat resolution of a foreclosure dispute as an individual case, and not an assembly line, many foreclosures can be prevented. Those programs consistently reports that in at least half of all cases the parties reach a loan modification and the foreclosure is prevented. But servicers have not shown an inclination to provide that careful case-by-case review outside mandatory programs, and standard judicial resources are overwhelmed by the scale of the crisis.

III. Servicers' Incentives Incline Them Towards Increased Fees and Foreclosures over Modifications.

Once a loan is in default, servicers must choose to foreclose or modify. A foreclosure guarantees the loss of future income, but a modification will also likely reduce future income, cost more in the present in staffing, and delay recovery of expenses. Moreover, the foreclosure process itself generates significant income for servicers.

After a refinancing, which is always the path of least resistance for a servicer facing a homeowner in default, foreclosure is the best option from the servicer's point of view. The servicer's expenses, other than the financing costs associated with advances, will be paid first out of the proceeds of a foreclosure. Thus, the servicer will recover all sunk expenditures upon completion of the foreclosure, including the cost of services provided by affiliated entities, like title and property inspection.

Whether and when costs are recovered in a modification is more uncertain. While the credit rating agencies have made steps to improve clarity on the treatment of advances in a modification, there are still ambiguities. Existing PSAs provide at best spotty coverage of how a servicer should be paid for doing a modification and what kinds of modifications are preferred, offering the vague "usual and customary practices" as guidance to skittish servicers. Worse, recovery of costs is delayed in a modification, with some costs, particularly the sunk costs of staffing and time, not recovered at all.

Servicers do not make binary choices between modification and foreclosure. Servicers may offer temporary modifications, modifications that recapitalize delinquent payments, modifications that reduce interest, modifications that reduce principal, or combinations of all of the above. Servicers may demand upfront payment of fees or waive certain fees. Or servicers may simply postpone a foreclosure, hoping for a miracle.

For servicers, the true sweet spot lies in stretching out a delinquency without either a modification or a foreclosure. Income from increased default fees and payments to affiliated entities can outweigh the expense of financing advances for a long time. This nether-world status also boosts the monthly servicing fee and slows down servicers' largest non-cash expense, the amortization of mortgage servicing rights, since homeowners who are in default are unlikely to prepay via refinancing.[17] Finally, foreclosure or modification, not delinquency by itself, usually triggers loss recognition in the pool. Waiting to foreclose or modify postpones the day of reckoning for a servicer. But delay can cost a homeowner the opportunity to obtain a modification.

How long a delay in the foreclosure will be profitable depends on the interplay of the servicers' ability to charge additional fees during the foreclosure, on the one hand, and the servicer's financing costs for advances and the time limits for proceeding through foreclosure imposed by the PSA and credit rating agencies, on the other hand. If the servicer can juggle the time limits—perhaps by offering short term workout agreements—the prospect of increased fees may outweigh interim interest costs. Once the servicer's financing costs outweigh the incremental fees that can be extracted by maintaining a borrower in delinquency, the servicer will choose the

[17] *See, e.g.,* Ocwen Fin. Corp., Annual Report (Form 10-K) 30 (Mar. 12, 2009):

> Servicing continues to be our most profitable segment, despite absorbing the negative impact, first, of higher delinquencies and lower float balances that we have experienced because of current economic conditions and, second, of increased interest expense that resulted from our need to finance higher servicing advance balances. Lower amortization of MSRs [mortgage servicing rights] due to higher projected delinquencies and declines in both projected prepayment speeds and the average balance of MSRs offset these negative effects. As a result, income . . . improved by $52,107,000 or 42% in 2008 as compared to 2007.

faster option, either a foreclosure or a modification, all other things being equal.[18] Unfortunately for homeowners and investors, the faster option is usually a foreclosure.

Effect of Components of Servicer Compensation on Likelihood and Speed of Foreclosure

	Favors Foreclosure?	Likely Effect on Speed of Foreclosure?
Structural Factors		
PSAs	Neutral	Speeds Up
Repurchase Agreements	Neutral	Slows Down
REMIC rules	Neutral	Neutral
FAS 140	Slightly Favors Foreclosure	Neutral
TDR Rules	Slightly Favors Foreclosure	Neutral
Credit rating agency	Slightly Favors Foreclosure	Speeds Up
Bond insurers	Slightly Favors Foreclosure	Speeds Up
Servicer Compensation		
Fees	Strongly Favors Foreclosure	Slows Down
Float Interest Income	Slightly Favors Foreclosure	Neutral
Monthly Servicing Fee	Strongly Favors Modification (but not principal reductions)	Slows Down
Residual Interests	Slightly Favors Modification (but not interest reductions)	Slows Down
Servicer Assets		
Mortgage Servicing Rights	Neutral	Slows Down
Servicer Expenses		
Advances	Strongly Favors Foreclosures	Speeds Up
Fee Advances to Third Parties	Slightly Favors Foreclosure	Speeds Up
Staff Costs	Strongly Favors Foreclosures	Speeds Up

A. Influence of Advances

Servicers have two main expenses when a loan is in default: advances of principal and interest to the trust and payments to third parties for default services, such as property inspections.

[18] Tomasz Piskorski, Amit Seru & Vikrant Vig, Securitization and Distressed Loan Renegotiation: Evidence from the Subprime Mortgage Crisis 5 (Dec. 2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1321646 (finding increased numbers of modifications when the foreclosure process is delayed).

Financing these costs is one of servicers' biggest expenses.[19] Recovery of these fees (but not the financing costs) is more certain and often swifter via a foreclosure than a modification. Only when a modification offers a faster recovery of advances than a foreclosure, might the financing costs incline a servicer toward a modification.[20]

Interest and Principal Advances to Investors

Servicers, under their agreements with investors, typically are required to continue to advance interest on loans that are delinquent.[21] Unpaid principal may or may not be advanced, depending on the PSA.[22] The requirement for advances usually continues until a foreclosure is completed, a loan modification is reached, or the servicer determines that there is no realistic prospect of recovering the advances from either the borrower or the collateral.[23] In a small number of cases, servicers may be exempted from continuing to make advances once the loan is in foreclosure or more than five months delinquent.[24] A servicer's failure to make advances, even "nonrecoverable" advances, can lead to the servicer's removal.[25]

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[19] Ocwen Fin. Corp., Annual Report (Form 10-K) 5 (Mar. 12, 2009); Mary Kelsch, Stephanie Whited, Karen Eissner, Vincent Arscott, Fitch Ratings, Impact of Financial Condition on U.S. Residential Mortgage Servicer Ratings 2 (2007).

[20] *Cf.* Wen Hsu, Christine Yan, Roelof Slump, FitchRatings, U.S. Residential Mortgage Servicer Advance Receivables Securitization Rating Criteria 4 (Sept. 10, 2009) (finding that modifications do not appear to accelerate the rate of recovery of advances, in part because of high rates of redefault).

[21] Larry Cordell, Karen Dynan, Andreas Lehnert, Nellie Liang, & Eileen Mauskopf, Fed. Reserve Bd. Fin. & Econ. Discussion Series Div. Research & Statistical Affairs, The Incentives of Mortgage Servicers: Myths and Realities 16 (Working Paper No. 2008-46).

[22] *See, e.g.,* Ocwen Fin. Corp., *supra* note 17, at 4 (advances include principal payments); Brendan J. Keane, Moody's Investor Services, Structural Nuances in Residential MBS Transactions: Advances 4 (June 10, 1994) (stating that Countrywide was in some circumstances only advancing interest, not principal).

[23] Keane, *supra* note 22, at 3.

[24] Servicers may also escape the requirement for advances if a borrower files for bankruptcy. Brian Rosenlund, Metropolitan West Asset Management RMBS Research 3 (Winter 2009).

[25] Rosenlund, *supra* note 24.

Servicers' advances are taken off the top, in full, at the post-foreclosure sale, before investors receive anything. [26] If advances of principal and interest payments remain beyond the sale value, servicers can usually collect them directly from the trust's bank account (or withhold them from payments to the trust).[27]

In contrast, when there is a modification, servicers are usually limited to recovering their advances from the modified loan alone, after required payments to the trust, or, if the advances are deemed nonrecoverable, from only the principal payments on the other loans in the pool, not the interest payments.[28] As a result, servicers can face a delay of months to years in recouping their advances on a modification. Modifications involving principal reductions compound the problem: they lengthen the time to recover advances on any individual modified loan as well as on other modified loans, by reducing the amount of principal payments available for application to recovery of advances.[29]

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[26] Cordell et al., *supra* note 21, at 11; Ocwen Fin. Corp., *supra* note 17, at 4 (advances are "top of the waterfall" and get paid first); Wen Hsu, Christine Yan, Roelof Slump, FitchRatings, U.S. Residential Mortgage Servicer Advance Receivables Securitization Rating Criteria 1 (Sept. 10, 2009) (same); Prospectus Supplement, IndyMac, MBS, Depositor, IndyMac INDX Mortgage Loan Trust 2007-FLX5, at 71 (June 27, 2007) [hereinafter Prospectus Supplement, IndyMac et al.] (servicers repaid all advances when foreclosure is concluded); Letter from Kathy D. Patrick to Countrywide Home Loans Servicing, Oct. 18, 2010 (notifying a trust and master servicer of breaches in the master servicer's performance)..

[27] *See, e.g.,* Ocwen Fin. Corp. *supra* note 17 at 11 ("[I]n the majority of cases, advances in excess of loan proceeds may be recovered from pool level proceeds."); Prospectus Supplement, IndyMac et al., *supra* note 26, at 71 (permitting principal and interest advances to be recovered from the trust's bank account); Prospectus, CWALT, INC., Depositor, Countrywide Home Loans, Seller, Countrywide Home Loans Servicing L.P., Master Servicer, Alternative Loan Trust 2005-J12, Issuer 47 (Oct. 25, 2005) (limiting right of reimbursement from trust account " to amounts received representing late recoveries of the payments for which the advances were made).

[28] Monica Perelmuter & Jeremy Schneider, Standard & Poor's, Criteria: Structured Finance: RMBS: Methodology for Loan Modifications That Include Forbearance Plans for U.S. RMBS 3 (July 23, 2009).

[29] *But see* Rod Dubitsky, Larry Yang, Stevan Stevanovic, Thomas Suer, Credit Suisse, Subprime Loan Modifications Update 8 (2008) (discussing how some servicers exploited then-existing imprecision in the accounting treatment of principal reduction modifications to use principal reduction modifications to halt interest advances).

Although the cost of the advances themselves may be recovered, the significant financing costs associated with making advances cannot be.[30] This incentive can encourage servicers to sell the investors out at a post-foreclosure fire sale, as the servicers seek to recoup their costs quickly once the possibility of additional fees is exhausted.[31]

The combined force of the limitations on the recovery of advances to the loan level and the non-recoverability of the cost of financing advances drives servicers to seek upfront payments from homeowners prior to modification. Few borrowers, having once defaulted, are in a position to make the large payments required to bring their loan current and then continue making regular payments; many redefault. But, of course, if the loan ends in foreclosure after a modification, the advances will again have super-priority status. Thus, servicers face no real risk by insisting on the payment of large upfront fees, even if the result is redefault.

Fee Advances to Third Parties

In addition to interest advances, servicers advance expenses associated with default servicing, such as title searches, drive-by inspections, or foreclosure fees.[32] Taxes and insurance costs are also often advanced.[33] Some PSAs impose caps on these fee advances.[34]

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[30] Joseph R. Mason, Mortgage Loan Modification: Promises and Pitfalls 4 (Oct. 2007). A large subprime servicer noted in its 2007 annual report that although "the collectibility of advances generally is not an issue, we do incur significant costs to finance those advances. We utilize both securitization, (i.e., match funded liabilities) and revolving credit facilities to finance our advances. As a result, increased delinquencies result in increased interest expense." Ocwen Fin. Corp., *supra* note 17, at 18; *see also* Wen Hsu et al., *supra* note 20 ("Servicer advance receivables are typically paid at the top of the cash flow waterfall, and therefore, recovery is fairly certain. However, . . . there is risk in these transactions relating to the timing of the ultimate collection of recoveries.").

[31] *See* Complaint at 11–15, Carrington Asset Holding Co., L.L.C. v. American Home Mortgage Servicing, Inc., No. FST-CV 09-5012095-S (Conn. Super. Ct., Stamford Feb. 9, 2009) (alleging that servicer conducted "fire sales" of foreclosed properties in order to avoid future advances and recover previously made advances); Kurt Eggert, *Limiting Abuse and Opportunism by Mortgage Servicers,* 15 Housing Pol'y Debate 753, 757 (2004) (reporting that servicers sometimes rush through a foreclosure without pursuing a modification or improperly foreclose in order to collect advances); Peter S. Goodman, *Lucrative Fees May Deter Efforts to Alter Troubled Loans*, N.Y. Times, July 30, 2009 [hereinafter Goodman, *Lucrative Fees*].

[32] Cordell et al., *supra* note 21 at 17; *cf.* American Securitization Forum, Operational Guidelines for Reimbursement of Counseling Expenses in Residential Mortgage-Backed Securitizations (May 20, 2008), *available at*

These fee advances may or may not represent actual out-of-pocket expense to the servicer. In many cases, affiliates of the servicer, not true third parties, receive the fees, and the resulting profit wipes out any cost of financing the advance.[35] These fees may also be marked-up: in one case, Wells Fargo reportedly charged a borrower $125 for a broker price opinion when its out-of-pocket expense was less than half that, $50.[36] Such padding more than offsets the cost of financing the advance. Force-placed insurance is frequently placed either through or an affiliate or in exchange for a commission from the insurance company paid back to the servicer—again wiping out any true cost and turning the nominal advance into a profit center for the servicer.[37]

B. Fees Are a Profit Center for Servicers

Most PSAs permit servicers to retain fees charged delinquent homeowners. Examples of these fees include late fees[38] and fees for "default management" such as property inspections.[39] The

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http://www.americansecuritization.com/uploadedFiles/ASF_Counseling_Funding_Guidelines%20_5%20_20_08.pdf (stating that payments of $150 for housing counseling for borrowers in default or at imminent risk of default should be treated as servicing advances and recoverable from the general securitization proceeds).

[33] *See, e.g.,* Ocwen Fin. Corp., *supra* note 17 at 4.

[34] Marina Walsh, *Servicing Performance in 2007,* Mortgage Banking 72 (Sept. 2008).

[35] *See* Complaint ¶ 15, Fed'l Trade Comm'n v. Countrywide Home Loans, Inc., No. CV-10-4193 (C.D. Cal. Jun. 7, 2010), available at http://www.ftc.gov/os/caselist/0823205/100607countrywidecmpt.pdf(alleging that Countrywide's "countercyclical diversification strategy" was built on its subsidiaries funneling the profits from marked-up default fees back to Countrywide); Peter S. Goodman, *Homeowners and Investors May Lose, But the Bank Wins*, N.Y. Times, July 30, 2009 [hereinafter Goodman, *Homeowners and Investors May Lose*]; Goodman, *Lucrative Fees, supra* note 31; Letter from Kathy D. Patrick to Countrywide Home Loans Servicing, Oct. 18, 2010 (notifying a trust and master servicer of breaches in the master servicer's performance). Letter from Kathy D. Patrick to Countrywide Home Loans Servicing, Oct. 18, 2010 (notifying a trust and master servicer of breaches in the master servicer's performance).

[36] *In re* Stewart, 391 B.R. 327, 346 (Bankr. E.D. La. 2008), *aff'd,* 2009 WL 2448054 (E.D. La. Aug. 7, 2009); *see also* Complaint ¶ 18, *Fed'l Trade Comm'n v. Countrywide, supra* note 35 (alleging a subsidiary of Countrywide routinely marked up property preservation fees by 100%); Jeff Horwitz, *Ties to Insurers Could Land Mortgage Servicers in More Trouble: Force-Placed Polices Impose Costs on Both Homeowner, Investor*, Am. Banker, Nov. 10, 2010 (reporting on fee markups in force-placed insurance).

[37] *See, e.g.,* Jeff Horwitz, *Ties to Insurers Could Land Mortgage Servicers in More Trouble: Force-Placed Polices Impose Costs on Both Homeowner, Investor*, Am. Banker, Nov. 10, 2010.

[38] *See, e.g.,* Prospectus, CWALT, INC., Depositor, Countrywide Home Loans, Seller, Countrywide Home Loans Servicing L.P., Master Servicer, Alternative Loan Trust 2005-J12, Issuer 56 (Oct. 25, 2005) ("In addition, generally

profitability of these fees can be significant.[40] Late fees alone constitute a significant fraction of many subprime servicers' total income and profit.[41]

Servicers can collect these fees post-foreclosure before the investors receive any recovery.[42] This guaranteed recovery of fees strongly favors foreclosures over modifications that waive fees, including HAMP,[43] and encourages servicers to delay foreclosures in order to maximize the

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the master servicer or a sub-servicer will retain all prepayment charges, assumption fees and late payment charges, to the extent collected from mortgagors). *But see* Prospectus Supplement, IndyMac et al., *supra* note 26at S-11 (late payment fees are payable to a certificate holder in the securitization).

[39] *See, e.g.*, Prospectus Supplement, IndyMac et al., *supra* note 26 at S-73:

> Default Management Services
>
> In connection with the servicing of defaulted Mortgage Loans, the Servicer may perform certain default management and other similar services (including, but not limited to, appraisal services) and may act as a broker in the sale of mortgaged properties related to those Mortgage Loans. The Servicer will be entitled to reasonable compensation for providing those services, in addition to the servicing compensation described in this prospectus supplement.

[40] *See In re Stewart*, 391 B.R. 327, 343, n.34 (Bankr. E.D. La. 2008) ("While a $15.00 inspection charge might be minor in an individual case, if the 7.7 million home mortgage loans Wells Fargo services are inspected just once per year, the revenue generated will exceed $115,000,000.00."), *aff'd*, 2009 WL 2448054 (E.D. La. Aug. 7, 2009); Complaint ¶ 15, *Fed'l Trade Comm'n v. Countrywide*, *supra* note 35.

[41] *See, e.g.*, Ocwen Fin. Corp., *supra* note 17, at 34 (revenue from late charges reported as $46 million in 2008 and made up almost 18% of Ocwen's 2008 servicing income); Eggert, *supra* note 31, at 758; Gretchen Morgenson, *Dubious Fees Hit Borrowers in Foreclosures*, N.Y. Times (Nov. 6, 2007) (reporting that Countrywide received $285 million in revenue from late fees in 2006).

[42] *See, e.g.*, Prospectus Supplement, Chase Funding Loan Acquisition Trust, Mortgage Loan Asset-Backed Certificates, Series 2004-AQ1, at 34, (June 24, 2004), *available at* http://www.sec.gov/Archives/edgar/data/825309/000095011604003012/four24b5.txt ("[T]he Servicer will be entitled to deduct from related liquidation proceeds all expenses reasonably incurred in attempting to recover amounts due on defaulted loans and not yet repaid, including payments to senior lienholders, legal fees and costs of legal action, real estate taxes and maintenance and preservation expenses."); Letter from Kathy D. Patrick to Countrywide Home Loans Servicing, Oct. 18, 2010 (notifying a trust and master servicer of breaches in the master servicer's performance).

[43] *See* Manuel Adelino, Kristopher Gerardi, and Paul S. Willen, Fed. Reserve Bank of Boston, Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitizations 6 (Publicy Pol'y Paper No. 09-4, July 6, 2009), *available at* http://www.bos.frb.org/economic/ppdp/2009/ppdp0904.pdf. ("In addition, the rules by which servicers are reimbursed for expenses may provide a perverse incentive to foreclose rather than modify."). Under the Department of the Treasury's Home Affordable Modification Program, servicers are required to waive unpaid late fees for eligible borrowers, but all other foreclosure related fees, including, presumably, paid late fees, remain recoverable and are capitalized as part of the new principal amount of the modified loan. *See* Home Affordable Modification Program, Supplemental Directive 09-01 (Apr. 6, 2009).

number of fees charged.[44] In a self-perpetuating cycle, the imposition of fees makes a foreclosure more likely, by pricing a modification out of a homeowners' reach.[45]

In addition to pre-foreclosure fees, servicers are usually entitled to recover the costs of selling the home post-foreclosure, before investors are paid.[46] The sometimes substantial fees paid to servicers in foreclosure tend to be invisible to investors.[47]

C. The two-track system increases foreclosures.

Credit rating agencies and investors typically require servicers to process both foreclosures and loan modifications at the same time. Subprime servicers, in particular, are expected to show "strict adherence to explicit timelines," offer and accept workouts from only a predefined and standardized set of options, and not delay foreclosure while loss mitigation is underway.[48] The speed at which loans are moved from default through foreclosure is "a key driver in the servicer rating,"[49] encouraging servicers to compete for the fastest time to foreclosure.

The foreclosure and loan modification will be handled by different departments at the servicer, with only imperfect communication. For years, training for housing counselors and attorneys seeking loan modifications for their clients has stressed the importance of speaking to loss mitigation, not collections or foreclosure. The continued vitality of that chestnut is borne out by

[44] Goodman, *Lucrative Fees, supra* note 31 ("So the longer borrowers remain delinquent, the greater the opportunities for these mortgage companies to extract revenue—fees for insurance, appraisals, title searches and legal services.").

[45] *See* Katherine Porter, *Misbehavior and Mistake in Bankruptcy Mortgage Claims,* 87 Tex. L. Rev. 121 (2008) ; Jones v. Wells Fargo Home Mortg. (*In re* Jones), 366 B.R. 584 (Bankr. E.D. La. 2007), *aff'd* Wells Fargo v. Jones, 391 B.R. 577, 595 (diversion" of mortgage payments to cover inspection charges led to increased deficiency and imperiled bankruptcy plan).

[46] *See, e.g.,* Prospectus Supplement, IndyMac et al., *supra* note 26 at S-73 (noting that the servicer is entitled to retain the costs of managing the REO property, including the sale of the REO property).

[47] Goodman, *Lucrative Fees, supra* note 31.

[48] Diane Pendley & Thomas Crowe, FitchRatings, U.S. RMBS Servicers' Loss Mitigation and Modification Efforts 11, 15 (May 26, 2009); *see also* Michael Guttierez, Michael S. Merriam, Richard Koch, Mark I. Goldberg, Standard & Poors, Structured Finance: Servicer Evaluations 15–16 (2004). The rating agencies do not set benchmarks for any of these, but expect servicers to develop timelines and standardized loss mitigation options for each loan product, with reference to the industry standards as developed by Fannie Mae and Freddie Mac.

[49] Pendley et al., *supra* note 48, at 9.

the recent experience of an Illinois homeowner whose case was, unbeknownst to her, transferred from loss mitigation to collections when she called on an especially busy day. The transfer resulted in denial of a loan modification, in part because, a helpful Chase employee told the homeowner's attorney, once a case is transferred from loss mitigation to collections, it cannot be transferred back.

Servicers rely heavily on the mechanized production of form documents in processing both foreclosures and loan modifications. Any variation from the cookie cutter norm imposed by the form documents causes delay and consternation, as an Illinois housing counselor learned when she asked that a waiver clause be stricken from a proferred loan modification. *See* Attachment A. The servicer informed the counselor that the form was generated by the computer and could not be changed.

In part because loan modifications often require more deviations from the norm, loan modifications often take more time to work out than foreclosures do. But the two-track system pushes the foreclosure forward regardless, with the result that foreclosures frequently occur while homeowners are negotiating a loan modification, sometimes even after they have been approved for a loan modification.

Even if a foreclosure never happens, the cost of the modification increases as the servicer imposes various foreclosure-related (and often improper) fees on the homeowner,[50] and the homeowner suffers the financial, credit, and emotional toll of defending a foreclosure. The two-

[50] *See* Katherine Porter, *Misbehavior and Mistake in Bankruptcy Mortgage Claims*, 87 Tex. L. Rev. 121 (2008) (reporting that servicers appear to be imposing often improper default-related fees on borrowers in bankruptcy proceedings).

track system allows servicers to increase their profit from fees, through the imposition of foreclosure related fees. These fees are lucrative to the servicer, but can price a modification out of a homeowner's reach. Moreover, where there is little or no equity left in the home, reimbursement for these fees will come out of the investor's pockets at any foreclosure sale or from future payments on the loan.

The two-track system was instituted to encourage servicers to minimize delay, but it does not in the current market even serve investors' interests well, since it does not reduce the costs skimmed by the servicer from the foreclosure sale. The result is unnecessary foreclosures. .

D. The Problem of Principal Reductions

In an era when one in four homeowners is underwater, principal reductions are key to stabilizing the housing market.[51] The double whammy of declining home values and job losses helps fuel the current foreclosure crisis.[52] 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.[53] Existing data on loan modifications shows that loan modifications with principal reductions tend to perform better.[54] In order to bring down the

[51] First American Core Logic Negative Equity Report Q22010, *available at* http://www.corelogic.com/uploadedFiles/Pages/About_Us/ResearchTrends/CL_Q2_2010_Negative_Equity_FINAL.pdf.

[52] *Preserving Homeownership: Progress Needed to Prevent Foreclosures: Hearing Before the Senate Comm. on Banking, Housing & Urban Affairs*, 111th Cong. 4–5 (July 16, 2009) (testimony of Paul Willen).

[53] 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. *See* Making Home Affordable[SM] Program, Handbook for Servicers of Non-GSE Mortgages v.1.0, at 17 (2010).

[54] Roberto G. Quercia, Lei Ding, Janneke Ratcliffe, Center for Community Capital, Loan Modifications and Redefault Risk: An Examination of Short-Term Impact (Mar. 2009), *available at*

redefault rate and make loan modifications financially viable for investors, principal reductions must be part of the package.[55]

Homeowners are underwater in large part as a result of systematic decisions made by lenders. Appraisal fraud was endemic in purchase money mortgages throughout the country in recent years.[56] Increased appraisal values on refinancings allowed lenders to strip equity from homes and increase their profits. The expansion of negatively amortizing products left additional homeowners further underwater and vulnerable to precisely the cratering of home values experienced in many parts of the country.

Investors have generally been receptive to the possibility of principal reductions, particularly when taken as direct writedowns in refinancing.[57] In that case, the loss is distributed throughout the securitization as contemplated in the original waterfall design, and the higher-rated tranches receive their capital and are able to reinvest it elsewhere should they so choose. Refinancing is currently not a likely prospect for most homeowners, but even without refinancing, principal writedowns restore rationality to the markets and, due to loss recognition rules embodied in most PSAs, result in the loss being distributed under the waterfall as anticipated at the inception of the

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http://www.ccc.unc.edu/documents/LM_March3_%202009_final.pdf; Pendley, *supra* note 9, at 16 (modifications without principal reductions experience higher redefault rates than those with principal reductions); Pendley *supra* note 48, at 2, 10–11 (modifications with principal reductions greater than 20% perform better than any other category of modifications, but few modifications with principal reductions done and redefault rates, even for loans with a 20% principal reduction, remain at 30%–40% after 12 months).

[55] *See, e.g.,* Bernanke, Speech at Federal Reserve, *supra* note 5 ("[P]rincipal write-downs may need to be part of the toolkit that servicers use to achieve sustainable mortgage modifications."); James R. Hagerty, *Mortgage Mess Breeds Unlikely Allies*, Wall St. J. (Feb. 9, 2010) (quoting Laurie Goodman, senior managing director at mortgage-bond trader Amherst Securities Group LP, "Principal reduction is the only answer.").

[56] National Consumer Law Center, The Cost of Credit: Regulation, Preemption, and Industry Abuses § 6.1 (4th ed. 2009), 11.6.6.

[57] *Preserving Homeownership: Progress Needed to Prevent Foreclosures: Hearing Before the Senate Comm. on Banking, Housing & Urban Affairs*, 111th Cong. (July 16, 2009) (testimony of Curtis Glovier, on behalf of the Mortgage Investors Coalition); *see also* Karen Weise, *When Denying Loan Mods, Servicers Often Wrongly Blame Investors,* ProPublica, July 23, 2010, http://www.propublica.org/article/when-denying-loan-mods-loan-servicers-often-blame-investors-wrongly (quoting managing director of brokerage securities firm as saying investors would prefer to see more modifications).

securitization trust. At least some investors would prefer to see more principal reductions through modifications in the absence of refinancing. [58]

HAMP has failed to mandate principal reductions, even when doing so would be in the investors' best interests. Instead, HAMP mandates principal forbearance, which leaves homeowners facing large balloon payments. One low-income Brooklyn homeowner, for example, was offered a HAMP loan modification with a $280,000 balloon payment, due when she would be 86.

Effect of Servicer Incentives on Default Outcomes

This chart shows whether specific elements of servicers' compensation and expenses create positive, negative, or neutral incentives for them pursue different types of outcomes for homeowners in default.

	Short-Term Forbearance or Repayment Agreement	Interest Rate Reduction	Principal Forbearance	Principal Reduction	Short Sale	Foreclosure
Repurchase Agreements	Positive	Negative	Negative	Negative	Neutral	Neutral
TDR Rules	Positive	Negative	Negative	Negative	Neutral	Neutral
Fees	Positive	Neutral	Negative	Negative	Negative	Positive
Float Interest Income	Neutral	Negative	Negative	Negative	Positive	Positive
Monthly Servicing Fee	Neutral	Neutral	Positive	Negative	Negative	Negative
Residual Interests	Positive	Negative	Negative	Negative	Negative	Negative
Advances	Positive	Neutral	Negative	Negative	Positive	Positive
Staff Costs	Neutral	Negative	Negative	Negative	Negative	Positive

All of servicers' incentives militate against principal reduction. Principal forbearance can be costly for servicers as well, but if servicers have a choice, they will choose forbearance over reduction, even though a forbearance does not provide for long-term sustainability as well as a principal reduction modification does.

[58] *See* Karen Weise, *When Denying Loan Mods, Servicers Often Wrongly Blame Investors,* ProPublica, July 23, 2010, http://www.propublica.org/article/when-denying-loan-mods-loan-servicers-often-blame-investors-wrongly (quoting managing director of brokerage securities firm as saying investors would prefer to see more modifications).

Principal forbearance, unlike interest or principal reductions, stabilizes the monthly servicing fee. Most PSAs appear to allow servicers to include in their calculation of the outstanding balance the amount of principal forbearance, while principal write-downs cannot be included in the amount of the outstanding balance.[59] Even better, the amount of forborne principal is not reduced by the borrower's monthly payments, leaving the servicer with an inflated income stream for the life of the loan.

Principal forbearance is generally less desirable than principal reduction from a borrower's viewpoint: with principal forbearance, borrowers do not accumulate equity, and they face a balloon payment at the end of the loan. And principal forbearance may result in higher-rated bond holders being shorted on interest payments. But, for a servicer, principal forbearance is preferable to principal reduction: it preserves more monthly servicing fee income for longer.

IV. As a Result of Misaligned Incentives and Servicer Abuses, Both Homeowners and Investors Suffer.

Homeowners obviously lose when servicers wrongfully foreclose. They lose their homes, they lose their equity, they lose their social networks. Homeowners facing foreclosure experience stress and strain, to say the least. Even if homeowners pushed into foreclosure are able to obtain a modification, their resources may well be exhausted by the struggle to obtain a modification, and the modification may leave them only slightly better off than they were before the modification.

But investors lose as well. Particularly in a market where no equity cushion exists to absorb servicers' excesses, the fees and costs come out of the supposed security for the

[59] *See* American Securitization Forum, Discussion Paper, *supra* note 63, at 8–9.

investors'money. According to some data, investors are now losing nearly 60% of the loan value on each foreclosure, over $145,000 per foreclosure.[60] In that context, the failure to perform modifications—and the corrosive effect of excess fees—eats away at any return investors could hope to have.[61] Recent reporting in the American Banker has illustrated the detrimental impact of force-placed insurance in particular on investor returns.[62]

HAMP only mandates loan modifications when the Net Present Value test predicts that the loan modification will return money to the investors compared to doing nothing. It weighs the odds of cure (vanishingly small in the current market), the chances of redefault (lower than you might expect with a HAMP mod), and the expected return on any ultimate foreclosure. When servicers fail to convert trial plans to permanent HAMP modifications, or wrongly deny HAMP modifications, they are costing investors money—hard money in the form of incentive payments from the government and hard money in the form of lost future payments from the homeowner.

Servicers, though nominally acting on behalf of investors, have wide discretion in deciding whether to modify a loan—or not.[63] As a result, servicers have chosen to modify loans only

[60] *See* Alan M. White, Sept. 26, 2010 Columbia Collateral File Summary Statistics, http://www.valpo.edu/law/faculty/awhite/data/sep10_summary.pdf.
[61] *See, e.g.,* Jody Shenn, *Mortgage Investors with $500 Billion Urge End of Practices, Lawyer Says,* Bloomberg News, July 23, 2010, http://www.bloomberg.com/news/2010-07-23/mortgage-investors-with-500-billion-urge-end-of-practices-lawyer-says.html (reporting on letters sent to trustees of mortgage pools on behalf of a majority of the investors in the pool); Letter from Kathy D. Patrick to Countrywide Home Loans Servicing, Oct. 18, 2010 (notifying a trust and master servicer of breaches in the master servicer's performance, including the imposition of excessive fees).
[62] Jeff Horwitz, *Ties to Insurers Could Land Mortgage Servicers in More Trouble: Force-Placed Polices Impose Costs on Both Homeowner, Investor*, Am. Banker, Nov. 10, 2010.
[63] *See, e.g.,* American Securitization Forum, Discussion Paper on the Impact of Forborne Principal on RMBS Transactions 1 (June 18, 2009) [hereinafter American Securitization Forum, Discussion Paper], *available at* http://www.americansecuritization.com/uploadedFiles/ASF_Principal_Forbearance_Paper.pdf (noting that servicers are largely left to their own discretion in determining what kinds of modifications to approve); Bernanke, Speech at Federal Reserve, *supra* note 5 ("The rules under which servicers operate do not always provide them with clear guidance or the appropriate incentives to undertake economically sensible modifications.").

when it suited their interests to do so, without much regard to the benefit to investors. Often, it has not suited servicers' interests to modify a loan. Indeed, servicers have seen their profitability per loan rise in the last year as losses to investors from foreclosures have skyrocketed.[64]

Investors have hitherto had very little opportunity to review data on loan modifications, let alone exercise control over a servicer's loan modification decisions. Obtaining information about the nature and extent of loan modifications is not easy, even for investors.[65] Determining how loan modifications impact the return on any one security is even harder.[66] The sometimes substantial fees paid to servicers in foreclosure tend to be invisible to investors.[67] Investors lack the necessary information to make judgments about the cost or benefit of a loan modification. As one commentator observed, "the investor has to completely trust the servicer to act in their behalf, often in substantially unverifiable dimensions."[68] The lack of data often inclines investors to support the certainty of foreclosures over the uncertainty of modifications.

Even once investors recognize there is a problem with the servicer's performance, it is often impossible to get the necessary number (usually a majority)[69] of investors to agree.[70] In large

[64] *Servicers Earn More Per Loan,* MortgageDailyNews.com, June 29, 2010.
[65] *See* Complaint at 6, *Carrington Asset Holding, supra* note 31 (noting that information on the disposition of foreclosed property was available to junior investor only because of "special rights" bargained for by institutional investor).
[66] *See, e.g.,* Matthew Tomiak & William Berliner, *The Complex New World of RMBS Shortfalls,* Am. Securitization Journal 16 (Winter/Spring 2010).
[67] Goodman, *Lucrative Fees, supra* note 31.
[68] *See, e.g.,* Joseph R. Mason, Servicer Reporting Can Do More for Modification Than Government Subsidies 14 (Mar. 16, 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1361331.
[69] *See, e.g.,* Prospectus Supplement, Asset-Backed Pass-Through Certificates, Series 2002-2, Ameriquest Mortgage Securities Inc., Depositor, Ameriquest Mortgage Company, Originator and Master Servicer 44–45 (June 3, 2002) (agreement of 51% of certificate holders required); Complaint at 6, Carrington Asset Holding Co., L.L.C. v. American Home Mortgage Servicing, Inc., No. FST-CV 09-5012095-S (Conn. Super. Ct., Stamford Feb. 9, 2009) (describing "special rights" Carrington allegedly bargained for as holder of the most junior certificates to direct the disposition of property after foreclosure and stating that certificate holders normally have no power to direct the actions of the servicer in property disposition).

subprime pools there may be hundreds of investors, who have differing views of what the appropriate response to a pending foreclosure is.[71] For most subprime securities, different investors own different parts of the security—principal payments, interest payments, or prepayment penalties, for example—and get paid in different orders depending on their assigned priority. Depending on the priority of payment and whether or not a modification reduces interest or principal payments, two investors in the same pool may fare very differently from a modification, with one investor seeing no change in payments and the other investor having its payments wiped out completely.[72]

V. Servicing Reforms Should Be Instituted.

Basic problems in the structure of the servicing industry need to be addressed in order for the homeowner-servicer relationship to be functional. From the homeowner's perspective, one of the biggest obstacles to loan modification is finding a live person who can provide reliable information about the loan account and who has authority to make loan modification decisions. Federal law should require that mortgage servicers provide homeowners with contact information for a real person with the information and authority to answer questions and fully resolve issues related to loss mitigation activities for the loan. While the Real Estate Settlement Procedures Act currently requires servicers to respond to homeowners' request for information and disputes within 60 days (and this time frame has been shortened under the Dodd-Frank Act), in practice many such inquires go unanswered. Despite this failure to respond, servicers are still

[70] *Cf.* Jody Shenn, *Mortgage Investors with $500 Billion Urge End of Practices, Lawyer Says,* Bloomberg News, July 23, 2010, http://www.bloomberg.com/news/2010-07-23/mortgage-investors-with-500-billion-urge-end-of-practices-lawyer-says.html (reporting on letters sent to trustees of mortgage pools on behalf of a majority of the investors in the pool); Letter from Kathy D. Patrick to Countrywide Home Loans Servicing, Oct. 18, 2010 (notifying a trust and master servicer of breaches in the master servicer's performance).

[71] Cordell et al., *supra* note 21, at 22.

[72] *Cf.* Maurna Desmond, *The Next Mortgage Mess: Loan Servicing? Claims of Fraud in the Subprime Mortgage Market Illuminate a Murky World,* Forbes.com, Mar. 20, 2009, http://www.forbes.com/2009/03/20/subprime-mortgages-carrington-capital-business-wall-street-servicers.html (noting that delaying foreclosures and concealing default helps junior investors but hurts senior investors).

permitted to proceed to collection activities, including foreclosure. Essential changes to this law governing servicers should ensure that homeowners facing foreclosure would no longer be at the mercy of their servicer. There should be transparency in the servicing process by allowing the homeowner to obtain key information about the loan and its servicing history. Servicers should be prohibited from initiating or continuing a foreclosure proceeding during the period in which an outstanding request for information or a dispute is pending.

1. **Eliminate the two-track system and mandate loan modification before a foreclosure.**

Foreclosures impose high costs on families, neighbors, extended communities, and ultimately our economy at large.[73] Proceeding with a foreclosure before considering a loan modification results in high costs for both investors and homeowners. These costs—which accrue primarily to the benefit of the servicer—can make an affordable loan modification impossible. Moreover, the two track system, of proceeding simultaneously with foreclosures and loan modification negotiations, results in many "accidental" foreclosures, due to bureaucratic bungling by servicers,[74] as one department of the servicer fails to communicate with another, or papers are lost, or instructions are not conveyed to the foreclosure attorney.

If a servicer can escape doing a modification by proceeding through a foreclosure, servicers can choose, and in many instances have chosen, to forgo nominal incentives to modify in favor of the certainty of recovering costs in a foreclosure. Staying all foreclosures during the pendency of a loan modification review would encourage servicers to expedite their reviews, rather than

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[73] Bernanke, Speech at Federal Reserve, *supra* note 5.

[74] For some descriptions of all too typical bureaucratic bungling by servicers, see Peter S. Goodman, *Paper Avalanche Buries Plan to Stem Foreclosures*, N.Y. Times, June 29, 2009, and Jack Guttentag, *New Plan to Jump-Start Loan Mods: Web Portal Would Centralize Communication, Break Logjam,* Inman News, July 20, 2009, *available at* http://www.inman.com/buyers-sellers/columnists/jackguttentag/new-plan-jump-start-loan-mods.

delaying them. Congress or the federal regulators should mandate consideration of a loan modification before any foreclosure is started, and should require loan modifications where they are more profitable to investors than foreclosure. Only federal action will ensure that residents of all states obtain this essential protection.

2. **Provide that the failure to offer a loan modification to a qualifying homeowner is an absolute defense to foreclosure, in both judicial and non-judicial foreclosure states.**

While government enforcement is essential to ensuring compliance with legal requirements, it generally is complemented and strengthened by the right of individuals to also seek accountability. One reason why HAMP compliance has been so weak is that homeowners do not explicitly have the right to demand it. Too many unnecessary foreclosures are proceeding as a result. A rule requiring loan modifications to qualified homeowners is intended to save homes. Yet, government enforcement does not have the resources to address each case of noncompliance that may lead to an unnecessary foreclosure. A rule providing a defense to foreclosure where loan modification requirements have not been followed would align the incentives of servicers with the priorities of both homeowners and investors, Moreover, a foreclosure defense can be crafted to protect homeowners while providing bright line rules for servicers and investors.

3. **Increase opportunities for loan modification by providing for quality mediation programs and funding for legal services.**

All too often servicers deny a modification, add fees, or institute a foreclosure without cause. Most of the time when servicers do those things, homeowners have no effective means of challenging the illegality of the servicers' actions or even bringing the servicer to focus on the individual facts and circumstances of the particular loan in order to reach a resolution. Court-supervised mediation and legal representation can even the playing field.

Court-supervised mortgage mediation programs help borrowers and servicers find outcomes that benefit homeowners, communities and investors. Evidence indicates that mediation programs can cut in half the number of completed foreclosures—a far more impressive result than that achieved under HAMP. The quality of programs varies widely, however, and most communities don't yet have mediation available. Government funding for mediation programs would expand their reach and help develop best practices to maximize sustainable outcomes.

Servicer excesses have come to light only through the diligent work of a small and dedicated group of attorneys. Only depositions and careful document review have revealed the robo-signing debacle. Homeowners need legal help to navigate complex and inaccurate paperwork and court filings hastily processed by banks. Yet the vast majority of homeowners go unrepresented. No legal services program has sufficient staff to represent all homeowners with meritorious defenses to foreclosure. Few have sufficient staff to represent even a third of the applicants for service.

Funding for foreclosure defense is particularly hard hit. The Institute for Foreclosure Legal Assistance (IFLA), a nonprofit organization, has been the major source of private foreclosure-related grants for legal services programs, but it will run out of funding in 2011. Many state and local funding sources are also drying up. The Home Ownership Preservation

Project at the Legal Assistance Foundation of Metropolitan Chicago, for example, expects to lose roughly half its staff to funding cuts by mid-2011, although foreclosure filings in Illinois continue to rise, with Chicago-area filing alone at about 50,000 per year.

The Dodd-Frank Wall Street Reform Act, HR 4173 Sec. 1498, authorizes $35 million in funding for legal services programs to assist low- and moderate-income homeowners and tenants in foreclosure, but the money has not been appropriated.

4. **Provide for principal reductions in HAMP and via bankruptcy reform.**

The double whammy of declining home values and job losses helps fuel the current foreclosure crisis.[75] 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.[76] Existing data on loan modifications shows that loan modifications with principal reductions tend to perform better.[77] In order to bring down the redefault rate and

[75] *Preserving Homeownership: Progress Needed to Prevent Foreclosures: Hearing Before the Senate Comm. on Banking, Housing & Urban Affairs*, 111th Cong. 4–5 (July 16, 2009) (testimony of Paul Willen).

[76] 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. *See* Handbook, *supra* note 53 at 17.

[77] Roberto G. Quercia, Lei Ding, Janneke Ratcliffe, Center for Community Capital, Loan Modifications and Redefault Risk: An Examination of Short-Term Impact (Mar. 2009), *available at* http://www.ccc.unc.edu/documents/LM_March3_%202009_final.pdf; Pendley, *supra* note 9, at 16 (modifications without principal reductions experience higher redefault rates than those with principal reductions); Pendley *supra* note 49, at 2, 10–11 (modifications with principal reductions greater than 20% perform better than any other category of modifications, but few modifications with principal reductions done and redefault rates, even for loans with a 20% principal reduction, remain at 30%–40% after 12 months).

make loan modifications financially viable for investors, principal reductions must be part of the package.[78]

HAMP permits principal reductions, but does not mandate them, even when an investor would be better off with a principal reduction than without. HAMP does require forbearance. 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. The HAMP guidelines should be revised so that they require the reduction of loan balances to at least 125 percent of the home's current market value, as does the Federal Reserve Board's loan modification program.

In addition, 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 can never modify.[79] 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.

[78] *See, e.g.,* Bernanke, Speech at Federal Reserve, *supra* note 5 ("[P]rincipal write-downs may need to be part of the toolkit that servicers use to achieve sustainable mortgage modifications."); James R. Hagerty, *Mortgage Mess Breeds Unlikely Allies*, Wall St. J. (Feb. 9, 2010) (quoting Laurie Goodman, senior managing director at mortgage-bond trader Amherst Securities Group LP, "Principal reduction is the only answer.").

[79] 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.

Further reform of the tax code to simplify the exclusion of discharge of indebtedness income would also be of assistance to many homeowners, particularly homeowners with significant refinancing debt whose servicers are persuaded to do sustainable principal reductions.[80]

5. **Regulate default fees.**

Fees serve as a profit center for many servicers and their affiliates. They increase the cost to homeowners of curing a default. They encourage servicers to place homeowners in default and can doom modifications. Fees cost both borrowers and investors.

Borrowers are not in a position to police default fees. The fees may be relatively small in an individual case. Moreover, a desperate borrower may agree to pay even an unaffordable fee, only to end up quickly back in foreclosure. Such a result is costly for everyone but the servicer.

Servicers' fees should be treated as nonrecoverable advances, in the event of either a modification or a foreclosure, subject to recovery from the pool, provided that such fees are legal, reasonable and necessary. This treatment would spread the cost of modifications more uniformly across the pool, in line with the loss allocations contemplated at the pool's origin, while creating parity between foreclosures and modifications.

Permitting servicers to recover waived default fees from all the income from a pool in the event of a modification would increase investors' incentive to monitor servicers' use of default fees, perhaps reducing the imposition of bogus fees. It would also reduce servicers' incentives to

[80] *See generally* 2008 Nat'l. Taxpayer Advocate Ann. Rep. at vi – vii (summarizing recommendations regarding changes to the treatment and reporting of cancellation of debt income in the mortgage context).

complete a foreclosure, and increase the availability of affordable modifications. Investors share borrowers' interests in sustainable modifications; investors are in a better position than borrowers to set and enforce prudential standards for the imposition of default fees.

Servicers should be limited to one reasonable appraisal fee before a the evaluation for a loan modification is completed. Additional valuations should be limited to no more than one every six months, absent a compelling change in circumstances. Title work should be limited to that reasonably necessary, and foreclosure attorney fees must be restricted to work actually performed.

Federal regulators should conduct random sample reviews of the servicing and payment history of all servicers. While abusive servicing fees have been well documented for many years, regulatory examination of these matters has been strikingly limited. Because analyzing the assessment of fees and the application of payments is a complex manner, regulators could adopt a sampling approach that would provide insight into how accounts have been handled.

6. **The remaining investor restrictions on modifications must be eased and communicated clearly to borrowers.**

Investor restrictions are not the main reason loan modifications are denied.[81] Indeed, investors often would prefer that servicers perform more modifications than they actually do. [82]

[81] *See, e.g.,* Congressional Oversight Panel, Foreclosure Crisis: Working Toward a Solution 23 (Mar. 6, 2009) ("the cap is not the major obstacle to successful modifications"). *See generally* Diane E. Thompson, 5-7 Why Servicers Foreclose When They Should Modify (Oct. 2009), *available at* consumerlaw.org.

[82] *See* Karen Weise, *When Denying Loan Mods, Servicers Often Wrongly Blame Investors,* ProPublica, July 23, 2010, http://www.propublica.org/article/when-denying-loan-mods-loan-servicers-often-blame-investors-wrongly (quoting managing director of brokerage securities firm as saying investors would prefer to see more modifications); Jody Shenn, *Mortgage Investors with $500 Billion Urge End of Practices, Lawyer Says,* Bloomberg News, July 23, 2010, http://www.bloomberg.com/news/2010-07-23/mortgage-investors-with-500-billion-urge-end-of-practices-lawyer-says.html (reporting on letters sent to trustees of mortgage pools on behalf of a majority of the investors in

Nonetheless, a small percentage of loans (probably no more than ten percent of all subprime loans) are in pools that originally prohibited all material modifications.[83] (In some cases, these restrictions have been lifted entirely from the securitization agreements, sometimes after sponsors of the securitization petitioned the trustee).[84]

Congress and the regulators should encourage investors to ease these restrictions in the minority of cases where they remain. Servicers must be encouraged to seek waivers of actual existing restrictions. All too often, purported investor restrictions evaporate when a determined advocate presses for and obtains the actual pooling and servicing agreement. In order to limit servicers hiding behind non-existent servicer restrictions, servicers must be required to document the restriction and their attempts to obtain a waiver, and provide that documentation to the borrower when relying on an investor denial.

Under HAMP, servicers are required to provide NPV positive modifications unless the investor contract prohibits such an agreement, the servicer has sought a change in policy from the investor and the investor has not agreed. The program requirements for documentation are weak, at best. Suggested language to provide transparency and accountability for homeowners is below:

> *When a servicer believes a PSA prevents an NPV-positive modification, the servicer shall contact the trustee and any other parties authorized under the terms*

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the pool); Letter from Kathy D. Patrick to Countrywide Home Loans Servicing, Oct. 18, 2010 (notifying a trust and master servicer of breaches in the master servicer's performance).

[83] John P. Hunt, Berkeley Ctr. for Law, Business, and the Economy, *What Do Subprime Securitization Contracts Actually Say About Loan Modification: Preliminary Results and Implications* 7 (Mar. 25, 2009), *available at* http://www.law.berkeley.edu/files/bclbe/Subprime_Securitization_Contracts_3.25.09.pdf.

[84] Moody's Investor Service, No Negative Ratings Impact from RFC Loan Modification Limits Increases (May 25, 2008); Morgan Stanley Omnibus Amendment (Aug. 23, 2007) (on file with author). The securitization's sponsor in this case likely held some equity interest in the securitization.

of the PSA to grant a waiver, whether individual investors, credit rating agencies, bond insurers, or otherwise, in order to obtain permission to perform a HAMP modification. The servicer shall provide the borrower or the borrower's representative a copy of the limiting language in the PSA, a copy of all correspondence with the lender and investors attempting to obtain authority to perform a modification, and electronic access to a complete and unaltered copy of the PSA.

7. **HAMP must be improved.**

   a. Enforcement and compliance mechanisms under HAMP must be adopted, including the enactment of the Franken Amendment that gives homeowners the ability to appeal HAMP servicer decisions.

It seems unlikely that all servicers will always accurately evaluate the qualifications of every homeowner who is eligible for HAMP. In fact, evidence to date indicates that errors in HAMP reviews are common. 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. While the current "escalations" program run by the Treasury Department and staffed by Fannie Mae aims to review and resolve homeowner complaints, outcomes too often do not result in HAMP compliance. Implementation of the "Franken Amendment" provisions to create an Office of the Homeowner Advocate would change this dynamic and provide much greater accountability.

   b. Principal forgiveness under HAMP must be mandated.

As discussed above, principal forgiveness is necessary to make loan modifications affordable for some homeowners. Practically, principal reductions may be key to the success of HAMP. Being "underwater" increases the risk of default, particularly when coupled with unaffordable payments.[85] Built into the HAMP NPV calculations is an assumption that default increases as a function of how far underwater the homeowner is. In order to bring down the redefault rate and make loan modifications financially viable for investors, principal reductions must be part of the package.

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 mandate principal reductions.

c. Coordination with the second lien program must be strengthened.

Servicers continue to express ignorance of the second lien program and widely refuse to modify second liens, even though certain large servicers have signed contracts to participate in the program. For example, Bank of America representatives recently told a Chicago-area housing counselor that it could not modify second liens.

Servicers will often service both the first and second liens. Frequently, servicers themselves hold the second lien. Servicers who hold second liens may prefer to gamble on a market recovery

[85] *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.

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

Failure to deal the second lien results in unsustainable loan modifications and invites gamesmanship and moral hazard on the part of servicers.

d. Homeowners suffering an involuntary drop in income should be eligible for an additional 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.

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.

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.[86]

For some homeowners, payments at 31% are not affordable. For those homeowners, monthly payments below 31% should be offered. Second mortgages or high medical debt can render a first mortgage payment of 31% or less unaffordable. Homeowners' actual, reasonable living expenses may mean that 31% is not, in fact, a sustainable and affordable payment when the total dollars available are quite low. Treasury should require and subsidizemodifications below 31% where the homeowner has low residual income or high fixed expenses.

e. Conversion from trial modifications to permanent modifications should be made automatic and self-executing.

The numbers and narratives both tell the same story. Tens of thousands of homeowners are faithfully making monthly trial modification payments with the understanding that a permanent modification will be the reward, yet that final modification is still elusive. The only way to ensure that homeowners obtain finalized agreements—and receive them on time so they can avoid additional increases in arrears and further damage to their credit—is to make conversions from trial modifications to permanent agreements an automatic process. Even homeowners who receive permanent modification offers in the mail find that this does not mean the process is over. Sometimes a servicer sends more than one permanent modification offer (including those that are essentially seeking to get the homeowner to opt out of HAMP). Even if the homeowner signs and returns the permanent modification agreement, servicers often delay by weeks or

[86] HUD Mortgagee Letter 2008-32, October 17, 2008.

months the countersigning of the document. Automatic conversions will streamline this last step in the HAMP process and decrease incentives for servicers to solicit opt-outs from HAMP.

f. The period of time for unemployment forbearance should be extended, no further trial modification period should be required after the unemployment forbearance period ends, and no fees other than interest should accrue during the period of unemployment forbearance, consistent with the treatment of homeowners in trial modification plans.

Despite the fact that the HAMP program no longer counts unemployment insurance as income, federal and state programs to assist unemployed homeowners are barely off the ground. Adjustments are needed to HAMP's treatment of the unemployed to ensure that these homeowners will still be in their homes when the programs intended to address their needs are fully functioning. Moreover, the trial modification requirement should be removed for homeowners who already have completed a forbearance period. Both trial modifications and forbearance programs result in increasing loan principals and no homeowner should be subjected to two different systems that will substantially raise their principal.

VI. Conclusion

Thank you for the opportunity to testify before the Committee today. The foreclosure crisis continues to swell. Servicers have exacerbated the crisis, as they profit from foreclosures. As revealed in the recent robo-signing scandal, servicers' lawless behavior threatens the integrity of our legal and economic systems. The need to act is great. The HAMP program must be strengthened. Homeowners who qualify must have the right to be offered a sustainable loan modification prior to foreclosure. Passage of legislation or adoption of regulations to reform the servicing industry, to allow for loan modifications in bankruptcy, and to address the tax consequences of loan modifications also would aid in protecting homeowners from indifferent and predatory servicing practices and reducing the foreclosure surge. Together, these measures would save many homes and stabilize the market. We look forward to working with you to address the economic challenges that face our nation today.

ATTACHMENT A—PNC LOAN MODIFICATION AGREEMENT

RECORD AND RETURN TO:
FIRST AMERICAN TITLE
P.O. BOX 27670
SANTA ANA, CA 92799-7670
ATTN: LMTS

THIS DOCUMENT WAS PREPARED BY:
ROBYN HUDSON
PNC MORTGAGE
3232 NEWMARK DRIVE
MIAMISBURG, OHIO 45342
937/910-1200

Tax Parcel No.: [redacted]

[Space Above This Line for Recording Data]

Original Recorded Date: SEPTEMBER 11, 2003 Loan No.: [redacted]
Original Principal Amount: $ 177,510.00

LOAN MODIFICATION AGREEMENT

(With Balloon Payment)

THIS AGREEMENT PROVIDES FOR PAYMENT IN FULL OF THE UNPAID BALANCE OF THE LOAN AT MATURITY. YOU MUST REPAY THE ENTIRE PRINCIPAL BALANCE OF THE LOAN, UNPAID INTEREST AND OTHER SUMS THEN DUE. THE LENDER IS UNDER NO OBLIGATION TO REFINANCE THE LOAN AT MATURITY. YOU WILL, THEREFORE, BE REQUIRED TO MAKE PAYMENT OUT OF OTHER ASSETS THAT YOU MAY OWN, OR YOU WILL HAVE TO FIND A LENDER, WHICH MAY BE THE LENDER YOU HAVE THIS LOAN WITH, WILLING TO LEND YOU THE MONEY. IF YOU REFINANCE THIS LOAN AT MATURITY, YOU MAY HAVE TO PAY SOME OR ALL OF THE CLOSING COSTS NORMALLY ASSOCIATED WITH A NEW LOAN EVEN IF YOU OBTAIN REFINANCING FROM THE SAME LENDER.

This Loan Modification Agreement ("Agreement"), made as of this 26TH day of OCTOBER, 2010 (the "Effective Date") between [redacted]

taken off in Quit claim deed

Should not be Listed.

(individually and collectively, the "Borrower") and PNC Bank, National Association, as successor by merger to PRIME FINANCIAL CORPORATION

for itself and its successors and assigns, (the "Lender"), amends and supplements (1) the note dated

CoreLogic Document Services
CoreLogic, Inc.
CLDS# PNC102 Rev. 01-29-10

AUGUST 28, 2003, as it may previously have been amended, (the "Note") and (2) the Mortgage, Deed of Trust or Security Deed, (the "Security Instrument"), bearing the same date as and securing, the Note and recorded in **Instrument N**[redacted], of the **OFFICIAL** Records of **COOK COUNTY, ILLINOIS**
(Name of Records) (County, State or other Jurisdiction)
which covers the real and personal property [redacted] ed therein as the "Property", commonly known as [redacted],
the real property described being set forth as follows:

SEE EXHIBIT "A" ATTACHED HERETO AND MADE A PART HEREOF;

The Note and Security Instrument together, as they may previously have been amended, are referred to as the "Loan Documents." The Borrower and Lender are sometimes collectively referred to together as the "Parties" and each as a "Party." Capitalized terms used in this Agreement and not defined herein have the meaning given to them in the Loan Documents.

In consideration of the mutual promises and agreements exchanged, and intending to be legally bound, the Parties hereto agree as follows:

1. The new Maturity Date will be: **NOVEMBER 1, 2050**

2. The modified principal balance of the Note will include all amounts and arrearages that will be past due as of the Effective Date, consisting of: (a) the unpaid principal balance of the sums loaned to Borrower by Lender, plus (b) any unpaid and deferred interest, fees, escrow advances and other costs (collectively, the "Unpaid Amounts"), less (c) any amounts paid to Lender but not previously credited to the Loan. The new principal balance of the Note will be $ **171,599.36** (the "New Principal Balance"). Borrower understands and agrees that by agreeing to add the Unpaid Amounts to the New Principal Balance, the added Unpaid Amounts, including unpaid interest, accrue interest based on the interest rate(s) in effect under this Agreement. $ **11,082.36** of the New Principal Balance shall be deferred (the "Deferred Principal Balance") and Borrower will not pay interest or make monthly payments on this amount. The New Principal Balance less the Deferred Principal Balance shall be referred to as the "Interest Bearing Principal Balance", and this amount is $ **160,517.00**. Interest at the rate of **2.000000** % will begin to accrue on the Interest Bearing Principal Balance as of **NOVEMBER 1, 2010** and the first new monthly payment on the Interest Bearing Principal Balance will be due on **DECEMBER 1, 2010**. The payment schedule for the modified Loan, including interest rate and payment changes, is as follows:

printout of what is included in this amount.

Years	Interest Rate Per Annum	Interest Rate Change Date	Monthly Principal and Interest Payment Amount	Estimated Monthly Escrow Payment Amount [If Applicable]*	Total Monthly Payment *	Payment Begins On	Number of Monthly Payments
1-5	2.000 %	11/01/2010	$ 486.09	$ 483.85 May adjust periodically	$ 969.94 May adjust periodically due to escrow account, if any	12/01/2010	60
6	3.000 %	11/01/2015	$ 564.72	May adjust periodically	May adjust periodically due to escrow account, if any	12/01/2015	12
7-40	3.875 %	11/01/2016	$ 637.03 **	May adjust periodically	May adjust periodically due to escrow account, if any	12/01/2016	408

*If the Loan has an escrow account, the escrow payments may be adjusted periodically in accordance with applicable law and therefore the Borrower understands that the total monthly payment may change accordingly.
**The final payment shall be an amount equal to: (a) the unpaid balance of the New Principal Balance, including the Deferred Principal Balance; plus (b) all accrued and unpaid interest on the Interest Bearing Principal Balance; plus all other amounts owed under this Agreement.

3. The terms in Section 2 shall supersede any provisions to the contrary in the Loan Documents, including, but not limited to, provisions for an adjustable or step interest rate or interest only payment period.

4. If the Lender has not received the full amount of any monthly payment owed under Section 2 by the end of 15 calendar days after the date it is due, Borrower will pay a late charge to Lender in the amount of 5.000 % of the overdue payment of principal and interest. Borrower will pay this late charge promptly but only once on each late payment.

5. Borrower will be in default if Borrower does not comply with the terms of the Loan Documents as modified by this Agreement. Borrower agrees to pay the Deferred Principal Balance and any other amounts due under the Loan Documents by the earliest of: (a) the date that Borrower sells or transfers an interest in the Property; (b) the date Borrower pays the entire Interest Bearing Principal Balance; or (c) the Maturity Date. If Borrower makes a partial prepayment of Principal, the Lender

may apply that partial prepayment first to any Deferred Principal Balance before applying such partial prepayment to other amounts due. If on the Maturity Date Borrower still owes amounts under the Note and Security Instrument, as amended by this Agreement, Borrower will pay these amounts in full. In the event of a default under the Loan Documents, as amended by this Agreement, interest will accrue on the unpaid amount of the New Principal Balance, including after acceleration, at the rate set forth in Section 2.

6. Borrower understands and agrees to the following:

   a. All persons who signed the Loan Documents, or their authorized representative(s) have signed this Agreement, unless: (i) a borrower or co-borrower is deceased; (ii) the borrower and co-borrower are divorced and the Property has been transferred to one spouse in the divorce decree, the spouse who no longer has an interest in the Property need not sign this Agreement (although the non-signing spouse may continue to be held liable for the obligation under the Loan Documents); or (iii) the Lender has waived this requirement in writing.

   b. This Agreement shall supersede the terms of any modification, forbearance, or workout plan that Borrower has previously entered into with Lender.

   c. To comply, except to the extent that they are modified by this Agreement, with all covenants, agreements, and requirements of the Loan Documents, including without limitation, Borrower's covenants and agreements to make all payments of taxes, insurance premiums, assessments, Escrow Items, impounds, and all other payments that Borrower is obligated to make under the Security Instrument, the amount of which may change periodically over the term of the Loan.

   d. That the Loan Documents are composed of duly valid, binding agreements, enforceable in accordance with their terms and are hereby reaffirmed.

   e. That: (i) all terms and provisions of the Loan Documents, except as expressly modified by this Agreement, remain in full force and effect, including, but not limited to, Lender's rights and remedies under the Loan Documents; (ii) nothing in this Agreement shall be understood or construed to be a satisfaction or release in whole or in part of the obligations contained in the Loan Documents; and (iii) that except as otherwise specifically provided in, and as expressly modified by, this Agreement, Borrower will be bound by, and will comply with, all of the terms and conditions of the Loan Documents.

   f. As of the Effective Date, notwithstanding any other provision of the Loan Documents, if all or any part of the Property or any interest in it is sold or transferred without Lender's prior written consent, Lender may, at its option, require immediate payment in full of all sums secured by the Security Instrument. However, Lender shall not exercise this option if applicable law, rules or regulations prohibit the exercise of such option as of the date of such sale or transfer. If Lender exercises this option, Lender shall give Borrower notice of acceleration. The notice shall provide a period of not less than 30 days from the date the notice is delivered or mailed within which Borrower must pay all sums secured by the Security Instrument, including the Deferred Principal Balance. If Borrower fails to pay these sums prior to the expiration of this period, Lender may invoke any remedies permitted by the Security Instrument.

[redacted]

g. All costs and expenses incurred by Lender in connection with this Agreement, including recording fees, title examination, and attorney's fees, shall be paid by the Borrower and shall be secured by the Security Instrument, unless stipulated otherwise by Lender in writing.

shouldn't have to pay any since he was in trial period

h. Borrower will cooperate fully with Lender in obtaining any title endorsement(s), or similar title insurance product(s), and/or subordination agreement(s) that are necessary or required by the Lender's procedures to ensure that the loan as modified is in first lien position and/or is fully enforceable upon modification and that if, under any circumstance and not withstanding anything else to the contrary in this Agreement, the Lender does not receive such title endorsement(s), title insurance product(s) and/or subordination agreement(s), then the terms of this Agreement will not become effective on the Effective Date and this Agreement will be null and void.

i. That Borrower will execute and deliver such other documents as may be reasonably necessary to either: (i) consummate the terms and conditions of this Agreement or (ii) correct the terms and conditions of this Agreement if an error is detected after the Effective Date. Borrower understands that a corrected Agreement will be provided to Borrower and, upon execution by Borrower, the corrected Agreement will supersede this Agreement. If Borrower elects not to sign any such corrected Agreement, the terms of the original Loan Documents shall continue in full force and effect and such terms will not be modified by this Agreement.

j. Borrower is solely responsible for the payment of any federal, state and/or local taxes with respect to the Deferred Principal Balance described above. Borrower understands, agrees and acknowledges that Lender has not made any representations to the Borrower concerning the taxability and/or nontaxable status of the Deferred Principal Balance, including the interest forgiveness thereof as provided in Section 2 above.

k. That, as of the Effective Date, Borrower understands that Lender will only allow the transfer and assumption of the Loan, including this Agreement, to a transferee of the Property as permitted under the Garn St. Germain Act, 12 U.S.C. Section 1701j-3. A buyer or transferee of the Property will not be permitted, under any other circumstance, to assume the Loan. Except as noted herein, this Agreement may not be assigned to, or assumed by, a buyer or transferee of the Property.

l. That Lender will collect and record personal information, including, but not limited to, Borrower's name, address, telephone number, social security number, credit score, income, payment history and information about account balances and activity. In addition, Borrower understands and consents to the disclosure of Borrower's personal information to any insurer that insures this Loan or any investor, guarantor or servicer that insures or owns, guarantees, insures or services Borrower's subordinate lien (if applicable) mortgage loan.

m. That Borrower consents to receiving calls, including calls using an automatic telephone dialing system or an artificial or prerecorded voice, and text messages from Lender or any of its affiliates, agents or third party representatives at any and all of Borrower's telephone numbers, including, but not limited to, Borrower's wireless (mobile/cellular) number, for servicing purposes, including debt collection, with respect to this Agreement and the Loan Documents, the loan account related thereto and any other account at Lender or any of its affiliates. These calls and messages may incur access fees from Borrower's cellular provider. Initial

n. That if any document related to the Loan Documents and/or this Agreement is lost, misplaced, misstated, inaccurately reflects the true terms and conditions of the Loan as modified, or is otherwise missing, Borrower will comply with the Lender's request to acknowledge, initial and deliver to the Lender any documentation the Lender deems necessary (all such documents are the "Documents"). Borrower agrees to deliver the Documents within ten (10) days after Borrower receives the lender's written request for such replacement.

7. **UNDER PENALTY OF PERJURY, ALL DOCUMENTS AND INFORMATION BORROWER HAS PROVIDED TO LENDER IN CONNECTION WITH THIS AGREEMENT ARE TRUE, COMPLETE AND CORRECT.** Initial

8. **IN CONSIDERATION OF THE TERMS AND CONDITIONS OF THIS AGREEMENT AND LENDER'S PROMISES AND UNDERTAKINGS SET FORTH HEREIN, BORROWER, FOR HIMSELF/HERSELF/THEMSELVES, AND ON BEHALF OF HIS/HER/THEIR SUCCESSORS AND PERMITTED ASSIGNS, DOES HEREBY REMISE, RELEASE, AND FOREVER DISCHARGE LENDER, AND ITS SUCCESSORS AND ASSIGNS, AND ALL AFFILIATES, SUBSIDIARIES, DIRECTORS, OFFICERS, AND EMPLOYEES OF LENDER (COLLECTIVELY, THE "LENDER RELEASED PARTIES") FROM ANY AND ALL OBLIGATIONS, CLAIMS, DEBTS, DEMANDS, COVENANTS, CONTRACTS, PROMISES, AGREEMENTS, LIABILITIES, COSTS, EXPENSES, ATTORNEY'S FEES, EXPERT WITNESS FEES, ACTIONS OR CAUSES OF ACTION OF ANY KIND OR NATURE WHATSOEVER, WHETHER LEGAL, EQUITABLE OR STATUTORY, KNOWN OR UNKNOWN, FORESEEN OR UNFORESEEN, ACCRUED OR NOT ACCRUED DIRECT OR INDIRECT, WHICH BORROWER EVER HAD OR NOW HAS, OR CAN, SHALL OR MAY HAVE IN THE FUTURE, UPON OR BY REASON OF ANY EVENT, MATTER, CAUSE OR THING WHATSOEVER AGAINST THE LENDER RELEASED PARTIES OR ANY OF THEM, FROM THE BEGINNING OF THE WORLD TO THE EFFECTIVE DATE ARISING FROM, RELATING TO, OR BASED UPON: (A) THE LOAN DOCUMENTS OR ANY OTHER DOCUMENT RELATED THERETO; (B) ANY LENDER RELEASED PARTIES' PERFORMANCE OF ITS OBLIGATIONS, IF ANY, UNDER THE LOAN DOCUMENTS OR OTHER DOCUMENTS RELATED THERETO; OR (C) ANY ACT OR OMISSION OF ANY OF THE LENDER RELEASED PARTIES IN CONNECTION WITH THE LOAN.** Initial

In Witness Whereof, the Lender and Borrower have executed this Agreement.

PNC MORTGAGE, A DIVISION OF PNC BANK, NA

Lender

By: JEAN SEXTON
AUTHORIZED AGENT

Date

Witness

Date

Witness

Date

(Seal)
Borrower
[redacted]

Date

(Seal)
Borrower
[redacted]

?

Date

(Seal)
Borrower

(Seal)

Date

(Seal)
Borrower

Date

(Seal)
Borrower

Date

(Seal)
Borrower

Date

[Space Below This Line for Acknowledgments]

BORROWER ACKNOWLEDGMENT

State of ILLINOIS

County of ____________

This instrument was acknowledged before me on ______________________ (date) by

[redacted]

____

____

____

(name/s of person/s).

______________________________ (Signature of Notary Public)

(Seal)

LENDER ACKNOWLEDGMENT

State of **OHIO**

County of **MONTGOMERY**

This instrument was acknowledged before me on ______________________ (date) by **JEAN SEXTON** as **AUTHORIZED AGENT**

of ____

____.

______________________________ (Signature of Notary Public)

(Seal)

EXHIBIT A

BORROWER(S): [redacted]

LOAN NUMBER: [redacted]

LEGAL DESCRIPTION:

[redacted]

ALSO KNOWN AS: [redacted]

Date: NOVEMBER 1, 2010
Loan Number: [redacted]
Lender: PNC MORTGAGE, A DIVISION OF PNC BANK, NA

Borrower: [redacted]

Property Address: [redacted]

NOTICE OF NO ORAL AGREEMENTS

THIS WRITTEN LOAN AGREEMENT REPRESENTS THE FINAL AGREEMENT BETWEEN THE PARTIES AND MAY NOT BE CONTRADICTED BY EVIDENCE OF PRIOR, CONTEMPORANEOUS OR SUBSEQUENT ORAL AGREEMENTS OF THE PARTIES.

THERE ARE NO UNWRITTEN ORAL AGREEMENTS BETWEEN THE PARTIES.

Receipt of Notice. The undersigned hereby admit to having each received and read a copy of this Notice on or before execution of the Loan Agreement. "Loan Agreement" means one or more promises, promissory notes, agreements, undertakings, security agreements, deeds of trust or other documents, or commitments, or any combination of those actions or documents, pursuant to which a financial institution loans or delays repayment of or agrees to loan or delay repayment of money, goods or any other thing of value or to otherwise extend credit or make a financial accommodation.

Borrower [redacted] Date

Borrower [redacted] Date

Borrower Date

Borrower Date

Borrower Date

Borrower Date

Date: **NOVEMBER 1, 2010**
Loan Number: [redacted]
Lender: **PNC MORTGAGE, A DIVISION OF PNC BANK, NA**

Borrower: [redacted]

Property Address: [redacted]

ERRORS AND OMISSIONS COMPLIANCE AGREEMENT

In consideration of **PNC MORTGAGE, A DIVISION OF PNC BANK, NA**

(the "Lender") agreeing to modify the referenced loan (the "Loan") to the Borrower, the Borrower agrees that if requested by the Lender, the Borrower will correct, or cooperate in the correction of, any clerical errors made in any document or agreement entered into in connection with the modification of the Loan, if deemed necessary or desirable in the reasonable discretion of the Lender, to enable Lender to sell, convey, seek guaranty or market the Loan to any entity, including without limitation, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, the Government National Mortgage Association, the Federal Housing Authority, the Department of Veterans Affairs or any municipal bond authority.

The Borrower agrees to comply with all such requests made by the Lender within 30 days of receipt of written request from the Lender. Borrower agrees to assume all costs that may be incurred by the Lender, including without limitation, actual expenses, legal fees and marketing losses, as a result of the Borrower's failure to comply with all such requests within such 30 day time period. ?

The Borrower makes this agreement in order to assure that the documents and agreements executed in connection with the modification of the Loan will conform to and be acceptable in the marketplace in the event the Loan is transferred, conveyed, guaranteed or marketed by the Lender.

[redacted] ______________________________ Date

[redacted] ______________________________ Date

______________________________ Date

______________________________ Date

______________________________ Date

______________________________ Date

ATTENTION!

IN COOK, KANE, PEORIA, AND WILL COUNTY, ILLINOIS THE LENDER IS REQUIRED TO ATTACH A FULLY EXECUTED CERTIFICATE OF COMPLIANCE OR CERTIFICATE OF EXEMPTION (WHICHEVER IS APPROPRIATE) TO THE MORTGAGE DOCUMENTS IN ORDER TO RECORD THE SECURITY INTEREST. THESE CERTIFICATES CAN BE RETRIEVED BY GOING TO:

WWW.ILAPLD.COM

Please remove this notice from the document package after complying with the above requirements and before providing the document package to the borrower.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM THOMAS J. MILLER

Q.1. Attorney General Miller, on November 3, the Wall Street Journal reported that you and officials from other States told Bank of America executives that "State attorneys general would like additional aid to be offered to borrowers, such as further principal reductions on certain delinquent loans where people owe much more than what their homes are worth."

Is it correct that you have asked mortgage lenders or servicers that you, in your role as State attorney general, would like them to offer more aid to borrowers, such as principal reductions?

If so, how did you balance the competing desires of borrowers and lenders to arrive at the conclusion that servicers should be offering modified mortgages with principal reductions?

A.1. It is estimated that approximately 23 percent of the homes in this country have mortgage principal balances that are larger than the current fair market value of the property. This status is commonly referred to as being "underwater." Many different groups, ranging from securities analysts, economists, investors in mortgage backed securities, to advocacy groups, have been calling for principal reductions for quite some time now. The simple proposition is that given the extremely high loss severities lenders and investors are suffering in certain markets when a home is taken to foreclosure sale, in some instances a modification with a significant principal reduction still produces more income than the foreclosure sale while giving the homeowner sufficient motivation to stay in the home. In other words, in appropriate circumstances, principal reductions produce a positive net present value for the owners of the loan.

We have consistently stated since 2007 that we are only interested in modifications that are net present value positive. Principal reductions are just another tool to arrive at a sustainable net present value positive modification in those markets that have experienced a severe drop in home prices over the last 3 to 4 years.

Q.2. Attorney General Miller, you testify, with respect to data collection efforts of your "State Working Group" which began in October 2007, that "our data collection was not as robust as it could have been due to the extremely short-sighted direction at the Office of the Comptroller of the Currency which forbad national banks from providing loss mitigation data to the States."

Has data sharing with the OCC improved since you began trying to collect data in 2007?

A.2. No. While the OCC and OTS have provided a public service by publishing their quarterly Mortgage Metrics Report, they have not shared any data directly with the State Attorneys General. We do not receive anything in addition to the public Metrics Report.

Q.3. Attorney General Miller, you testify that "We must find a way to make sure that all borrowers who have the desire to keep their home and qualify for a modification receive that modification."

Have you found cases in your jurisdiction in which homeowners who qualify for mortgage modifications have been illegally denied modifications?

If so, have you pursued legal remedies in Iowa?

If not, what analysis can you provide that leads you to believe that "many borrowers, who under a strict economic analysis should receive a modification, are falling through the cracks"?

A.3. My office helped found and helps run the "Iowa Mortgage Help Hotline." This is the premier loan modification effort in the State of Iowa. We have had over 13,000 Iowans open applications with Iowa Mortgage Help and many thousand more have contacted the Hotline without formally opening a file. In addition, my Consumer Protection Division received almost 600 complaints regarding mortgage origination and servicing in 2010 alone. In fact, mortgages are now the number one consumer complaint category in my office, representing 14.5 percent of all written complaints submitted to my office. The vast majority of these complaints involve loan servicing and requests for a loan modification.

Through this front-line experience, we have seen many instances of borrowers who through a strict economic analysis should have received a loan modification, but for a variety of systemic failures by the servicers did not receive such a modification. Through the intervention of both the Iowa Mortgage Help mediators and my Consumer Protection Division, many of these borrowers have received modifications when they would have otherwise lost the family home to foreclosure. Keep in mind that these modifications were all in the best economic interests of the owners of the loan.

Our experience in this regard is consistently echoed every time we talk to HUD approved housing counselors in both Iowa and other States, and by my fellow Attorneys General. In fact, several of the Senators during the hearing stated that their offices have received many complaints with a similar fact pattern. If you talk to anyone who has front-line experience working directly with borrowers attempting to get loan modifications, you will hear countless horror stories where the incompetence of the servicers prevented a modification from occurring. There is little doubt that many borrowers are indeed falling through the cracks.

Q.4. Attorney General Miller, your testimony States that you believe "It is well past time to once and for all tackle the issue of foreclosures and loan modifications with the resources and urgency it deserves." Your statement leads me to conclude that you do not believe that efforts by the Treasury Department and the Obama administration to address a large and potentially growing foreclosure wave have been successful.

What would you recommend that the Administration do to achieve success in battling the issue of foreclosures, and what is the economic and distributional analysis upon which you base your recommendation?

A.4. I commend the Obama administration for the wide variety of efforts it has undertaken to battle the issue of foreclosures. While the HAMP program has not been as successful as we all hoped, it must be given credit for creating a national standard for modifications and bringing considerable stability to a chaotic situation. HAMP must be placed in its proper historical context. Prior to HAMP there was no coherent national strategy with regard to loan modifications. The previous Administration's response was the very tepid creation of the industry backed HOPE NOW group, consisting of a 1–800 number and little else. In large part, the Obama administration's efforts have been stymied by the failures of the loan servicers. Ultimately, all loan modification programs rely on the servicers to fulfill their duties and until the loan servicers put sufficient resources into loss mitigation and work out their numerous procedural problems, any modification program is going to have difficulties.

Q.5. Attorney General Miller, in your testimony you state: "In recent weeks, many have opined that the temporary halt on foreclosures and foreclosure sales by several servicers was greatly damaging the economy. With all due respect, it is the foreclosures in the first instance that pose the greatest threat to the economy."

There is an absolute need for any servicer to proceed legally with a foreclosure sale. However, with blanket action, the vast majority of the delayed foreclosures likely were ones that would have been executed properly.

Is it your position that delays in proper foreclosures or foreclosure sales do not represent a significant cost to our economy? What evidence have you examined to arrive at this conclusion?

If you do believe there is an economic cost to delaying forecloses, what do you estimate that cost to be? Has this been a factor in your decisionmaking?

A.5. It is my understanding that there has been no Government action in regard to any foreclosure delays. All such delays were done *voluntarily* by those servicers who determined on their own that they had possibly violated State law in their foreclosure procedures. In addition, there has been no blanket action. Delays were only instituted by those servicers that felt it necessary. It is further my understanding that the servicers who did institute delays did not do so for every single loan they serviced, but only for those loans where they thought violations of the law may have occurred. Finally, the State Attorneys General are in the midst of an ongoing investigation of multiple servicer practices and a variety of State and Federal regulators are also conducting multiple examinations and reviews. The early results suggest that multiple, serious problems exist within the mortgage servicing industry. For all of these reasons, it is hard to conclude that "the vast majority of the delayed foreclosures likely were ones that would have been executed properly."

Furthermore, given the historic levels of property that is already owned by the lenders (commonly known as "real estate owned" or "REO") and the very large "shadow inventory" (homes that could be taken through the foreclosure process to completion but have deliberately been withheld by the servicers), it is likely that any additional REO properties would only further depress property values. Thus, any economic damage caused by a several month delay of some foreclosures is likely negligible. This is particularly true given the many loans that servicers could take all the way through a foreclosure sale right now, but the servicers have chosen instead to leave these properties in a legal limbo (a state of foreclosure purgatory if you will); out of a desire to avoid responsibility for the upkeep of these properties and to avoid putting any more foreclosed properties onto the real estate market. The fact that the servicers themselves are avoiding putting more foreclosed properties onto the market severely undercuts any argument that a temporary, voluntary delay has or will cause significant economic damage.

Q.6. Given the varying State laws that govern foreclosure, there must be the opportunity to observe both best and worst practices. While foreclosures are not the preferred option for any party at the onset of a loan, sometimes it is the path forward that presents the least harm to borrowers, lenders and the economy. In those instances, it is essential that our foreclosure process be effective.

Which States do each of you feel provide the most efficient path forward in foreclosures, while providing borrowers proper legal channels in the event that there is a dispute? What is the average length of time between original delinquency and foreclosure sale in these States?

Which States do each of you feel have the most problems in effectively executing foreclosures? What is the average length of time between original delinquency and foreclosure sale in these States?

A.6. The fundamental problem in today's mortgage servicing market is the policies and practices of the servicers themselves, not variations among State foreclosure laws. A broad range of financial institutions successfully comply with a broad range of differing State, not to mention international, laws in their daily operations. The recent servicing problems arise not from the differences among State foreclosures laws, but from a business model that is not equipped to manage the current volume of distressed loans.

Q.7. To better gauge the level of violations surrounding the topic of this hearing it is necessary for us to understand who is being affected. Admittedly, this question is probably best suited for the regulators, and we hope to receive this information from them at some point.

In your research and investigations, how many individuals were discovered to have been fully current on their mortgage payments but foreclosed upon by their servicer? Please provide the data and evidence that you evaluated to arrive at your conclusions.

A.7. Harm is not limited to borrowers who are fully current on their payments but foreclosed upon. In fact, we are finding a wide variety of servicer misconduct and practices which harm borrowers in a variety of situations. Other areas of harm include, but are not limited to:

1. The inability of some servicers to complete such simple tasks as properly applying the borrower's monthly payment or properly boarding the loan upon receiving the servicing rights.
2. The well publicized challenges some servicers are having with one of the mostfundamental facts: proving ownership of the note and the mortgage and the right to foreclose.
3. The inability of servicers to properly handle loss mitigation requests, including such basic responsibilities as repeatedly losing borrower submitted financial documents and consequently requiring borrowers to repeatedly resubmit such documents. Other examples include foreclosing on borrowers when a loan modification is being considered (the so called "dual track" issue); loss mitigation representatives giving borrowers con-

flicting or incorrect information; failure to respond to borrowers in a timely manner, and so on. In our conversations with housing counselors and legal aid lawyers we have been repeatedly told that there is no rhyme or reason why a particular loan modification request is granted or denied, that the system is arbitrary and capricious and depends mostly on who answers the phone on the other end, not on a principled basis.

4. We have heard multiple complaints of borrowers who have the money necessary to reinstate their loan, yet cannot find a servicing employee who can accept and apply that money.
5. We have heard multiple complaints of borrowers who have signed loan modifications, yet the servicer does not recognize the modification and continues to foreclose. My staff has personally intervened on several of these cases and without such intervention we believe a foreclosure would have likely occurred.
6. Many borrowers have complained that they had a buyer willing to purchase their property for less than the principal balance on the loan, but considerably more than the lender would receive from a foreclosure sale (commonly known as a "short sale"), but that the servicer was so disorganized that any response came much too late and the buyer walked away, resulting in a much more expensive foreclosure.
7. We have heard complaints about the servicing of a loan being transferred to a new servicer and the new servicer refuses to recognize either a pending loan modification application or even a completed modification with the previous servicer.
8. We have heard many, many complaints about servicers imposing thousands of dollars of unjustified fees as part of the foreclosure process. In some cases, these fees have pushed the borrower over the edge and made it impossible for the borrower to save the home.
9. Similarly, we hear complaints about servicers imposing very expensive "force-placed" homeowners insurance, when the borrowers' homeowners insurance was in place the entire time.

In short, there are many different kinds of harm that borrowers suffer due to servicer misconduct and incompetence.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR BROWN FROM THOMAS J. MILLER

Q.1. What improvements should be made to Federal regulation of mortgage servicers?

A.1 The number one thing is to elevate the importance of mortgage loan servicing. It is my understanding that traditionally most effort by Federal banking regulators has been focused on the origination of mortgage loans. What we have learned the hard way over the last three and a half years is that loan servicing is equally as important. Thus, the Federal regulators should give loan servicing much more attention in their examinations than they have previously. It is also clear to me that there is a need for more detailed regulation of servicing standards.

While I support increased Federal regulation of loan servicing, it must be made clear that any such efforts should be in addition to and not in place of regulation at the State level. Some have attempted to blame servicers' current troubles on the fact that foreclosure is controlled by State law. Nothing could be further from the truth. The servicers' troubles are not based on an inability to comply with differences in State law, they are much more basic. The simple fact is that the current servicing model was never designed for the high delinquency environment we are experiencing today and the system is fundamentally broken.

Foreclosure is an inherently local transaction, with devastating effects on local neighborhoods and communities and serious impacts on city, county, and State budgets. Accordingly, State law has controlled foreclosure proceedings since the founding of this Nation. Any attempt to use the current crisis to preempt State law is deeply misguided.

RESPONSE TO WRITTEN QUESTIONS OF CHAIRMAN DODD FROM BARBARA J. DESOER

Q.1. During discussion of the dual-track process, you mentioned that your ability to halt the practice of "dual tracking" of loans simultaneously through the modification and foreclosure processes could be constrained on loans you are servicing for outside trusts, but that you would have the ability to halt the dual-track process on loans held in portfolio by Bank of America.

I understand that you are in negotiations with State AGs on a potential agreement on this and other aspects of servicing. In the meantime, however, many families could continue to be confused by this dual-track process.

Have you unilaterally halted the dual-track process and suspended the foreclosure process for loans held by Bank of America that are in the review and modification processes? If not, do you plan to do so soon? If not, why not, and what would need to happen before BofA would halt dual-tracking on its loans?

A.1. As your question acknowledges, parallel foreclosure and modification processes are required by many investors, and reflect an industry-wide servicing practice. The majority of the loans we service—approximately 77 percent—are for outside investors. We want to partner with Members of Congress, State Attorneys General, regulators, other servicers, and investors to agree on ways to improve industry practices with respect to the evaluation of borrowers for modifications after they have been referred to foreclosure. At the same time, we are actively working to reduce the borrower confusion that may result from dual tracking.

For borrowers who are referred to foreclosure, Bank of America's policies are designed to prevent a loan from going to a foreclosure sale, consistent with regulatory directives and investor requirements, if the borrower is being evaluated for a HAMP or proprietary modification. In addition, for borrowers who enter a trial plan after their loan has been referred to foreclosure, to the extent consistent with its legal and contractual obligations, Bank of America's policy is to suspend the foreclosure process, including refraining from scheduling sales or causing judgments to be entered, on a basis consistent with HAMP for proprietary or traditional loan modifications that are successfully performing under the trial plan. Bank of America also has introduced an additional review procedure to delay foreclosure sales if there is ongoing modification, short-sale, or deed-in-lieu activity.

We are also addressing concerns about customer confusion by improving our communication with distressed borrowers. In particular, we are redesigning our modification process to assign eligible borrowers who have submitted to us at least one document in support of their modification application to an associate with relevant expertise for help at each particular stage of the modification process. We are implementing this new approach to modifications, and so far we have paired customers with an associate on this basis over 230,000 times. We are also implementing a similar model for our short sale and deed-in-lieu foreclosure alternatives.

More generally, in the past 2 years, We have committed significant resources to helping distressed homeowners, including by hiring and training over 11,000 people, so that we now have a team of about 30,000 working with customers in default. We have also reached out to our customers by opening customer assistance centers, going door-to-door to reach customers with modification offers, and participating in more than 550 housing rescue fairs across the country. We are also partnering with non-profits to address foreclosure prevention in diverse communities.

Q.2. In response to questions from Senator Johnson, Mr. Lowman and Ms. Desoer, you characterized the HAMP 2MP program as a good approach to second lien modification. You also noted your organizations' participation in 2MP, with Ms. Desoer pointing out that Bank of America had been the first servicer to sign up for the program. Yet, as of Sept 30, only 21 second lien modifications worth $10,500 had been made under 2MP since its implementation in March 2010.

Why, in your opinion, have so few modifications been made under 2MP so far? Do you see your organization increasing its number of 2MP modifications in the coming months?

A.2. Bank of America was the first servicer to sign up to participate in the 2MP second lien modification program. This program is limited to borrowers whose first liens are modified under HAMP and who agree to a modification of the second lien under the terms of the program. If a borrower fails a trial HAMP modification, that borrower is not eligible for 2MP. In addition, 2MP requires a 3-month trial period for delinquent borrowers before the 2MP modification can become effective.

Phyllis Caldwell, Chief of Homeownership Presentation Office of the Department of Treasury, explained to this Committee:

> The program uses a third-party database to match second lien loans with first lien loans permanently modified under HAMP . . . The implementation of this database began over the summer. Five 2MP Servicers have already begun matching modified first liens with their corresponding second liens, while the other 12 are in some phase of developing systems capacity to do so.

Bank of America is one of five servicers that have led the way in matching modified first liens with corresponding second liens. As of the end of December 2010, we had matched approximately

29,000 Bank of America second lien customers to a permanent HAMP modification of a first lien. We are currently working through these matches and issuing modifications to 2MP-eligible customers.

Bank of America also has proprietary modifications that it applies to second liens independently of 2MP. Since 2008, we have completed over 95,000 second lien modifications through proprietary or other programs.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM BARBARA J. DESOER

Q.1. Mr. Levitin, your testimony States that a common response from banks—and I assume here you mean servicers—about problems in the foreclosure process is that it doesn't matter to them because the borrower still owes on the loan and has defaulted. As you put it: "This 'No Harm, No Foul' argument is that homeowners being foreclosed on are all a bunch of deadbeats, so who really cares about due process?" You say that this argument, that you attribute loosely to "banks," condones "vigilante foreclosures: so long as the debtor is delinquent, it does not matter who evicts him or how."

Does any representative of the servicer industry on the panel wish to comment on this?

A.1. Bank of America is committed to treating our customers responsibly and fairly. We acknowledge our obligation to do our best to protect the integrity of the foreclosure proceedings. And when that has not happened, we accept responsibility for it, and we deeply regret it.

We were the only servicer that stopped foreclosure sales nationwide to review our procedures. We also halted evictions and are only restarting them with 30 days advance notice to the borrower of the restart. We know that the concerns are not just technical issues. We are already well along in making improvements with respect to foreclosure documentation. We take seriously our obligation to the customer, the investor, the legal process, and the economy.

Since suspending foreclosure sales and evictions, the Bank has implemented new or revised policies and procedures to strengthen controls over our foreclosure activities. We also have added and redeployed human resources to execute on our commitment to improve our processes. We hope that these new measures and controls give all stakeholders added confidence that foreclosure proceedings, when necessary, will move forward with integrity.

Q.2. Ms. Desoer and Mr. Lowman, it is important that this Committee has an adequate understanding of the current state of affairs as it relates to delinquency and foreclosures. Please briefly discuss the following statistics as they relate to your companies:

What is the total number of mortgages that your company services?

How many mortgages are currently in foreclosure?

What is the average number of days that a borrower is delinquent on his or her mortgage at the time of a foreclosure sale?

What percentage of homes are vacant at the time of a foreclosure sale?

A.2. Bank of America services nearly 14 million mortgage loans. The majority of our customers—86 percent—are current and making their mortgage payments on time every month. Fortunately, that number is stabilizing. But the segments of the portfolio that are distressed include large numbers of customers who are seriously delinquent. Of Bank of America's 1.3 million customers who are more than 60-days delinquent, nearly 600,000 have not made a mortgage payment in more than a year, and more than 190,000 have not made a mortgage payment in 2 years.

The following are delinquency statistics for completed foreclosure sales in the third quarter of 2010:

- Eighty (80) percent of borrowers had not made a mortgage payment for more than 1 year.
- The average loan had been in delinquent status for 560 days.
- Thirty-three (33) percent of properties were vacant.
- Fifteen (15) percent of properties were non-owner occupied at the time of origination.

Helping our customers remain in their homes where possible is a top priority for Bank of America—as evidenced by our nearly 750,000 completed loan modifications since 2008. This number includes over 250,000 mortgage modifications in 2010.

Q.3. This Committee has a responsibility to ensure that actors on all sides of the foreclosure process, including servicers, are acting legally and in the best interest of our society. We must address and remedy situations where this is not the case.

However, unnecessarily delaying foreclosures is not without cost. Representatives of the secondary mortgage market have told us that, on average, a delay in foreclosure costs approximately $30–40 per day, per home. This is in addition to any changes in home values during that time.

Ms. Desoer and Mr. Lowman, could you discuss what additional costs your institutions may incur during a foreclosure process if that process is delayed?

A.3. As we stated in our Third Quarter Form 10–Q filing with the SEC, Bank of America and its subsidiaries cannot predict the ultimate impact or cost of the temporary delay in foreclosure sales. If the time to complete foreclosure sales increases temporarily, that may result in an increase in nonperforming loans and the cash advances that as servicer we are required to make to taxing authorities, insurers, and other third parties, and may impact the collectability of such advances and the value of our mortgage servicing rights asset. Delays in foreclosure sales, including any delays beyond those currently anticipated, could increase the costs associated with our mortgage operations. Delays also may subject us to penalties for failing to meet investor foreclosure timelines. In addition, delays may adversely impact our held for investment portfolio due to real estate value declines resulting in decreased foreclosure sale prices.

Q.4. Given this Committee's oversight responsibilities, it is vital that we examine the regulatory actions taken before and after reports surfaced detailing the problems surrounding some foreclosures.

Ms. Desoer and Mr. Lowman, did your regulator contact you prior to any of these press reports to review your foreclosure procedures?

What, if any, directives or recommendations were made by your regulator surrounding the definition of "personal knowledge" as it relates to those in your companies who must sign foreclosure documents?

What, if any, directives or recommendations were made by your regulator with regard to the notary process for these documents?

A.4. Under the rules and regulations of the Office of the Comptroller of the Currency (OCC), a national bank may not disclose information concerning examinations or investigations performed by the OCC. For example, pursuant to 12 CFR § 4.36(d), a national bank may not disclose non-public OCC information to third parties because it is considered the property of the OCC.

Julie Williams, Chief Counsel and First Senior Deputy Comptroller, stated the following at a December 2, 2010 hearing of the House Judiciary Committee:

> [N]either banks' internal quality control tests, internal audits, nor the OCC's own consumer complaint data suggested foreclosure document processing was an area of systemic concern.
>
> . . .
>
> There were no warning signs from internal audit, quality control or even complaints relating to the foreclosure documentation aspect of mortgage servicing, that were triggering red lights for us.

In addition, Ms. Williams stated:

> [Wlhen problems were identified at Ally Bank, which is not a national bank, we immediately directed the eighth largest national bank mortgage servicers to review their operations and take corrective actions. In concert with other regulatory agencies, OCC examiners are now reviewing samples of individual loan files where foreclosures have either been initiated or completed to test the validity of bank self assessments and corrective actions, whether foreclosed borrowers were appropriately considered for loss-mitigation alternatives such as loan modifications, and whether fees charged were appropriate, documents were accurate and appropriately reviewed, proper signatures were obtained and documents necessary to support a legal foreclosure proceeding were provided.
>
> . . .
>
> Where we find errors or deficiencies, we are directing national banks to take immediate corrective action.

Q.5. Unfortunately, neither Fannie Mae, Freddie Mac, nor the Federal Housing Finance Administration were present at the hearing to discuss the "approved lenders" list that Fannie and Freddie publish to guide servicers as they select in-State counsels to act on their behalf.

Given that, Ms. Desoer and Mr. Lowman, please describe what the GSE's require of your firms with respect to these lists, and indicate whether there have been any changes to them since news of problems with "foreclosure mills" began to surface.

A.5. The GSEs place numerous requirements on servicers for the loans the GSEs own. Certain of those requirements relate to the hiring of outside counsel. With some exceptions, we ordinarily select outside counsel with respect to the foreclosure of GSE loans from Fannie Mae and Freddie Mac lists of preapproved counsel. The GSEs have modified those lists recently.

Q.6. Ms. Desoer, your company must try to execute modification programs, but requirements of these programs are often changed by Treasury, investors, or other constituencies. You have identified in your testimony that in the HAMP program alone, there have been nearly 100 major program changes in the past 20 months.

Do you believe that the constantly changing requirements and restrictions on the Government-sponsored mortgage modification programs are confusing to consumers and counterproductive to attaining actual mortgage modifications?

A.6. When working with delinquent customers, we aim to achieve an outcome that meets both customer and investor interests, consistent with our obligations to the investor. Many investors limit Bank of America's discretion to make modifications, and even when they do not, our legal duties to investors add complexities to the execution of modification programs. While very few investors have an outright prohibition on modifications, their eligibility criteria and requirements vary.

The Treasury Department, investors, and other constituencies have frequently changed the requirements of their modification programs. These differences and changes significantly contribute to the complexity of the modification process, strain a servicer's operations and systems, and may be a source of frustration and confusion felt by borrowers.

As I previously testified, HAMP alone has had nearly 100 program changes in the past 20 months. In testimony before the House Judiciary Committee on December 2, 2010, Phyllis Caldwell, Chief of the Homeownership Preservation Office of the Department of the Treasury, testified that "we have made so many changes" to HAMP and that "some would say we've made too many changes that the system can't absorb them." Fannie Mae and Freddie Mac have layered on additional, and in many cases, different requirements, conditions and restrictions for HAMP processing of the loans they own. When these changes occur, we and other servicers have to change our processes, retrain our staff, and update our technology. These changes can also affect what is required of the customer, including requiring new or different documentation. In addition, States also have made statutory and regulatory changes to the foreclosure process, requiring various types of loss mitigation efforts, all of which have to be coordinated with the changing Federal directives.

Q.7. Ms. Desoer, your company and other large mortgage servicers portray a mortgage-servicing industry that, confronted with enormous adjustment challenges, is responding well and with, as you say in your testimony, "extraordinary speed." From the perspective of large mortgage-servicing firms, it sounds as though homeowners facing distress are treated with dignity, are offered a wide array of possible modification alternatives, and are treated fairly. In striking contrast, however, consumer activists portray mortgage servicers as profit-centric firms with sloppy record keeping and little aversion to cutting corners in order to reach foreclosure.

Ms. Desoer, with stories circulating that homeowners who should not have been foreclosed upon are finding their locks changed as a result of a sloppy foreclosure process, why should I believe industry claims that borrowers are being treated fairly and with respect?

Do you have detailed data, preferably verified by an independent party, to show that you have not wrongfully foreclosed on homeowners?

A.7. We do not claim perfection, and we address mistakes quickly and responsibly when they arise. We also appreciate and take seriously the perspective of consumer advocates. We would note that the cases reported in the press are often more complex than some reports suggest but financial privacy concerns prevent us from discussing the specifics of these cases publicly.

After concerns emerged at other lenders regarding the foreclosure affidavit process in judicial foreclosure States, Bank of America initiated a review of our foreclosure procedures. On October 1, 2010, we voluntarily suspended foreclosure judgments in the 23 judicial foreclosure States while we completed this review. One week later, we paused foreclosure sales nationwide as we launched a voluntary review of our foreclosure processes in those States as well. We believe these steps were appropriate and responsible.

We have identified areas for improvement as a result of our review. We are taking these matters very seriously and are implementing changes accordingly. These changes in the foreclosure process include, among other things, a new affidavit form and additional quality control checks.

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

Q.8. Attorney General Miller's testimony today states the following:

> While the servicer is free to lose documents as many times as they want or to take as long as they want, the servicer often demands strict compliance from the borrower. Thus, no matter how many times the borrower has previously submitted his or her paperwork, if the borrower fails one time, the loan modification is denied.

Do any representatives of the servicer industry wish to respond to Mr. Miller's claims?

A.8. Our commitment at Bank of America is to ensure that no property is taken to foreclosure sale until our customer is given a fair opportunity to be evaluated for a modification. If a modification is not possible, we explore a short sale or deed in lieu solution. Foreclosure is our last resort.

We launched a foreclosure hold in October 2008 for borrowers potentially eligible for our National Home Ownership Retention Program and have participated in several others, as new programs were developed and launched, in order to ensure no customer who has a reasonable option to stay in their home goes to foreclosure sale.

It is not the case that borrowers are given only one opportunity to be considered for a modification. Subject to investor requirements, we re-evaluate borrowers for home retention options throughout the foreclosure process. Modifications can occur after borrowers have failed to respond to initial requests for documentation and borrowers are given more than one opportunity to provide documentation. We have worked hard to improve borrower response rates by partnering with non-profits such as the Neighborhood Assistance Corporation of America (NACA), the National Urban League, the National Council of La Raza and the National Association of Asian Pacific Americans for Community Development. It is also our policy to check to determine whether a borrower is being evaluated for a modification all the way up until the day before the foreclosure sale.

In addition, as noted above in response to Senator Dodd's first question, we are redesigning our modification process to assign eligible borrowers who have submitted to us at least one document in support of their modification application to an associate with relevant expertise for help at each particular stage of the modification process. We are implementing this new approach to modifications, and so far we have paired customers with an associate on this basis over 230,000 times.

Q.9. Ms. Thompson testifies that, " . . . the problems occasioned by mortgage servicer abuse run rampant." That is a strong accusation. Ms. Thompson also frequently, though without definition, refers to "abuses" committed by servicers and "excessive" fees. She accuses servicers of failing to negotiate in good faith and of preparing false affidavits. She states that "Servicers do not believe that the rules that apply to everyone else apply to them." Their attitude, according to Ms. Thompson, is "lawless" and they commit "wrongful foreclosure on countless American families." She also states that "The lack of restraint on servicer abuses has created a moral hazard juggernaut that at best prolongs and deepens the current foreclosure crisis and at worst threatens our global economic security."

Do any of the servicer representatives here wish to respond to Ms. Thompson's allegations?

A.9. We categorically reject Ms. Thompson's characterization of our commitment to serving our customers. We have worked aggressively to respond to more than a million customers in distress. We don't claim perfection, but we have led with innovative ideas and continue to put forward solutions that respond to customer needs. That's a responsibility that comes with being America's leading consumer bank—and a responsibility every associate at Bank of America is working diligently to uphold. We fully understand our responsibility to be fair, to be responsive and, where a foreclosure is unavoidable, to treat customers with respect as they transition to alternative housing.

Unfortunately, we have reached a crossroads between loan modification efforts and the reality of foreclosure. The majority of our distressed customers have been evaluated for available programs or afforded a fair opportunity to be evaluated, and many customers will be dealing with the reality that despite the range of loss mitigation solutions and our best efforts, foreclosure is unavoidable. This will drive an increase in the concerns you and we hear from distressed homeowners. Our increases in staffing and foreclosure alternative programs are directed at respectfully helping customers move through this difficult period. We believe that these efforts are working, as every day we reduce the backlog in both modification decisions and customer complaints.

Q.10. Given the varying State laws that govern foreclosure, there must be the opportunity to observe both best and worst practices. While foreclosures are not the preferred option for any party at the onset of a loan, sometimes it is the path forward that presents the least harm to borrowers, lenders and the economy. In those instances, it is essential that our foreclosure process be effective.

Which States do each of you feel provide the most efficient path forward in foreclosures, while providing borrowers proper legal channels in the event that there is a dispute? What is the average length of time between original delinquency and foreclosure sale in these States?

Which States do each of you feel have the most problems in effectively executing foreclosures? What is the average length of time between original delinquency and foreclosure sale in these States?

A.10. The processes and requirements governing foreclosure vary significantly among States, and in some cases, from one local jurisdiction to another. We have not undertaken a review to compare the relative efficiency and effectiveness of foreclosure regimes in the 50 States. We would note that States face varying challenges, including their respective volumes of delinquent borrowers and economic conditions.

As to the average duration of the foreclosure process, for the loan population serviced by Bank of America, it takes nearly a year, on average, from the time a customer receives a foreclosure notice until the actual foreclosure sale is completed. The timeline in judicial States is generally longer. In Florida, for example, the timeline can be closer to 2 years.

While Bank of America does not track this data across all servicers, we are aware of various third parties that do endeavor to provide State-by-State averages. For example, RealtyTrac *(http://www.realtytrac.com/foreclosure-laws/foreclosure-laws-comparison.asp)* provides information on State-by-State procedures and foreclosure timelines. The Mortgage Bankers Association also provides information on foreclosure timelines (see *http://www.mortgagebankers.org/IndustryResources/ResourceCenters/ForeclosureProces)*. While we cannot verify the accuracy of this third party data, we share them with you as potential sources of information.

Q.11. To better gauge the level of violations surrounding the topic of this hearing it is necessary for us to understand who is being affected. Admittedly, this question is probably best suited for the regulators, and we hope to receive this information from them at some point.

In your research and investigations, how many individuals were discovered to have been fully current on their mortgage payments but foreclosed upon by their servicer? Please provide the data and evidence that you evaluated to arrive at your conclusions.

A.11. As noted in response to question 7 above, when industry concerns arose with the foreclosure affidavit process, we took steps to stop foreclosure sales nationwide and launch a voluntary review of our foreclosure procedures. While we don't claim perfection, our review to date indicates that the issues with the affidavit process did not affect the basis of our foreclosure decisions.

The decision to refer a loan to foreclosure is made by Bank of America after a foreclosure review process that is based on a careful evaluation of our servicing records. This evaluation precedes and is independent from the process used to create and execute affidavits of indebtedness.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR BROWN FROM BARBARA J. DESOER

Q.1. Please describe in detail the reviews that your organizations conducted pursuant to your announced moratoriums, including: how many employees were involved; how many files they reviewed; how much time, on average, an employee spent reviewing a file.

How many errors did you uncover, and what was the nature of those errors?

How did you inform homeowners that their foreclosure filings were being reviewed?

A.1. When industry concerns arose with the foreclosure affidavit process, we took affirmative steps to stop foreclosure sales so that we could review our related foreclosure procedures. On October 1, 2010, we voluntarily suspended foreclosure judgments in the 23 judicial foreclosure States while we completed this review. One week later, we paused foreclosure sales nationwide in order to extend our voluntary review of our foreclosure process to all 50 States. We determined that, out of an abundance of caution, we would replace every affidavit of indebtedness in every pending foreclosure case.

The new affidavits will be prepared through an improved process, which includes, among other things, a new affidavit form to enhance the quality and uniformity of our process and additional quality control checks throughout the process in order to ensure that the accuracy of each affidavit is verified at several key points. We are also adding measures to validate that each affidavit is individually reviewed by the signer, properly executed, and promptly notarized. In addition, we are implementing new procedures for selecting and monitoring outside counsel.

We are taking these matters very seriously and are carefully restarting the affidavit process with these controls in place.

Q.2. How many files that you reviewed were missing the original note?

A 2007 study found that 40 percent of bankruptcy filings involving mortgages were missing the original note. How many of your foreclosure filings are missing their original note?

A.2. We believe that our investors hold notes for substantially all of the mortgage loans we service, and we rarely prepare and file lost note affidavits. It bears note that the fact that a note is lost does not mean that the debt is extinguished or is unenforceable. The law in all States permits lost notes to be enforced and the related mortgages to be foreclosed subject to certain conditions.

While rules and practice over the filing or submission of originals or copies of promissory notes vary significantly from court to court, if our local counsel is required to file or submit the original note or a copy of the original note, we request it from the applicable custodian or investor and send the original or a copy of the note (or, in those rare cases when a note has been lost, a lost note affidavit) to our local counsel to be filed or submitted. Your reference to a 2007 study may be to an article by Katherine Porter entitled *Misbehavior and Mistake in Bankruptcy Mortgage Claims,* 87 Texas Law Review 121 (2008). Ms. Porter did not study whether servicers had access to notes or whether they were filed or submitted in foreclosure actions. Her study was limited to assessing whether proofs of claim initially filed in bankruptcy cases included copies of notes (she did not look at any amendments or responses to requests).

Q.3. Do all of your organization's note endorsements comply with the requirements of your pooling and servicing agreements?

A.3. Bank of America believes that it has complied in all material respects with the mortgage loan document delivery requirements of pooling and servicing agreements with respect to note endorsements. Trustees or their designated document custodian generally have a contractual obligation to review the loan documents provided by the seller for conformity with the delivery requirements of the pooling and servicing agreement. This process is called "certification." If a seller did not deliver a proper note endorsement, in the ordinary course this error should be identified by the trustee or the document custodian as part of the certification process.

Q.4. Have your regulators participated in or overseen your reviews, and if so, how?

A.4. Under the rules and regulations of the Office of the Comptroller of the Currency (OCC), a national bank may not disclose information concerning examinations or investigations performed by the ace. For example, pursuant to 12 CFR § 4.36(d), a national bank may not disclose non-public OCC information to third parties because it is considered the property of the OCC.

John Walsh, Acting Comptroller of the Currency, testified to this Committee on December 1, 2010 that "[w]hen problems were identified outside the national banking system at Ally Bank, we immediately directed the eighth largest national bank servicers to review their operations and take corrective action" and that the OCC "began organizing onsite examinations at each of those major servicers which are now well underway, with more than 100 national bank examiners assigned to this task." In addition, Mr. Walsh testified at a November 18, 2010 hearing of the House Financial Services Committee, Housing & Community Opportunity Subcommittee, that "[t]he examinations that we're now undertaking on an interagency basis are going to just grind right down to the most granular detail to understand what has gone on in this process; to make sure that those processes are remedied so that they operate in a fair and legal manner."

Q.5. There is some disagreement about whether the problems within the loan modification and foreclosure processes were isolated incidents, systemic failures, or were caused by rogue individuals following mistaken guidelines. Who determines your affidavit signing policies and procedures?

Were your employees following company policy? If so, has any employee responsible for designing that policy been disciplined, and how?

Were any employees disobeying company policy? If so, have they been disciplined, and how?

A.5. As noted above in response to your first question, we are implementing a series of steps to improve our process for generating affidavits of indebtedness. Our new policies and enhancements to our judicial foreclosure process are designed to provide additional assurance that going forward, affidavits of indebtedness will be prepared in accordance with best practices and all applicable rules. Our efforts include an enhanced training program for all employees involved in the affidavit process, including affiants and notaries, on the revised process and their specific responsibilities. We are taking these matters very seriously.

Q.6. An article published in the Cleveland Plain Dealer on October 17 titled "Mortgage Foreclosure Uproar Sweeps Up Northeast Ohioans" told the stories of three Northeast Ohio families that had their houses taken from them despite not missing any mortgage payments. What is your response to this story, and do you believe that such a report is consistent with statements like that from Mr. Lowman's written testimony that information in your files about "default and indebtedness was materially accurate" and that foreclosure record-keeping and affidavit issues "did not result in unwarranted foreclosures"?

A.6. As noted above in response to Senator Shelby's questions 7 and 11, when industry concerns arose with the foreclosure affidavit process, we took steps to stop foreclosure sales nationwide and launch a voluntary review of our foreclosure procedures. While we don't claim perfection, our review to date indicates that the issues with the affidavit process did not affect the basis of our foreclosure decisions.

We would note that the cases reported in the press are often more complex than some reports suggest but financial privacy concerns prevent us from discussing the specifics of these cases publicly.

Q.7. Mr. Lowman's written testimony says that "servicer compensation would tend to favor modification over foreclosure," and that "the cost for servicers to take a loan to foreclosure generally is significantly greater than the cost of a modification." Please describe the compensation structure of your mortgage servicing business.

A.7. At Bank of America, foreclosure is the last resort. From a business standpoint, a loan modification is the preferred solution because foreclosures are almost always more costly than modifications.

For context, of the loans Bank of America has taken to foreclosure sale, the foreclosure typically takes 19 months to complete from the time of delinquency to actual sale versus a loan modification that typically takes 4 months to complete from default to workout. The associated servicing-related costs to foreclose on average are four times higher than the cost to modify a loan.

The cost of servicing a non-performing loan for an extended period of time exceeds any offsetting income from fees. In addition, Bank of America suffers the full loss on loans it holds for investment.

Q.8. How many second liens do you hold on properties that you are also servicing?

A.8. Bank of America owns the second lien on approximately 11 percent of the portfolio of loans we service.

Q.9. Please describe any barriers to mortgage modifications that servicers may encounter.

A.9. As we discussed above in response to Senator Shelby's question 6, when working with delinquent customers, we aim to achieve an outcome that meets both customer and investor interests, consistent with our obligations to the investor. Many investors limit Bank of America's discretion to make modifications, and even when they do not, our legal duties to investors add complexities to the execution of modification programs. While very few investors have an outright prohibition on modifications, their eligibility criteria and requirements vary.

The Treasury Department, investors, and other constituencies have frequently changed the requirements of their modification programs. These differences and changes significantly contribute to the complexity of the modification process, strain a servicer's operations and systems, and may be a source of frustration and confusion felt by borrowers.

As I previously testified, HAMP alone has had nearly 100 program changes in the past 20 months. In testimony before the House Judiciary Committee on December 2, 2010, Phyllis Caldwell, Chief of the Homeownership Preservation Office of the Department of the Treasury, testified that "we have made so many changes" to HAMP and that "some would say we've made too many changes that the system can't absorb them." Fannie Mae and Freddie Mac have layered on additional, and in many cases, different requirements, conditions and restrictions for HAMP processing of the loans they own. When these changes occur, we and other servicers have to change our processes, retrain our staff, and update our technology. These changes can also affect what is required of the customer, including requiring new or different documentation. In addition, States also have imposed statutory and regulatory changes to the foreclosure process requiring various types of loss mitigation efforts, all of which have to be coordinated with the changing Federal directives.

Notwithstanding these challenges, Bank of America has completed nearly 750,000 loan modifications since 2008.

RESPONSE TO WRITTEN QUESTION OF CHAIRMAN DODD FROM R.K. ARNOLD

Q.1. Last year we enacted the Helping Families Save Their Homes Act. The Act added a provision to the Truth in Lending Act, known as TILA, which requires loan owners and assignees to disclose their identity to homeowners. Now, TILA requires the mortgage industry to keep homeowners informed—in writing—whenever their mortgage is sold, transferred or assigned.

How does MERS' core function—that of recording MERS as the mortgagee of record in public documents and then tracking future assignments in its internal, proprietary database—match up with the disclosure provisions of the Truth in Lending Act?

How are homeowners notified about who owns or who services their loans—and who has the right to foreclose on them—when it is being tracked by MERS?

A.1. The functions and operations of MERS are completely consistent with, and supportive of, the provisions of the Truth in Lending Act, and in particular, with the original requirement for servicers to notify homeowners when the servicing rights are transferred, and the new requirement implemented by the Helping Families Save Their Homes Act for notification of the homeowner when the ownership of a mortgage loan changes.

While the primary responsibility in notifying the borrowers of changes in ownership and servicing of a mortgage loan fall (respectively) upon the owner and the servicer of the mortgage loan, MERS has always attempted to operate in conformance with the mandates and directives of TILA. From the outset, the MERS® System has allowed borrowers to consult the database and determine the identity of the servicer for their loan if their loan is registered on the MERS® System.

Following the passage of the Helping Families Save Their Homes Act, MERS introduced an optional new service called MERS InvestorID that took two steps to help further the Act's objectives. First, it added a new feature to the system that allows its members to automatically generate an "Investor Transfer Notice" that informs homeowners of the change to their loan's ownership.

Second, MERS expanded its Web-based servicer look-up system (*www.mers-servicerid.org*) so that a borrower can also determine who owns their mortgage loan if their loan is registered on the MERS® System. Participation in the InvestorID program is optional for MERS members, and members may choose to keep the investor identity confidential. However, to date 97 percent of MERS' 3,000 members have agreed to participate and disclose the identity of the owner of the loan. MERS continues to work with our remaining members and seeks to have 100 percent participation. In those cases where the investor information is not available, MERS is frequently willing and able to work with the borrower and help them secure this information through other sources (such as the Web site of Freddie Mac, which has opted not to participate in InvestorID at this time but has enabled their own Web site, *www.freddiemac.com,* to provide the same service).

In addition to providing investor information online and free of charge, borrowers may also confirm the identity of their current servicer through MERS. The same service where borrowers can obtain the identity of their investor will also identify their current servicer (*www.mers-servicerid.org*). This is particularly useful in detecting fraud for borrowers by letting them confirm the content of any hello-and-goodbye letter they receive and preventing them from sending a loan to the wrong (and possibly fraudulent) address. Regardless of the availability of information on the MERS® System, the borrower still retains the right under TILA to obtain the ownership information from the servicer. The principle legal obligation to provide borrowers with this information rests with the servicer, and the naming of MERS as mortgagee does not diminish or change this duty in any way. MERS' disclosure of investor information is and always was intended to be a supplement to, rather than a replacement of, this legal right.

MERS strives to improve the availability and reliability of information for all participants in the mortgage finance process—borrowers, lenders, investors, servicers, and regulator—and we are open to any suggestions that further those goals.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM R.K. ARNOLD

Q.1. Mr. Levitin, your testimony states that a common response from banks—and I assume here you mean servicers—about problems in the foreclosure process is that it doesn't matter to them because the borrower still owes on the loan and has defaulted. As you put it: "This 'No Harm, No Foul' argument is that homeowners being foreclosed on are all a bunch of deadbeats, so who really cares about due process?" You say that this argument, that you attribute loosely to "banks," condones "vigilante foreclosures: so long as the debtor is delinquent, it does not matter who evicts him or how."

Does any representative of the servicer industry on the panel wish to comment on this?

A.1. MERSCORP, Inc. and its subsidiary, Mortgage Electronic Registration Systems, Inc., is not a servicer or a representative of any servicer or the servicer industry. Mortgage Electronic Registration Systems, Inc. serves as a common agent for the mortgage finance industry for the limited purpose of holding and tracking mortgages. Neither company is involved in the servicing of loans and makes no decisions and has no role in the any decisions regarding loan modifications or loan foreclosures. As such, we have no comment on Mr. Levitin's statements.

Q.2. Attorney General Miller's testimony today states the following:

> While the servicer is free to lose documents as many times as they want or to take as long as they want, the servicer often demands strict compliance from the borrower. Thus, no matter how many times the borrower has previously submitted his or her paperwork, if the borrower fails one time, the loan modification is denied.

Do any representatives of the servicer industry wish to respond to Mr. Miller's claims?

A.2. MERSCORP, Inc. and its subsidiary, Mortgage Electronic Registration Systems, Inc. is not a servicer or a representative of any servicer or the servicer industry. Mortgage Electronic Registration Systems, Inc. serves as a common agent for the mortgage finance industry for the limited purpose of holding and tracking mortgages. Neither company is not involved in the servicing of the loan and makes no decisions and has no role in the any decisions regarding loan modifications or loan foreclosures. As such, we have no comment on Attorney General Miller's statement.

However, it should be noted that in 2005, when it became apparent to us that foreclosures undertaken in Florida were relying excessively on lost note affidavits, MERS adopted a rule forbidding the use of lost note affidavits when foreclosures were done in the name of MERS in Florida. That rule was extended nationally in 2006 and is still in effect today. MERS believes that borrowers are entitled to know that the company foreclosing has all of the necessary paperwork and rights to do so. Showing up with the original note provides the borrower and the court with proof that the foreclosing company is the proper party to foreclose.

Q.3. Mr. Arnold, your company relies on people who you refer to as "certifying officers." These are people who work in companies that are members of your system and who your company grants certain authorities, such as the authority to initiate foreclosures.

Please explain what authorities are granted to certifying officers and the mechanisms that your company has in place to monitor the performance and behavior of those officers.

A.3. Mortgage Electronic Registration Systems, Inc. takes the majority of its actions as the mortgagee through the use of officers commonly referred to as "certifying officers." From inception, the concept of certifying officers has always been fundamental to the operations of MERS. In the white paper [1] calling for the creation of MERS, it was recognized that members would need to have a form of authority to act on behalf of MERS when MERS is the mortgagee on their behalf. That authority took the form of appointing persons (designated by the member) as officers with limited authority to take certain actions. The offices to which each of these individuals are officially appointed to are vice president and assistant secretary.

The authority granted to these officers is limited to: (1) executing lien releases, (2) executing mortgage assignments, (3) initiating foreclosures, (4) executing proofs of claims and other bankruptcy related documents (*e.g.,* motions for relief of the automatic stay), (5) executing modification and subordination agreements needed for refinancing activities, (6) endorsing over mortgage payment checks made payable to MERS (in error) by borrowers, and (7) taking such other actions and executing documents necessary to fulfill the member's servicing duties. It is important to note that the certifying officers are the same officers whom the lenders and servicers use to carry out these same functions above for their company even when MERS is not the mortgagee.

MERS has specific controls over who can be identified by its members as a certifying officer. To be a MERS certifying officer, one must be a company officer of the member institution, have basic knowledge of MERS, and pass a certifying examination ad-

[1] In 1993, a 36-page white paper entitled "Whole Loan Book Entry Concept for the Mortgage Finance Industry" addresses the concepts underlying MERS and the problems it was designed to address. It is available upon request.

ministered by MERS, which is renewed on an annual basis for each individual.

Concerning the monitoring and oversight of certifying officers, as noted in our testimony (*see p.19–21*), MERS has taken actions in the past to help ensure that certifying officers were acting in a manner consistent with MERS rules. Earlier this year, when we became aware of acceleration in foreclosure document processing, we grew concerned that some certifying officers might have been pressured to perform their responsibilities in a manner inconsistent with our rules. When we did not get the assurances we thought were appropriate to keep this from happening, we suspended our relationships with those companies.

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

Q.4. Mr. Arnold, does MERS derive any revenue from foreclosures?

A.4. No. Neither MERSCORP, Inc. nor its subsidiary, Mortgage Electronic Registration Systems, Inc., receive any fees or other form of compensation from foreclosures.

MERS derives its revenue solely from its members. MERS makes its money through an annual membership fee (ranging from $264 to $7,500) based on organizational size, and through loan registration and servicing transfer fees. MERS charges a one-time $6.95 fee to register a loan and have Mortgage Electronic Registration Systems, Inc. serve as the common agent (mortgagee) in the land records. For loans where Mortgage Electronic Registration Systems, Inc. will not act as the mortgagee, there is only a small one-time registration fee ($0.97). This is known as an iRegistration. Transactional fees (ranging from $1.00 to $7.95) are charged to update the database when servicing rights on the loan are sold from one member to another.

MERS charges no fees and makes no money from mortgage origination or payments, from the securitization or transfer of mortgages, or from foreclosures done in its name.

Q.5. Ms. Thompson testifies that, " . . . the problems occasioned by mortgage servicer abuse run rampant." That is a strong accusation. Ms. Thompson also frequently, though without definition, refers to "abuses" committed by servicers and "excessive" fees. She accuses servicers of failing to negotiate in good faith and of preparing false affidavits. She states that "Servicers do not believe that the rules that apply to everyone else apply to them." Their attitude, according to Ms. Thompson, is "lawless" and they commit "wrongful foreclosure on countless American families." She also states that "The lack of restraint on servicer abuses has created a moral hazard juggernaut that at best prolongs and deepens the current foreclosure crisis and at worst threatens our global economic security."

Do any of the servicer representatives here wish to respond to Ms. Thompson's allegations?

A.5. MERSCORP, Inc. is not best suited to answer this question. MERSCORP, Inc. and its subsidiary, Mortgage Electronic Registration Systems, Inc. is not a servicer or a representative of any servicer or the servicer industry. Mortgage Electronic Registration Systems, Inc., serves as a common agent for the mortgage finance industry for the limited purpose of holding and tracking mortgages. Neither company is involved in the servicing of the loan and makes no decisions and has no role in the any decisions regarding loan modifications or loan foreclosures. As such, we have no comment on Ms. Thompson's statements.

Q.6. Given the varying State laws that govern foreclosure, there must be the opportunity to observe both best and worst practices. While foreclosures are not the preferred option for any party at the onset of a loan, sometimes it is the path forward that presents the least harm to borrowers, lenders and the economy. In those instances, it is essential that our foreclosure process be effective.

Which States do each of you feel provide the most efficient path forward in foreclosures, while providing borrowers proper legal channels in the event that there is a dispute? What is the average length of time between original delinquency and foreclosure sale in these States?

Which States do each of you feel have the most problems in effectively executing foreclosures? What is the average length of time between original delinquency and foreclosure sale in these States?

A.6. MERSCORP, Inc. is not best suited to answer this question. MERSCORP, Inc. and its subsidiary, Mortgage Electronic Registration Systems, Inc. is not a servicer or a representative of any servicer or the servicer industry. Mortgage Electronic Registration Systems, Inc. serves as a common agent for the mortgage finance industry for the limited purpose of holding and tracking mortgages. Neither company has any role in the decisions regarding loan modifications or loan foreclosures.

Q.7. To better gauge the level of violations surrounding the topic of this hearing it is necessary for us to understand who is being affected. Admittedly, this question is probably best suited for the regulators, and we hope to receive this information from them at some point.

In your research and investigations, how many individuals were discovered to have been fully current on their mortgage payments but foreclosed upon by their servicer? Please provide the data and evidence that you evaluated to arrive at your conclusions.

A.7. MERSCORP, Inc. is not best suited to answer this question. MERSCORP, Inc. and its subsidiary, Mortgage Electronic Registration Systems, Inc. is not a servicer or a representative of any servicer or the servicer industry. Mortgage Electronic Registration Systems, Inc. serves as a common agent for the mortgage finance industry for the limited purpose of holding and tracking mortgages. Neither company is involved in the servicing of the loan and makes no decisions and has no role in the any decisions regarding loan modifications or loan foreclosures.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR BROWN FROM R.K. ARNOLD

Q.1. How many individuals are employed by MERS, Inc. and MERSCORP, Inc., including vice presidents, assistant secretaries, or other "certifying officers" designated pursuant to corporate resolution?

Are these employees also employed by other organizations? If so, which ones?

A.1. Measured by direct employment, MERSCORP, Inc. is a relatively small organization. About 50 people work for MERSCORP, Inc. in our Reston, VA, office. Hewlett-Packard and Genpact are our technology partners, and they run the database, the help desk and mailroom with an additional 150 people dedicated to the MERS account.

MERS Certifying Officers

Mortgage Electronic Registration Systems, Inc. takes the majority of its actions as the mortgagee through the use of officers commonly referred to as "certifying officers." From inception, the concept of certifying officers has always been fundamental to the operations of MERS. In the white paper calling for the creation of MERS, it was recognized that members would need to have a form of authority to act on behalf of MERS when MERS is the mortgagee on their behalf. That authority took the form of electing persons (designated by the member) as officers with limited authority to take certain actions. The offices to which each of these individuals are officially appointed are vice president and assistant secretary. The authority granted to these officers is limited to: (1) executing lien releases, (2) executing mortgage assignments, (3) initiating foreclosures, (4) executing proofs of claims and other bankruptcy related documents (*e.g.,* motions for relief of the automatic stay), (5) executing modification and subordination agreements needed for refinancing activities, (6) endorsing over mortgage payment checks made payable to MERS (in error) by borrowers, and (7) taking such other actions and executing documents necessary to fulfill the member's servicing duties.

It is important to note that the certifying officers are the same officers whom the lenders and servicers use to carry out these functions even when MERS is not the mortgagee. MERS has specific controls over who can be identified by its members as a certifying officer. To be a MERS certifying officer, one must be a company officer of the member institution, have basic knowledge of MERS, and pass a certifying examination administered by MERS.

Under the corporate law in Delaware (where MERS is incorporated), there is no requirement that an officer of a corporation also be an employee of that corporation. A corporation is allowed to appoint individuals to be officers without having to employ those individuals or even pay them. This concept is not limited to MERS. Corporations cannot operate without officers; they can and often do operate without employees. It is not uncommon for large organizations to have all its employees employed by an operating company and for those employees to be elected as officers of affiliated companies that are created for other purposes (all corporations are required by law to have officers to act for it). Even for loans where MERS is not the mortgagee, employees of the servicer are generally delegated the power to take actions (*e.g.,* initiate foreclosures) and execute documents (*e.g.,* lien releases and assignments) on behalf of the owner of the loan (and the servicer, in turn, may further delegate such authority to a third-party vendor).

As of November 15, 2010, MERS has 20,302 certifying officers who work with the more than 31 million active loans registered on the MERS® System.

Q.2. Is Mortgage Electronic Registration Systems (MERS) considered a nominee or mortgagee for the mortgages that it registers?

A.2. MERS is a mortgagee who holds the mortgage lien in a nominee capacity for the lender and the lenders successors and assigns. When MERS is named as mortgagee in a mortgage document, it holds the legal title to that mortgage, while the beneficial interest in that mortgage flows to the owner of the promissory note. A MERS mortgage makes clear that MERS is acting as the nominee (agent) of the lender-the original owner of the beneficial interest in the mortgage-and holds the legal title to the mortgage in this capacity.

Mortgage law is abundantly clear that a promissory note owner may empower an agent with the authority to hold and enforce a mortgage lien on behalf of the note owner, and that courts should make every effort to recognize this agency relationship. (See Restatement (Third) Property, § 5.4, comment e)

The practice of having an agent hold legal title to the mortgage for a note-owner long pre-dates the creation of MERS in 1995. It became a standard practice in the mortgage finance industry.

Q.3.–1. What is the status of a mortgage if a State court rules that MERS has not legally obtained or transferred title?

A.3.–1. As a rule, the mortgage is said to follow the note, *i.e.,* that the holder of the note also holds the beneficial and equitable (but not legal) title to the mortgage, and transfer of the promissory note conveys the beneficial and equitable interest in the mortgage. Therefore, the note-holder always has the right to foreclose. If a lender has possession of the note and seeks to foreclose, the note-holder will be viewed as having an equitable assignment of the mortgage because the mortgage follows the note. This general principle applies whether or not MERS is the mortgagee.

We are not aware of any State where the law of that State prohibits MERS from being the mortgagee, or that MERS has not legally obtained or transferred title. There have been a few cases that turned on the specific facts of the case and some may mistakenly interpret these cases to hold that MERS cannot be the mortgagee (*e.g.,* the Maine Supreme Judicial Court decision in *Mortgage Electronic Registration Systems, Inc. v. Saunders,* 2010 ME 79, Cum–09–640 (MESC), August 12, 2010). Such an interpretation is not correct, in *Saunders* or any other case that we are aware.

For example, the *Saunders* court did not hold or state anywhere in the opinion that MERS cannot hold a mortgage lien. What the court actually concluded is that "MERS does not qualify as a mortgagee *pursuant to [Maine's] foreclosure statute, 14 M.R.S.* §§ 6321–6325." (par. 11 of the opinion, emphasis added). The statute outlines steps that a mortgagee must take to commence and complete a judicial foreclosure in that State. It does not specifically define the term "mortgagee" or in any way determine *who* may be a mortgagee under Maine's broader real property law. As for the *Saun-*

ders decision itself, it does not in any way conflict with or otherwise repudiates the basic legal principals upon which the MERS business model is based.

When MERS is named as mortgagee in a mortgage document, it holds the legal title to that mortgage, while the beneficial interest in that mortgage flows to the owner of the promissory note. The *Saunders* opinion acknowledges this very same point. A MERS mortgage makes clear that MERS is acting as the nominee (agent) of the lender—the original owner of the beneficial interest in the mortgage—and holds the legal title to the mortgage in this capacity for the lender and successors-in-interest to the lender.

A foreclosing party—be it MERS or anyone else—must both hold the note and be the mortgagee of record. As the *Saunders* court noted, Maine's adoption of the Uniform Commercial Code (UCC) specifically allows the holder of the promissory note the right to enforce its terms. The note is the primary evidence of the borrower's obligation to repay the debt, and the mortgage is subordinate to the note.

For this reason, MERS rules require that before it will move forward with a foreclosure, MERS must be the mortgagee *and* MERS must be the holder of the note. MERS has established rules and procedures for foreclosures to ensure that the necessary evidence is presented to the court and the claim is clearly presented in the pleading. When these rules and procedures are followed, MERS foreclosures are successful. It has been noted in the press and elsewhere that some courts have held that MERS did not have the right to foreclose, despite the fact that MERS is named as mortgagee on the document. However, these cases are typically the result of a MERS member and/or certifying officer failing to follow the established rules and procedures for a foreclosure. The MERS member fails to provide the court the proper evidence and plead the case appropriately to establish the standing and claim for MERS. The most common failing in these cases is the failure to provide a copy of the note.

The court specifically acknowledged—and we agree—that MERS holds legal title to the property. We are not aware of any court ruling or opinion where MERS has been the mortgagee and presented the note as the note holder where the court has found that MERS does not have standing to foreclose. Further, we are not aware of any court ruling or opinion holding that a mortgage naming MERS as the mortgagee is unenforceable or void.

Q.3.–2. Who holds the mortgage? Who holds the right to foreclose?

A.3.–2. When faced with the issue of whether MERS can hold the mortgage, numerous courts have concluded that pursuant to the language in the security instrument, MERS is the mortgagee and holds legal title to the mortgage. Courts have also held that as the mortgagee, MERS has the authority to commence foreclosure, whether judicially or non-judicially, under State statutes governing foreclosure. See *In re Mortgage Electronic Registration Systems (MERS) Litigation,* a Multi-district litigation case (D.Ariz., Sept. 30, 2010, MDL Docket No. 09–2119–JAT); *Pantoja v. Countrywide Home Loans, et al.*—U.S. Dist. Ct., 5:09cv016015 (N.D. Cal., 2009); *Mortgage Electronic Registration Systems, Inc. v. Azize,* (965 So. 2d

151, 153–54 Fla. Dist. Ct. App. 2007); *Warque v. Taylor, Bean & Whitaker, MERS, et al,* 09–1906 (D. Ga. 8/18/2010); *Mortgage Electronic Registration Systems, Inc., v. Bellistri,* 2010 WL 272080 *6, ¶1A37 (E.D. Mo. July 1, 2010); *Ramos v. Mortgage Electronic Registration Systems, Inc., et al.,* 2:08cv01089 (D. Nevada., 2009); *Athey v. Mortgage Electronic Registration Systems, Inc.,* 2010 WL 1634066 (Tex. App.—Beaumont; *Burnett v. Mortgage Electronic Registration Systems, Inc.,* 09–69 (D. Ut. 2009); *Ruben Larota-Florez v. Goldman Sachs Mortgage Co., et al.,* #09cv1181, U.S. Dist. Ct., Eastern Dist. of VA (December 8, 2009); and *Moon v. GMAC Mortgage Corporation, et al,* No. C08–969Z, 2008 WL 4741492 (W.D. Wash. Oct. 24, 2008).

Likewise, numerous courts have held that when MERS is the mortgagee identified in the security instrument, it has the authority to assign its interest in the mortgage or deed of trust, and that the assignee of MERS has standing to commence foreclosure proceedings. *See Lane vs. Vitek Real Estate Industries Group, et al.,* 2:10cv335 (E.D. Cal., 2010); *Trotter v. Bank of New York Mellon et al,* Kootenai County District Court, Case No. CV–10–95 (July 2, 2010); *Deutsche Bank National Trust Co. v. Traxler,* 2010–Ohio-3490, the Ninth Judicial District Court of Appeal finding that MERS, as the mortgagee had the authority to assign the mortgagee and that Deutsche Bank, as the assignee, had standing to foreclose; *US Bank National Assoc. v. Flynn,* 897 N.Y.S. 2d 855 or LexisNexis at 2010 N.Y. Misc. Lexis 511 (March 12, 2010); and *Griffin v. Wilshire Credit Corporation, et al.,* Case No. 4:09–CV–715–Y (U.S. Dist. Ct., N.D. Texas, June 8, 2010).

Q.3.–3. What are the rights of the investors in the mortgage-backed security (MBS)?

A.3.–3. With respect to the securitization process, MERS' role is limited to assisting investors and servicers to reduce the need for assignments to be recorded in the local land records when MERS Members trade rights in mortgage loans. While we understand generally that investors in mortgage-backed securities own the underlying promissory notes which have been pooled and securitized, MERS does not participate in the actual process of pooling the mortgage loans and issuing the securities and is not in a position to comment in detail on the rights of the investors to these financial products.

Q.4. If the trustees of the MBS never secured the assets from the originators because of their own failure to complete diligence, who holds the mortgage?

What is the impact on the MBS?

What are the rights of the investors in the MBS?

A.4. MERS is not part of how mortgage loans get securitized. That role belongs to the note-owner who decides whether a note should be sold, or transferred to a trust, or ultimately securitized with a pool of other loans.[2] Loans were securitized long before MERS be-

[2] The issue of whether transfers of residential mortgage loans made in connection with securitizations are sufficient to transfer title and foreclosure rights is the subject of a "View Point" article entitled "Title Transfer Law 101" by Karen Gelernt that appeared in the October 19, 2010 edition of the *American Banker.* A copy was provided as attachment 3 of MERS' testimony.

came operational, and in fact, there are loans in securities today that do not name Mortgage Electronic Registration Systems, Inc. as the mortgagee. As such, MERSCORP, Inc. is not in a position to comment on some portions of this question.

For mortgages where Mortgage Electronic Registration Systems, Inc. is the mortgagee, MERS holds legal title to the mortgage as nominee and common agent on behalf of the originator of the mortgage loan and any successors or assignees of the mortgage loan. This does not change regardless of whether the mortgage loan is assigned or securitized (successfully or unsuccessfully). The beneficial and equitable rights to the mortgage move with the promissory note, but the legal title remains grounded with MERS.

The disposition of beneficial and equitable interests in the mortgage following a failed sale, transfer or negotiation of the promissory note will turn upon the facts of the case, but it is most likely that they will ultimately rest with the party found to hold the promissory note. However, MERS is not in a position to comment upon the specific hypothetical posed by this question.

Other MBS-related aspects of this question are beyond the scope of MERS' operation and knowledge. Senator Brown may wish to consult the American Securitization Forum's November 16, 2010 whitepaper, "Transfer and Assignment of Residential Mortgage Loans in the Secondary Mortgage Market."

Q.5. If the assets are never properly secured for an MBS, who is responsible, both legally and financially—the servicers, trustees, or investors?

What is the liability of the law firms that failed to conduct proper due diligence?

A.5. MERS and the MERS® System have limited involvement in the securitization process. MERS has no role in determining whether any loan will be securitized, into what asset pool or trust that loan might be placed, or the creation of any security that might be issued in reliance upon that loan. All of this activity is controlled by the owners of the loans and legally occurs outside of the MERS® System. It is the obligation of the trustee and its custodian to verify and ensure that the conveyance of loans to the trust is done correctly. MERS is fundamentally a database that tracks servicing rights and beneficial interests based on information provide by its members. The rating agencies, however, do require that the name of the trustee (or the trust) be registered in the investor field on the MERS® System following the sale of the loan to the securitization trust.

As a result, this question is beyond the scope of MERS' operation and knowledge, and MERS therefore has no comment. Senator Brown may wish to consult the American Securitization Forum's November 16, 2010 whitepaper, "Transfer and Assignment of Residential Mortgage Loans in the Secondary Mortgage Market."

Q.6. If States reach opposing legal conclusions regarding the mortgage holder of record in MERS transactions, what would be the impact on MBS that contain mortgages from multiple States?

What are the rights of the investors in the MBS?

A.6. MERS and the MERS® System have limited involvement in the securitization process. MERS has no role in determining whether any loan will be securitized, into what asset pool or trust that loan might be placed, or the creation of any security that might be issued in reliance upon that loan. All of this activity is controlled by the owners of the loans and legally occurs outside of the MERS® System. It is the obligation of the trustee and its custodian to verify and ensure that the conveyance of loans to the trust is done correctly. MERS is fundamentally a database that tracks servicing rights and beneficial interests based on information provide by its members. The rating agencies, however, do require that the name of the trustee (or the trust) be registered in the investor field on the MERS® System following the sale of the loan to the securitization trust.

As a result, this question is beyond the scope of MERS' operation and knowledge, and MERS therefore has no comment. Senator Brown may wish to consult the American Securitization Forum's November 16, 2010 whitepaper, "Transfer and Assignment of Residential Mortgage Loans in the Secondary Mortgage Market."

Q.7. On Thursday, November 18, the Washington Post reported that "[t]he [financial services] industry is seeking legislation that would effectively affirm MERS's legality and block any bill that would call into question what MERS does." Is MERS or any of its members seeking Federal legislation? If so, please describe the proposed legislation sought by the industry.

A.7. MERS has no knowledge of the source or basis for the Washington Post report. MERS has not proposed and is not seeking any Federal legislation.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM ADAM J. LEVITIN

Q.1. Mr. Levitin, you state that problems in the mortgage market potentially "represent a systemic risk of liabilities in the trillions of dollars, greatly exceeding the capital of the U.S.'s major financial institutions."

The Dodd-Frank Act sets up a Financial Stability Oversight Council. According to Section 112 of the Act, the Council is supposed to identify risks to the financial stability of the United States. You argue that existing mortgage market problems are potentially systemic.

Do you believe that the Council has been appropriately engaged on the foreclosure issue, and, if so, what actions has it taken to help deal with the issue? If not, what do you believe the Council should be doing?

A.1. I am not aware of the Financial Stability Oversight Council (FSOC) having taken any meaningful steps to engage with potential systemic risks from chain of title problems in mortgage securitization. Having clear title to property is among the most fundamental components of a modern, functioning economy, and any concerns about widespread clouds on title necessarily raise systemic risk concerns.

There are two potential sources of chain of title problems for mortgage securitization. The first involves unresolved questions of law. There is little that the FSOC can do regarding these questions other than note their existence and try to reach its own conclusions about how courts might rule. I would caution that the FSOC needs to be careful to ask how a court might rule, not what it believes to be the proper (or convenient) answer. The fact that there is little the FSOC can do about unresolved legal questions underscores just how troubling it is that a $1.2 trillion private label securitization market hinges on debatable legal presumptions in its product design. I would underscore that it was the unregulated, private-label securitization industry, not the GSEs or Ginnie Mae, that designed products lacking either clear statutory or caselaw support for their legal structures.

The other source of chain of title problems for mortgage securitization is a compliance question—did mortgage securitizations actually get the signatures and move the paper the way they were supposed to do in order to be legally effective? FSOC can answer this question—if it wants to. To determine whether there are widespread compliance problems in mortgage securitization, financial regulators could have properly trained examiners look at a sufficiently broad sampling of loan files in mortgage securitizations. Currently, Federal bank regulators lack the expertise to perform this sort of examination; mortgage loan documentation is beyond the traditional scope of bank examiner duties. If the FSOC were so motivated, however, it could have examiner teams properly trained to sent to do unannounced, random sampling of securitized mortgage loan files.

Q.2. Mr. Levitin, your testimony states that a common response from banks—and I assume here you mean servicers—about problems in the foreclosure process is that it doesn't matter to them because the borrower still owes on the loan and has defaulted. As you put it: "This 'No Harm, No Foul' argument is that homeowners being foreclosed on are all a bunch of deadbeats, so who really cares about due process?" You say that this argument, that you attribute loosely to "banks," condones "vigilante foreclosures: so long as the debtor is delinquent, it does not matter who evicts him or how."

Mr. Levitin, do you really believe that mortgage servicers do not care about due process?

Does any representative of the servicer industry on the panel wish to comment on this?

A.2. I do not believe that mortgage servicers care about due process, and I do not think it should be surprising to anyone that they do not. Due process has no value to mortgage servicers; it only adds to their costs. I believe that like any profit maximizing business, mortgage servicers care about their bottom line and that they evaluate compliance with the law according to this metric: is it more profitable to comply with the law or not?

A sad, but basic reality of consumer finance is that it is often profitable for financial service provides to violate the law. Consumers are unaware of their legal rights or legal violations, and even when they are aware, they often lack the resources to stand up for their rights. Moreover, it simply is not worthwhile for a consumer to litigate over a violation that costs the consumer a few hundred or even a few thousanddollars. And when a consumer does make a determined stand for his or her rights, it is very easy for the financial service provider to claim that the violation of the law was a mistake, apologize, and continue violating the law with other consumers. This makes it quite profitable to violate the law on a wide-scale, but in a manner than only harms individual consumers a relatively small amount.

Seen against this background, it is hard to reach any conclusion other than that due process is a hindrance to servicers, not a value. It adds to the cost of foreclosures and slows down the process, which increases the length of time for which servicers must advance payments of principal and interest on the defaulted mortgage to their investors for which servicers are reimbursed, but without interest. No matter how loudly any of the servicers testifying protest that they would of course adhere to the law and would never knowingly violate consumers due process rights, the plain fact is that they routinely do so and will continue to do so as long as it is profitable. Servicers' public protestations of morality and legality will hardly overcome the basic forces of economics.

Q.3. Given the varying State laws that govern foreclosure, there must be the opportunity to observe both best and worst practices. While foreclosures are not the preferred option for any party at the onset of a loan, sometimes it is the path forward that presents the least harm to borrowers, lenders and the economy. In those instances, it is essential that our foreclosure process be effective.

Which States do each of you feel provide the most efficient path forward in foreclosures, while providing borrowers proper legal channels in the event that there is a dispute? What is the average length of time between original delinquency and foreclosure sale in these States?

Which States do each of you feel have the most problems in effectively executing foreclosures? What is the average length of time between original delinquency and foreclosure sale in these States?

A.3. There is a tradeoff between efficiency and procedural due process. The States that have non-judicial foreclosure have a more efficient foreclosure process from the standpoint of lenders, in that foreclosures are quicker and less expensive, but this efficiency comes at the price of procedural protections.

There is a study that indicates that mortgage availability is generally greater (and hence mortgage costs are lower) in States with non-judicial foreclosure procedures. *See* Karen M. Pence, *Foreclosing on Opportunity,* 88 Review of Economics and Statistics, 177–82 (2006). This would imply that part of the savings from a more efficient foreclosure process are transmitted back to mortgage borrowers.

The mere fact that non-judicial foreclosure results in somewhat lower costs of mortgage credit, however, is not alone sufficient reason to endorse non-judicial foreclosure. Homeowners in States with judicial foreclosure pay slightly more for their mortgages, but they gain procedural protections. While many homeowners would likely opt for lower up-front mortgage costs and fewer procedural protections, there is good reason to believe that homeowners are likely to undervalue procedural protections in foreclosures: homeowners rarely enter into a mortgage thinking that it will end up in foreclosure. Because homeowners are likely to think the likelihood of foreclosure is more remote than it is, they will underestimate the value of procedural protections, a phenomenon known as hyperbolic discounting.

The myriad procedural problems that have become apparent in foreclosures today make clear just how valuable due process is in foreclosures; it is when homeowners are at their most vulnerable that they most need procedural protections. In non-judicial foreclosure States, a homeowner must bring a quiet title action to challenge a foreclosure. The result is really a burden shifting from lenders to homeowners. Given the disparity in resources between lenders and homeowners, particularly homeowners in foreclosure, this sort of burden shifting makes due process simply unaffordable for many homeowners.

While judicial foreclosure adds costs, I believe they are worthwhile one from a social standpoint, as judicial foreclosure functions as a type of mandatory insurance designed to bolster homeownership preservation policies and address the adverse selection problem that would ensue if homeowners could decide if they wanted judicial or non-judicial foreclosure.

Ultimately, we need foreclosure processes that strike the optimal balance between efficiency and procedural due process. I would submit that non-judicial foreclosure systems are so lacking in procedural due processes that they are unlikely to be the proper balance. Instead, the question is really one of the extent of procedural protections within a judicial foreclosure system.

Q.4. To better gauge the level of violations surrounding the topic of this hearing it is necessary for us to understand who is being affected. Admittedly, this question is probably best suited for the regulators, and we hope to receive this information from them at some point.

In your research and investigations, how many individuals were discovered to have been fully current on their mortgage payments but foreclosed upon by their servicer? Please provide the data and evidence that you evaluated to arrive at your conclusions.

A.4. My research has not examined the issue of the number of homeowners who are current but have ended up in foreclosure, and I do not know of anyone who has examined this issue empirically. Anecdotally, however, there are a troublingly large number of examples of homeowners who have ended up in foreclosure while current on their mortgages, or who have ended up in foreclosure as the result of servicer induced defaults for reasons such as improper crediting of payments (such as to late fees first, and then to principal and interest) or by the imposition of exorbitantly priced force-placed insurance.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR BROWN FROM ADAM J. LEVITIN

Q.1. Please describe any barriers to mortgage modifications that servicers may encounter.

A.1. Beyond the problem of mortgage servicer incentives, which I address in response to Senator Brown's third question for the record, there are two major types of barriers to mortgage modifications for servicers.

First, servicers are often contractually limited in their ability to perform modifications. Servicing contracts, known as pooling and servicing agreements (PSAs), frequently contain limitations on modifications. Most PSAs restrict modifications to loans that are in default or where default is reasonably foreseeable and limit servicers' ability to extent the term of a loan more than a year or so (to the final maturity date of any other loan in the securitized pool). PSAs sometimes have further restrictions such as limiting the amount by which interest rates can be reduced, limiting the number of loans in a pool that may be modified, or limiting changes in amortization.

The other major barrier is the presence of junior liens ("second liens") on a property. Servicers are reluctant to modify a loan if there is a junior lien on the property because any cash flow freed up by the modification benefits the junior lien holder. While junior liens are not a per se obstacle, their presence makes servicers hesitant to perform modifications.

Q.2. What systems should mortgage servicers implement to correct their mistakes and compensate the individual homeowners who have suffered through the actions of others?

A.2. There is no simple way for servicers to correct their mistakes and compensate individual homeowners who have been harmed. A starting point would be a thorough review of foreclosure procedures to identify all possible mistakes. Unfortunately, I do not believe that servicers are capable of performing such a review. Servicers as companies and particularly servicer employees involved in foreclosure operations have very strong incentives not to identify possible mistakes. Unless servicers are given such an incentive or an honest-broker third party with expertise in the area examines hundreds of thousands of foreclosure filings from the past several years, it is impossible to truly know the extent of the problem or the harm caused. Let me underscore that I do not believe that any of the Federal bank regulators have the expertise to carry out such an examination, and that some of the regulators are frankly compromised when it comes to disciplining servicers.

Once the scope of the problem is determined, then compensation questions can be considered. While there might be interest from the servicer side in simply creating a compensation fund for servicing victims, I am loathe to see Kenneth Feinberg as the solution to all of America's problems, and am concerned that such an approach would fail to shine much needed sunlight on a seriously troubled industry.

Q.3. What are the financial incentives encouraging mortgage servicers to foreclose on homeowners?

A.3. There are several financial considerations that encourage mortgage servicers to foreclose rather than modify mortgages. First, in foreclosure servicers are often able to lard on various "junk fees," meaning either fees for services never performed, fees for which the homeowner is not actually liable, or inflated fees for in-sourced services or services outsourced to vendors that provide kickbacks. Because servicers are paid off the top of foreclosure sale proceeds, it does not matter whether the sale brings in enough to cover the mortgage debt; the servicer's claim for various servicing fees and expenses will be paid. This means, then, that in most cases—that is cases where the debt is actually or functionally non-recourse—servicers' junk fees are really coming out of the pocket of mortgage backed securities investors.

While a foreclosed loan does not generate servicing fee and float income for servicers, junk fees can easily off-set this income. Thus, in Countrywide's 2007 third quarter earnings call, Countrywide's President David Sambol emphasized that increased revenue from in-sourced default management functions could offset losses from mortgage defaults.

> Now, we are frequently asked what the impact on our servicing costs and earnings will be from increased delinquencies and loss mitigation efforts, and what happens to costs. And what we point out is, as I will now, is that *increased operating expenses in times like this tend to be fully offset by increases in ancillary income in our servicing operation, greater fee income from items like late charges, and importantly from in-sourced vendor functions* that represent part of our diversification strategy, a counter-cyclical diversification strategy such as our businesses involved in foreclosure trustee and default title services and property inspection services.

Transcript, "Countrywide Financial Corporation Q3 2007 Earnings Call," Oct. 26, 2007 (emphasis added). Sambol also mentioned that "Our vertical diversification businesses, some of which I mentioned, are counter-cyclical to credit cycles, like the lender-placed property business in Balboa and like the in-source vendor businesses in our loan administration unit."

Countrywide is now owned by Bank of America. I have no reason to believe that the fundamental economics of servicing acknowledged by Mr. Sambol changed when Countrywide was purchased by Bank of America.

Second, loan modification is expensive. To modify (or attempt to modify) a loan is essentially to underwrite a new loan. There are costs for doing this in terms of personnel time and overhead, as well as pulling a credit report, *etc.* Servicing agreements do not generally provide reimbursement for modification expenses. Moreover, not all attempted modifications result in an actual modification. Attempted modifications still involve expenses, however, Thus, unless a servicer believes that its income from a modified loan—discounted for the likelihood that there will be a modification and that the modified loan will redefault—will outweigh both the costs of modification and the forgone junk fees that could be collected in foreclosure, attempting a modification is a losing economic proposition for the servicer.

HAMP attempts to change these incentives by paying a $1,000 modification bounty (and assorted other bounties) to servicers for each permanent modification. HAMP bounties have to be discounted, however, by the fact that only 39 percent of HAMP trial modifications successfully converted to permanent status. This means that 61 percent of the time servicers put in the time and expense to doing a HAMP modification, but receive no reimbursement. The net result is that HAMP incentives may simply be too small to have their desired effect.

Finally, servicers are required to advance payments of principal and interest (and sometimes taxes and insurance) on defaulted loans to mortgage investors. These payments are reimbursed out of foreclosure sale proceeds, but without interest. This means that there are considerable time value and liquidity costs to making advances. The faster a servicer can foreclose, the less advancing it has to do. Servicers are often concerned that if they modify a loan, the loan will redefault, which will increase the total number of months of advances they will have to pay.

In short, residential mortgage servicers are subject to strong financial incentives that discourage mortgage modification and encourage foreclosure. I do not believe that Government foreclosure mitigation programs like the Home Affordable Modification Program offer servicers' sufficient compensation to overcome these incentives, and I do not believe it is appropriate for the Government to be paying servicers to perform their contractual duty of maximizing the value of mortgages for RMBS investors. Residential mortgage servicing is a failed business model, and mortgage servicers are simply incapable of handling the current mortgage foreclosure crisis in a manner that mitigates the harm to the economy and society at large. In light of this, I think it is necessary to consider solutions to the foreclosure crisis that remove mortgage servicers from the decisionmaking process, be it through modification of mortgages in bankruptcy or through a Federal agency program modeled on the Home Owners Loan Corporation.

RESPONSE TO WRITTEN QUESTION OF CHAIRMAN DODD FROM DAVID B. LOWMAN

Q.1. In response to questions from Senator Johnson, Mr. Lowman and Ms. Desoer, you characterized the HAMP 2MP program as a good approach to second lien modification. You also noted your organizations' participation in 2MP, with Ms. Desoer pointing out that Bank of America had been the first servicer to sign up for the program. Yet, as of Sept. 30, only 21 second lien modifications worth $10,500 had been made under 2MP since its implementation in March 2010.

Why, in your opinion, have so few modifications been made under 2MP so far? Do you see your organization increasing its number of 2MP modifications in the coming months?

A.1. Response: Chase routinely modifies second liens, just as it does first liens, when appropriate to achieve affordable payments for borrowers. From January 2009 through November 2010, Chase offered over 65,000 second lien modifications of which 16,015 were made permanent. Through November 2010, Chase had offered 2,319 HAMP 2MP modifications, of which 2,070 were completed.

Chase implemented 2MP in May 2010, making Chase one of the first major servicers to do so, but the program did not become fully effective under the Treasury's re-issued July Supplemental Directive until August 1, 2010. We believe that 2MP will become more effective over time, as more HAMP modifications are implemented on first liens—to be eligible for a 2MP modification, a homeowner must have first received a HAMP modification of their first mortgage—and as the process and common database continue to operate.

Because to be eligible for 2MP modification a homeowner must have received a HAMP modification on their first lien, information regarding both liens is necessary to initiate the process. Accordingly, Chase's initial efforts under the 2MP program focused on borrowers for whom Chase serviced both the first and second liens. Once Treasury's loan matching files—providing information regarding loans serviced by other servicers—became available in August 2010, Chase was able to expand its efforts to borrowers for whom it serviced only the second lien.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM DAVID B. LOWMAN

Q.1. Mr. Levitin, your testimony states that a common response from banks—and I assume here you mean servicers—about problems in the foreclosure process is that it doesn't matter to them because the borrower still owes on the loan and has defaulted. As you put it: "This 'No Harm, No Foul' argument is that homeowners being foreclosed on are all a bunch of deadbeats, so who really cares about due process?" You say that this argument, that you attribute loosely to "banks," condones "vigilante foreclosures: so long as the debtor is delinquent, it does not matter who evicts him or how."

Does any representative of the servicer industry on the panel wish to comment on this?

A.1. We disagree with Mr. Levitin. Chase is committed to ensuring that all applicable laws are followed in the foreclosure process. We regret the errors that we have discovered in our foreclosure processes, and we are working hard to correct these processes so we get them right. At the same time, we do not believe that there have been unwarranted foreclosures as a result of these issues. Of course, if we have made any mistakes, we will fix them.

Q.2. Ms. Desoer and Mr. Lowman, it is important that this Committee has an adequate understanding of the current state of affairs as it relates to delinquency and foreclosures. Please briefly discuss the following statistics as they relate to your companies:

What is the total number of mortgages that your company services? How many mortgages are currently in foreclosure? What is the average number of days that a borrower is delinquent on his or her mortgage at the time of a foreclosure sale?

What percentage of homes are vacant at the time of a foreclosure sale?

A.2. As of November 30, 2010, Chase serviced approximately 8.6 million home loans. As of November 30, 2010, Chase serviced 349,586 loans that were in foreclosure, that is, approximately 4.07 percent of the total loans serviced were in foreclosure. The average borrower's loan is 448 days delinquent at the time of foreclosure sale.

In the third quarter of 2010, 11 percent of foreclosure sales were of properties that had been owner-occupied, but were vacant at the time of sale. In addition, 57 percent of foreclosure sales in the third quarter of 2010 were of non-owner-occupied properties, some of which were also vacant at the time of sale. Our best estimate is that 35–40 percent of properties are vacant at the time of foreclosure sale.

Q.3. This Committee has a responsibility to ensure that actors on all sides of the foreclosure process, including servicers, are acting legally and in the best interest of our society. We must address and remedy situations where this is not the case.

However, unnecessarily delaying foreclosures is not without cost. Representatives of the secondary mortgage market have told us that, on average, a delay in foreclosure costs approximately $30–40 per day, per home. This is in addition to any changes in home values during that time.

Ms. Desoer and Mr. Lowman, could you discuss what additional costs your institutions may incur during a foreclosure process if that process is delayed?

A.3. Delays in the foreclosure process could lead to additional fees on the property, such as taxes and insurance, maintenance costs of the property, and potentially additional attorneys fees, each of which is heavily dependent on the geography of the property, the condition of the property, and the loan amount.

Q.4. Given this Committee's oversight responsibilities, it is vital that we examine the regulatory actions taken before and after reports surfaced detailing the problems surrounding some foreclosures.

Ms. Desoer and Mr. Lowman, did your regulator contact you prior to any of these press reports to review your foreclosure procedures? What, if any, directives or recommendations were made by your regulator surrounding the definition of "personal knowledge" as it relates to those in your companies who must sign foreclosure documents? What, if any, directives or recommendations were made by your regulator with regard to the notary process for these documents?

A.4. Prior to September 30, 2010, when the referenced press reports were published, we did not receive specific directives from our regulators regarding the definition of "personal knowledge" or the notary process.

Q.5. Unfortunately, neither Fannie Mae, Freddie Mac, nor the Federal Housing Finance Administration were present at the hearing to discuss the "approved lenders" list that Fannie and Freddie publish to guide servicers as they select in-State counsels to act on their behalf.

Given that, Ms. Desoer and Mr. Lowman, please describe what the GSE's require of your firms with respect to these lists, and indicate whether there have been any changes to them since news of problems with "foreclosure mills" began to surface.

A.5. Although the question mentions an "approved lenders" list, we understand the Senator to be seeking information regarding the "approved counsel" list, which relates to the selection of in-State counsel. Fannie Mae and Freddie Mac require servicers to use foreclosure counsel that are identified on the GSE's lists of approved counsel for each State. Although GSE-approved foreclosure counsel have contracts directly with servicers and operate under the same agreements as non-GSE approved foreclosure counsel, they also will take direction directly from the GSEs on GSE-owned loans. Over the last 90 days, we have been notified by the GSEs of changes to their approved counsel lists.

Q.6. Attorney General Miller's testimony today states the following:

> While the servicer is free to lose documents as many times as they want or to take as long as they want, the servicer often demands strict compliance from the borrower. Thus, no matter how many times the borrower has previously submitted his or her paperwork, if the borrower fails one time, the loan modification is denied.

Do any representatives of the servicer industry wish to respond to Mr. Miller's claims?

A.6. Chase attempts to ensure that borrower paperwork is received and scanned into Chase's imaging systems thoroughly and systematically. One potential reason for multiple requests for documents would be the submission of incomplete documents. For example, since HAMP regulations have very specific requirements for documentation, borrowers who make incomplete submissions may need to resubmit a complete set of documents in order to qualify for modification under the program.

Chase has made significant investments in people, technology and process improvements to enhance the effectiveness of the modification process and reduce borrower frustration, especially with the documentation process. Specifically:

- Chase has 51 Community Home Ownership Centers ("CHOCs") throughout the country where borrowers can provide documentation in person and work with a Chase employee to ensure that their package is complete.
- To improve our customer service and our modification process effectiveness, in May 2010 we created a new role—the Relationship Manager ("RM")—to be accountable for each customer through the home retention process. As of November 2010, Chase employed 1,921 RMs, and we now assign an RM to each borrower as soon as they contact Chase for assistance due to financial hardship, such as loss of income or other major life event. The RM becomes the single point of contact with Chase for the borrower during the modification process. The RM tells the borrower about our foreclosure-avoidance solutions and helps the borrower complete the needed paperwork so a modification request can be submitted to underwriting. The RM continues to monitor the loan to ensure the process moves forward and will contact the borrower with the ultimate decision on modification. If the borrower is approved for a modification, the RM contacts the borrower to review the approval and assist them with the final steps in the process, which includes reviewing and executing the modification documents. If a modification is not approved, the RM may suggest a short sale or other alternative, depending on the underlying reasons for the denial, and if the borrower agrees, will transfer the borrower to the Chase's Liquidation teams to further discuss other foreclosure avoidance solutions.
- At the end of 2009, Chase implemented imaging technology and created a document repository to centralize the handling of all incoming customer documentation. Customers now are

directed to send all communications and documents to this location, which receives and indexes the document to the appropriate loan file for that borrower which is available electronically, eliminating the need to move paper files. Quality Control assures the thousands of unique documents received daily are uploaded in a timely fashion, properly indexed (assigned to the correct loan), and are legible. This new centralized system is available to employees throughout the loss mitigation process. Letters mailed by Chase to customers are also uploaded to this centralized repository, enabling customer-facing staff access to the most current and complete information about the loan.

- Chase implemented the verified model, which requires borrowers to provide all necessary documents prior to being evaluated for a potential solution, across all the portfolios we service. This has slowed the rate at which modification trials are initiated, but it should significantly increase the percentage of trials that lead to permanent modifications.
- Chase policy requires adherence to Treasury's guidance regarding responsiveness to borrowers' requests for modifications. With the implementation of verified trial plans, borrowers are to receive answers within 30 days of submitting a complete request, including all the necessary documents to evaluate the application.

Q.7. Ms. Thompson testifies that, " . . . the problems occasioned by mortgage servicer abuse run rampant." That is a strong accusation. Ms. Thompson also frequently, though without definition, refers to "abuses" committed by servicers and "excessive" fees. She accuses servicers of failing to negotiate in good faith and of preparing false affidavits. She states that "Servicers do not believe that the rules that apply to everyone else apply to them." Their attitude, according to Ms. Thompson, is "lawless" and they commit "wrongful foreclosure on countless American families." She also states that "The lack of restraint on servicer abuses has created a moral hazard juggernaut that at best prolongs and deepens the current foreclosure crisis and at worst threatens our global economic security."

Do any of the servicer representatives here wish to respond to Ms. Thompson's allegations?

A.7. Chase believes that Ms. Thompson's allegations are entirely unfounded. Chase is committed to ensuring that all applicable laws are followed in the foreclosure process. We regret the errors that we have discovered in our foreclosure processes, and we are working hard to correct these processes so we get them right. At the same time, we do not believe that there have been unwarranted foreclosures as a result of these issues. Of course, if we have made any mistakes, we will fix them.

As to Ms. Thompson's reference to fees, the fees imposed by Chase are not excessive. Importantly, Chase does not foreclose on borrowers if their loan payments are current but they owe fees. Chase applies borrowers' payments to their debt prior to applying them to any fees owed.

It is also critical to note that the analysis we use in deciding whether to proceed with a modification or foreclosure—which involves a net present value analysis to determine what is in the best interest of the investor—does not take into account servicer compensation over time. Furthermore, if it were considered, which it is not, servicer compensation would tend to favor modification over foreclosure. Indeed, with a successful modification, Chase is able to continue to service the loan and earn servicer fees; but when a property is sold as a result of foreclosure, Chase's role as servicer ends and Chase receives no further fees.

Q.8. Given the varying State laws that govern foreclosure, there must be the opportunity to observe both best and worst practices. While foreclosures are not the preferred option for any party at the onset of a loan, sometimes it is the path forward that presents the least harm to borrowers, lenders and the economy. In those instances, it is essential that our foreclosure process be effective.

Which States do each of you feel provide the most efficient path forward in foreclosures, while providing borrowers proper legal channels in the event that there is a dispute? What is the average length of time between original delinquency and foreclosure sale in these States?

Which States do each of you feel have the most problems in effectively executing foreclosures? What is the average length of time between original delinquency and foreclosure sale in these States?

A.8. Each State has different procedures for foreclosures, and all provide some mechanism for the borrower to challenge the propriety of the foreclosure. Chase is not really in a position to weigh the relative efficiency of one State versus another. Nationwide, the average borrower's loan is 448 days delinquent at the time of foreclosure sale.

Q.9. To better gauge the level of violations surrounding the topic of this hearing it is necessary for us to understand who is being affected. Admittedly, this question is probably best suited for the regulators, and we hope to receive this information from them at some point.

In your research and investigations, how many individuals were discovered to have been fully current on their mortgage payments but foreclosed upon by their servicer? Please provide the data and evidence that you evaluated to arrive at your conclusions.

A.9. Thus far, we are not aware of any individuals who were current on their mortgage payments but were foreclosed upon by Chase. Chase has in place numerous safeguards designed to ensure that loans are not referred to foreclosure unless foreclosure is appropriate. To begin with, Chase communicates with a customer beginning at 5 days after a missed payment, and continuing through foreclosure. Outgoing letters and phone attempts to discuss modification options commence at 40 days past due and continue through foreclosure referral. The average number of contacts a borrower receives from Chase before a foreclosure sale is 111. These communications should help ensure that Chase becomes aware of any errors in its calculations of outstanding indebtedness.

Further, an Independent Foreclosure Review team within Chase reviews each loan at two specific points to make sure that a loan has been appropriately referred for foreclosure. The Independent Foreclosure Review confirms that the loan is past due and that Chase has complied with its pre-referral policies, including repeated efforts to contact the borrower to discuss alternatives. Under Chase's policies, only after the Independent Foreclosure Review is complete can a loan be referred for foreclosure proceedings. The Independent Foreclosure Review is repeated 2 to 3 weeks prior to any scheduled sale. A final review is also conducted approximately 96 hours prior to a foreclosure sale to review the borrower's payment history and to ensure that loss mitigation is closed and the borrower is not in bankruptcy.

Of course, if Chase discovers that any foreclosures were initiated improperly, it will take action to correct any error.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR BROWN FROM DAVID B. LOWMAN

Q.1 Please describe in detail the reviews that your organizations conducted pursuant to your announced moratoriums, including: how many employees were involved; how many files they reviewed; how much time, on average, an employee spent reviewing a file.

How many errors did you uncover, and what was the nature of those errors?

How did you inform homeowners that their foreclosure filings were being reviewed?

A.1. Beginning in late September 2010, Chase temporarily halted foreclosures in 43 States and territories where documents signed by Chase may be required. Since that time, Chase has focused on reviewing and enhancing its document execution procedures, and training its document execution employees.

Chase also has put in place a remediation plan designed to identify Chase-signed affidavits in each pending foreclosure file, and file substitute affidavits based on a reverification of the information in the affidavits by the individual executing those affidavits. Chase is still in the process of implementing this plan and is not able at this stage to provide the detailed loan level information sought by this question.

Q.2. How many files that you reviewed were missing the original note?

A 2007 study found that 40 percent of bankruptcy filings involving mortgages were missing the original note. How many of your foreclosure filings are missing their original note?

A.2. We are not able at this stage in our remediation plan to provide numbers of instances in which original notes were missing in pending foreclosure proceedings. Chase has not historically tracked the frequency of lost note affidavits because there has been no need for such information in the past. Chase is generally unable to determine the total number of lost note affidavits submitted during the timeframe identified in the request.

Two businesses acquired by Chase in 2008—EMC (which Chase acquired in March 2008) and Washington Mutual (certain assets of which Chase acquired in September 2008)—did use systems that kept track of affidavits that were submitted to Chase for execution that local counsel characterized as Lost Note Affidavits. However, Chase's systems did not keep track of whether these affidavits were actually executed and filed. Still, the 40 percent figure is extremely high based on our general experience.

Chase is keeping track of the number of Lost Note Affidavits submitted in connection with foreclosure actions on a going forward basis.

Q.3. Do all of your organization's note endorsements comply with the requirements of your pooling and servicing agreements?

A.3. As a general matter, when Chase functioned as the depositor for a securitization, it received a certification report from the custodian on the deal (often Chase Custody Services) certifying its possession of the documentation for the loans, including the note, mortgage, and any assignments. Generally, per the pooling and servicing agreement, a final trust receipt reflecting the certification with respect to the loans contained in the securitization was issued to the trustee by the custodian. We are not aware of instances in which there were material deviations from these procedures in connection with securitizations in which Chase was the depositor.

Q.4. Have your regulators participated in or overseen your reviews, and if so, how?

A.4. The Office of the Comptroller of Currency is Chase's primary regulator and has been conducting an onsite audit of Chase (together with the Federal Reserve and the FDIC) since early November 2010. Chase has kept the OCC apprised of developments relating to foreclosure procedures.

Q.5. There is some disagreement about whether the problems within the loan modification and foreclosure processes were isolated incidents, systemic failures, or were caused by rogue individuals following mistaken guidelines. Who determines your affidavit signing policies and procedures?

Were your employees following company policy? If so, has any employee responsible for designing that policy been disciplined, and how? Were any employees disobeying company policy? If so, have they been disciplined, and how?

A.5. With regard to the portion of your question relating to problems within the loan modification processes, we do not believe that there have been systemic issues in connection with Chase's implementation of HAMP or its own proprietary programs. Chase has invested substantially in its loss mitigation efforts in recent years because, as I explained during my testimony, loan modifications are preferable to foreclosure from the servicer's perspective.

Specifically, with respect to loan modification, Chase has:

- Added more than 9,000 new employees to the Default and Loss Mitigation organization since 2008, more than doubling our staff;
- Chase assigns each new modification applicant to one of approximately 1,900 dedicated Relationship Managers, who are responsible for supporting borrowers who have asked for help throughout the entire mortgage modification process;
- Opened 51 regional CHOCs and a Home Ownership Preservation Office to assist borrowers face-to-face with modification efforts. CHOCs were opened in geographic areas with the high-

est rates of payment delinquencies and have assisted more than 118,480 borrowers through since their launch in early 2009.

- Handled over 32.3 million inbound calls to our call centers from homeowners seeking foreclosure prevention assistance since 2009, including 5.3 million calls to our dedicated customer hotline for modification inquiries;
- Offered over 1 million modifications to struggling homeowners since the beginning of 2009, through HAMP, the GSEs and Chase modification solutions; converting 275,152 into permanent modifications;
- Provided a graceful exit through a short sale for over 92,000 borrowers where a homeownership retention solution was not an option;
- Prevented over 467,000 foreclosures through various foreclosure avoidance programs since January 2009;
- Sent more than 3.7 million letters inviting borrowers to attend outreach events;
- Hosted or participated with community groups in more than 1,284 local events since 2009, including multi-day events reaching over 60,000 homeowners to educate and inform homeowners about foreclosure prevention solutions and assist in the completion of required documents;
- Helped the Hope Now Alliance establish a new Web-based portal to facilitate the loan modification process for homeowners working with Hope Now counseling agencies and the Hope Now Hotline.

With respect to the issues that have arisen in connection with affidavits filed in foreclosure cases, at all times, Chase policy required that its employees verify the accuracy of the affidavits prior to their execution, and our understanding is that our employees followed this policy. Therefore, we do not believe that the affidavits contained material inaccuracies in terms of the amount of indebtedness.

However, prior to approximately June 2010, our policies—which evolved over time and in the past, differed between Chase platforms—did not always require that the same employee who reviewed the business records to verify the information in the affidavit actually sign it. Rather, during certain periods, Chase's policies instructed employees who verified the affidavits to bring them to an officer for signature. This policy developed in part because it was believed to be preferable for an officer of the company to sign the affidavit rather than an analyst. In cases where an officer signed the affidavit, he or she did so in reliance on the research that had been performed by the analyst who reviewed the document instead of their own review of the business records.

Chase's review is ongoing, but thus far we have not determined that discipline of our employees is warranted. Our review to date indicates that all of our employees believed in good faith that they were complying with legal requirements and complying with firm policy.

Q.6. An article published in the *Cleveland Plain Dealer* on October 17 titled "Mortgage foreclosure Uproar Sweeps Up Northeast Ohioans" told the stories of three Northeast Ohio families that had their houses taken from them despite not missing any mortgage payments. What is your response to this story, and do you believe that such a report is consistent with statements like that from Mr. Lowman's written testimony that information in your files about "default and indebtedness was materially accurate" and that foreclosure recordkeeping and affidavit issues "did not result in unwarranted foreclosures"?

A.6. Chase did not service any of the loans discussed in the *Cleveland Plain Dealer* article.

We believe that the information in the affidavits we have filed regarding the fact of default and the amount of indebtedness was materially accurate. This information was in fact verified by Chase personnel before the affidavits were filed. We are not aware of any individuals who were current on their mortgage payments but were foreclosed upon by Chase.

Chase has in place numerous safeguards designed to ensure that loans are not referred to foreclosure unless foreclosure is appropriate. To begin with, Chase communicates with a customer beginning at 5 days after a missed payment, and continuing through foreclosure. Outgoing letters and phone attempts to discuss modification options commence at 40 days past due and continue through foreclosure referral. The average number of contact attempts a borrower receives from Chase before a foreclosure sale is 111. These communications should help ensure that Chase becomes aware of any errors in its calculations of outstanding indebtedness.

Further, an Independent Foreclosure Review team within Chase reviews each loan at two specific points to make sure that a loan has been appropriately referred for foreclosure. The Independent Foreclosure Review confirms that the loan is past due and that Chase has complied with its pre-referral policies, including repeated efforts to contact the borrower to discuss alternatives. Under Chase's policies, only after the Independent Foreclosure Review is complete can a loan be referred for foreclosure proceedings. The Independent Foreclosure Review is repeated 2 to 3 weeks prior to the scheduled foreclosure sale. A final review is also conducted approximately 96 hours prior to a foreclosure sale to review the borrower's payment history and to ensure that loss mitigation is closed and the borrower is not in bankruptcy.

Of course, if Chase discovers that any foreclosures were initiated improperly, it will take action to correct any error.

Q.7. Mr. Lowman's written testimony says that "servicer compensation would tend to favor modification over foreclosure," and that "the cost for servicers to take a loan to foreclosure generally is significantly greater than the cost of a modification." Please describe the compensation structure of your mortgage servicing business.

A.7. From both a revenue and cost perspective, servicers clearly have a greater incentive to enter into an appropriate modification rather than to foreclose.

First, a servicer derives the lion's share of its servicing revenue from monthly servicer fees. For GSE loans, payment of servicer fees ceases upon borrower default. For other investor-owned loans, these monthly servicer fees cease upon foreclosure. By contrast, if a loan is modified and continues to perform, the servicer will receive servicer fees going forward. Even if the servicer fees are reduced—for example, as may be the case as a result of principal reduction—the continued revenue stream is greater than would be received in the case of foreclosure, after which there is obviously no servicer fee.

Second, in the event of a HAMP or GSE modification, a servicer also receives an incentive fee in the event of a successful modification. A servicer receives no additional revenue or fees in the event of foreclosure.

Third, the existence of certain fees charged or expenses incurred by the servicer in the event of delinquency—such as late payment fees or advances—are typically not incentives to favor foreclosure over modification because the servicer, provided it does not own the loan, typically receives repayment of these fees either way.

Fourth, the cost of processing a modification is not materially different from the cost of foreclosing. Further, a modification typically will occur significantly more quickly than a foreclosure. Nationally, foreclosures take an average of 14 months to complete, and in some jurisdictions, much longer.

Chase has incentive plans for employees involved in the modification process, and these plans are aligned with borrower-centric outcomes. The incentive plans strike a balance between the quality and productivity of these employees. Employees involved in foreclosure operations (*e.g.,* affiants, notaries, attorney management) are not compensated through incentive plans.

Q.8. How many second liens do you hold on properties that you are also servicing?

A.8. Chase services 6.83 million first-lien mortgages; of those, 1.15 million have a second lien, which also is serviced by Chase.

Q.9. Please describe any barriers to mortgage modifications that servicers may encounter.

A.9. The number one reason for foreclosure continues to be financial problems caused by illness, a job loss, underemployment, or other life-changing events. Foreclosures cut across all types of people, regardless of factors like income level, education or type of house. Simply put, foreclosure can affect anyone.

Borrowers overwhelmed by their circumstances don't know where to turn, and they often think that Chase can't (or won't) help them. Two of Chase's bigger challenges in helping borrowers avoid foreclosure are getting them to call or meet with Chase to explain their situation as well as provide a complete set of documents to allow for an evaluation of their modification application. The majority of people rejected for modifications are rejected because they have failed to submit the complete set of documents required to evaluate their application.

Chase recognized early in the current crisis that customers facing financial stress managing their mortgage payments require special attention and dedication to their needs. We acknowledged the importance of enhancing customer access and service levels to help customers understand their foreclosure prevention options, either directly through Chase or through our partnerships with community leaders and non-profit credit counselors. Regardless of how the customer chooses to engage with Chase for homeownership assistance our commitment is to do everything in our power to assist in a respectful and timely fashion as described in response to question 5 from Senator Brown.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY OF DIANE E. FROM THOMPSON

Q.1. Ms. Thompson, you conclude your testimony by calling for legislation or regulations to "reform the servicing industry, to allow for loan modifications in bankruptcy, and to address the tax consequences of loan modifications . . . " These actions would, according to you, "aid in protecting homeowners from indifferent and predatory servicing practices and reducing the foreclosure surge." When analyzing effects of alternative possible actions that would affect the mortgage and housing markets, you focus on protecting homeowners. Indeed, such a focus is welcome and warranted. There is also, of course, a need to consider effects of any action on securities holders, including retirement funds that help provide interest and other income to retirees who continue to struggle in the current zero-interest rate environment to live off of the assets they accumulated during their working years.

Ms. Thompson, could you discuss the economic, financial, and distributional analysis you have performed to arrive at the policy recommendations that you provide in your conclusion?

A.1. You correctly note that my analysis focuses on the homeowners. The interests of homeowners have been, in my view, almost entirely overlooked during the foreclosure crisis. This is particularly unfortunate since it is the failure to pay attention to those interests and reduce the foreclosure rate that has caused the economic recession.[1] Preserving homeownership, where economically appropriate, has a net positive benefit for the society at large and the unnecessary destruction of homeownership hurts the rest of us from an economic and financial perspective.

The impact of the foreclosure crisis has damaged the financial interests of many constituencies in this country, including securities holders. Aside from the indirect financial harm caused by the scale of the financial crisis—the weak economy, the slumping interest rates, the outright collapse of many securities—foreclosures hurt all homeowners in the communities in which they occur. Violent crime increases in neighborhoods with increased foreclosures—at

[1] *See, e.g.,* Ben S. Bernanke, Chairman, Board 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) [hereinafter Bernanke, Speech at Federal Reserve], available at *http://www.federalreserve.gov/newsevents/speech/bernanke20081204a.htm* ("Despite goodfaith efforts by both the private and public sectors, the foreclosure rate remains too high, with adverse consequences for both those directly involved and for the broader economy.").

twice the rate of the increase in the foreclosure rate.[2] Surrounding neighbors watch their housing values plummet and their insurance costs increase.[3] The losses to communities in taxes are staggeringly high, amounting to millions to billions of dollars in lost taxes.[4] For securities holders who own homes, or pay taxes, or live in neighborhoods with increasing crime, their interests are not distinct from those of homeowners subject to foreclosure.

Retirees are themselves often homeowners,[5] and all too often subject to abusive lending and foreclosure.[6] For many retirees, their home is their largest asset—of far more importance to their financial (not to mention psychological and social) well-being than their pension funds invested in derivatives. The interests of retirees, as a class, are not substantially different from the interests of homeowners, as a class.

Retirees, like all securities holders, have watched servicers strip wealth from them by piling on unnecessary and excessive fees in foreclosure.[7] The servicer can either collect these fees from the homeowner—reducing the likelihood of a successful modification—or collect them from monies otherwise payable to the trust upon the conclusion of a foreclosure. Either path leaves securities hold-

[2] Dan Immergluck & Geoff Smith, *The Impact of Single-Family Mortgage Foreclosures on Neighborhood Crime,* 21 Housing Studies 851 (2006), *available at www.prism.gatech.edu/~di17/housingstudies.doc* (calculating that for every 1 percent increase in the foreclosure rate in a census tract there is a corresponding 2 percent increase in the violent crime rate).

[3] *See, e.g.,* Ctr. for Responsible Lending, Soaring Spillover: Accelerating Foreclosures to Cost Neighbors $502 Billion in 2009 Alone; 69.5 Million Homes Lose $7,200 on Average (2009), *available at www.responsiblelending.org/mortgage-lending/research-analysis/soaringspillover-acceleratingforeclosures-to-cost-neighbors-436-billion-in-2009-alone-73-4-millionhomes-lose-5-900-onaverage.html* (estimating losses to neighboring property values due to the foreclosure crisis at $1.86 trillion dollars); John P. Harding, Eric Rosenblatt, Vincent W. Yao, *The Contagion Effect of Foreclosed Properties,* J. of Urban Econ. (forthcoming), *available at http://papers.ssrn.com/sol3/papers.cfm?abstract__id=1160354* (finding a 1.2 percent drop in market value for each additional neighboring home in foreclosure; effect drops to 0.6 percent if property in foreclosure is one-eighth of a mile away); 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).

[4] *See, e.g.,* Staff of the Joint 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 2b94d398d27&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 Apgar & Mark Duda, Collateral Damage: The Municipal Impact of Today's Mortgage Foreclosure Boom, at 4 (May 11, 2005), *available at www.hpfonline.org/PDF/Apgar-Duda__Study__Final.pdf* (estimating costs to the city of Chicago per foreclosure upwards of $30,000 for some vacant properties).

[5] U.S. Census Bureau, Housing Vacancies and Homeownership T 17 (2009), *available at http://www.census.gov/hhes/www/housing/hvs/annual09/ann09ind.html* (reporting that the 2009 homeownership rates for Americans 65 and over was 80.5 percent).

[6] AARP Public Pol'y Inst., A First Look at Older Americans and the Mortgage Crisis 5 (2008), *http://assets.aarp.org/rgcenter/econ/i9__mortgage.pdf.* Cf. Ellen E. Schulz & Theo Francis, *High-Interest Lenders Tap Elderly, Disabled,* Wall St. J., Feb. 12, 2008 (reporting that payday lenders concentrate their outlets around subsidized elder housing).

[7] *See, e.g.,* Jody Shenn, *Mortgage Investors with $500 Billion Urge End of Practices, Lawyer Says,* Bloomberg News, July 23, 2010, *http://www.bloomberg.com/news/2010-07-23/mortgage-investors-with-500-billion-urge-end-of-practices-lawyer-says.html* (reporting on letters sent to trustees of mortgage pools on behalf of a majority of the investors in the pool); Complaint, Carrington Asset Holding Co., L.L.C. v. American Home Mortgage Servicing, Inc., No. FST–CV 09–5012095–S (Conn. Super. Ct., Stamford Feb. 9, 2009) (complaint alleges that servicer's practices regarding fees and post-foreclosure sales were costly to investors); Ass'n of Mortg. Investors Press Release, AMI Supports Long Term, Effective, Sustainable Solutions to Avert Foreclosure; Invites Bank Servicers to Join, Nov. 16, 2010 (citing servicers' profit from fees and payments from affiliates as an impediment to loan modifications that would be in the interests of investors); Letter from Kathy D. Patrick to Countrywide Home Loans Servicing, Oct. 18, 2010 (notifying a trust and master servicer of breaches in the master servicer's performance).

ers poorer. Servicing reform benefits all stakeholders in the system-except, of course, to the extent that servicing reform prevents servicers themselves from profiting at the expense of both homeowners and securities holders. Our specific proposals focus on providing a net benefit to investors as well as homeowners. You cite three proposals: reform of the servicing industry, allowing loan modifications in bankruptcy, and addressing tax consequences for homeowners. Our recommendations include requiring servicers to modify loans where doing so would provide a net benefit to the investor. There is considerable evidence that servicers fail to modify loans, even when the investor would benefit from a modification. Investors, including pension funds, lose dramatically when servicers fail to modify loans and foreclose instead. The foreclosure will in many cases cutoff the flow of payments to the ultimate beneficiaries of the trust, who are often, as you note, retirees, dependent on that income to maintain a comfortable standard of living. Available data suggests that those retirees and other investors are losing, on average, over $145,000 per foreclosure.[8] They would do much better if more loan modifications were made.

Servicers' fee-gouging hurts securities holders. Fees come off the top in a foreclosure: servicers get paid before the investors do.[9] When times are good, and equity in homes is increasing, securities holders can afford to ignore fees. Indeed, until recently, the impact of servicers' fee-skimming was largely invisible to investors.[10] But with one in four homes underwater,[11] and foreclosures at an all time high, the cost of those fees is reducing investors' profits.[12]

[8] *See* Alan M. White, Sept. 26, 2010 Columbia Collateral File Summary Statistics, *http://www.valpo.edu/law/faculty/awhite/data/sep10__summary.pdf.*

[9] *See, e.g.,* Prospectus Supplement, Chase Funding Loan Acquisition Trust, Mortgage Loan Asset-Backed Certificates, Series 2004–AQ1, at 34, (June 24, 2004), *available at http://www.sec.gov/Archives/edgar/data/825309/000095011604003012/four24b5.txt* ("[T]he servicer will be entitled to deduct from related liquidation proceeds all expenses reasonably incurred in attempting to recover amounts due on defaulted loans and not yet repaid, including payments to senior lienholders, legal fees and costs of legal action, real estate taxes and maintenance and preservation expenses."); Prospectus, CWALT, INC., Depositor, Countrywide Home Loans, Seller, Countrywide Home Loans Servicing L.P., Master Servicer, Alternative Loan Trust 2005–J12, Issuer 56 (Oct. 25, 2005) ("In addition, generally the master servicer or a subservicer will retain all prepayment charges, assumption fees and late payment charges, to the extent collected from mortgagors); Prospectus Supplement, IndyMac, MBS, Depositor, IndyMac INDX Mortgage Loan Trust 2007–FLX5, at S–73 (June 27, 2007):

Default Management Services

In connection with the servicing of defaulted Mortgage Loans, the Servicer may perform certain default management and other similar services (including, but not limited to, appraisal services) and may act as a broker in the sale of mortgaged properties related to those Mortgage Loans. The Servicer will be entitled to reasonable compensation for providing those services, in addition to the servicing compensation described in this prospectus supplement.

Letter from Kathy D. Patrick to Countrywide Home Loans Servicing, Oct. 18, 2010 (notifying a trust and master servicer of breaches in the master servicer's performance).

[10] *E.g.,* Peter S. Goodman, *Lucrative Fees May Deter Efforts to Alter Troubled Loans,* N.Y. Times, July 30, 2009.

[11] First American Core Logic Negative Equity Report Q22010, *available at http://www.corelogic.com/uploadedFiles/Pages/About__Us/ResearchTrends/CL__Q2__2010__Negative__Equity__FINAL.pdf.*

[12] *See, e.g.,* Jody Shenn, *Mortgage Investors with $500 Billion Urge End of Practices, Lawyer Says,* Bloomberg News, July 23, 2010, *http://www.bloomberg.com/news/2010-07-23/mortgage-investors-with-500-billion-urge-end-of-practices-lawyer-says.html* (reporting on letters sent to trustees of mortgage pools on behalf of a majority of the investors in the pool); Complaint, Carrington Asset Holding Co., L.L.C. v. American Home Mortgage Servicing, Inc., No. FST–CV 09–5012095–S (Conn. Super. Ct., Stamford Feb. 9, 2009) (complaint alleges that servicer's practices regarding fees and post-foreclosure sales were costly to investors); Ass'n of Mortg. Investors Press Release, AMI Supports Long Term, Effective, Sustainable Solutions to Avert Foreclosure; Invites Bank Servicers to Join, Nov. 16, 2010 (citing servicers' profit from fees and payments from affiliates as an impediment to loan modifications that would be in the interests of inves-

Continued

The reforms we propose are either directly beneficial or neutral for securities holders, in addition to the important positive impacts these reforms would have in stabilizing the housing market and the larger economy.

Comprehensive servicing reform has two primary components: requiring servicers to offer homeowners a modification where the modification would provide a net benefit to the securities holders and limiting fees to those both reasonable and necessary. Securities holders, as much as homeowners, stand to benefit from both those reforms.

Currently, there is only one type of lien that bankruptcy judges can never modify in any way: first liens on single-family principal residences. Loans on vacation homes, boats, cars, and corporate collateral can be modified. Even junior liens on single-family principal residences can be modified if they are wholly underwater, as many are today. By contrast, first liens on principal residences cannot be reduced to the value of the security interest and the interest rate cannot be changed. Securities holders, however, have not suffered larger losses from the modification of these other secured loans than they have from the foreclosure of home loans: it is the large losses on home loans that have driven the current economic crisis.

Judicial modification of secured liens often provides creditors (and any ultimate securities holders) with a better return than foreclosure. Creditors do not have to absorb the same losses in bankruptcy as they do with a forced foreclosure sale, with its below market price and out-of-pocket expenses. If bankruptcy courts were permitted to modify first-lien loans on primary residences by reducing the secured balance to the value of the property, securities holders would not be saddled with losses as a result of below market prices and mortgage servicers' foreclosure costs. Instead, securities holders, who are suffering catastrophic losses now, would receive a stable flow of income from borrowers able to make ongoing payments on the reduced principal balance. Significantly, judicial modification in bankruptcy is limited to reducing the loan to the actual current value of the home; moreover, bankruptcy judges also have long experience balancing the claims of competing creditors to maximize returns to creditors. Losses to security holders, borrowers, and communities would likely be lower if bankruptcy judges had the power to modify residential home loans.

Addressing the tax consequences of loan modifications is unlikely to have any significant impact on securities holders or on the fisc. Few lay people believe that a reduction in the value of a loan to its fair market value is taxable income; indeed, existing exceptions to the general rule that any reduction in the value of a loan is taxable income mean that homeowners who have access to a competent tax attorney or CPA are likely to be able to exclude that imputed value from income, but these exceptions, and the reporting forms are sufficiently complicated that unrepresented homeowners are unlikely to be able to avail themselves of the exception. The

tors); Letter from Kathy D. Patrick to Countrywide Home Loans Servicing, Oct. 18, 2010 (notifying a trust and master servicer of breaches in the master servicer's performance).

National Taxpayer Advocate has repeatedly identified the treatment of cancellation of debt income as a serious problem.[13]

The proposals outlined in my November testimony are designed to align the interests of the servicers with those of investors and society at large, so that modifications will be made when doing so provides a net benefit. In this distributional analysis, it is only the servicers who lose. Servicers have made more money per loan in the recent times, precisely while securities holders are suffering steep losses from foreclosures.[14] The servicers, when loan modifications that produce a net benefit to the investor are required before foreclosure, when servicing reform limits their ability to strip equity by piling on fees, and when bankruptcy judges have the power to force modifications that leave securities holders better off, will have to find a different business model. Instead of using default fees to cushion the cost of default, they will have to learn to make modifications and save money for both investors and homeowners. This is not an impossible goal: indeed, specialty servicers have long proclaimed their ability to make money by doing modifications.[15] Servicers should not be allowed to strip wealth from both securities holders and homeowners but should be required to provide service to both groups in exchange for their substantial fees.

Q.2. Given the varying State laws that govern foreclosure, there must be the opportunity to observe both best and worst practices. While foreclosures are not the preferred option for any party at the onset of a loan, sometimes it is the path forward that presents the least harm to borrowers, lenders and the economy. In those instances, it is essential that our foreclosure process be effective.

Which States do each of you feel provide the most efficient path forward in foreclosures, while providing borrowers proper legal channels in the event that there is a dispute? What is the average length of time between original delinquency and foreclosure sale in these States?

Which States do each of you feel have the most problems in effectively executing foreclosures? What is the average length of time between original delinquency and foreclosure sale in these States?

A.2. The answer to this question depends a great deal on how one defines the appropriate goal for an effective foreclosure law. Speed is one goal; reducing losses to investors is another. A third is providing a fair and transparent process, to ensure that homeowners are not wrongfully deprived of their home. Speed by itself, as you suggest in the question, cannot be the ultimate measure of the effectiveness and efficiency of the foreclosure process in any State. Rather, the focus in most cases should be on providing a fair process for homeowners and reducing losses to investors.

We should remember that it is not so much the State laws that make the foreclosure process efficient or effective as servicers' compliance with those laws. Frequently, servicers are guilty of failing to process a foreclosure efficiently. When servicers fail to comply with long standing requirements for affidavit execution or notice to

[13] *See, e.g.,* 2007 Nat'l Taxpayer Advocate Report to Congress 13–33, *available at http://www.irs.gov/pub/irs-utl/arc_2007_vol_1_cover_msps.pdf.*

[14] *Servicers Earn More Per Loan, MortgageDailyNews.com,* June 29, 2010.

[15] *See, e.g.,* Press Release, Paul A. Koches, Ocwen Fin. Corp. 2 (Feb. 25, 2010).

borrowers, their procedures are neither effective nor efficient, as they call into jeopardy the successful completion of a foreclosure and often result in unnecessary and costly litigation. As discussed in my testimony, and in response to Senator Brown's questions, servicers have significant incentives to process foreclosures inefficiently and often do so. That is not the fault of the laws (although it may reflect weak enforcement); it is the fault of the servicers. The effectiveness or lack thereof cannot be judged by the complications created by servicers' willful noncompliance.

NCLC is generally supportive of strengthening weak and ineffective State foreclosure laws; we do not believe that a Federal foreclosure process would be appropriate. The foreclosure process has historically been part of State real property law and should remain so. Necessary servicing reform can be conducted at the Federal level without undermining States' rights in this area traditionally regulated by the States. Greater detail on these questions can be found in a recent study co-authored by my NCLC colleagues John Rao and Geoff Walsh.[16]

Protections for Homeowners: The foreclosure process in the United States falls into roughly two categories: the traditional, judicial foreclosure process, which has required courts since colonial times to supervise foreclosure proceedings and prevent unjust results and a comparatively recent "non-judicial" process, which allows lenders to foreclose without court involvement. Slightly less than one-half of the States mandate court supervision over residential mortgage foreclosures.[17] In the remaining States, foreclosure sales may proceed without any oversight by a court or neutral third party. In non-judicial foreclosures, homeowners with valid complaints about their treatment by a lender or mortgage servicer must hire an attorney to prepare a cumbersome and expensive lawsuit in order to stop an imminent foreclosure. In some States, they may even be required to post bond in the amount of the mortgage loan before the homeowner's challenge to the foreclosure can be heard in court. The direct and inexpensive access to the courts, as occurs now in the many States requiring judicial foreclosure, is essential to an effective foreclosure system—one that protects the rights and interests of all parties.

State laws work best to prevent avoidable foreclosures when they include concrete options for the homeowner to terminate a foreclosure proceeding prior to a sale. For example, several State laws provide for a borrower's right to "cure" a mortgage default before the mortgage holder may accelerate the loan and begin foreclosure proceedings. Before taking any action to foreclose, the mortgage holder must give the borrower a clear notice of the amount due and time within which to pay. This legal requirement promotes resolution of potential foreclosures before either party incurs any costs. Approximately 15 States now provide for this type of pre-accelera-

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[16] John Rao & Geoff Walsh, Nat'l Consumer L. Ctr., Foreclosing a Dream: State Laws Deprive Homeowners of Basic Protections (2009), *http://www.nclc.org/images/pdf/foreclosure_mortgage/state_laws/foreclosing-dreamreport.pdf.*

[17] *See* National Consumer Law Center, *Foreclosing a Dream: State Laws Deprive Homeowners of Basic protections* February 2009, *available at http://www.nclc.org/images/pdf/foreclosure_mortgage/state_laws/foreclosing-dream-report.pdf.* This report contains State-by-State summaries of the States' foreclosure laws, highlighting features related to court access and oversight of loss mitigation actions.

tion notice of right to cure, with Massachusetts, New Jersey, New York, and Maryland having recently added clear statutory notice of right to cure provisions to their foreclosure laws.[18]

Twenty-two States provide for a right to cure an arrearage, pay costs and fees incurred, and reinstate the loan after commencement of foreclosure proceedings and up until the time of a foreclosure sale.[19] When borrowers have clear notice of a right to reinstate, it is more likely that they will avail themselves of this opportunity. They will avoid foreclosure by restoring the loan to its original contract terms. In these post-acceleration reinstatements the mortgage holder ultimately suffers no loss because the borrower must reimburse foreclosure costs.

In approximately half the States borrowers have some form of post-sale redemption right that allows them to pay the sale price plus costs and set the foreclosure sale aside.[20] The post-sale redemption periods range from 60 days (North Dakota) to 1 year (Iowa, Kansas, Kentucky, Alabama, and Montana). In some States redemption rights and timeframes vary according to factors such as extent of the borrower's equity in the property or whether a third party purchased at the sale.

Reducing Losses to Investors: Investors lose enormous sums of money in foreclosure, $2.7 billion from foreclosure sales in the month of September 2010 alone.[21] For that month the average loss per foreclosed property was $145,636, representing a loss of over 58 percent of the original principal per loan.[22] Loan modifications substantially reduce these losses. For example, when mortgages were modified to forgive a portion of loan principal during September 2010, the recognized loss per loan averaged about 20 percent of the typical loan balance.[23] Loans modified under the HAMP program, for example, show low redefault rates, less than half those of other loan modifications made at the same time, even though the HAMP modifications typically do not provide for principal reductions and only a temporary below-market interest rate reduction.[24] These and similar modifications targeting borrower affordability provide investors with a steady stream of payments on the original loan principal. A foreclosure law that best facilitates sustainable loan modifications instead of foreclosures should be considered most "effective" in minimizing investor losses.

State laws can set a requirement that mortgage holders consider loss mitigation options, including a loan modification, before a foreclosure sale will be allowed. For example, the South Carolina Supreme Court issued an administrative order in May 2009 requiring that all foreclosure complaints filed in the State describe how a servicer complied with any obligation it had to modify a loan under

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[18] National Consumer Law Center, *Foreclosing a Dream: State Laws Deprive Homeowners of Basic protections* February 2009, *supra* ____.

[19] *Id.*

[20] *Id.*

[21] Alan M. White, September 26, 2010 Columbia Collateral File Summary Statistics, Valparaiso University School of Law, *available at http://www.valpo.edu/law/faculty/awhite/data/sep10__summary.pdf.*

[22] *Id.*

[23] *Id.*

[24] Congressional Oversight Panel December 2010 Oversight Report, A Review of Treasury's Foreclosure Prevention Programs 34.; OCC/OTS Mortgage Metrics Report, Third Quarter 2010 at 37 (reporting a redefault rate on HAMP modifications after 6 months of 10.6 percent).

the HAMP program.[25] The Connecticut courts approved a similar order that went into effect in September 2010.[26] In several judicial foreclosure States, including New York, Maine, Vermont, and Connecticut, legislatures have recently enacted statutes requiring mediation or supervised conferences in foreclosure cases.[27] The goal of these sessions is to bring representatives of mortgage servicers and the borrowers together to consider loss mitigation options that mutually benefit all parties. Court-initiated programs in Ohio, Florida, Pennsylvania, Kentucky, New Mexico, New Jersey, Indiana, and Delaware are now offering similar mediation and conference programs.[28] Particularly where these programs involve use of net present value tests to examine the relative benefit to investors of an affordable loan modification as opposed to foreclosure, the sessions can provide a quick and effective means to determine whether foreclosures make economic sense for investors under accepted industry standards.[29]

Recently, several State legislatures have incorporated mediation and conference requirements into non-judicial foreclosure procedures. For example, in Nevada, a traditionally non-judicial foreclosure State, the courts now supervise a statewide mediation program. In Maryland, homeowners may request hearings before a State agency to review the servicer's loss mitigation activities. Parties to a foreclosure in Maryland may also appeal conference decisions to the courts. The District of Columbia, another non-judicial foreclosure jurisdiction, recently enacted a foreclosure mediation law that will go into effect in early 2011.

Time Frames: Both Fannie Mae and HUD (on behalf of FHA) publish guidelines for what they consider to be the reasonable timeframes from the initiation of a foreclosure to a sale in each of the 50 States.[30] The expected time to foreclosure varies depending on State law and court procedures. Fannie Mae and HUD use these guidelines to assess performance of attorneys who are paid to conduct foreclosures of FHA insured and Fannie Mae owned and guaranteed loans. The guidelines show wide variations in foreclosure timeframes from State to State. For example, HUD lists three non-judicial foreclosure States (Missouri, Rhode Island, and Texas) with timeframes of 3 months from the commencement of foreclosure to sale. Nine non-judicial States have 4-month timeframes.[31] On the other hand, HUD's permissible timeframes in judicial foreclosures States typically run 10 months and longer.[32] Actual times to fore-

[25] South Carolina Supreme Court Administrative Order 2009–05–22–01 (May 22, 2009) at *http://www.judicial.state.sc.us/courtOrders/displayOrder.cfm?orderNo=2009–05–22–01.*

[26] State of Connecticut Superior Court Mortgage Foreclosure Standing Order Federal Loss Mitigation Programs, JD–CV–117 Rev 8/10 (August 18, 2010) *available at http://www.jud2.ct.gov/webforms/forms/CV117.pdf.*

[27] Links to the texts of these statutes can be found at the National Consumer Law Center Web site: *http://www.nclc.org/issues/foreclosure-mediation-programs-by-state.html.*

[28] Links to the court Web sites describing these programs are available on the same NCLC Web page, *http://www.nclc.org/issues/foreclosure-mediation-programs-by-state.html.*

[29] The foreclosure mediation programs in effect in Maine and Vermont require use of these net present value tests.

[30] Fannie Mae Servicing Guide (2010 version) Part VIII, sec. 104.05, Allowable Time Frames for Completing Foreclosure, *https://www.efanniemae.com/sf/guides/ssg/annltrs/pdf/2010/svc1012.pdf* and HUD Mortgagee Letter 2005–30 (July 12, 2005) with attachments, *http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/2005ml.cfm.*

[31] Alabama, Arizona, Georgia, Mississippi, New Hampshire, Tennessee, and Virginia.

[32] *E.g.* 17 months (Iowa), 14 months (New Jersey, Vermont), 13 months (New York), 12 months (Illinois, Maine, Ohio, Wisconsin), 10 months (Indiana, Pennsylvania, South Dakota).

closure can vary wildly, depending on how aggressive and competently a servicer handles a foreclosure, ranging in the same State from 30 days to years to complete a foreclosure.

Vagaries in the reporting of these timeframes exaggerates the discrepancy between non-judicial and judicial foreclosure States. The clock starts to run at a different point in time for judicial and non-judicial foreclosures. In non-judicial foreclosures the initial action is typically the publication of a notice of sale or the recording of a notice of default. In judicial foreclosures it is usually the filing of a foreclosure complaint in a court. But neither point in time measures how long it has been from default to the initiation of foreclosure. In many cases, the servicers will wait at least 3 months after the initial default before commencing a foreclosure, either because of contract limitations in the mortgage, or because of loss mitigation requirements imposed on Government-insured loans and some loans insured with private mortgage insurance, or because of custom.[33] Post-sale redemption periods in some non-judicial foreclosure States (Michigan, Alabama, Minnesota Missouri and Wyoming) can extend the process beyond the Fannie Mae numbers in periods lasting from 3 months to 1 year. The time to completed foreclosures in these non-judicial foreclosure States is actually more in line with those of judicial foreclosure States.

Debates over changes to State foreclosure laws often focus on the relative speed of different foreclosure procedures. Some industry representatives suggest that longer foreclosure timeframes harm consumers because lenders must raise the cost of credit on a State-by-State basis in response to lengthening of foreclosure timeframes. There is little empirical evidence indicating that this actually happens.[34]

On the other hand, we now have analytical tools that allow us to see how the costs of foreclosure compare to the costs of various alternatives to foreclosure. We can easily quantify the cost to investors in interest lost during the 5 months additional time that a judicial foreclosure may take in comparison to a non-judicial foreclosure. However this short term incremental cost pales in relation to the overall loss of $145,000 that investors incur in the typical foreclosure today. Foreclosure laws that allow for full consideration of loss mitigation can drastically reduce that loss. In today's housing crisis, an analysis of State foreclosure laws that focuses on length of foreclosure time is dangerously outdated. An effective foreclosure system must provide a framework within which an evaluation of the true costs of foreclosure takes place in a timely and transparent manner.

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[33] 24 C.F.R. 203.355(a).

[34] One study by a Federal Reserve Board economist offered some limited data on this subject. Karen M. Pence, *Foreclosing on Opportunity: State Laws and Mortgage Credit,* 88 Review of Economics and Statistics 177 (February 2006). The author looked for variances in home mortgage credit terms in States with judicial and non-judicial foreclosure laws. The study concluded that borrowers in judicial foreclosure States tended to receive marginally smaller loan amounts than those in non-judicial foreclosure States, but found no significant disparities in loan terms such as interest rates. The report could not conclude that borrowers in judicial States were necessarily worse off than borrowers in non-judicial States. According to the report, "homeownership might even increase if the judicial protections help borrowers remain in their homes." The Report noted that further study was needed to assess the balance between any minor negative effects on credit terms and the benefits that heightened homeowner protections create for a housing market.

States with Relatively Effective and Efficient Foreclosure Laws: The foreclosure laws in New York and Maine include: (1) judicial supervision over entry of judgments and sales; (2) clear pre-foreclosure notices to borrowers advising them of their rights in a potential foreclosure, including a right to cure before commencement of proceedings and during proceedings; (3) timely referrals to counseling resources; and (4) an opportunity for conferences or mediations supervised by neutral third parties who can enforce good faith participation by the borrower, mortgage holder, and servicer. The laws in Connecticut and Vermont similarly encourage efficient review of loss mitigation options.

Because the State laws in New York, Maine, Connecticut, and Vermont require court orders to schedule and approve sales, and allow time periods to negotiate and cure defaults, the foreclosure timelines from initiation of foreclosure to sale in these States are longer than in most other States and run from 9 months to slightly over a year.[35]

States with Relatively Ineffective and Inefficient Foreclosure Laws: Several non-judicial foreclosure States, including Georgia, Tennessee, Rhode Island, Virginia, and Missouri combine ineffective notice and cure rights, no judicial oversight, and a timeframe that gives few homeowners a practical opportunity to participate actively in the foreclosure process.

The timelines in Georgia, Tennessee, Rhode Island, Virginia, and Missouri are shorter, running about 4 months.[36]

Q.3. To better gauge the level of violations surrounding the topic of this hearing it is necessary for us to understand who is being affected. Admittedly, this question is probably best suited for the regulators, and we hope to receive this information from them at some point.

In your research and investigations, how many individuals were discovered to have been fully current on their mortgage payments but foreclosed upon by their servicer? Please provide the data and evidence that you evaluated to arrive at your conclusions.

A.3. Of course, I am not primarily a researcher, nor do I have access to the servicers' proprietary databases or an ability to conduct a comprehensive review of their loan files. While I did provide examples where the servicer wrongfully initiated foreclosure in my written testimony, including five homeowners who were foreclosed upon while negotiating a loan modification and making payments as instructed by the servicer, two homeowners who were placed into foreclosure solely because of the servicers' improper imposition of fees, three homeowners who were foreclosed upon although they were current in their required payments, and three cases where the servicer initiated foreclosure proceedings in the name of the wrong owner of the loan, these examples were illustrative and not

[35] FHA's "reasonable diligence" timelines for these States are: Vermont (14 months); New York (13 months); Maine (12 months); Connecticut (9 months). Vermont, Maine, and Connecticut provide for a redemption period between entry of judgment and sale. These redemption periods are included in the timelines.

[36] FHA's "reasonable diligence" timelines for these States are: Georgia (4 months); Tennessee (4 months); Rhode island (3 months); Virginia (4 months); Missouri (3 months). In cases in which the mortgage holder purchases the property at the sale, Missouri permits a 1-year redemption period for a borrower who makes an appropriate request within 10 days of sale and posts a bond.

exhaustive. As you note, regulators with supervisory authority are better positioned to review the millions of foreclosure filings than I. As we recommend in our testimony, it is essential that the regulators begin random sampling of servicers' files to determine the extent of the problem we are facing.

In an attempt to quantify the extent of the problem, absent the hard data only careful supervisory exams are likely to provide, the National Association of Consumer Advocates, in conjunction with NCLC, conducted a survey of attorneys representing homeowners in foreclosure. The 96 attorneys from 34 States reported representing over 1,200 homeowners who had been placed into foreclosure by a servicer when they were current on their payments. Those attorneys reported representing an additional 1,800 homeowners who had been placed into foreclosure by the servicer despite making payments as agreed under a plan.

More importantly, this is not a question easily answered. By the time homeowners seek legal counsel, they have usually spent several months attempting to resolve their dispute with the servicer on their own, and sorting out the payment history is cumbersome and often uncertain. There are frequently divergences between the servicer's records and the homeowner's, and reconciling those records can take months, in my experience. Several courts have noted that the gross inaccuracies pervading servicers' records often make it impossible to determine whether a homeowner is in default and the extent of any default.[37]

There is also the difference between the homeowner's status at the time the servicer declares default and the time a foreclosure is formally filed. There is usually a lag of several months between the servicer's declaring default and the filing of a foreclosure in a judicial foreclosure State; a homeowner who was current at the time of the declaration of default is unlikely to be current when the foreclosure is filed (the servicer will ordinarily refuse payments in that circumstance, or homeowners may give up making payments, assuming that they will lose the home).

Moreover, whether homeowners are current on their payments or not may depend on whether the servicer accepted the homeowner's payments, whether the servicer instructed the homeowner to stop making payments, whether the servicer properly applied the homeowner's payments, whether the servicer charged improper fees or forceplaced insurance. An analysis that only looks to the servicers' records as to the homeowners' status at the time of foreclosure is likely to miss most if not all of these cases where the homeowner was, by any sensible measure, current in the payments at the time the servicer initiated foreclosure. In my experience representing homeowners, it is not uncommon for servicers to initiate foreclosure where the homeowner has a good faith basis to dispute the servicer's accounting. Furthermore, problems in servicing cannot easily be disentangled from problems in origination: borrowers may fail to make payments because they were told not to, told that the amount owed was a different amount, or borrowers may make pay-

[37] *See, e.g.,* Schlosser v. Fairbanks Capital Corp., 323 F.3d 534 (7th Cir. 2003); Maxwell v. Fairbanks Capital Corp. (*In re* Maxwell), 281 B.R. 101 (Bankr. D. Mass. 2002); Chu v. Green Point Sav. Bank, 628 N.Y.S. 2d 527 (2nd App. Dist. 1995) (finding servicers' conduct in foreclosing "frivolous" and imposing sanctions).

ments to the wrong entity.[38] Fundamentally, if a loan modification would save the investors money, and the borrower qualifies for a loan modification, a servicer who initiates a foreclosure is acting wrongfully, in violation of their fiduciary obligations to the securities holders, in breach of the mortgage contract with the borrower, which requires good faith and fair dealing, and, often, in blatant disregard of regulatory guidance and HAMP Servicer Participation Agreements.

There continue to be press accounts—unrelated to either my testimony or the survey—documenting baseless foreclosures. Press reports from around the country have documented cases where servicers have initiated foreclosure, even though the homeowner was current in payments.[39] In some instances, servicers have foreclosed on mortgages that the homeowner had already paid off in full.[40] In other cases, servicers have foreclosed on the wrong home.[41] A recent story in The New York Times reports on four separate cases where the servicer completed a foreclosure illegally.[42] In one of those cases, the mortgage was paid off; in two of those cases, the homeowner was attempting to sort out the confusion following a loved one's death. Servicers will frequently refuse to accept payments from a spouse, partner, or child following a mortgagor's death, despite the fact that Federal law forbids servicers from exercising their due-on-sale clauses in this context[43] and despite the fact that ordinary human feeling—or good business judgment—would suggest allowing the grieving survivor to continue making payments without hassle.

Servicer abuses are widespread and unquestionably result in wrongful foreclosure. Determining the true extent of the problem will require careful, independent scrutiny of both servicers' and homeowners' records.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR BROWN FROM DIANE E. THOMPSON

Q.1. Please describe any barriers to mortgage modifications that servicers may encounter.

A.1. In general, the barriers servicers face to mortgage modifications have been overstated. The barriers servicers face are usually surmountable or of their own making.

Servicers often complain about staffing shortages. Staffing is certainly expensive for servicers, particularly default staffing, al-

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[38] *See, e.g.,* Karen Weise, ProPublica, *One "Nightmare" Mortgage: Problems from Origination through Foreclosure* Nov. 22, 2010, *http://www.propublica.org/article/one-nightmare-mortgage-problems-from-origination-through-foreclosure* (homeowner sent her payments to mortgage broker who failed to forward payments on).

[39] *See, e.g.,* George Gombossy, *Bank of America's Christmas Present: Foreclose Even Though Not a Missed Payment, ctwatchdog.com,* Dec. 24, 2010, *http://ctwatchdog.com/2010/12/24/bank-of-americas-christmas-present-foreclose-even-though-not-a-payment-missed;* Jon Yates, *Processing Mistake Leads to Erroneous Foreclosure,* Chi. Trib. Nov. 23, 2010.

[40] *See, e.g.,* Andrew Martin, *In Sign of Foreclosure Flaws, Suits Claim Break-Ins by Banks,* N.Y. Times, Dec. 22, 2010, at A1; Aldo Svaldi, *Foreclosure Paperwork Miscues Piling Up,* Denver Post, Nov. 14, 2010.

[41] *See, e.g.,* Harriet Johnson Brackey, *Lauderdale Man's Home Sold Out From Under Him in Foreclosure Mistake,* Sun Sentinel, Sept. 23, 2010; Tony Marrero, *Bank of America Forecloses on House that Couple Had Paid Cash For,* St. Petersburg Times, Feb. 12, 2010.

[42] Andrew Martin, *In Sign of Foreclosure Flaws, Suits Claim Break-Ins by Banks,* N.Y. Times, Dec. 22, 2010, at A1.

[43] 12 U.S.C. §1701j–3.

though servicers continue to have enviable margins in their servicing of the majority of loans that are performing.[1] By any reasonable measure though, servicers have sufficient staff to perform modifications.[2] Training and supervision of staff may be an issue, as may the implementation of procedures to perform loan modifications correctly, but those are questions about servicers' will to implement modifications, not their ability to do so.

Servicers often assert that investors prohibit modifications. As detailed in my written testimony, often those representations are entirely false. Most PSAs permit modifications of loans in default freely.[3] Where securitizations contain absolute bars to modifications, sponsors of those securitizations have successfully petitioned the trustee to amend the contract to allow modifications generally, so long as the loan is in default or at imminent risk of default.[4] Increasingly, groups representing investors call on servicers to perform more loan modifications, including principal reductions, and assert that servicers are failing to perform modifications, contrary to servicers' wishes.[5]

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[1] *See, e.g.,* Mortg. Servicing News, *Servicers' Collection Profits May Outweigh Cost of Defaults,* Dec. 28, 2010 (noting that while default servicing is expensive, servicing of performing loans is highly lucrative for large servicers, with the direct costs running perhaps $60 a year and the principal based mortgage servicing income paid by the trust running $450 a year on a midsized prime loan of $180,000).

[2] For example, in April of this year, Bank of America reported that it had over 15,000 people working in customer outreach. Jennifer Harmon, Am Banker, *B of A Deploys More Resources from Origination to Servicing,* Apr. 12, 2010. By October, Bank of America had fewer than 80,000 HAMP permanent modifications in place. Making Home Affordable Program, Servicer Performance Report Through Oct. 2010. That suggests that it is taking Bank of America more than two full work days to process a homeowner for a HAMP modification-a highly standardized application that requires little individual underwriting. Jack Guttentag, *New Plan to Jump-Start Loan Mods: Web Portal Would Centralize Communication, Break Logjam,* Inman News, July 20, 2009, *available at http://www.inman.com/buyerssellers/columnists/jackguttentag/new-plan-jump-start-loan-mods* (noting that it should take no more than an hour for a servicer to process a loan modification request; at that rate, Chase's 3500 loan modification counselors should be able to process at least 70,000 loan modifications a week-approximately the number of Making Home Affordable modifications that Chase has processed in the first 5 months of the HAMP program).

[3] John P. Hunt, Berkeley Ctr. for Law, Business, and the Economy, Loan Modification Restrictions in Subprime Securitization Pooling and Servicing Agreements from 2006: Final Results 2 (July 2010), *available at http://www.law.berkeley.edu/files/bclbe/Subprime__Securitization__Paper__John__Hunt__7.2010.pdf* (only 8 percent of subprime contracts reviewed barred modifications); John P. Hunt, Berkeley Ctr. for Law, Business, and the Economy, What Do Subprime Securitization Contracts Actually Say About Loan Modification: Preliminary Results and Implications 7 (Mar. 25, 2009), *available at http://www.law.berkeley.edu/files/bclbe/Subprime__Securitization__Contracts__3.25.09.pdf* (discussing various limitations and quantifying the frequency of limitations); *See* Manuel Adelino, Kristopher Gerardi, and Paul S. Willen, Fed. Reserve Bank of Boston, Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitizations 28 (Publicy Pol'y Paper No. 09–4, July 6, 2009), *available at http://www.bos.frb.org/economic/ppdp/2009/ppdp0904.pdf.* (summarizing several different studies finding no meaningful PSA restrictions in a majority of securitizations reviewed); Larry Cordell, Karen Dynan, Andreas Lehnert, Nellie Liang, & Eileen Mauskopf, Fed. Reserve Bd. Fin. & Econ. Discussion Series Div. Research & Statistical Affairs, The Incentives of Mortgage Servicers: Myths and Realities 22 (Working Paper No. 2008–46) (reporting that of 500 different PSAs under which a large servicer operated, 48 percent had no limitations on modifications other than that they maximize investor return; only 7.5 percent of the PSAs had meaningful limits on then types of modifications a servicer could authorize); Credit Suisse, The Day After Tomorrow: Payment Shock and Loan Modifications (2007), *available at http://www.creditsuisee.com/researchandanalytics* (finding that 65 percent of survey PSAs contain no meaningful restrictions on ability to modify loans); American Securitization Forum, Statement of Principles, Recommendations, and Guidelines for the Modification of Securitized Subprime Residential Mortgage Loans 2 (June 2007) ("Most subprime transactions authorize the servicer to modify loans that are either in default or for which default is either imminent or reasonably foreseeable.").

[4] *See, e.g.,* Morgan Stanley Omnibus Amendment (Aug. 23, 2007) (on file with author).

[5] Jody Shenn, *Mortgage Investors with $500 Billion Urge End of Practices, Lawyer Says,* Bloomberg News, July 23, 2010, *http://www.bloomberg.com/news/2010-07-23/mortgage-investors-with-500-billion-urge-end-of-practices-lawyer-says.html* (reporting on letters sent to trustees

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Servicers' delayed recovery of expenses in modifications may create a barrier to performing modifications. Servicers have two main expenses when a loan is in default: advances of principal and interest to the trust and payments to third parties for default services, such as property inspections. The requirement for advances usually continues until a foreclosure is completed, a loan modification is reached, or the servicer determines that there is no realistic prospect of recovering the advances from either the borrower or the collateral.[6] Financing these costs is one of servicers' biggest expenses.[7]

Modifications in general do not allow servicers to recover their costs as quickly as foreclosures do.[8] Servicers' advances are taken off the top, in full, at the post-foreclosure sale, before investors receive anything.[9] If advances of principal and interest payments remain beyond the sale value, servicers can usually collect them directly from the trust's bank account (or withhold them from payments to the trust).[10] In contrast, when there is a modification, servicers are usually limited to recovering their advances from the modified loan alone, after required payments to the trust, or, if the advances are deemed nonrecoverable, from only the principal payments on the other loans in the pool, not the interest payments.[11] As a result, servicers can face a delay of months to years in recouping their advances on a modification. Modifications involving principal reductions compound the problem: they lengthen the time to recover advances on any individual modified loan as well as on other modified loans, by reducing the amount of principal payments available for application to recovery of advances.[12] Limiting

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of mortgage pools on behalf of a majority of the investors in the pool); Ass'n of Mortg. Investors Press Release, AMI Supports Long Term, Effective, Sustainable Solutions to Avert Foreclosure; Invites Bank Servicers to Join, Nov. 16, 2010 (citing servicers' profit from fees and payments from affiliates as an impediment to loan modifications that would be in the interests of investors); Letter from Kathy D. Patrick to Countrywide Home Loans Servicing, Oct. 18, 2010 (notifying a trust and master servicer of breaches in the master servicer's performance).

[6] Brendan J. Keane, Moody's Investor Services, Structural Nuances in Residential MBS Transactions: Advances 3 (June 10, 1994).

[7] Ocwen Fin. Corp., Annual Report (Form 10–K) 5 (Mar. 12, 2009).; Mary Kelsch, Stephanie Whited, Karen Eissner, Vincent Arscott, Fitch Ratings, Impact of Financial Condition on U.S. Residential Mortgage Servicer Ratings 2 (2007).

[8] Wen Hsu, Christine Yan, Roelof Slump, FitchRatings, U.S. Residential Mortgage Servicer Advance Receivables Securitization Rating Criteria 4 (Sept. 10, 2009) (finding that modifications do not appear to accelerate the rate of recovery of advances, in part because of high rates of redefault).

[9] Larry Cordell, Karen Dynan, Andreas Lehnert, Nellie Liang, & Eileen Mauskopf, Fed. Reserve Bd. Fin. & Econ. Discussion Series Div. Research & Statistical Affairs, The Incentives of Mortgage Servicers: Myths and Realities 11 (Working Paper No. 2008–46); Ocwen Fin. Corp., Annual Report (Form 10–K) 4 (Mar. 17, 2008) (advances are "top of the waterfall" and get paid first); Wen Hsu, Christine Yan, Roelof Slump, FitchRatings, U.S. Residential Mortgage Servicer Advance Receivables Securitization Rating Criteria 1 (Sept. 10, 2009) (same); Prospectus Supplement, IndyMac, MBS, Depositor, IndyMac INDX Mortgage Loan Trust 2007–FLX5, at S–71 (June 27, 2007) (servicers repaid all advances when foreclosure is concluded).

[10] *See, e.g.,* Ocwen Fin. Corp., Annual Report (Form 10–K) 11 (Mar. 12, 2009) ("[I]n the majority of cases, advances in excess of loan proceeds may be recovered from pool level proceeds."); Prospectus Supplement, IndyMac, MBS, Depositor, IndyMac INDX Mortgage Loan Trust 2007–FLX5, at S–71 (June 27, 2007) (permitting principal and interest advances to be recovered from the trust's bank account); Prospectus, CWALT, INC., Depositor, Countrywide Home Loans, Seller, Countrywide Home Loans Servicing L.P., Master Servicer, Alternative Loan Trust 2005–J12, Issuer 47 (Oct. 25, 2005) (limiting right of reimbursement from trust account "to amounts received representing late recoveries of the payments for which the advances were made).

[11] Monica Perelmuter & Waqas Shaikh, Standard & Poor's, Criteria: Revised Guidelines for U.S. RMBS Loan Modification and Capitalization Reimbursement Amounts 3 (Oct. 11, 2007).

[12] *But see* Rod Dubitsky, Larry Yang, Stevan Stevanovic, Thomas Suer, Credit Suisse, Subprime Loan Modifications Update (2008) (discussing how some servicers exploited then existing imprecision in the accounting treatment of principal reduction modifications to use principal reduction modifications to halt interest advances).

recovery of servicer expenses when a modification is performed to the proceeds on that loan rather than allowing the servicer to recover more generally from the income on the pool as a whole, as is done in foreclosure, clearly biases servicers against meaningful modifications, particularly modifications with principal reduction or forbearance.

Moreover, since the significant financing costs associated with making advances cannot be recovered,[13] servicers are likely to push through a foreclosure quickly when the cost of financing advances is climbing, even at the expense of investors who might prefer a modification.[14]

The two-track system also impedes servicers' ability to perform modifications. Proceeding with a foreclosure before considering a loan modification results in high costs for both investors and homeowners. These costs—which accrue primarily to the benefit of the servicer—can make an affordable loan modification impossible. Moreover, the two track system, of proceeding simultaneously with foreclosures and loan modification negotiations, results in many "accidental" foreclosures, due to bureaucratic bungling by servicers,[15] as one department of the servicer fails to communicate with another, or papers are lost, or instructions are not conveyed to the foreclosure attorney. To some extent, the two-track system is still mandated by large investors and the FHFA. Ending the two-track system would facilitate servicers' ability to complete loan modifications.

Q.2. What systems should mortgage servicers implement to correct their mistakes and compensate the individual homeowners who have suffered through the actions of others?

A.2. We believe that servicers must take steps to redress harm caused consumers, ensure fair and effective processing going forward, and begin complying with existing standards.

Compliance. Compliance with existing rules and policies must come first. Any redress to harmed borrowers is undercut if servicers do not stop violating existing standards. We continue to hear examples of outright misrepresentations by all of the major servicers. Bank of America, for example, has continued to require

[13] Joseph R. Mason, Mortgage Loan Modification: Promises and Pitfalls 4 (Oct. 2007). A large subprime servicer noted in its 2007 annual report that although "the collectability of advances generally is not an issue, we do incur significant costs to finance those advances. We utilize both securitization, (*i.e.,* match funded liabilities) and revolving credit facilities to finance our advances. As a result, increased delinquencies result in increased interest expense." Ocwen Fin. Corp., Annual Report (Form 10–K) 18 (Mar. 17, 2008); *see also* Wen Hsu, Christine Yan, Roelof Slump, FitchRatings, U.S. Residential Mortgage Servicer Advance Receivables Securitization Rating Criteria 1 (Sept. 10, 2009) ("Servicer advance receivables are typically paid at the top of the cash-flow waterfall, and therefore, recovery is fairly certain. However, . . . there is risk in these transactions relating to the timing of the ultimate collection of recoveries.").

[14] *See* Complaint at 11–15,); Carrington Asset Holding Co., L.L.C. v. American Home Mortgage Servicing, Inc., No. FST–CV 09–5012095–S (Conn. Super. Ct., Stamford Feb. 9, 2009) (alleging that servicer conducted "fire sales" of foreclosed properties in order to avoid future advances and recover previously made advances); Kurt Eggert, *Limiting Abuse and Opportunism by Mortgage Servicers,* 15 Housing Pol'y Debate 753, 757 (2004) (reporting that servicers sometimes rush through a foreclosure without pursuing a modification or improperly foreclose in order to collect advances); Peter S. Goodman, *Lucrative Fees May Deter Efforts to Alter Troubled Loans,* N.Y. Times, July 30, 2009.

[15] For some descriptions of all too typical bureaucratic bungling by servicers, see Peter S. Goodman, *Paper Avalanche Buries Plan to Stem Foreclosures,* N.Y. Times, June 29, 2009, and Jack Guttentag, *New Plan to Jump-Start Loan Mods: Web Portal Would Centralize Communication, Break Logjam,* Inman News, July 20, 2009, *available at http://www.inman.com/buyers-sellers/columnists/jackguttentag/new-plan-jump-start-loan-mods.*

homeowners to sign waivers for its proprietary loan modification program, despite representations to the contrary. Chase has been sending out letters that implicitly discourage homeowners from applying for Pennsylvania's HEMAP program. Servicers must comply with both the letter and the spirit of the law.

Improved Processing. In addition to taking steps to comply with existing standards, servicers could implement the following systems to ease the process for homeowners going forward.

- End dual track. Stop the foreclosure process during modification applications (and modifications), even for people already in foreclosure at the time of application.
- Create a single point of contact for each homeowner, one with real decisionmaking authority and ability to follow through.
- Process modification applications in hours instead of months or years. Expedited review.
- Clear in-house escalations for homeowners who have been denied a modification or encountered difficulties in obtaining a modification.

Redress. Providing redress for homeowners harmed will not be easy and would require a significant commitment on the part of servicers. There are two basic categories of homeowners who have been harmed by servicers' malfeasance: 1) those who have lost their homes and 2) those who are still in their homes, but have been denied a loan modification, pushed into default, or merely had improper fees tacked onto their account. Addressing the former category, homeowners who lost their homes, is more complex than providing relief to those who have not yet lost their homes at a foreclosure sale.

For homeowners who have not yet lost their home in a foreclosure sale, servicers should institute a supervised, full review of every file marked in default. This review must include a review of the payment history, including the timing and application of payments and the validity of fees charged.

- Homeowners found not to be in default should be removed from foreclosure, corrections of credit reporting status must be provided to the credit bureaus, and accounts should be fully corrected.
- All pending foreclosures should be halted while this review takes place, and dual track processing must be stopped on all loans so that the modification review can be completed.
- Fees should be rolled back and limited to reasonable and necessary ones.
- Recalculation of principal balances should be done to account for improperly assessed fees or overcharged interest.

The servicers should also be required to undertake a review of all completed foreclosures. There are two large categories of cases for which servicers should attempt to make redress: first, cases where the foreclosure was executed on the wrong home or where the homeowner was not in default; and second, cases where the foreclosure was completed without completing the loan modification review process, providing a written denial to the homeowner, or failing to offer a qualifying homeowner an appropriate modification.

- If the home has not yet been sold to a bona fide third party, the servicer should offer to restore the mortgage, with a reduction of the principal balance to account for all assessed foreclosure fees, as well as any improper fees. If the borrower is in default, the servicer also should provide a reduction of the interest rate to the Freddie Mac Prime Weekly Rate, if that is lower. Such homeowners further should be evaluated for a deeper modification where the monthly payment would be greater than 31 percent of the homeowner's income. As part of those NPV positive modifications, servicers should be required to reduce the principal balance on the loan to the assessed value of the property that the servicer relied on in evaluating the loan for foreclosure originally. Servicers must further provide corrected credit reporting to the credit bureaus to mitigate the negative credit reporting.
- If the home has already been sold to a third party or if the homeowner no longer wishes to retain the home, the servicer should be required to refund to the homeowner all foreclosure fees assessed against the homeowner's account, plus the amount by which the valuation the servicer relied on exceeds the foreclosure sale price. Servicers must also take steps to repair the homeowner's credit in these situations.

No waiver of the homeowner's rights should be required.

If the homeowner who was subject to a wrongful foreclosure cannot be located, the servicer should be required to deposit the money that would otherwise be paid to the homeowner into a fund for legal services and housing counselors. Funding must be available to legal services lawyers to support foreclosure litigation, as well as counseling.

Q.3. What are the financial incentives encouraging mortgage servicers to foreclose on homeowners?

A.3. As detailed in my report, "Why Servicers Foreclose When They Should Modify,"[16] the balance of servicer incentives leans toward foreclosure over modification.

Staffing costs: Servicers encounter increased staffing costs that are not reimbursed when they modify. In contrast, the staffing costs of foreclosures, which are often lower than those for modifications, may be outsourced and charged back to the trust. Many of those foreclosure staffing needs are provided by affiliates or other organizations that provide financial compensation to the servicers in exchange for repeat business.[17]

[16] Diane E. Thompson, Why Servicers Foreclose When They Should Modify and Other Puzzles of Servicer Behavior: Servicer Compensation and its Consequences (Oct. 2009), *available at www.consumerlaw.org.*

[17] *See* Complaint ¶ 15, Fed'l Trade Comm'n v. Countrywide Home Loans, Inc., No. CV–10–4193 (C.D. Cal. Jun. 7, 2010), *available at http://www.ftc.gov/os/caselist/0823205/100607countrywidecmpt.pdf;* (alleging that Countrywide's "countercyclical diversification strategy" was built on its subsidiaries funneling the profits from marked-up default fees back to Countrywide); Peter S. Goodman, *Homeowners and Investors May Lose, But the Bank Wins,* N.Y. Times, July 30, 2009 (describing Bank of America's refusal to entertain three separate short sale offers during 2 years of non-payment while its affiliate continues to assess property inspection

Continued

Fees: Servicers get paid off the top in a foreclosure for any costs and expenses, before the investors get paid. But when a loan is modified, servicers can only collect their fees and expenses from the payments on that loan.

Servicers can charge homeowners and investors more fees in a foreclosure than in a modification. There are property preservation fees, REO sale costs, attorney fees, and title work, to name a few. For example, one servicer recently charged the account of a Maine homeowner $600 for cutting the grass, once. The servicer charged this "property preservation fee" multiple times over the course of a few months. The servicer tacked these fees onto a petition for deficiency judgment against the homeowner; had the homeowner not been able to force those fees to be waived, the servicer would likely have collected any unpaid amount from the trust, before the investors got paid. Additionally, HAMP and other loan modification programs may require waiver of late fees, which servicers are otherwise entitled to retain.[18]

Pressure from credit rating agencies to expedite foreclosures: Credit rating agencies rate servicers' performance on the speed to conduct a foreclosure.[19] Since servicers are dependent on the credit rating agencies for approval to enter into new mortgage servicing contracts and affordable financing, servicers have a strong financial incentive to push forward a foreclosure rather than allowing for the possibility of a loan modification.

Troubled debt restructuring rules: The troubled debt restructuring rules discourage servicers from performing permanent modifications, as well as more generally discouraging those modifications most likely to be successful-modifications that provide deep payment reductions and modifications before default. While the TDR accounting rules only apply to loans held in portfolio,[20] preserving the assets of the trust from the originators' creditors has required that servicers generally categorize modifications using the TDR rules.[21]

FAS 15 generally requires all permanent modifications occasioned by the "borrower's financial difficulties" to be treated as "troubled debt restructurings."[22] A TDR usually results in immediate loss recognition and, for loans held in portfolio, a cessation of

fees); Peter S. Goodman, *Lucrative Fees May Deter Efforts to Alter Troubled Loans, N.Y. Times,* July 30, 2009.

[18] *See* Home Affordable Modification Program, Supplemental Directive 09–01 (Apr. 6, 2009).

[19] Diane Pendley & Thomas Crowe, FitchRatings, U.S. RMBS Servicers' Loss Mitigation and Modification Efforts 11, 15 (May 26, 2009); *see also* Michael Guttierez, Michael S. Merriam, Richard Koch, Mark I. Goldberg, Standard & Poors, Structured Finance: Servicer Evaluations 15–16 (2004). The rating agencies do not set benchmarks for any of these, but expect servicers to develop timelines and standardized loss mitigation options for each loan product, with reference to the industry standards as developed by Fannie Mae and Freddie Mac.

[20] Fin. Accounting Standards Bd., Accounting by Creditors for Impairment of Loans, An Amendment of FASB Statement No. 5 and 15, Statement of Fin. Accounting Standards No. 114 (1993).

[21] FASB has recently altered the rules protecting the bankruptcy-remote status of the trust. Instead of qualifying as a Special Purpose Entity, all "variable interest entities" now must be reviewed to determine the extent to which the transferring entity maintains control and appropriate disclosures provided. This is unlikely to impact the weight of the TDR rules directly, but it does change the formal mechanism by which bankruptcy-remote status is achieved and evaluated. *See* Transfers of Financial Assets, An Amendment to FASB Statement No. 140, Statement of Fin. Accounting Standards No. 166 (2009).

[22] Fin. Accounting Standards Bd., Accounting by Debtors and Creditors for Troubled Debt Restructurings, Statement of Fin. Accounting Standards No. 15 at §2 (1977).

interest payments.[23] The FAS 15 rules apply whether the loan is current or delinquent when modified. A servicer who modifies a loan pre-default-say an adjustable rate mortgage in advance of a rate reset-will have to report that loan as a TDR. Many servicers prefer to postpone that paper loss, thus converting the paper loss into a real loss, at least for the homeowner and investors.[24]

Junior liens: Servicers who own junior liens will be reluctant to modify those loans. Homeowners often continue to pay on junior liens after they have defaulted on first mortgages, because the smaller payment associated with the junior lien feels more manageable. As long as that mortgage is performing, servicers will be reluctant to recognize a loss, even if doing so would enable a greater return on the first mortgage.

Advances: Servicers' requirement to advance the principal and interest payments on loans that are in default favors foreclosures. Servicers have two main expenses when a loan is in default: advances of principal and interest to the trust and payments to third parties for default services, such as property inspections. Servicers, under their agreements with investors, typically are required to continue to advance interest on loans that are delinquent until a foreclosure is completed.[25] Financing these costs is one of servicers' biggest expenses.[26] Recovery of these fees (but not the financing costs) is more certain and often swifter via a foreclosure than a modification.

Servicers' advances are taken off the top, in full, at the post-foreclosure sale, before investors receive anything.[27] If advances of principal and interest payments remain beyond the sale value, servicers can usually collect them directly from the trust's bank account (or withhold them from payments to the trust).[28] In contrast, when there is a modification, servicers are usually limited to recovering their advances from the modified loan alone, after required payments to the trust, or, if the advances are deemed nonrecover-

[23] Manuel Adelino, Kristopher Gerardi, and Paul S. Willen, Fed. Reserve Bank of Boston, Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitizations 23–24 (Publicy Pol'y Paper No. 09–4, July 6, 2009), *available at http://www.bos.frb.org/economic/ppdp/2009/ppdp0904.pdf.*

[24] Manuel Adelino, Kristopher Gerardi, and Paul S. Willen, Fed. Reserve Bank of Boston, Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitizations 23–24 (Publicy Pol'y Paper No. 09–4, July 6, 2009), *available at http://www.bos.frb.org/economic/ppdp/2009/ppdp0904.pdf.*

[25] Larry Cordell, Karen Dynan, Andreas Lehnert, Nellie Liang, & Eileen Mauskopf, Fed. Reserve Bd. Fin. & Econ. Discussion Series Div. Research & Statistical Affairs, The Incentives of Mortgage Servicers: Myths and Realities 16 (Working Paper No. 2008–46).

[26] Ocwen Fin. Corp., Annual Report (Form 10–K) 5 (Mar. 12, 2009).; Mary Kelsch, Stephanie Whited, Karen Eissner, Vincent Arscott, Fitch Ratings, Impact of Financial Condition on U.S. Residential Mortgage Servicer Ratings 2 (2007).

[27] Larry Cordell, Karen Dynan, Andreas Lehnert, Nellie Liang, & Eileen Mauskopf, Fed. Reserve Bd. Fin. & Econ. Discussion Series Div. Research & Statistical Affairs, The Incentives of Mortgage Servicers: Myths and Realities 11 (Working Paper No. 2008–46); Ocwen Fin. Corp., Annual Report (Form 10–K) 4 (Mar. 17, 2008) (advances are "top of the waterfall" and get paid first); Wen Hsu, Christine Yan, Roelof Slump, FitchRatings, U.S. Residential Mortgage Servicer Advance Receivables Securitization Rating Criteria 1 (Sept. 10, 2009) (same); Prospectus Supplement, IndyMac, MBS, Depositor, IndyMac INDX Mortgage Loan Trust 2007–FLX5, at 71 (June 27, 2007) (servicers repaid all advances when foreclosure is concluded).

[28] *See, e.g.,* Ocwen Fin. Corp., Annual Report (Form 10–K) 11 (Mar. 12, 2009) ("[I]n the majority of cases, advances in excess of loan proceeds may be recovered from pool level proceeds."); Prospectus Supplement, IndyMac, MBS, Depositor, IndyMac INDX Mortgage Loan Trust 2007–FLX5, at 71 (June 27, 2007) (permitting principal and interest advances to be recovered from the trust's bank account); Prospectus, CWALT, INC., Depositor, Countrywide Home Loans, Seller, Countrywide Home Loans Servicing L.P., Master Servicer, Alternative Loan Trust 2005–J12, Issuer 47 (Oct. 25, 2005) (limiting right of reimbursement from trust account " to amounts received representing late recoveries of the payments for which the advances were made).

able, from only the principal payments on the other loans in the pool, not the interest payments.[29] As a result, servicers can face a delay of months to years in recouping their advances on a modification. Modifications involving principal reductions compound the problem: they lengthen the time to recover advances on any individual modified loan as well as on other modified loans, by reducing the amount of principal payments available for application to recovery of advances.[30]

Although the cost of the advances themselves may be recovered, the significant financing costs associated with making advances cannot be.[31] Thus, servicers are encouraged to reach a resolution of default as quickly and completely as possible, even at the expense of investors who might prefer a modification.[32]

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[29] Monica Perelmuter & Waqas Shaikh, Standard & Poor's, Criteria: Revised Guidelines for U.S. RMBS Loan Modification and Capitalization Reimbursement Amounts 3 (Oct. 11, 2007).

[30] *But see* Rod Dubitsky, Larry Yang, Stevan Stevanovic, Thomas Suer, Credit Suisse, Subprime Loan Modifications Update 8 (2008) (discussing how some servicers exploited then existing imprecision in the accounting treatment of principal reduction modifications to use principal reduction modifications to halt interest advances).

[31] Joseph R. Mason, Mortgage Loan Modification: Promises and Pitfalls 4 (Oct. 2007). A large subprime servicer noted in its 2007 annual report that although "the collectability of advances generally is not an issue, we do incur significant costs to finance those advances. We utilize both securitization, (*i.e.,* match funded liabilities) and revolving credit facilities to finance our advances. As a result, increased delinquencies result in increased interest expense." Ocwen Fin. Corp., Annual Report (Form 10–K) 18 (Mar. 17, 2008); *see also* Wen Hsu, Christine Yan, Roelof Slump, FitchRatings, U.S. Residential Mortgage Servicer Advance Receivables Securitization Rating Criteria 1 (Sept. 10, 2009) (same) ("Servicer advance receivables are typically paid at the top of the cash-flow waterfall, and therefore, recovery is fairly certain. However, . . . there is risk in these transactions relating to the timing of the ultimate collection of recoveries.").

[32] *See* Complaint at 11–15, Carrington Asset Holding Co., L.L.C. v. American Home Mortgage Servicing, Inc., No. FST–CV 09–5012095–S (Conn. Super. Ct., Stamford Feb. 9, 2009) (alleging that servicer conducted "fire sales" of foreclosed properties in order to avoid future advances and recover previously made advances); Kurt Eggert, *Limiting Abuse and Opportunism by Mortgage Servicers,* 15 Housing Pol'y Debate 753, 757 (2004) (reporting that servicers sometimes rush through a foreclosure without pursuing a modification or improperly foreclose in order to collect advances); Peter S. Goodman, *Lucrative Fees May Deter Efforts to Alter Troubled Loans,* N.Y. Times, July 30, 2009.

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

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Re: HOLDERS' NOTICE TO TRUSTEE AND MASTER SERVICER OF FAILURE OF MASTER SERVICER TO PERFORM GIVEN PURSUANT TO §7.01(ii) OF POOLING AND SERVICING AGREEMENTS PERTAINING TO THE RESIDENTIAL MORTGAGE BACKED SECURITIES LISTED ON THE ATTACHED EXHIBIT "A"

Dear Sir or Madam:

Unless otherwise indicated, all capitalized terms used in this letter have the meaning ascribed to them in those certain Pooling and Servicing Agreements (PSAs) governing

Residential Mortgage-Backed Securities (RMBS) evidenced by the Countrywide Mortgage Pass-Through Certificates (Certificates) listed on the attached Exhibit "A."

The undersigned are the Holders of not less than 25% of the Voting Rights in Certificates issued by the Trusts listed on the enclosed Exhibit A.

Pursuant to Section 7.01(ii) of the applicable PSAs, the Trustee and the Master Servicer are hereby notified of the Master Servicer's failure to observe and perform, in material respects, the covenants and agreements imposed on it by the PSAs. Specifically, the Master Servicer has failed and refused to do the following, which have materially affected the rights of Certificateholders:

1. Section 2.03(c) of the PSAs states that "Upon discovery by any of the parties hereto of a breach of a representation or warranty with respect to a Mortgage Loan made pursuant to Section 2.03(a) … that materially and adversely affects the interests of the Certificateholders in that Mortgage Loan, the party discovering such breach shall give prompt notice thereof to the other parties." The Master Servicer has failed to give notice to the other parties in the following respects:

    a. Although it regularly modifies loans, and in the process of doing so has discovered that specific loans violated the required representations and warranties at the time the Seller sold them to the Trusts, the Master Servicer has not notified the other parties of this breach;
    b. Although it has been specifically notified by MBIA, Ambac, FGIC, Assured Guaranty, and other mortgage and mono-line insurers of specific loans that violated the required representations and warranties, the Master Servicer has not notified any other parties of these breaches of representations and warranties;
    c. Although aware of loans that specifically violate the required Seller representations and warranties, the Master Servicer has failed to enforce the Sellers' repurchase obligations, as is required by Section 2.03; and,
    d. Although there are tens of thousands of loans in the RMBS pools that secure the Certificates, the Trustee has advised the Holders that the Master Servicer has *never* notified it of the discovery of *even one* mortgage that violated applicable representations and warranties at the time it was purchased by the Trusts.

2. In violation of its prudent servicing obligations under Section 3.01 of the applicable PSAs, the Master Servicer has:

    a. Failed to maintain accurate and adequate loan and collateral files in a manner consistent with prudent mortgage servicing standards;
    b. Failed to demand that sellers cure deficiencies in mortgage records when deficient loan files and lien records are discovered;
    c. Exacerbated losses experienced by the Trusts;

d. Incurred wholly avoidable and unnecessary servicing fees and servicing advances to maintain mortgaged property, all as a direct result of the Master Servicer's deficient record-keeping; and,
e. Prejudiced the interests of the Trusts and the Certificateholders in the mortgages by fostering uncertainty as to the timely recovery of collateral.

3. Section 3.11 (a) states that the Master Servicer "use reasonable efforts to foreclose upon or otherwise comparably convert the ownership of properties securing such of the Mortgage Loans as come into and continue in default and as to which no satisfactory arrangements can be made for collection of delinquent payments." Despite these covenants, the Master Servicer has continued to keep defaulted mortgages on its books, rather than foreclose or liquidate them, in order to wrongfully maximize its Servicing Fee, at the expense of the Certificateholders' best interests, including rights to recover from pool or financial guaranty insurance policies. In addition, the applicable provisions of the PSAs contemplate that foreclosures and liquidations of defaulted mortgages will proceed forthwith and in accordance with applicable law, provided the documentation is in order, as a matter of fairness to all parties. The Servicers' failure to proceed appropriately and their failure to maintain records in an accurate, appropriate, and adequate manner has impeded this process and caused wholly avoidable delays that have injured investors, borrowers, neighborhoods, and communities. To make matters worse, these delays have also enriched the Servicers, as they have continued to charge unearned and unwarranted servicing fees on mortgages which would have been liquidated but for the Servicers' breach of their duties;

4. Section 3.11 of the PSAs provides that "Countrywide may agree to a modification of any Mortgage Loan" in certain specified circumstances. The Holders do not seek to halt bona fide modifications of troubled loans for borrowers who need them. When, however, modifications are required to remedy predatory lending violations, Section 2.03(c) of the PSAs requires that the offending seller of the mortgage bear the costs to "cure such breach in all material respects...." Nowhere do the PSAs permit the costs of curing predatory loans to be imposed on the Trusts or the Certificateholders. Despite these provisions, the Master Servicer has breached the PSAs by agreeing to modify loans held in the Trusts for the purpose of settling predatory lending claims made by various Attorneys' General against its parent company while breaching its obligation to demand that the offending mortgage seller (its parent company) bear the costs of curing the violation, as well as the expenses reasonably incurred in enforcement of the mortgage seller's obligation to cure predatory mortgages. *Id.* at §2.03(c). The Master Servicer has also unjustly enriched its parent company by using Trust collateral to settle claims that are not, and could never be, made against the Trusts, in a manner that has "materially and adversely affected the interest of the Certificateholders..." *Id.* The Master Servicer has therefore:

a. Failed to perform its obligation to demand that Countrywide *comply* with the requirement that it cure or repurchase predatory and ineligible loans it has agreed to modify in the Attorney General settlement;
b. Failed to track or notify the Trustee concerning which specific loans the Master Servicer has modified pursuant to these provisions, even though the PSAs require that "the Modified Mortgage Loan shall be automatically be deemed transferred and assigned to Countrywide…"; and,
c. Failed to perform its obligation to "deliver to the Trustee a certification of a Servicing Officer to the effect that all requirements of this paragraph have been satisfied with respect to the Modified Mortgage Loan."

5. Section 3.14 of the PSAs provides that the Master Servicer shall be entitled to recover Servicing Advances that are "customary, reasonable and necessary 'out of pocket' costs and expenses incurred in the performance by the Master Servicer of its Servicing Obligations including but not limited to the cost of (i) the preservation, restoration, and protection of a Mortgaged Property…" Despite the requirement that Servicing Advances were to be incurred only for reasonable and necessary out of pocket costs, the Master Servicer instead utilized affiliated vendors--who marked up their services to a level 100% or more above the market price--to provide services related to the preservation, restoration, and protection of" Mortgaged Property, in a fraudulent, unauthorized, and deceptive effort to supplement its Servicing income. *See* ¶ 3(a) and (b), above.

6. Section 3.01 of the PSAs requires that the Master Servicer "shall service and administer the Mortgage Loans in accordance with the terms of this Agreement and customary and usual standards of practice of prudent mortgage servicers." Despite this requirement, the Master Servicer has repeatedly and deliberately failed to perform this covenant by:

    a. Creating Countrywide-affiliated vendors to provide maintenance, inspection, and other services with regard to defaulted mortgages that should have been undertaken *only* if they were in the Certificateholders' best interest. The Federal Trade Commission, however, found that Countrywide repeatedly and deliberately overcharged for these services by as much as 100% or more in order to increase its profits from default-related service fees; and,[1]
    b. As a result of these wrongful practices, Countrywide has increased the losses to the Trusts.

Each of these failures to perform the Master Servicer's covenants and agreements violated the prudent servicing obligations imposed on the Master Servicer by PSA §3.01. Each of these failures to perform the Master Servicer's covenants and agreements also materially affected the rights of the Certificateholders. Each of these failures to perform is continuing. If

[1] The specific details of the Master Servicers' wrongful conduct are available in a press release issued by the Federal Trade Commission, which is accessible at the following website:
http://www.ftc.gov/opa/2010/06/countrywide.shtm.

they continue for an additional sixty days from the date of this letter, each of them—independently—will constitute an Event of Default.

[INTENTIONALLY LEFT BLANK]

The undersigned Holders therefore demand that the Master Servicer immediately cure these endemic and grievous defaults in its obligations under the PSAs. By this letter, the Holders further notify the Trustee of the Master Servicer's failure to perform its covenants and agreements.

The undersigned Holders also reserve all other rights and remedies they may have, individually and under the PSAs, as a result of the matters described in this letter. We invite you to communicate with our counsel, Ms. Kathy Patrick of Gibbs & Bruns LLP, should you wish to discuss this matter further.

Very truly yours,

BlackRock Financial Management, Inc. and
its advisory affiliates

By: ______________________
Printed Name: John Vibert
Title: Managing Director

Freddie Mac Corporation

By: ______________________
Printed Name: ______________________
Title: ______________________

Kore Advisors, LP

By: ______________________
Printed Name: ______________________
Title: ______________________

The undersigned Holders therefore demand that the Master Servicer immediately cure these endemic and grievous defaults in its obligations under the PSAs. By this letter, the Holders further notify the Trustee of the Master Servicer's failure to perform its covenants and agreements.

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Very truly yours,

Blackrock Financial Management, Inc. and
its advisory affiliates

By: ____________________
Printed Name: ____________________
Title: ____________________

Federal Home Loan Mortgage Corporation in
Conservatorship ("Freddie Mac")

By: Ray Romano
Printed Name: Ray Romano
Title: EVP Chief Credit Officer

Kore Advisors, LP

By: ____________________
Printed Name: ____________________
Title: ____________________

The undersigned Holders therefore demand that the Master Servicer immediately cure these endemic and grievous defaults in its obligations under the PSAs. By this letter, the Holders further notify the Trustee of the Master Servicer's failure to perform its covenants and agreements.

The undersigned Holders also reserve all other rights and remedies they may have, individually and under the PSAs, as a result of the matters described in this letter. We invite you to communicate with our counsel, Ms. Kathy Patrick of Gibbs & Bruns LLP, should you wish to discuss this matter further.

Very truly yours,

Blackrock Financial Management, Inc. and
its advisory affiliates

By: ____________________
Printed Name: ____________________
Title: ____________________

Freddie Mac Corporation

By: ____________________
Printed Name: ____________________
Title: ____________________

Kore Advisors, LP

By: ____________________
Printed Name: J. Gary Kosinski
Title: Principal

Maiden Lane, LLC; Maiden Lane II, LLC; and,
Maiden Lane III, LLC by
Federal Reserve Bank of New York,
Managing Member

By: ______________________
Printed Name: Zachary Taylor
Title: Assistant Vice President

Metropolitan Life Insurance Company

By: ______________________
Printed Name: ______________________
Title: ______________________

Neuberger Berman Europe, Ltd.
as investment manager to a managed account client

By: ______________________
Printed Name: ______________________
Title: ______________________

PIMCO Investment Management Company LLC

By: ______________________
Printed Name: ______________________
Title: ______________________

Western Asset Management Company,
for its clients and managed accounts

By: ______________________
Printed Name: ______________________
Title: ______________________

Maiden Lane, LLC; Maiden Lane II, LLC; and,
Maiden Lane III, LLC by
Federal Reserve Bank of New York,
Managing Member

By: ____________________________
Printed Name: ____________________
Title: ___________________________

Metropolitan Life Insurance Company

By: Charles Scully
Printed Name: Charles S. Scully
Title: Managing Director

Neuberger Berman Europe, Ltd.
as investment manager to a managed account client

By: ____________________________
Printed Name: ____________________
Title: ___________________________

PIMCO Investment Management Company LLC

By: ____________________________
Printed Name: ____________________
Title: ___________________________

Western Asset Management Company,
for its clients and managed accounts

By: ____________________________
Printed Name: ____________________
Title: ___________________________

Maiden Lane, LLC; Maiden Lane II, LLC; and,
Maiden Lane III, LLC by
Federal Reserve Bank of New York,
Managing Member

By: ____________________
Printed Name: ____________________
Title: ____________________

Metropolitan Life Insurance Company

By: ____________________
Printed Name: ____________________
Title: ____________________

Neuberger Berman Europe, Ltd.
as investment manager to a managed account client

By: ____________________
Printed Name: OPE AGBAJE
Title: EXECUTIVE DIRECTOR

PIMCO Investment Management Company LLC

By: ____________________
Printed Name: ____________________
Title: ____________________

Western Asset Management Company,
for its clients and managed accounts

By: ____________________
Printed Name: ____________________
Title: ____________________

Maiden Lane, LLC; Maiden Lane II, LLC; and,
Maiden Lane III, LLC by
Federal Reserve Bank of New York,
Managing Member

By: ________________________
Printed Name: ____________________
Title: ________________________

Metropolitan Life Insurance Company

By: ________________________
Printed Name: ____________________
Title: ________________________

Neuberger Berman Europe, Ltd.
as investment manager to a managed account client

By: ________________________
Printed Name: ____________________
Title: ________________________

PIMCO Investment Management Company LLC

By: ________________________
Printed Name: Daniel J. Ivascyn
Title: Managing Director

LEGAL
R. LIEBMAN

BUSINESS
K. SMITH

Western Asset Management Company,
for its clients and managed accounts

By: ________________________
Printed Name: ____________________
Title: ________________________

Maiden Lane, LLC; Maiden Lane II, LLC; and,
Maiden Lane III, LLC by
Federal Reserve Bank of New York,
Managing Member

By: ______________________________
Printed Name: ________________________
Title: ______________________________

Metropolitan Life Insurance Company

By: ______________________________
Printed Name: ________________________
Title: ______________________________

Neuberger Berman Europe, Ltd.
as investment manager to a managed account client

By: ______________________________
Printed Name: ________________________
Title: ______________________________

PIMCO Investment Management Company LLC

By: ______________________________
Printed Name: ________________________
Title: ______________________________

Western Asset Management Company,
for its clients and managed accounts

By: ______________________________
Printed Name: C.A. Ruys de Perez
Title: General Counsel

Maiden Lane, LLC; Maiden Lane II, LLC; and,
Maiden Lane III, LLC by
Federal Reserve Bank of New York,
Managing Member

By: ______________________
Printed Name: ______________________
Title: ______________________

Metropolitan Life Insurance Company

By: ______________________
Printed Name: ______________________
Title: ______________________

Neuberger Berman Europe, Ltd.
as investment manager to a managed account client

By: ______________________
Printed Name: ______________________
Title: ______________________

PIMCO Investment Management Company LLC

By: ______________________
Printed Name: ______________________
Title: ______________________

Western Asset Management Company,
for its clients and managed accounts

By: C. a R.
Printed Name: C. A. Ruyi de Perez
Title: General Counsel

Exhibit "A"

Deal Name
CWALT 2004-32CB
CWALT 2004-6CB
CWALT 2004-J1
CWALT 2005-14
CWALT 2005-21CB
CWALT 2005-24
CWALT 2005-32T1
CWALT 2005-35CB
CWALT 2005-36
CWALT 2005-44
CWALT 2005-45
CWALT 2005-56
CWALT 2005-57CB
CWALT 2005-64CB
CWALT 2005-72
CWALT 2005-73CB
CWALT 2005-74T1
CWALT 2005-81
CWALT 2005-AR1
CWALT 2005-J5
CWALT 2005-J9
CWALT 2006-14CB
CWALT 2006-20CB
CWALT 2006-37R
CWALT 2006-41CB
CWALT 2006-HY12
CWALT 2006-OA11
CWALT 2006-OA16
CWALT 2006-OA17
CWALT 2006-OA6
CWALT 2006-OA9
CWALT 2006-OC10
CWALT 2006-OC2
CWALT 2006-OC4
CWALT 2006-OC5
CWALT 2006-OC6
CWALT 2006-OC7
CWALT 2007-17CB
CWALT 2007-23CB
CWALT 2007-24
CWALT 2007-OA7
CWALT 2008-2R

Deal Name
CWHL 2004-22
CWHL 2004-25
CWHL 2004-29
CWHL 2004-HYB9
CWHL 2005-11
CWHL 2005-14
CWHL 2005-18
CWHL 2005-19
CWHL 2005-2
CWHL 2005-3
CWHL 2005-30
CWHL 2005-9
CWHL 2005-HYB3
CWHL 2005-HYB9
CWHL 2005-R3
CWHL 2006-9
CWHL 2006-HYB2
CWHL 2006-HYB5
CWHL 2006-J2
CWHL 2006-OA5
CWHL 2006-R2
CWHL 2007-12
CWHL 2007-16
CWHL 2008-3R
CWL 2005-10
CWL 2005-11
CWL 2005-13
CWL 2005-16
CWL 2005-2
CWL 2005-4
CWL 2005-5
CWL 2005-6
CWL 2005-7
CWL 2005-8
CWL 2005-9
CWL 2005-AB2
CWL 2005-AB3
CWL 2005-AB4
CWL 2005-BC5
CWL 2005-IM1
CWL 2006-10
CWL 2006-12

Deal Name
CWL 2006-15
CWL 2006-16
CWL 2006-19
CWL 2006-2
CWL 2006-20
CWL 2006-22
CWL 2006-24
CWL 2006-25
CWL 2006-26
CWL 2006-3
CWL 2006-5
CWL 2006-7
CWL 2006-9
CWL 2006-BC2
CWL 2006-BC3
CWL 2006-BC4
CWL 2006-BC5
CWL 2006-SD1
CWL 2006-SD3
CWL 2006-SD4
CWL 2006-SPS2
CWL 2007-2
CWL 2007-5
CWL 2007-6
CWL 2007-7
CWL 2007-9
CWL 2007-BC1
CWL 2007-BC2
CWL 2007-BC3
CWL 2007-QH1
CWL 2007-S3

WACHTELL, LIPTON, ROSEN & KATZ

51 WEST 52ND STREET
NEW YORK, N.Y. 10019-6150
TELEPHONE: (212) 403-1000
FACSIMILE: (212) 403-2000

November 4, 2010

Kathy D. Patrick, Esq.
Gibbs & Bruns, LLP
1100 Louisiana Street
Suite 5300
Houston, TX 77002

Re: Gibbs & Bruns Letter Dated October 18, 2010

Dear Ms. Patrick:

We have received your letter addressed to Countrywide Home Loans Servicing LP ("Countrywide HLS") and dated October 18, 2010, entitled "Holders' Notice to Trustee and Master Servicer of Failure of Master Servicer to Perform Given Pursuant to §7.01(ii) of Pooling and Servicing Agreements Pertaining to the Residential Mortgage Backed Securities Listed on the Attached Exhibit 'A'," purportedly delivered on behalf of eight signatories.

We are reviewing your letter, and if, upon receipt of your clients' documentation, we determine that they meet the required ownership threshold with respect to any of the referenced trusts, will respond further based on any contractual obligations we may have.

Even on an initial review, however, some things are glaringly evident:

- Your letter fails to set forth a single fact in support of *any* of your allegations, but rather relies solely on conclusory and often misleading statements. For example, your claim that loan modifications are evidence of breach, rather than a proper response to an unprecedented housing crisis and in furtherance of the stated policy of the federal government, is utterly baseless. We note with surprise your claim that Countrywide HLS breached its obligations by entering into a settlement with the states' Attorneys General that favored loan modifications. That settlement only committed Countrywide HLS to modifications that are economically beneficial to both investors *and* homeowners.

- We are taken aback that your letter attacks Countrywide HLS for not foreclosing on homeowners quickly enough and for making loan modifications that may keep borrowers in their homes. Unsurprisingly, you and your clients failed to even mention this aspect of your attack when commenting publicly on the letter.

- At least one of your clients, Freddie Mac, consistent with the policy of the federal government, repeatedly has stated publicly that it is "deeply committed to helping troubled homeowners keep their homes." Your demands to hasten foreclosures and to reduce loan modifications are patently inconsistent with that stated aim.

- Your letter makes no attempt to show how any of the purported servicing issues have caused any loss or damage to any Holder. This is particularly true for those Holders who bought the Certificates at distressed prices, well aware of the economic difficulties that many homeowners currently face, and now evidently seek short-term profits at homeowners' expense.

- Your letter also fails to specify anywhere how Countrywide HLS has acted other than in good faith – a showing that would have to be made to hold Countrywide HLS liable.

These and other troubling aspects of your letter strongly suggest that it was written for an improper purpose, or in furtherance of a ulterior agenda.

In order for us to determine whether any investigation of your allegations is warranted, your clients need to establish that they: i) meet the requisite ownership threshold to assert an Event of Default under the PSAs and ii) have a sufficient factual basis for their allegations. Exhibit A to your letter lists 115 different Trusts for which Countrywide HLS acts as the Master Servicer. Each Trust is governed by its own Pooling and Servicing Agreement ("PSA"). The 115 PSAs contain material differences, including with respect to the obligations of the Master Servicer thereunder. Thus, any notice of an alleged failure by the Master Servicer to perform its obligations under the PSA of a particular Trust must identify the specific provisions of the specific PSA that is alleged to have been breached. Likewise, any such notice must be submitted by the Holders of at least 25% of the Voting Rights evidenced by the Certificates of that Trust.

Please provide the following information for each of the 115 Trusts listed in Exhibit A:

1. Identification of the specific provisions of the PSA for that Trust that were allegedly breached by Countrywide HLS.

2. Specify the factual basis for each allegation of failure to perform with respect to that Trust.

3. Identification of which of the Holders listed in your letter are claimed to be Holders of at least 25% of the Voting Rights in that Trust.

4. For each Holder identified in response to Request No. 3: the class, certificate number, denomination, registered owner, acquisition date, and purchase price for each Certificate evidencing that Holder's Voting Rights in that Trust.

5. For each Holder identified in response to Request No. 3 that you claim to represent: (i) the names of the individuals who authorized the Holder's signature on the letter, (ii) whether the Holder's board of directors (or equivalent body) authorized the letter, and (iii) whether any controlling owner(s) of the Holder authorized the letter, and if so, the identities of the individuals who gave such authorization.

WACHTELL, LIPTON, ROSEN & KATZ

Kathy D. Patrick, Esq.
November 4, 2010
Page 4

We reserve all rights with respect to costs, fees and damages that may arise from your baseless allegations.

Sincerely,

Theodore N. Mirvis
Wachtell, Lipton, Rosen & Katz

Brian E. Pastuszenski

Brian E. Pastuszenski
Goodwin Procter LLP

Marc T.G. Dworsky
Munger, Tolles & Olson LLP

cc: The Bank of New York, Corporate Trust MBS Administration

FORECLOSURE PAPERWORK MISCUES PILING UP

The Denver Post, Sunday, November 14, 2010

By Aldo Svaldi

Brent and Wendy Diers of Fruita thought their foreclosure nightmare would end in April when they sent a check to pay off their mortgage.

But more than 6 months later, CitiMortgage hasn't followed through on repeated assurances it would release the lien and give them title.

And despite a judge's ruling that they are not in default, the lender's law firm, Castle Meinhold & Stawiarski, continues to pursue a foreclosure sale.

"We are not in default and they do not have authorization to sell our house," a frustrated Wendy Diers said.

Although the Diers case is extreme, it is just one of several stories of borrowers in Colorado and elsewhere who find themselves trapped in a frustrating state of limbo.

A surge in foreclosures has strained the system across the country, creating problems of lost paperwork, uncertain ownership on mortgages, and sloppy processing that has forced some lenders in recent weeks to pull back.

And those individuals who fall through the cracks like the Dierses find it hard to get out.

In a phone conversation, the Dierses recorded a CitiMortgage employee in May telling them "rest assured, we do have the check. Everything is fine."

In July, the couple were told the title was being contested. Another CitiMortgage representative, named Jennifer, in late July tells them, "We have the title clear. The mortgage has been paid."

A Mesa County judge cited the recordings in rejecting Castle Meinhold's request to sell the home at foreclosure auction.

"Under Colorado law, we cannot and will not take further action until we have authorization from the court," Mesa County Public Trustee Paul Brown said.

Still, the auction date has been postponed, not dismissed. The Dierses said they can't figure out what is going on. Public trustees don't have the authority to throw out foreclosure filings a judge has rejected or to sanction law firms pursuing illegitimate claims, Brown said.

The inability of Castle Meinhold and CitiMortgage to straighten out the situation is bordering on harassment, the Dierses said.

Neither firm responded to interview requests.

The couple don't deny missing payments after Brent suffered a work injury and lost his job in 2008.

But unlike most people in that predicament, they had a relative willing to lend them enough to pay off the mortgage, more than $212,000 in their case. "We did everything we were supposed to do," Wendy said. "This is such a boondoggle of a mess."

Fees of $1,000 added

On a smaller scale, the Compo family of Colorado Springs also found out how difficult it can be to escape foreclosure.

The family wanted to modify their mortgage payments after their business income dropped. A worker with GMAC Mortgage told them they couldn't do so unless they had missed two payments, Susan Compo said.

The Compos started missing payments, but set aside the mortgage money into savings. After three different rejections for a modification, the family, whose financial situation eventually improved, requested a reinstatement statement.

That statement tells borrowers what they owe to get caught up and escape foreclosure. Compo said she sent a check for the amount law firm Castle Meinhold requested, about $17,200, due Sept. 30.

But after the check was sent off, the law firm added about another $1,000 in charges. The payment didn't arrive at GMAC Mortgage until Oct. 12.

The Compo family didn't find out about the added fees until GMAC rejected the check as insufficient.

"We don't have the money for the fees," Compo said.

Castle Meinhold didn't return a phone call from The Denver Post. But the firm did call the Compos offering to waive the additional fees, she said.

"I am giving them an opportunity to make this right," Compo said. "Let's see what they do."

Confusion over true creditor

Even when borrowers simply ask a lender to clear up confusion regarding who really owns their mortgage, they can face a major headache.

Most mortgages are sold and resold and eventually land in investment pools owned by thousands of investors. Several lenders and investment banks also collapsed in 2007 and 2008, complicating ownership.

A Longmont couple, William Hough and Jacqueline Resaul, faced that problem when they got behind on mortgages they took out with Washington Mutual for their home and two rental properties.

They received letters from Washington Mutual, JPMorgan Chase and LaSalle Bank all claiming to be the creditor on their loans, said Michael Wussow, an attorney with Stigler Wussow & Braverman in Boulder.

Hough, a developer, got into financial trouble after suffering a heart attack that put him into a coma.

LaSalle Bank, trustee of the investment pools that claimed to be holding the mortgages in question, initiated the original foreclosures.

Hough, who once worked as a mortgage broker, asked what he thought was a simple request—produce the original notes to clear up any confusion.

LaSalle's law firm in the case, Robert J. Hopp & Associates of Denver, failed to produce the notes, although it obtained an affidavit from JPMorgan Chase claiming LaSalle was the holder, Wussow said.

A Boulder County judge had enough doubts to throw out two of the foreclosures filed in that county. After months of legal wrangling, the foreclosures were refiled under JPMorgan Chase, which had inherited the note from the failed WaMu.

While Hopp was conceding in Boulder County court that JPMorgan Chase was the actual owner, Wussow alleges they didn't tell a Larimer County judge, who approved a foreclosure under LaSalle.

Wussow said he was so ticked off that he filed a motion for sanctions against the Hopp law firm and the lenders involved.

He wants them to pay the $52,000 in attorney fees his clients incurred because the paperwork wasn't straight.

"That is what I said all along—come with the notes and we are done. They made us go through a year of litigation," he said.

In a response to the motion, Denver law firm Kutak Rock, now representing the lenders, claims Wussow's motion can't be brought up under the limited scope of a Rule 120 hearing, where judges determine the merits of a foreclosure action. A call to the Hopp law firm was not returned.

After losing their home, Hough and his wife moved to South America, where the cost of living was lower, Wussow said.

But they fought because they felt it important to ensure the proper parties foreclose and to not let the big banks run roughshod over the system.

"I think there should be some sort of requirement that you show up with the original note or with a detailed document showing the transfers," Wussow said. "They should have the right parties foreclosing. They should have been recording documents."

PROBLEMS IN MORTGAGE SERVICING FROM MODIFICATION TO FORECLOSURE

WEDNESDAY, DECEMBER 1, 2010

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 9:34 a.m. in room SD–538, Dirksen Senate Office Building, Hon. Christopher J. Dodd, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN CHRISTOPHER J. DODD

Chairman DODD. The Committee will come to order. Let me thank all of you for your presence here this morning, colleagues and guests and our witnesses who are being a part of this hearing this morning entitled "The Problems in Mortgage Servicing From Modification to Foreclosure." And this is the second of two hearings we have had. I thought it was a good idea to do this, and Senator Shelby also advocated it. You can make a case that maybe we should have had you first and had the people we had first second, but either way I think it is going to be helpful to get the perspective of those of you at the table here today.

Some of you have nothing to do with this other than your observations. I know particularly Sheila Bair, of the FDIC, this is not your particular responsibility, but you have been terrific on these issues, and so we wanted you to be a part of the discussion today as to how we ought to proceed, and I am grateful to you for that.

I am going to make a brief couple of opening comments, and then I will turn to Senator Shelby and any of our colleagues who would like to be heard on some opening thoughts on this. We have two panels, so it will take a little time this morning to get through this, but I am very grateful to all of you.

Before I begin, this is likely my—I hesitate to say likely my last hearing as Chairman of the Banking Committee, having taken over in January of 2007 for Paul Sarbanes, who did a wonderful job. As I have told many of you the story, I was sitting in the chair where Tim Johnson sits at a hearing in the fall of 2006 after Paul had announced the fact that he was no longer running—I guess in the spring of 2006—and he put his right arm around me at this chair here, and there was chaos going on in the Committee room. People were screaming and yelling over something that had been said. The police were coming in to remove people. And as the screaming was going on and the bellowing was occurring, he put his arm around you shoulder and said, "Just think, in 6 months all of this is yours."

[Laughter.]

Chairman DODD. I had no idea what he was predicting for me over the next 4 years on the subject matter. So to my colleagues and staff and all, I thank you immensely for the wonderful support and how enjoyable it has been to work with all of you over these past 4 years. In a sense, we are almost ending—I am ending here, at least, where we began. As Richard will recall in another Committee—I think our second hearing in February, the first week in February of 2007, was on the foreclosure issues, and we had a series of them, of course, all that year, and 2008. For those 2 years, we could not get anyone really to pay attention within the administration or others at the time. I do not know how many times I heard Bob Menendez say, coin the phrase "the tsunami" coming. I think that was in February or March of 2007, almost 4 years ago talking about this as well. And between the two of us up here, that is 54 years between Shelby and me. That is a long time here, Richard, going back to the days of——

Senator SHELBY. I am going to miss you.

Chairman DODD. Well, I will miss you as well. I want you to know that. So I want to thank all of you, and I particularly want to say to all of you here, but particularly Dick Shelby, I know the assumption is that obviously people do not report about planes that fly, as we say in this business. You only hear about the planes that do not make it. But every single day people up here work together and get things done. Paul Sarbanes had the relationship with Dick Shelby, and I have had it as well. We are good friends, and we spend a lot of time together far beyond the confines of this Committee room. And for that, I will be eternally grateful to this great friend from Alabama who has been a good partner. We have not always agreed on every issue, but he has been a gentleman and always kept me informed as to where things were and how things were progressing, and I thank you immensely.

Senator SHELBY. Thank you.

Chairman DODD. Anyway, I want to welcome all of the witnesses who are here today for their testimony about the problem of mortgage servicing. This is a continuation, as I mentioned at the outset, of a hearing we held last month at which we heard from witnesses within the servicing industry and others. Today we will hear from some of the regulators responsible for overseeing the industry.

First let me explain what we mean by mortgage servicing. I know all of our witnesses know this, but sometimes I think the audience and those who are following this might not understand what we are talking about by servicing. Individual mortgages are often bundled into pools of similar mortgages and sold in the secondary market as a mortgage-backed security. We have heard a lot about that over the last 4 years.

After the origination, all processing—and this is where the servicing comes in. All processing related to the loan is managed by a mortgage servicing company. Now, the Nation's four largest banks—JPMorgan Chase, Wells Fargo, Bank of America, and Citi are also the largest mortgage servicers. Mortgage servicers have a long list of administrative responsibilities from collecting monthly payments, maintaining detailed accounting records, paying taxes and insurance premiums, and distributing payments to the holders of the mortgage security. And for this work, they receive a servicing fee. That is a rather abbreviated description, but basically that is the purpose and that is what servicing companies do.

At the last hearing, we learned that many of the servicers have not been doing their jobs, and these servicers, including many of the Nation's biggest banks, failed to maintain proper records, failed to properly administer the Home Affordable Modification Program, the HAMP program; hired so-called robo-signers, submitted thousands of false and possibly fraudulent affidavits and in some cases even foreclosed unfairly on people who should not have lost their homes.

Since our last hearing, news reports have suggested that the problem may be actually a lot larger than we previously thought. I do not wish that to be the case, but evidence seems to be mounting that it may, in fact, be the case. An employee of the Bank of America testified in court that the bank's standard mortgage servicing practices failed to meet basic loan documentation requirements—a failure that could call a huge number of loans into question. If there are more revelations of that nature, this situation could ultimately have ramifications for the safety and soundness of the financial system. Investors in the mortgage securities market, including the New York Fed Reserve Bank and Freddie Mac, are pushing banks to repurchase loans that may not have been originated as represented.

Last month, the Congressional Oversight Panel estimated that these lawsuits and repurchasers would ultimately cost banks about $52 billion. Subsequent to that report, Barron's Magazine used data from a research firm called CompassPoint and estimated that the losses to banks could be as high as $164 billion. Other estimates are even higher still. Now, even for Wall Street, that is a lot of money to be talking about.

It is important also to remember that while it was servicers who caused this problem, it is borrowers who are, of course, paying the price. Confusion over sloppy and incomplete documentation has slowed the mortgage modification process for countless borrowers. Conflicts of interest in the industry may be incentivizing third-party servicers to actively seek to block modifications that would prevent foreclosures but cut into their profits. These problems may have resulted in problems for borrowers who otherwise may have been able to pay their mortgages or in pushing troubled borrowers to foreclosure who otherwise may have been able to save their homes with reasonable modification efforts.

At any rate, this is a problem that the servicers should have seen coming, in my view. They had plenty of warnings from Congress. Sheila Bair, who is with us today, of the FDIC, also provided those warnings. Many Members up here—I mentioned Bob Menendez, among others in this Committee, going back a long time who talked about this literally—in fact, Jim Bunning and Jack Reed were talking about it in 2006 in hearings that they held in those days. So we are getting near 5 years that we have been talking about this issue, and yet here we are still watching a problem associated with all of that getting worse is possibly the case.

Whether it was out of greed or ignorance or the failure to recognize the disaster on the horizon, we now are left, of course, to pick up the pieces of this problem and to try and help homeowners caught up in the forces beyond their control and to do everything in our power to fix the system and prevent these problems again in the future.

Today we are going to hear from regulators about what they did or did not do, what ideas you have as well, and I appreciate all of you being here, not only regulators but also from the academic world who have followed these questions. What do you recommend we do, the Congress do, done by Treasury, done by regulators? I do not want to argue and I do not want a lot of finger pointing going on as to how we are here. We all know where we are. The question now is, What do we do about it? And, obviously, this is my last hearing on all of this, but, obviously, this Committee will have to pick up this subject matter and work on it, and we would like to know what we can do to be a part of that solution. I suspect that all of us would agree with that conclusion. So today I appreciate, again, your participation, and let me turn to Senator Shelby.

STATEMENT OF SENATOR RICHARD C. SHELBY

Senator SHELBY. Mr. Chairman, I ask that my written statement be made part of the record, and other than that, I look forward to the testimony of the witnesses.

Chairman DODD. Thanks very much.

Anyone else want to be heard in the opening? Yes, Bob.

STATEMENT OF SENATOR ROBERT MENENDEZ

Senator MENENDEZ. Mr. Chairman, first of all, I do not know if this is or is not your last hearing, but in the eventuality that it is, I want to just say that I think history will record that you presided over some of the most tumultuous times in our financial system and that the response to that day when Chairman Bernanke came before Members of this Committee and members of leadership and described in 2008 the challenges and the consequences of the potential collapse of a series of financial institutions and what they would have meant to this country in terms of systemic risk to the entire Nation's economy. And I will never forget asking the question: Well, we must have enough tools at the Federal Reserve? And his answer: If you do not act in the next 2 to 3 weeks, we will have a global financial meltdown.

Chairman DODD. Yes.

Senator MENENDEZ. That is what you chaired over, and I think history will record that the way in which you led in that period of time really helped save our Nation from what would have been a new depression, and I appreciate your service very deeply.

Chairman DODD. Thanks, Bob.

Senator MENENDEZ. Just a moment on an issue that I have been pursuing for some time. You are right, it was in March of 2007, I think it was Secretary Paulson who was sitting here, and I said, you know, I think we are going to have a tsunami of foreclosures. And I remember the response as "I think that is an exaggeration." I wish he had been right and I had been wrong. The reality is that we ended up with we have not even seen fully the crest of that tsunami even yet.

And what I am concerned about is not just for all of those families who clearly are under a life-changing set of circumstances where their home will be taken away from them, but it is even for the greater risk to everyone in a community that faces the consequences of multiple foreclosures in their neighborhood, the loss of property values, the loss of ratables, and all of the consequences that flow from that.

And so I appreciate that 18 of my colleagues signed with me a letter to the Treasury Secretary. One, about the whole issue you have discussed, is about the robo-signings, the rubber stamping of foreclosures by banks that exercise lax oversight. It is not certainly only shocking, but it is one example of how banks have mishandled both foreclosures and mortgage modification requests. And if the robo-signing is directly attributable to banks not doing proper due diligence, which is inexcusable when dealing with a matter as monumental as taking someone's home away, I think the more important point might very well be that banks and servicers are not handling even basic foreclosure procedures correctly; it is that they are also not correctly evaluating homeowners for mortgage modifications. And I have serious concerns about that process.

I have listened to constituents time and time again who talked to me about the horrors still today, even after this Committee has raised these issues time and time again, of the process that they have gone through. I am concerned that, despite the best efforts of the HAMP program, which estimated that 79 million families could restructure or refinance their homes, we have only had since January of 2010 about 495,000. That does not seem to be working in a way that we want it to.

And, finally, you know, countless constituents have told us stories of being stonewalled by banks for very long periods of time, of not being told the reasons for their rejection of their modification request, of significant delays caused by banks losing their paperwork, and trial modifications canceled with no rationale. And that just cannot continue to happen, Mr. Chairman. So I appreciate that you are having this hearing today and the work the Committee will continue to do.

Chairman DODD. Thanks very much, Senator.

Anyone else want to make any opening comments on this? If not, we will turn——

Senator TESTER. Just very quickly, if I might, Mr. Chairman.

Chairman DODD. Yes.

STATEMENT OF SENATOR JON TESTER

Senator TESTER. First of all, I want to express my appreciation for your comments on the floor yesterday. I thought they were spot on, and I thank you for your leadership on this Committee. You will be missed.

Chairman DODD. Thank you.

Senator TESTER. Thank you all for being here today, the folks on the panel. I appreciate you taking the time. I think these are an important set of hearings. It has been established, well established I think, that these are significant issues, that they are not isolated cases. My office has experienced a number of complaints, a significant number of complaints, by constituents who have had their places foreclosed on and have not been treated fairly. So I think it is important that we pay attention to this issue because I do not think there has been adequate attention paid to this issue.

Mortgage servicers have a trust placed in them, but there is not a lot of verification that what they are doing is—well, there is not a lot of requirements for verification. So hopefully these investigations will result in some changes that will ensure that homeowners are treated with honesty and respect and we can really get down to the root of what the magnitude of these problems really are.

I know that last week many of you, as part of the Financial Stability Oversight Council, echoed the concerns and recognized the potential risks to our system by this processing problem. My hope is that through your investigations we will finally be able to understand the full size and scope and its potential impact to the financial markets. And then we can move forward in a sensible way from there. So thank you all for being here.

Thank you, Mr. Chairman.

Chairman DODD. Thank you, Senator Tester, very, very much.

Anyone else? Are we all set to go with the witnesses? Good. Very good.

Let me introduce them, if I can, very briefly to you. First of all, Phyllis Caldwell is the Chief of the Homeownership Preservation Office at Treasury, leads the Administration's efforts to assist with the home loan conversion process. She joined the Treasury in November of 2009, and we thank you very much for being with us today.

Sheila Bair, you could almost sit up on this side of the dais, you have been here so often, but obviously with the FDIC, and I think all of us acknowledge, Sheila, your tremendous participation and efforts over the last 4 years that I have been grappling with this, as the Committee has. Again, we appreciate you being here today in a sense for your thoughts and observations on this as well.

Dan Tarullo is well known. He used to sit on this side of the dais up here, not on this Committee but with Senator Kennedy going back years ago, and has been a good friend over the years. He is obviously one of the six current Governors of the Board of Governors of the Federal Reserve, served in that capacity since January of 2009, and was a professor of law at Georgetown University, among other things. We thank you, Dan, for your observations.

John Walsh, again a frequent participant in our discussions, is the Comptroller of the Currency, oversees that office, supervises some 1,500 federally chartered commercial banks and about 500 Federal branches of the agencies of foreign banks in the United States. He has been with the OCC since 2005 and previously served as chief of staff, and we thank you for your service as well.

Ed DeMarco, the last witness in our first panel, is the Acting Director of the Federal Housing Finance Agency and has been doing a very good job, in my view, regulating Fannie and Freddie and the 12 home loan banks within the United States. Prior to this capacity, he was the Chief Operating Officer of FHFA.

Let me just say, by the way, that with a lot of the criticism going on, there is a lot of good news coming out of the management as well under this process that was put in place a number of years ago, so we thank you for your work as well.

With that, I would ask—by the way, I want to ask consent that all of the opening statements and comments of our colleagues will be included in the record, as will all of your statements and any supporting documents or information you think would be valuable for the Committee.

With that, Ms. Caldwell, we will begin with you. If you could try and keep your statements down to about 5 minutes or less, then we can get to the questions and get to our second panel as well.

STATEMENT OF PHYLLIS CALDWELL, CHIEF, HOMEOWNERSHIP PRESERVATION OFFICE, DEPARTMENT OF THE TREASURY

Ms. CALDWELL. Chairman Dodd, Ranking Member Shelby, and Members of the Committee, thank you for the opportunity to testify before you today on issues surrounding mortgage servicing and servicer performance in the Making Home Affordable program.

The foreclosure problems that have recently come to light underscored the continued critical importance of the Making Home Affordable program launched by Treasury, of which HAMP is a part. Preventing avoidable foreclosures through modifications and other home retention opportunities continues to be critical priority. Foreclosures dislocate families, disrupt the communities, and destabilize local housing markets.

Over the last 20 months, we have developed rules and procedures to facilitate meaningful modifications. We have urged servicers to increase staffing and improve customer service. We have developed specific guidelines and certifications on how and when homeowners must be evaluated for HAMP and other home retention options. HAMP has strong compliance mechanisms in place to ensure that servicers follow program guidelines.

Treasury has built procedural safeguards and appropriate communication standards in HAMP to minimize those instances where borrowers are dual-tracked, where they are being evaluated for HAMP at the same time they are being put through the foreclosure process. Specifically, HAMP program guidelines require participating servicers of non-agency loans to: evaluate homeowners for HAMP modifications before referring those homeowners to foreclosure; suspend any foreclosure proceedings against homeowners who have applied for HAMP modifications while their applications are pending; evaluate whether homeowners who do not qualify for HAMP (or who have fallen out of HAMP) qualify for private modification programs; evaluate whether homeowners may qualify for a short sale or deed-in-lieu of foreclosure; and provide a written explanation to any homeowner not eligible for HAMP and to delay any foreclosure sale for at least 30 days afterwards to give the homeowner time to appeal.

Servicers may not proceed to foreclosure sale unless they have tried these alternatives. Servicers must first issue a written certification to their foreclosure attorney or trustee stating that "all available loss mitigation alternatives have been exhausted and a non-foreclosure option could not be reached." On October 6, Treasury clearly reminded servicers of this existing HAMP rule.

We have instructed our compliance team to review the ten largest servicers' processes and procedures for complying with that guideline. If we find incidents of non-compliance, Treasury will direct those servicers to take corrective action, which may include suspending those foreclosure proceedings and re-evaluating the affected homeowners for HAMP.

In terms of compliance, it is important to remember that although Treasury administers the Making Home Affordable program and HAMP, it does so through voluntary contracts with the servicer versus regulatory or enforcement agency authority. Thus, our compliance efforts are focused on ensuring that servicers are following the contractual requirements of their servicer participation agreements.

We are looking to ensure that borrowers are being properly evaluated for HAMP. Compliance remedies have included: re-evaluating loans for HAMP eligibility; re-soliciting borrowers; enhancing servicer processes; and providing additional training to servicer staff.

To date, almost 1.4 million homeowners have started trial modifications, and over 520,000 have started permanent modifications. These homeowners have experienced a 36-percent median reduction in their mortgage payments, or more than $500 a month.

Consider that in the first quarter of 2009, nearly half of mortgage modifications increased borrowers' monthly payments or left them unchanged. By the second quarter of 2010, 90 percent of mortgage modifications lowered payments for the borrower. Homeowners today have access to more sustainable foreclosure prevention solutions.

HAMP uses taxpayer resources efficiently. Its pay-for-success design supports borrowers who are committed to staying in their homes by paying out servicer, borrower, and investor incentives over 5 years, and the investor, not the taxpayer, retains the risk of borrower payment.

In conclusion, we believe that these foreclosure problems underscore the continued need for servicers to focus on evaluating borrowers for all home retention options, starting with HAMP. We appreciate the efforts of both the Members of this Committee and our partners in the housing community in holding servicers accountable and improving HAMP's design and performance.

I look forward to taking your questions. Thank you.

Senator JOHNSON. [Presiding.] Ms. Bair.

STATEMENT OF SHEILA C. BAIR, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Ms. BAIR. Thank you. Senators Johnson and Shelby, and thank you, Members of the Committee, for requesting the views of the Federal Deposit Insurance Corporation on deficiencies in mortgage servicing and the impact on the financial system. It is unfortunate that problems in mortgage servicing and foreclosure prevention continue to require the scrutiny of this Committee. The robo-signing issue is symptomatic of persistent shortcomings in the foreclosure prevention efforts of our Nation's largest mortgage servicers.

While the FDIC is not the primary supervisor for these companies, we do have a significant interest as the insurer of many of these institutions. Through our back-up examination authority, our examiners have been working on-site as part of an interagency review team at 12 of the 14 major mortgage servicers. The weaknesses that have been identified in mortgage servicing practices during the mortgage crisis are a by-product of both rapid growth in the number of problem loans and a compensation structure that is not well designed to support loss mitigation measures such as loan modifications.

The traditional structure of third-party mortgage servicing fees, put in place well before the crisis, is based on a flat fee that is tied to the outstanding mortgage balance and does not provide additional compensation for the proper management of distressed loans. The flaws in the structure were not evident when the number of problem loans was low. Large servicers aggressively automated systems and consolidated servicing to maximize short-term returns. However, the historic rise in mortgage defaults in recent years has driven up servicing cost structures, creating incentives to cut corners just at a time that servicers needed to be devoting more careful individualized attention to their management of problem loans.

The problems we are seeing go beyond robo-signing and other technical documentation issues to include questions regarding chain of title and the proper establishment of private sector securitization trusts. Their implications are potentially serious and damaging to the Nation's housing recovery and to some of our largest institutions.

One implication is the risk of a wider disruption to the foreclosure process. A transparent, functioning foreclosure process, while painful, is necessary to the recovery of our housing market and our economy.

Another implication is that mortgage documentation problems cast a cloud of uncertainty over the ownership rights and obligations of mortgage borrowers and investors. Moreover, there are numerous private parties and Government entities that may have significant claims against firms central to the mortgage markets.

While we do not see immediate systemic risk, the clear potential is there. The Financial Stability Oversight Council, or FSOC, was established under the Dodd-Frank Act to deal with just this type of emerging risk. It is in a unique position to provide needed clarity to the market by coordinating consistent interpretations of what standards should be applied to establishing the chain of title for mortgage loans and recognizing the true sale of mortgage loans in establishing private securitization trusts.

While my written statement goes into more detail, there are principles, I believe, that should be part of any broad agreement among the stakeholders to this issue.

One, establish a single point of contact for struggling homeowners. This will go a long way toward eliminating the conflicts and miscommunications between loan modifications and foreclosures in today's dual-track system and will provide borrowers assurance that their application for modification is being considered in good faith.

Two, simplify loan modification efforts to reduce the number of foreclosures. The modification process has become far too complicated given the volume of troubled loans and the shortage of mortgage servicing resources. The modification process needs to be dramatically streamlined. Modifications need to be put in place at an early stage of delinquency and should provide for a significant reduction in the borrower's monthly payment. Our experience at IndyMac shows that these are the key factors that determine the long-term success of modifications. In exchange, mortgage servicers should have a safe harbor that will assure them that their claims will be recognized if foreclosure becomes unavoidable.

Three, invest appropriate resources to maintain adequate numbers of well-trained staff and strengthen quality control processes. Inadequate staffing, lax standards of care, and failure to follow legal requirements cannot be tolerated. Servicers need to strengthen their practices, and regulators must ensure that servicers adhere to the highest standards.

Four, tackle the second lien issue head-on. Servicers should be required to take a meaningful write-down of any second lien if a first mortgage loan is modified or approved for short sale. All stakeholders must be willing to compromise if we are to find solutions to the foreclosure problem and lay the foundation for recovery in our housing markets.

Thank you for the opportunity to testify, and I look forward to your questions.

Senator JOHNSON. Thank you.

Mr. Tarullo.

STATEMENT OF DANIEL K. TARULLO, MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. TARULLO. Thank you, Senator, and Senator Shelby and Members of the Committee. Let me build on some of what Sheila has said to add a few introductory comments.

First, on the extent of the problem, which is the question Senator Shelby started with at your last hearing, I want to first caution that the three—or four, actually—agencies represented here are all still in the middle of investigating the firms themselves, whether the GSEs or the banking institutions. So we need to be provisional in any observations that we make.

But I think with respect to the documentation issue, it is already pretty apparent that there are significant weaknesses in risk management, in quality control, in audit and compliance practices, in staff training, and in oversight of third-party providers, such as law firms. The extent of the problem appears to vary across firms, but my suspicion is that when all is said and done, we are going to find some problems in all servicers, large, medium, and small. The problem will be particularly acute in some servicers where the difficulties and the shortcomings have been the greatest.

When we look at those problems in the context of all the difficulties associated with loan modifications that Senator Menendez referred to earlier, it seems to me that we do need to have some structural changes in how servicers are organized, monitored, and regulated.

I also want to say a word about put-back exposure. This is something which is not directly related to the foreclosure documentation problem, but documentation problems have both drawn attention to the issue and maybe motivated some investors to pursue some additional arguments for why sponsors should take mortgages back.

The exposure here results from the interplay of default rates on the underlying mortgages which motivate the put-back efforts by the investors who hold the securities and the legal liability of a securitizer or originator. This liability could be quite significant for some firms, although particularly with respect to private-label securitizations, the losses may well be spread over a considerable period of time as litigation ensues.

With respect to put-back liability, we had already started a process of requiring each of the major holding companies to produce to us their comprehensive capital plans, which we are supposed to get in early January. That is an exercise apart from mortgage foreclosure problems. But as part of that exercise, we have asked for an assessment by the firms of the put-back liability that they may be facing.

Turning now to supervisory responses, I noted in my written testimony the range of supervisory and enforcement tools that are available to the three banking agencies here. I expect that many or all of these tools will be used as appropriate with respect to specific institutions. So I just note from the particular supervisory position of the Federal Reserve that our rating of management at the holding company level will be influenced by the extent of these problems even if the problems occurred in a banking subsidiary.

As to how these problems have shaped our thinking about supervision more generally, I would say, again from our perspective, two points are already apparent. First, we need to use to its fullest the additional authority given the Federal Reserve in Dodd-Frank to send our examiners into non-bank affiliates of large holding companies. And second, I think we all need to find ways to leverage control process audits of some functions in firms into improvements in control processes across the firm, because we are never going to be able to audit every single control process in all of these institutions.

Before closing, I want to say a few more words on the loan modification issue, but from more of a macroeconomic perspective, because I think there is a close relationship, as many of you have suggested already, between the foreclosure difficulties and the relatively sluggish pace of modifications. The race that frequently occurs between a modification of a particular mortgage and foreclosure proceedings has more often than not been won by the foreclosure process. And, of course, we now know that the race was often not being fairly run in the first place. But even if it is, there is a larger macroeconomic point to be made here. Foreclosures are costly not only for the parties involved, but for the housing market and the economy as a whole. And while there is no single simple method for gaining more of a balance between foreclosures and modifications, I wholeheartedly agree with Sheila's perspective that it is incumbent on people in industry and at all levels of Government to renew attention to measures that can facilitate sensible modifications across the country and thereby to help create the conditions for a housing recovery which will be, in turn, important for supporting renewed stronger growth in our own economy.

Thank you very much.

Senator JOHNSON. Mr. Walsh.

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

Mr. WALSH. Thank you, Senator, Ranking Member Shelby, and Members of the Committee. I appreciate the opportunity to discuss improprieties in the foreclosure process and the steps being taken by the Office of the Comptroller of the Currency to address them.

When I appeared before the Committee in September, I described early steps to address the foreclosure problem at eight of the largest mortgage services the OCC supervises. I can report today that we have greatly expanded those efforts to address this critical problem, working with other Government agencies.

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

In recent years, as problem loans surged, the OCC's primary focus was on efforts to prevent avoidable foreclosures by increasing the volume and sustainability of loan modifications. When we saw, using loan-level data from our mortgage metrics project, that an inordinate number of modifications initiated in 2008 were re-defaulting, we directed national bank servicers to take corrective action. Since then, we have seen a sharp increase in modifications that lowered monthly payments and fewer re-defaults. While these efforts are preventing some foreclosures, many families are still struggling and face the prospect of losing their home. We owe these homeowners our best efforts to assure that they receive every protection provided under the law.

Questions have arisen about the practice of continuing foreclosure proceedings even when a modification has been negotiated and is in force. We agree that the dual track is unnecessary confusing for distressed homeowners and the OCC is directing national bank servicers to suspend foreclosure proceedings for successfully performing modifications where they have the legal ability and are not already doing so. It is important to remember, however, that the GSEs and private investors dictate the terms for non-HAMP modifications, so this option may not always be available to servicers.

It is also the case that foreclosures are governed by State law and requirements vary considerably across jurisdictions. As a result, most nationwide servicers hire local firms familiar with those requirements. Both Fannie Mae and Freddie Mac require servicers to use law firms they pre-approve for a given locality.

The OCC reviews a bank's foreclosure governance process to determine if it has appropriate policies, procedures, and internal controls necessary to ensure the accuracy of information relied upon in the foreclosure process and compliance with Federal and State law. We expect banks to test these processes through periodic internal audits and their ongoing quality control function. Examiners generally do not directly test standard business processes or practices, such as the validity of signed contracts or the processes used to notarize documents absent red flags that indicate systemic flaws in those business practices.

Unfortunately, neither internal quality control tests, internal audits, nor data from our consumer call center suggested foreclosure document processing was an area of systemic concern. When problems were identified outside the national banks at Ally Bank, we immediately directed the eight largest national bank servicers to review their operations and take corrective action. We began organizing onsite examinations at each of those major servicers, which are now well underway, with more than 100 national bank examiners assigned to the task.

In concert with other regulatory agencies, these examiners are reviewing whether foreclosed borrowers were appropriately considered for loan modifications, whether fees charged were appropriate, documents were accurate and appropriately reviewed, and that proper signatures were obtained. We are reviewing whether servicers complied with State laws and whether they had possession and control over documents necessary to support a legal foreclosure proceeding.

The OCC is also heading an onsite interagency examination of the Mortgage Electronic Registration System, or MERS, in coordination with the Federal Reserve, the FDIC, and the Federal Housing Finance Agency, and we are participating in an examination led by the Federal Reserve of lender processing services which provides third-party foreclosure services to banks.

Where we find errors or deficiencies, we are directing banks to take immediate corrective action and we will not hesitate to take an enforcement action or impose civil money penalties, removals from banking, and criminal referrals if warranted. We expect to complete our examinations by mid- to late-December and to determine by the end of January whether additional supervisory or enforcement actions are needed.

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

Chairman DODD. [Presiding.] Thank you very much, Mr. Walsh. Mr. DeMarco, welcome.

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

Mr. DEMARCO. Thank you. Good morning, Chairman Dodd, Ranking Member Shelby, Members of the Committee.

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

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

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

As I reported previously to the Committee, the Enterprises, Fannie Mae and Freddie Mac, minimize losses on delinquent mortgages by offering distressed borrowers loan modifications, repayment plans, or forbearance. These loss mitigation tools reduce the Enterprises' losses on delinquent mortgages and help homeowners retain their homes. Servicers of Enterprise mortgages know that these tools are the first response to a homeowner who falls behind on their mortgage payments.

Yet for some delinquent borrowers, their mortgage payments are simply not affordable due to unemployment or other hardship and a loan modification is not a workable solution. For these cases, the Enterprises offer foreclosure alternatives in the form of short sales and deeds in lieu of foreclosure. Despite these options for a graceful exit from a home, foreclosure remains the final and necessary option in many cases.

As we know, foreclosure process deficiencies have emerged at several major servicers. Recently, FHFA provided the Enterprises and services a four-point policy framework for handling these deficiencies. The four points are rather simply stated. First, verify that the foreclosure process is working properly. Second, remediate any deficiencies identified in foreclosure processing. Third, refer suspicions of fraudulent activity. And fourth, avoid delay in processing foreclosures in the absence of identified problems.

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

As conservator of the Enterprises, FHFA expects all companies servicing Enterprise mortgages to fulfill their contractual responsibilities, which include compliance with both the Enterprises' seller servicer guides and applicable law. Also, FHFA remains committed to ensuring borrowers are presented with foreclosure alternatives. Still, it is important to remember that FHFA has a legal obligation as conservator to preserve and conserve the Enterprises' assets. This means minimizing losses on delinquent mortgages. Clearly, foreclosure alternatives, including loan modifications, can reduce losses relative to foreclosure. But when these alternatives do not work, timely and accurate foreclosure processing is critical for minimizing taxpayer losses.

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

Thank you.

Chairman DODD. Thank you very much, Mr. DeMarco.

Again, I will ask the Clerk to time us on, say, 6 minutes, and we will try and stick with that a little bit. Again, we have got a large panel here and a second panel to get through, so we will try and keep to that time.

Senator SHELBY. Mr. Chairman, is that 6 minutes of questions?

Chairman DODD. That is 6 minutes of questions for you and me, and then for everyone else, it is 6 minutes of time.

[Laughter.]

Chairman DODD. Well, let me begin, Dan, with you, if I can. I thought your testimony was—I am sorry, I had to go down to a markup downstairs, but I actually read your testimony last evening so I am familiar with your point here. You described the banking agencies' review of the mortgage crisis and state that preliminary findings suggest weaknesses in risk management, quality control, audit, compliance practices, shortcomings in staff, training, coordination among loan modification and foreclosure staff, and management and oversight and third-party providers, including legal servicers. Aside from that, there were not too many problems, I guess you said.

Anyway, according to experts, including Professor Eggert, who will be testifying in the next panel, these problems have been documented for years, I think he claims since 2003, by actions taken by the FTC, for example. So there was some real background to all of this.

First, I would like to ask you whether or not the other agencies that are at the table with you agree with Governor Tarullo's conclusions in his testimony, whether or not you feel as though what he has said is an accurate description of the situation, and then given the apparent severity of these problems, I want to ask you, as well, why the various agencies that do have regulatory authority have not been taking action earlier, the obvious question for us here. Again, there has been a lot of evidence. This is not some new information we are getting. Why have the agencies not been more aggressive about this earlier on? We will start with that.

Ms. CALDWELL. Thank you for the question. I will talk from the perspective of the HAMP program, and I think it is important, again, just to say that HAMP is a voluntary program and we have contractual relationships with the larger servicers to participate in the mortgage modification program. We are in those largest servicers every month. Certainly, our observations have been that they were ineffective in soliciting homeowners for HAMP. There was delayed processing of HAMP. There was improper use of the Treasury net present value model.

And as a result of that, actions that we have taken have included sending the servicers back to re-solicit certain pools of borrowers where we identified they were not solicited. We have had them rerun the net present value model. And in January of this year, we instituted a temporary review period where we said servicers could not decline a homeowner from HAMP until they had reviewed and verified the status of their documentation, their payment, notified the homeowner of what their records showed, and gave the homeowner an opportunity to review.

So again, we agree that there has not been sufficient capacity in the servicing shops relative to the magnitude of this problem.

Chairman DODD. Let me jump to the OCC. John, this is, again, not new information. Why have we not been more aggressive as regulators here in dealing with this?

Mr. WALSH. Certainly, it is not new information that there have been capacity constraints going back to 2008. As I mentioned in my testimony, we had been both gathering more information but also conducting horizontal exams in the major servicers focused on the modification problems that were occurring, and clearly, we had seen a rise in the number of complaints through our own system that had indicated problems with mortgage modifications. We were in the exam process seeing that there were clear deficiencies that were otherwise being reported. We were consistently pushing the servicers to hire, to train, to adopt the succession of procedures that were coming forward from HAMP, to develop their own proprietary modification programs, but the push that was being made was always trying to get them to ramp up.

As has been described, a very large surge of problem loans was coming into the system. They were clearly not ready for it. They have made substantial efforts to improve processing and deal with the problems that are there, but they clearly have not caught up with the modification piece of it.

We have now seen the surge of cases move through to foreclosure. There was somewhat of a pause going back 6 to 9 months as HAMP and other programs, in fact, did ramp up and we saw increased modification activity. But the foreclosures that were coming were an inevitable piece of this. As I mentioned in my testimony, we relied upon internal audit quality assurance and the other things that are often relied upon to look at these large volume activities. But, the institutions failed in their oversight of, for example, third-party agents, law firms and others. They did not ensure quality assurance both in their own activities and in their use of third parties. Clearly, in hindsight, we should have seen that that problem was going to appear successfully in each link in the chain, but—and so now that is where we are focused.

Chairman DODD. Dan, do you want to comment on this?

Mr. TARULLO. So I asked the same question of our people that you just asked of us.

Chairman DODD. Yes.

Mr. TARULLO. Everybody has their own supervisees and so everybody has a specific story for the specific supervisee. But I came away with a few observations.

One, as John has already said, I think there were a lot of supervisory resources focused on servicing and servicers, but they were dominantly focused on modification, or the slow pace of modifications. I actually asked our folks to pull the records of consumer complaints that we collect through the Community and Consumer Affairs Division of the Board, and dominantly, the complaints about foreclosure are complaints from people being foreclosed when they think they are eligible for, or should be in, a modification. And so that is where a lot of the attention was directed.

The second thing is that the control process audit that I mentioned a moment ago is one that I have now concluded needs to be rethought, because what you essentially do is pick out a particular function of an institution where you say, OK, there may be some problems here. We have heard of some problems here. Let us dig in, and you dig in and once you have finished digging in, you find difficulties—or do not, but usually do—and then you take some sort of supervisory action.

You cannot audit all control process functions. You just do not have anywhere near the number of examiners you need. So in the absence of specific complaints about specific processes, the question is how do you use those audits that you do to try to identify or rectify problems elsewhere.

And although I do not want to push this point too far, because I think it is pretty provisional in our own thinking, we do have some sense that in institutions where, for example, on the modification problems we had been doing a control process audit and asking for some changes, that we still see an incidence of problems on the strict documentation foreclosure side, but they do not seem to be quite as pervasive.

And so what we are trying to figure out going forward is whether there is some sort of causal relationship between having done one kind of control audit on the one hand, and on the other getting the firm to pay more attention to what it does. Or, frankly, Senator, it may be that it was a coincidence. But that is my observation at this point.

Chairman DODD. Well, thank you for that. Obviously, I have a lot more questions, but my time has expired.

Senator Shelby?

Senator SHELBY. Governor, I would like to follow up on something you talked about earlier, and that is risk management——

Mr. TARULLO. Yes.

Senator SHELBY.——and quality control. You alluded to the fact that there are obviously weaknesses here. When did you or the Fed, or did the Fed realize that there were problems in this documentation process dealing with mortgages?

Mr. TARULLO. For me personally, it was really not very long at all, maybe a day or so before the public, because, one institution that we are the primary supervisor for, Ally, did come in and tell the supervisors of the holding company that they had self-identified these problems.

Senator SHELBY. What do you believe is the fundamental problem here that needs to be resolved? For example, for years and years, you know, we have got State property laws, we have got laws that if you buy a home, you execute a note and a mortgage. The mortgage is sold, say, to Fannie Mae or somebody and they historically used to record the assignment, you know, every time a mortgage was sold. Has this electronic system that we talk about, is that part of the problem? Or where are we, because we are trying to solve this problem.

For example, if somebody is not paying their mortgage, my gosh, you know, I believe that you have got to foreclosure unless you agree to modify it or something like that. Now, to foreclose, you have got to own that mortgage, in a sense. That is the law, is it not?

Mr. TARULLO. Right.

Senator SHELBY. So where are we, and what do you think needs to be done?

Mr. TARULLO. So I can only give a provisional answer to that, Senator.

Senator SHELBY. Sure.

Mr. TARULLO. But I have to say, getting briefed on the extent of the problem, the complexities of national servicers doing not just foreclosures but servicing in every State, in many counties within particular States, the differences in requirements and the continued requirement for physical recording obviously is for them a substantially costly undertaking.

Senator SHELBY. But those are State property laws, are they not?

Mr. TARULLO. That is right, and, certainly we the regulators cannot do anything about them. I suppose you could if you decided that it was important to have a national system of——

Senator SHELBY. In other words, preempt the State in property and recording? That is a strong——

Mr. TARULLO. Exactly. So that is why I did not propose that in my testimony. What I proposed was thinking about national standards for servicers——

Senator SHELBY. Let us go back a few years, let us say seven, eight, or 10 years ago, 2001, or it will be. Did we have those problems then? I mean, for years, we did not have those problems. People executed the mortgage, they sold the mortgage, they recorded the assignment, they did the documentation, risk management, quality control. Did they get too risky, too sloppy, too shoddy in what they were doing although they were dealing in hundreds of thousands of dollars worth of mortgages—billions of dollars worth—and does that taint the securities, in a sense, that you sell?

Mr. TARULLO. Well, so I——

Senator SHELBY. You securitize the mortgage——

Mr. TARULLO. Right. I would say a couple of things. One, in all honesty, we do not know what the situation actually was in 2001, or at least I certainly do not. We do not know whether, if an examination had been done of servicers in 2001, some of these issues might have been found. But because housing prices were rising and foreclosures were pretty contained, you did not have the opportunity for a potential problem in documentation to show up at the courthouse door, as it were.

I do not think there is any doubt but that the enormous increase in the servicing operations——

Senator SHELBY. So the volume of the mortgages?

Mr. TARULLO. A huge volume of the mortgages, absolutely, and more concentration in the servicing——

Senator SHELBY. Well, where do we go from here, today? This is December 1, 2010.

Mr. TARULLO. Right.

Senator SHELBY. We have still got this problem. Senator Dodd has had a number of hearings. We had other people. Are we close to solving this problem, or where are we?

Mr. TARULLO. From my perspective, Senator, I would not say we are close to solving the problem for several reasons. One, as I said earlier, I think it is related to the relative balance between foreclosures and modifications. Two, I think that until you get a more or less integrated approach to——

Senator SHELBY. What do you mean by an integrated approach?

Mr. TARULLO. I think you need a set of standards that apply to servicers whether they are in a national bank——

Senator SHELBY. OK.

Mr. TARULLO.——an affiliate of a bank, or, and this may be increasingly the case in the future, or a non-bank institution.

Senator SHELBY. And what kind of standards are you talking about? Are you talking about recording and showing ownership or stuff? But we have had that, have we not, for years?

Mr. TARULLO. Yes. I do not know that we have had clearly articulated standards as opposed to requiring firms to have their own processes which assure that they abide by the law, and so I think what this has shown us is we do need more standards and particularly during a period in which there is, as I say, sometimes literally a race between foreclosure and modification within particular servicers. I think some sense of how that race is supposed to be conducted needs to be set forth on a standardized basis.

Senator SHELBY. OK. Thank you, Mr. Chairman.

Chairman DODD. Thank you very much, Senator Shelby.

Senator Reed?

Senator REED. Thank you, Mr. Chairman.

Chairman Bair, the HAMP program, as mentioned, is voluntary. It covers roughly, my guess is about 25 percent of the modifications. And as a result, for the vast majority of the loans, there is no requirement for banks or servicers to offer modifications or do most anything. Should we mandate that 100 percent of loans should at least be evaluated and offered a modification?

Ms. BAIR. Well, I think that is a very important observation. What we have suggested is to try to have some type of global settlement where we could actually leverage all the deficiencies we are finding and procedural hurdles that are appearing to foreclosure because of lack of documentation and not following fully the State and local laws pertaining to foreclosure; that if they provide some type of streamlined mod and give it some period of time—say 3 months—to see if you can rehabilitate the loan, they need to do that first. If the loan cannot be rehabilitated, then they could proceed to foreclosure, and perhaps law enforcement officials and borrowers would agree to waive procedural objections. So I think actually trying to take a lemon and make lemonade, this might actually provide some additional leverage to get a more streamlined modification process for the nongovernment modifications.

Legislation would be an option. I do not know if this is possible, though. I guess I am looking for more things that we could perhaps implement immediately.

Senator REED. Well, again, the legislative process, as we prove every day, unfortunately is slow. So——

Ms. BAIR. You are talking about bank regulators.

Senator REED. So you are envisioning a regulatory solution initially which would use what authorities you have, which are substantial, to deal with a host of issues. One is making sure everyone is offered or at least evaluated for modification, not a small fraction, under half, not voluntary but everybody; dealing with issues of quieting title and standing, *etc.,* which may require legislation, but at least you could pursue it at a regulatory level. The other sets of issues would be the capacity of the institutions to do their jobs, which you would have to increase. But there is another issue here which is the individualized evaluation in the foreclosure process of the status of the person. And you are probably aware, I am sure, that at least in some districts, the bankruptcy trustees have become very active about requiring the paperwork be correct. Is that something that you would like to see broadened? Because it appears to be within the power, the existing power of bankruptcy trustees.

Ms. BAIR. Well, it is not just bankruptcy trustees. In judicial States, it is the courts as well. Local courts, as well, increasingly are becoming much, much more stringent and exacting in terms of requiring proof of good chain of title, challenging the MERS process. So I think this is a real issue.

And, again, as Dan said, we are still collecting the facts, but it is not clear to me, depending on how the case law goes, that all of these procedural problems can actually be cured. And if that is the case, it seems to me we need to think about some type of safe harbor provision, again, using that as leverage to try to get loan modifications early in the process, give the borrower a fighting chance, let them see if it can work; if not, then waive the procedural objections and permit proceeding to foreclosure.

But I think this is—getting back to Senator Shelby's question, you know, "how did we use to do it?" I think community banks are still doing it the way they used to do it, and, you know, when you are keeping your loans in portfolio, servicing them yourselves, you have every economic incentive to work out the loan to mitigate your losses. When you separate ownership from the loan through the securitization process, the same economic incentives are not there. You have this very high volume of troubled mortgages that these servicers are trying to deal with, with a compensation system that was based on benign times when there were very few troubled loans.

So I think going forward, you know, the compensation structure——

Senator REED. My time is limited, but essentially what you are saying, the model that worked before does not work any longer.

Ms. BAIR. It does not. It does not.

Senator REED. And we are pursuing this model in the same old fashion, just do a little bit more and do a little of this and that.

Ms. BAIR. It is not going to work.

Senator REED. It is not going to work. Time is of the essence. There are huge sets of issues here with respect to the legal liabilities of large financial institutions, securities law violations, tax law violations, *etc.* And the sooner there is, I think, a coming together of the financial community and the regulator, with a coherent program that addresses these issues, the better off we will all be. But what I am concerned about is that the people who will be left out are the mortgage holders who are struggling to stay in their homes—not the flippers, not those folks, but people who have seen one spouse lose a job, tuition increases, *etc.,* struggling. And until they are part of this solution, we are not going to get a total solution. That goes to the bankruptcy issue, empowering bankruptcy trustees to be much more proactive.

Let me just turn quickly to Mr. Walsh and Mr. Tarullo. What you have pointed out I think can be characterized as severe managerial failures in many of these companies. Would that be your conclusion, Governor Tarullo, in terms of the way they are operating, in terms of how they accumulated these mortgages?

Mr. TARULLO. As I said earlier, I would want to withhold a final characterization, but as I also said, we have already seen a lot of problems. And when you see a lot of problems, there is some degree of management failure, and I would suspect in some institutions a rather substantial degree of management failure.

Senator REED. Mr. Walsh, your conclusion from your banks?

Mr. WALSH. I would have to second that. Clearly, when banks are self-reporting that they have had major problems, they have major problems.

Senator REED. And let me ask you what steps you have taken in terms of ensuring that the resources are available, that the managerial skills are available, that the emphasis from the very top of the institution all the way down, and maybe in terms of the compensation arrangements which are doled out fit this critical national goal of stabilizing the mortgage markets, of fixing this issue of the securitization model and a servicing model that no longer works. What have you done?

Mr. WALSH. As I had mentioned earlier, we have certainly leaned in hard on the modification part of this and done a series of exams and have been focused since 2008 on shortcomings in staffing and process and the rest. And the banks have improved. They have not improved enough. They have not improved fast enough. Now the problem has migrated on to the foreclosure process where they have again been caught short.

Clearly there are deficiencies there, but the deficiencies that were laid bare by this surge of problems are ones that, should these problems pass through and the system returns to normal, it may look like its old self. But these problems will now have been exposed and the question is how do we deal with them over time.

Senator REED. Thank you. My time has expired.

Thank you, Mr. Chairman. Thank you, gentlemen. Thank you, Madam Chairman.

Chairman DODD. Thank you very much.

Senator Corker.

Senator CORKER. Thank you, Mr. Chairman. In keeping with the normal principle, I did not make any opening comments, but I want to thank you for your leadership on this Committee. I have been on the Committee 3 of your 4 years as Chairman. I asked about ten Senators, when I had the option of coming on this Committee, and 9 out of 10 said, "Whatever you do, do not go on the Banking Committee. It is the most boring Committee in the Senate."

[Laughter.]

Senator CORKER. It has been anything but that. I thank you very much for the way that you have handled this Committee. I thought your comments yesterday on the floor were just outstanding, and for a person who sometimes scratches his head and asks is this really worth a grown man's time because of some of the issues we get involved in, I want to say that I thought it was inspiring; and I hope that we live up to those aspirational comments that were made yesterday. So I thank you for that, and I hope you will give me another minute in my questioning.

Chairman DODD. You take as long as you would like.

[Laughter.]

Chairman DODD. The prerogative of the Chair.

Senator CORKER. But, seriously, we have had, as Senator Menendez said, numbers of very difficult issues, and I think the way Committee Members have interacted with each other has been a reflection of your outstanding leadership, and I thank you for that.

Chairman DODD. As I said, I said this about Senator Shelby as well, and my colleagues here know the tremendous job they have done on this side. But I would be remiss if I did not point out—and I have said this in so many venues and so many places, particularly on the financial reform package, the work of Senator Bob Corker, working with Mark Warner, working with so many people on this side over here made a major, major contribution to the effort. And while we all did not come to an agreement on it, the effort, I think, made a far better product than would otherwise have been the case. And so I will be eternally grateful to a guy from Tennessee named Bob Corker for your efforts.

Senator CORKER. Thank you. And I plan to attend the Latin America hearing later today, having traveled with you to Central America and seeing that you could run for president of any of those countries. I plan on attending that as well.

But with that, I will move on to our wonderful witnesses. I thank you all for being here. I know Senator Bunning is about to get nauseous over here with all of these comments.

[Laughter.]

Senator CORKER. But, in any event, I thank all of you for coming today. I wonder, as it relates to just the macroprudential issue of the institutions, the servicers that are involved, we have not really talked much about that. We have talked about some of the issues. All of us have offices that are being flooded with phone calls over problems with this. Candidly, you have all been very helpful to us as we have tried to navigate that.

But as it relates to just the macroprudential issue, the strength of these organizations, what may happen over time to them financially, I would love for Chairman Bair and Mr. Tarullo and Mr. Walsh to just respond as to how they see this impacting our financial system in general.

Ms. BAIR. Well, as I say in my testimony, we do not see a systemic impact at this point, but I think the potential is there. We need concerted, proactive action to get ahead of this to make sure it does not spin into something that we do not want to see.

I think that there are two key issues. One is what this does to the housing market, which could more broadly impact a lot of institutions and others. We do need a functioning foreclosure process. That is just the unfortunate fact of it. And so I think getting this situation cleared up so that borrowers on the front-end are given a fair chance at a rehabilitated loan. But, if that does not work out, if foreclosure is unavoidable, that there is a process to proceed that has certainty in terms of ownership and legal rights I think is important.

There are also a lot of potential litigation exposures here, and potential for law enforcement actions. And, I do not think we have a good handle on that yet. I think we have asked the institutions to do their own risk assessment of the financial risks that are involved in this, but I think we are continuing to collect information and just do not have a good handle on it yet.

Senator CORKER. I am aware of a number of those issues, but do you have any sense of the order of magnitude, though, of—I know you do not know exactly, but is this something that we should be concerned about as it relates to especially the large servicers and their organizations? Is the magnitude large? Or is this something that really does not matter and we ought to move on?

Ms. BAIR. I think as Dan said, it could be very significant. It could occur over a period of years, but it could be quite significant. A lot of it relates to open legal issues and how they are resolved. And I think the put-back risk is something in particular that the Fed is taking the lead in analyzing. So I am sorry, we do not have all the facts yet. A lot of it would be determined by how courts might resolve various open legal issues, which is why I think that the FSOC can provide some leadership and coordinate interpretations now, at least where we have appropriate authorities. I think that would be helpful.

Senator CORKER. And as you are answering, Mr. Tarullo, in these contracts, these servicing contracts, is there typically recourse back to servicers? Is there significant recourse back to them?

Mr. TARULLO. Let me echo what Sheila said on the issue of the housing market and just add to that something I noted in my written testimony, which is until we get a handle on and reduction in the overhang of the foreclosed inventory in the housing markets, and until we have a process that is moving smoothly, I hope both with modifications and with foreclosures, there are going to continue to be problems in the housing market, and obviously thus for the rest of the economy.

With respect to put-back risk, that is a function of several things. One is the default rate that one anticipates, because security holders only want to put back securities when there are enough defaults that they are not paying well. That we can at least model based on certain macro assumptions.

Second is the legal set of issues. Those are harder to pull apart right now at least. I think Mr. DeMarco can probably give you a pretty straightforward answer about put-back liabilities with respect to the GSEs. But when you get to private label securities, those agreements vary enormously, and the representations and warranties in those agreements vary. So even if there is litigation over one, that may not tell you what the liabilities in others may be.

The third factor is the particular configuration of the defaults and the legal exposure at a particular institution. So you could have an institution that securitized a bunch of mortgages that are not doing very well but had a set of representations and warranties which were either very weak or which they met. So it is just going to take time to disentangle that. As I said, we are going to take a first stab at getting the firms themselves to do it in the capital plan, but that may not be final.

In terms of order of magnitude, Senator, I do not want to give you a number. Senator Dodd noted that the order of magnitude in public or nongovernmental assessments differs by a factor of three or four. We do not have a better number than that, but I do think, as I said in my testimony, that with respect to some institutions, this could be a significant exposure.

Senator CORKER. And before Mr. Walsh—my time is going to expire, so if you could maybe, all of you, even respond to whether pricing—you know, the servicing pricing seems to be—obviously, it was priced for no problems, and there are lots. What length of time is an appropriate length of time for foreclosure? I know in judicial States it is one length of time, in non-judicial another, both of which are incredibly long. But how long should a foreclosure process take? Is it 90 days, 100 days? It is probably not 492. And then, last, just the issue of conflicts, I know that we have been talking more about the mechanisms of servicers, but I know we had an amendment on the floor we were unsuccessful in passing over the last year and a half, but to me there is a built-in conflict with servicers who end up having home equity loans and others. That to me is a huge issue that we do need to deal with because the fact is I think in many cases they are putting their interests ahead of the first mortgage holder, which really inverts and greatly changes property rights.

So with that, I will stop, Mr. Chairman. Thank you for the latitude, and hopefully there will be a little bit of a response.

Chairman DODD. Absolutely. Thank you.

Do you want to quickly respond to that at all, to Senator Corker's point? Does anybody want to jump in on that just quickly?

Mr. WALSH. I mean, I would just say on the systemic piece, there is a systemic risk here, but it is unlike the sort of market crisis in 2008 or 2009. It is something that appears to be something that will be drawn out as we sort through the problems that are there, as Governor Tarullo mentioned.

On the length of the foreclosure process, it tended to average 8 or 9 months. Now it is averaging 15 to 18 months. I mean, it takes a long time, but it takes a long time by design. I mean, it is not supposed to be easy to take somebody's house away from them. But it has now become quite drawn out, and the question is, you know, do we need to streamline that in some way.

Mr. TARULLO. If I could, Mr. Chairman.

Chairman DODD. Certainly.

Mr. TARULLO. Senator, I completely agree with your observation on the first and second liens, and I think that is one of the many reasons why we do need to have a more consolidated set of standards applicable to servicers, because there is an inherent conflict there, and when you observe a second lien doing quite well and a first lien moving toward default, you do raise your eyebrow a bit.

Chairman DODD. Sheila?

Ms. BAIR. Also, I just want to note when we have done our own securitization as part of mortgages that we have acquired from failed banks, we have tried to implement servicing reform so the compensation structure does go up if a loan needs to be worked out. There is third-party servicer oversight. We have also included servicing reforms as part of our securitization safe harbor. And we have also engaged in discussions with our fellow regulators about defining qualified residential mortgages as part of the Dodd-Frank Act implementation, and whether servicing should also be addressed. And I think at the top of our list there is a second lien problem so that if a servicer is going to service a first lien and own the second lien, the securitization documents have to spell out in advance what is going to happen if that first lien gets into trouble so we do not get into this in the future.

Chairman DODD. That is a good suggestion.

Senator Menendez.

Senator MENENDEZ. Thank you, Mr. Chairman.

You know, Ms. Caldwell, I mentioned in my opening statement that 17 of my colleagues joined with me in a letter to the Secretary, and it is our concern about HAMP. We are concerned about the servicers and the banks, and I will get to that in a minute. But we are also concerned about HAMP, which was originally projected to take care of 7 to 9 million homeowners. It has fallen far short with about 495,000 permanent modifications since January of 2009. At the same time, in 2010 we are estimating that there is going to be about 3.5 million homeowners who will receive foreclosure notices, and less than 2 percent of the funds allocated for HAMP have been expended. Now, something is wrong with that.

We sent a letter that outlines a series of actions that can be done not with congressional approval, simply administratively by the Secretary, including a process of holding servicers accountable. Treasury offers incentives for their participation, but no disincentive or no consequence for mistakes. You know, the issue of a Office of Homeowner Advocate, the issue of automatic conversions if you have a successful trial modification, the issue of revised eligibility requirements, the documenting of investor base modification denials, the release of net present value analysis. Why can't we get that done by Treasury?

Ms. CALDWELL. Well, I heard a lot of suggestions there. Let me just first talk in general about the program.

You know, I think it is important to remember that when we started the program, you know, 18 months ago, folks said, "Servicers will never sign up for a voluntary program." It went from zero to over 100 servicers signed up. Then it was, "We will never get homeowners in the program," and we set a goal of getting 500,000 homeowners to trial modifications by November. We hit that.

Then we reached the conversion challenge, and at the beginning of 2010, we had about 31,000 permanent modifications and a backlog of close to 700,000 trials, and folks said, "They will not convert." We have gone in the first three quarters of this year from 31,000 modifications to over 500,000. And what we do know about those modifications is that they are affordable to the homeowner and based on the OCC OTS metrics, they perform better than historical modifications. So while we certainly have not hit the numbers we want and continue to focus on outreach efforts to homeowners through our call centers, through our events, what we do know is that those homeowners that are in HAMP have affordable and sustainable modifications that have used taxpayer resources wisely. But we continue to focus our efforts on outreach, absolutely.

Senator MENENDEZ. Well, I appreciate your defense of the program. I do not quite see it the way you see it. I do not think many Members see it the way you see it in terms of what our goals are and what the accomplishments are. And so I hope that we will get a response from Treasury toward these six, seven items that can be done internally administratively, and many of us, including many of us on this Committee, think that, in fact, would transform that into a much better, more successful program. So we would like to get a response from Treasury on it.

Mr. Tarullo, a couple of weeks ago, your colleague on the Federal Reserve Board, Sarah Bloom Raskin, said that the numerous procedural flaws that have been unearthed are "part of a deeper systemic problem," and that as long as the business incentives for bank and loan servicers run counter to the interest of homeowners, there is a need—and this is her word—"a need for close regulatory scrutiny of these issues and for appropriate enforcement action that addresses them."

Now, to me that makes a lot of sense, and as long as the servicers are incentivized to quickly push foreclosures through, they will ignore, I think, very often the ordinary homeowner's needs and the accompanying dead weight cost of foreclosures. How do we get those incentives somehow realigned? What steps should banks and regulators such as the Fed take, if any?

Mr. TARULLO. This gets back, Senator, to my point about the need for a combined or generally applicable set of standards which are going to apply to servicers whether or not they are an insured depository institution, an affiliate of an insured depository institution, or completely independent.

I do think that with respect to fair treatment of homeowners, with respect to the way in which a servicer deals with conflicts it may have as between one lien holder and another, with respect to the relationship between the servicer and the investors in a securitized mortgage, that the system as it is now was simply not developed with the prospect of a large number of foreclosures and troubled loans in mind.

So I think that while you will see problems across the board, you are going to need more of an across-the-board approach, and that is why I said in my testimony and will repeat here, I think we do need more of a national effort to impose standards on everybody. We can do things as we are—I mean, with respect to one of our institutions where even partway through the examination we just see a lot of problems, we are pushing them to change now. We do not need to wait for the end of the examination. But that kind of step-by-step process, one institution by one institution, specific issues here, I do not think gets to the larger points that you and Senator Corker and others have been raising.

Senator MENENDEZ. Mr. Chairman, I have one final one. Mr. DeMarco, both Freddie and Fannie are participants in the second loan modification program which helps a lot of homeowners who are struggling with multiple mortgages, and servicers are supposed to implement this program by January of this coming year. But given the stories we have heard from homeowners and consumer advocates about servicers' reluctance to engage in second loan modifications, let alone the first loan modifications, I am concerned about how the implementation of this program is going.

What rules are in place for ensuring that servicers are knowledgeable about the second lien modification program, that they actually participate? And how does your agency plan to oversee this program to ensure that servicers are in compliance?

Mr. DEMARCO. So, Senator, first, the second lien program you are talking about is part of the HAMP program, so that is administered by the Treasury Department. It is a Treasury program.

But to the general point—and this goes back to some comments that were made just a few minutes ago in response to a question by Senator Corker—the existence of second liens has been very problematic for us in overseeing the Enterprises and their loss mitigation activities with respect to first liens. And it is really quite turning things upside down to find situations—and this is rather common—where borrowers are continuing to pay on their second mortgage, and they are not paying on their first mortgage. But the property rights here actually run first to the first lien holder, and this has been a true conundrum in this whole loan modification and loss mitigation effort that we have all been engaged in, is to figure out that the way this ought to work is that the second lien holder ought to be taking the first credit loss here, and yet we are continuing to do loan modifications on first liens that basically provide protection to second liens.

So I would share the comments of my colleagues that as we think about our housing finance system going forward, I think that this is an area that clearly needs addressing. But as we go along right now, with second lien—with loan modifications, yes, it is very much our expectation as a conservator of Fannie and Freddie that the second lien holders be participants in providing relief to a troubled homeowner. If the first mortgage holder is going to provide relief through a reduced payment, an affordable payment, we certainly think that the second lien holder ought to be sharing in that.

Senator MENENDEZ. Thank you.

Chairman DODD. Thank you, Senator, very much.

Senator Bunning.

Senator BUNNING. Thank you, Mr. Chairman.

I am going to say something that you all will not like, but in 2006, we had a huge housing crisis in this country. And even before that, the mortgage crisis showed its face in 2001 and 2002 and everything. All you people here have not come up with a solution to solve it. All your brains, and you have got a lot of them, have not come up with a solution. And I have sat on this Committee for 12 years and listened to the same absolute gobbledygook from everyone who has come up here. You have not had an answer to any of the questions. All you do is deal in hyperbole. You do not deal in fact.

How do you solve the problem? How do you get out the first mortgage holder and the second mortgage holder, how do you get them out? I cannot believe that with all the brains that are sitting at that table that there is not one of you that can come up with the answer to solve this crisis—which is about to go the wrong way again. If you saw the numbers in 2010 for October, you saw them minus 2 percent in housing.

Now, I am telling you, if it goes badly in November and December—because all the programs that we had in place are no longer in place, I mean, that supplemented the mortgage market and the housing market. And until we get the housing market straightened out and the loan market straightened out, we are not going to get the economy straightened out.

Chairman Bair, I know you have heard this before, but it is too important not to repeat to you again today. I continue to hear from well over 40 Kentucky community banks about the heavy hand of your examiners and their supervisors. I have talked to you about this before. These banks are not the ones that caused the housing mess. But your examiners are blocking them from making good loans and forcing them to treat good loans like bad ones. Your regional supervisors are even adding more requirements on banks beyond what the examiners think are necessary. And the biggest complaint is your agency is being inconsistent in applying the regulations day to day and bank to bank.

When are you going to do something about this and get off the backs of our community bankers?

Ms. BAIR. Well, Senator, whenever this issue comes up, and we were discussing it before, if you can give me specific names of banks that have had problems, we can review that and make sure that whatever our examiners are doing in the field is consistent with the policies we have issued in Washington. We have issued a lot of policies on this. We want a balanced examination approach. We want bankers making good loans.

The community banks have been doing a better job lending than any other sector, certainly much better than the larger institutions. So the facts are the community banks have been lending. Their loan balances have been maintaining steady throughout this crisis. There are some community banks that have a lot of troubled commercial real estate loans, and if that is the case, they are going to be capital constrained because they are going to maintain their capital to absorb losses from their troubled commercial real estate loans.

Senator BUNNING. But I am talking about people that have 30 percent down on a home——

Ms. BAIR. Mm-hmm.

Senator BUNNING.——and can go out—30 percent down used to be——

Ms. BAIR. If they have a 30 percent downpayment and have income to support the mortgage, they should be approved for the mortgage if——

Senator BUNNING. They are not being.

Ms. BAIR. Well, please, give me specific examples. We will correct that very quickly.

Senator BUNNING. I will be more than happy to give you 40 names of 40 banks.

Ms. BAIR. OK, good. We will take a look at all of them.

Senator BUNNING. OK. Mr. Tarullo, Mr. DeMarco, what kinds of losses—and Sheila, you can also get in this—what kind of losses do you expect the Fed and the GSEs to take on their holdings of mortgage and mortgage-backed securities as a result of mortgage servicing problems?

Mr. TARULLO. I can say from our point of view, Senator, the mortgage-backed securities which we purchased as part of the large-scale asset purchase program last year are only those that are guaranteed by Fannie and Freddie. So we do not have an independent issue there. We have the guarantee of Fannie and Freddie.

Senator BUNNING. OK. Then he will pick it up at Freddie and Fannie.

Mr. DEMARCO. Right. So it is something that we are—both Enterprises are totaling up and it is a servicer-specific issue and it goes to the losses that result from delays in foreclosure processing because the individual servicer has a problem.

Senator BUNNING. Four trillion, or where are we?

Mr. DEMARCO. No, sir. It is nowhere near that amount. I mean, the fact that there is a loss already coming on the mortgage because it is seriously delinquent and it is in foreclosure has already been reserved for. What we are looking at in the foreclosure processing problem is the incremental cost of delay and possible litigation that results from this. So no, I do not think we are looking at any——

Senator BUNNING. Well, how many foreclosures, then, are we still engaged in?

Mr. DEMARCO. I can get that number for you, Senator. We report it up here on a monthly basis to the Committee. But I would say that——

Senator BUNNING. Well, does somebody on the Committee staff have that number?

Chairman DODD. We will get it for you.

Senator BUNNING. OK.

Mr. DEMARCO. We will certainly provide it again, Senator. We report—just so you understand, we report monthly to the Committee——

Senator BUNNING. Well, since you report it, I thought maybe they had it.

Mr. DEMARCO. I understand. We report monthly what is called the Federal Property Managers' Report in which we report for each Enterprise updated data on mortgage delinquencies as well as the whole range of loss mitigation activities that are taking place, loan modification——

Senator BUNNING. Well, I have got another question and you are talking me through it. Are the Fed and the GSEs going to aggressively pursue pull-back of mortgages to the originators and investment banks to reduce taxpayer losses?

Mr. DEMARCO. I am very much in the process of doing that, Senator. At FHFA, we have been quite clear and public about that for months. The instruction to the Enterprises, and the mortgage servicers know this, is that we will—where there are representation and warranty violations by a servicer or loan originator, we are having the Enterprises put those loans back. In my prepared written statement, I provided data on how much was done last year and this year.

And I would say further, Senator, your question about private label mortgage-backed securities, in July, the FHFA issued 64 subpoenas to a range of institutions to gather data on mortgages in private label mortgage-backed securities that the Enterprises hold. This is to gather information to be able to assess whether there have been representation warranty violations in those securities. This is going to be a long process. But FHFA has been committed to it as a necessary part of being the conservator and having a responsibility to protect the taxpayer.

Senator BUNNING. Sheila, let me explain why you have not heard from those bankers. They are afraid to put their names forward to figure that the FDIC will jump down their throats because they are in total and complete control of who and how they can lend money. So that is their reluctancy to come forward.

Ms. BAIR. You have my personal assurance that would not happen. I have——

Senator BUNNING. I love that.

Ms. BAIR.——to make sure that is not—no, you have my personal assurance that will not. I cannot respond, though, to generalized issues——

Senator BUNNING. Well, it is no big deal. I will get the names——

Ms. BAIR. OK.

Senator BUNNING.——from the head of the Kentucky Bankers Association.

Ms. BAIR. That would be fine.

Senator BUNNING. Thank you.

Chairman DODD. Thank you, Senator, very much.

Senator Merkley.

Senator MERKLEY. Thank you very much, Mr. Chair, and thank you for your leadership on this Committee over the last 2 years that I have been on it. It has been an extraordinary exploration of the process by which we aggregate capital, disburse capital, and the many, many challenges that have arisen in the course of mortgage practices, both at the retail level and then at the securitization level, and these issues are going to continue to reverberate for a long time. We are addressing one little slice of it today. But thank you for your leadership on Dodd-Frank, a huge effort to try to stabilize our financial sector and have it serve our nation well in the decades ahead. It has been a pleasure to be a part of your team.

Chairman DODD. Well, thank you, Senator, and you have made a wonderful contribution, as well, to the efforts and I want to publicly thank you. As a new Member of the Committee, you became very active and played a very important role in the process and I thank you for that effort.

Senator MERKLEY. Thank you, Mr. Chair.

I wanted to start, Mr. Tarullo, by asking you a little bit about the put-back risk. The numbers that you lay out in your testimony are that Freddie and Fannie between them have $13.3 billion in outstanding repurchase requests. The four largest banks have reserves of less than $10 billion. So the reserves are not expected to grow, and yet the repurchase requests are probably going to grow substantially over the $13.3 billion, and that is just Fannie and Freddie, not other investors that are——

This situation, in terms of its systemic risk down the road, I believe that the Federal Reserve is conducting a detailed examination of this risk. When do you anticipate that there will be a point that you will have a report, and is the Systemic Risk Council also undertaking this issue?

Mr. TARULLO. Senator, we have requested the comprehensive capital plans from the largest bank holding companies, whether or not they are mortgage servicers, I should say. This is an independent exercise. But for those which are big servicers, obviously, put-back is a significant risk. We have requested those plans by the first part of January, which will be the occasion, for us digging into each of them for each of the institutions with respect to specific issues, and where there are issues that may call for supervisory guidance or action, we would take those.

I would not anticipate that we would release firm-specific information about that, but obviously we would be happy to communicate on our general evaluation of the level of put-back risk with respect to the institutions as a whole.

Senator MERKLEY. On a scale of one to ten, how big of an issue do you anticipate this is going to be?

Mr. TARULLO. Instead of being evasive, let me just say I am going to be evasive and that I will not——

[Laughter.]

Mr. TARULLO. I do not want to give you a number on that because we really are in the middle of the process right now. But I will tell you, if I had to guess, that for a few institutions, that number would be reasonably high, and for many, it will actually be reasonably low, even if the dollar amount is significant, just because these are such big institutions.

Senator MERKLEY. OK. Thank you very much. I think it is important that you flagged it in your testimony and that we continue to pay attention to it in a Congressional oversight fashion.

Ms. Caldwell, I wanted to turn to your comments about the dual track. I am not sure if I have this word for word, but I think you said that you have done procedural safeguards to minimize dual track, that is, to make sure that the foreclosure process does not move ahead simultaneously with the loan modification process. Did I roughly capture your comment?

Ms. CALDWELL. Yes, you did, and I just also want to acknowledge the work, Senator, of your staff in providing input into the HAMP program and some of those borrower protections that were announced in January that did put clarification around minimizing the dual-track program, so——

Senator MERKLEY. So thank you. We will continue to work with you all. But I must say, we are much more worried about this than I think perhaps Treasury is, based on your testimony. We had recently two major banks here, Chase and Bank of America, which said very clearly that it is their policy to pursue both tracks simultaneously, that the only factor that is kind of a caveat to that is that they do not go through with the sale if the modification process is still underway.

But that process, the foreclosure process going forward simultaneously in which the homeowner is receiving notice after notice, phone calls, notices posted on their door—I read a letter, actually, about one of the homeowners in Oregon—is enormously confusing and enormously stressful to our families. I wish there was, in fact, a rule in place that said the foreclosure track will not be pursued until the modification is completed because that would change the dynamic of the modification process enormously for the families involved. Is that a potential point that Treasury can back, completely suspend the foreclosure track until the modification track is completed?

Ms. CALDWELL. Again, with respect to the HAMP program, servicers may not start the foreclosure process until loans have been evaluated for HAMP or until a certain measure of outreach efforts to the homeowner has been tried and exhausted.

Senator MERKLEY. So——

Ms. CALDWELL. In the hearing——

Senator MERKLEY. I am going to interrupt you for just a second——

Ms. CALDWELL. OK. Sure.

Senator MERKLEY.——because my time is out. Can I pursue this for just a second?

Chairman DODD. Yes.

Senator MERKLEY. Thank you, Mr. Chair.

The situation is that often when folks seek a modification, they are told by the servicer, you need to be delinquent before you start this. You need to be one or two or 3 months delinquent. At 3 months delinquent or 90 days, then that is kind of the official start of a foreclosure process. So now that the foreclosure process is underway and the modification is being initiated, the banks do not suspend the foreclosure process.

And so essentially—I guess what I am saying is that technically, you are making a correct point, is that if no foreclosure process has begun, it cannot begin if they are in a modification. But so often, the interaction results in the family being 90 days behind and therefore triggering the foreclosure process before the bank will proceed with the modification, and then the foreclosure process is not suspended. That is the reality on the ground that all of us are seeing with our constituents. And so we need a much stronger position in regard to that situation.

Ms. CALDWELL. You know, we completely agree with you that the dual-track process is confusing for homeowners, but I just want to make sure to clarify that within the HAMP program, we issued guidance that effective in June of this year, servicers had to stop the process in place and evaluate that homeowner for HAMP.

In the last hearing that this Committee had, the two large servicers did testify that for those loans in their HAMP book, they do, in fact, stop that process, but that for those loans that are subject to other investor guidelines where they are not permitted to do so, they cannot. So HAMP does not have the authority to override existing investor contracts, but that is a specific HAMP guidance that was issued in January of 2010, effective in June, and it was done in response to the overwhelming complaints we heard during 2009 about confusion among homeowners with the process.

Senator MERKLEY. I will just conclude with this, then. Because of those existing agreements, what you are describing has little practical effect because Fannie and Freddie are telling those servicers to continue with the foreclosure process, not the final sale but the foreclosure process, the intermediate steps to get there, and so we have a real problem on the ground that needs to be addressed.

Mr. DEMARCO. Senator, if I may, to the extent that concerns are about GSE loans, Fannie Mae and Freddie Mac loans, I would like to say that it is under our authority. It is not—while it is run in tandem with and is meant to be in alignment with the HAMP program, those are not HAMP loans per se, and I will be glad to speak to the concern you have about dual-tracking with respect to what is said about the Enterprises because I think that this is a matter of confusion not just for homebuyers, or homeowners, but it is confusion in a lot of other places, as well.

I think that the responsibility here and the way this is run for Enterprise loans, which is in harmony with what is done in the HAMP program, is that as soon as a borrower starts missing payments or reaches out and contacts their mortgage servicer that they have a difficulty with their mortgage, there is a single track, and that is to work on a loss mitigation option that is tailored to the particular circumstances of that borrower. Foreclosure does not begin, and that is what we should be working on.

But at some point, foreclosure does need to begin, and that typically is at 4 months, and as has been reported in the testimonies of several of us and has been discussed at this hearing, the foreclosure process is extraordinarily long, and so I think that we have got to be a little bit careful about terms here—to have a dual-track. If you have got a foreclosure process that is going to take a year or more, it means that while you are going through that foreclosure process, there remains an opportunity for the homeowner to cure that loan or to qualify for some other kind of loss mitigation activity.

I fully understand the concern about the confusion for the borrowers, and I think we all have a responsibility to be working on greater clarity for the borrowers. But at some point, once the foreclosure process starts, I am looking at having to conserve the assets of these Enterprises on behalf of the taxpayer and I do think that I have got a responsibility as conservator for the lengthy foreclosure process to be moving along if we are not making or hitting a meaningful milestone with respect to loss mitigation alternatives that are offered, and these offers are numerous.

So I would just like to sort of leave it at we absolutely want the servicers of Fannie Mae and Freddie Mac loans to be doing everything possible to come up with an appropriate foreclosure alternative starting with a loan modification. That must start months before any foreclosure processing would start. And if there is meaningful progress and milestones met on those loan modification activities, foreclosure will not start. But once the foreclosure process does start, I do think that there is a responsibility to be moving that along, and when a successful trial modification is initiated, consistent with the terms of the HAMP program, then we will cease the foreclosure proceedings.

I hope that that helped clarify. This is a very difficult issue and it is one we all share, the concern for both the homeowner and for the taxpayer.

Senator MERKLEY. I am completely dissatisfied. We will continue the conversation. And I apologize to my colleagues. I am deep into their time——

Chairman DODD. No, it is an important question. I thank you.

Senator MERKLEY. Thank you.

Chairman DODD. Senator Bunning asked Mr. DeMarco for numbers, and just to put these in the record, between January and the end of August, there were 278,409 completed foreclosures, and since January to date, the ones that are now in process of foreclosure are 761,611. So those are the two numbers, and I will put this whole graph in the record, Jim, as well.

Senator BUNNING. Thank you.

Chairman DODD. I just note, as well, by the way, in this chart, and maybe I ought to inquire here, the top five reasons for delinquency, and interestingly, the overwhelming number, almost 50 percent of delinquencies are curtailment of income, and so——

Senator BUNNING. Loss of job?

Chairman DODD. Well, you know, it is confusing, because one says curtailment of income. There is an unemployment statistic, and that only accounts for about 8 percent. I do not know what the difference between curtailment of income and unemployment is. I started to ask staff the question, what the distinction is. I do not want to take up the time of Senator Bennet, but someone else may answer that question for me, what the distinction is. How do you——

Mr. DEMARCO. Well, curtailment of income could be that there is a dual-income household and one person has lost——

Chairman DODD. All right.

Mr. DEMARCO. It could also mean reduction in hours and so forth.

Chairman DODD. But more than likely, it is loss of employment? OK.

Senator Bennet.

Senator BENNET. Thank you, Mr. Chairman, and thank you for your leadership of this Committee, for allowing me to participate and for your excellent, excellent speech yesterday.

Chairman DODD. Thank you very much.

Senator BENNET. I hope we hear a lot more like that one going forward.

I wanted to go back to an observation Mr. Tarullo made at the very outset of this hearing, which were the macroeconomic implications of what we are talking about here, because I think they are potentially devastating. We had this housing bubble. We had this crash. We had a lot of people try to figure out, well, how do you preserve these home values, which you know is like holding back the ocean.

But now I am very concerned that we are moving in exactly the opposite direction, that because of all of the issues that have been raised here, we find ourselves in a place where, though it is in the investors' economic interest for a lot of these loans to be modified rather than houses foreclosed upon, because it is in the homeowners' interest to get modifications done, not to be foreclosed upon, and because it is in the broader economic interest of this entire country that we do not drive housing prices down because we are foreclosing in neighborhoods unnecessarily, somehow, we still find ourselves incapable of streamlining this process. And I think the dual track has a lot to do with it. I think that the observations that the servicers made when they were here was that because of Fannie and Freddie, they said, they cannot get out of this dual track. They cannot find a way to modify the loans in the way they want to.

And I guess the question that I have—sorry for the long windup—is, is this really an issue about standards, which is what you said, national standards, or is it a broken system of incentives, and we do not understand the incentives in the marketplace here, or is it some combination of those two things, because, you know, for us—at least from my point of view, this entire conversation has been like watching a slow-moving train wreck for 22 months. And for the homeowners in my State, there have been devastating consequences as a result of this. And I am the first to say you cannot hold values up when the market drops. It is impossible. What I am worried about is that we are engaged in a process of value destruction and therefore creating a horrible potential economic consequence to the country.

So I do not know if you want to respond to that, or if Sheila or anybody else——

Mr. TARULLO. I can start, Senator. I am sure others have something to say on that.

Senator BENNET. OK.

Mr. TARULLO. First of all, obviously, I agree with your point about the macroeconomic consequences here.

Second, in response to your specific question, I think it is about standards, but the standards themselves can be about incentives. The first lien, second lien issue is a very good example of that.

Senator BENNET. Right.

Mr. TARULLO. But also, the standards are going to need to be about resources, because you have heard a number of us mention the inadequacy of resources to deal with foreclosure, with modifications, and perhaps even with the ongoing servicing of non-foreclosed mortgages.

So the reason why I come at the standards is not because rules are going to be the end-all and be-all, but I think it will be an occasion for a consolidated group, whether it is in the FSOC or somewhere else, to think about how all these things interact and to try to get a more or less uniform set of standards and expectations for how this needs to proceed.

But I do not want to take up more time, because I am sure others have more to say.

Ms. BAIR. Well, I guess, as I have indicated before, I think we will not fix the securitization market going forward unless we deal with the huge economic incentives that have really been the key driver of this mess we have, with not having servicing done appropriately on these loans. I guess that is number one.

Number two, I think the GSEs really do have a big role to play in setting standards in the short term and I think we can, as members of the FSOC, the FSOC can play a broader role in this process.

On the question of dual track specifically, one of the reasons we have suggested that all servicers be required to designate a single point of contact for the borrower is, to just acknowledge the reality that in some circumstances, it may be a legal requirement that they do dual track. If there is a huge backlog, there might be a valid reason to start the process. It may be legally required in some jurisdictions.

But there needs to be somebody talking to the borrower, saying if we can get this modification to go through, you will not be foreclosed upon. We have a legal requirement to do this, but we are explaining it to you. Do not be scared by it. Give them a phone number and a real person who is going to answer the phone to call if they get confused because of this process. And I think this would be operationally challenging for the servicers, but I think they should do it, because borrowers are confused and scared. The thing that is happening now is that people in good faith who want to keep paying on their mortgage but cannot make the current payment, need to reduce their payment. They are getting caught in this confusing trap, and the people who want to game the system and just play it out for as long as they can without paying anything are benefiting.

Senator BENNET. Right.

Ms. BAIR. It is completely upside down. In the short term, that would be our solution, with the single point of contact.

Mr. WALSH. Just to add to that, I think the two actually go together. A number of institutions have talked about instituting a single point of contact to eliminate confusion in that form. But we do agree, and in the conversations we are now all too frequently having with servicers, they share the concern that the dual track is confusing. If you have entered into a modification and are performing under it, you should not be getting things in your mailbox and things stuck on the door of your house and finding an ad in the paper about the home that you live in.

So where we are—where the servicers have the flexibility to do so, we are directing them to halt the foreclosure process when there is a mortgage modification in place. But the fact is that it is a space that is dominated by contractual obligations because of the servicing arrangements, and so in many cases, what happens is either through private-label arrangements or the GSEs, there are particular rules that apply and I think we need to give some attention to sorting that out and trying to produce some uniformity.

Senator BENNET. Thank you, Mr. Chairman.

Chairman DODD. Thank you very much.

You know, let me ask you something. I am sitting here, and Senator Bunning in his usual, very forthright manner expressed his frustration that others of us have tried to express in less direct terms, and I thank my colleague sometimes for his directness—he gets to the point very quickly—every person represented on this table here today is a member of the Financial Services Oversight Commission, the one that we established in the Dodd-Frank legislation as one of the major points of this bill, to try and anticipate systemic problems, chaired by the Treasury. And I realize you are not the Secretary of the Treasury, Ms. Caldwell, but nonetheless, you are here.

I have raised it several times here, but the question of why we have not been able to come up with some answers, given your regulatory authority you have, and again, there may be contractual issues that limit even regulators' capacity to be able to implement some of these very ideas that you seem to agree on would make some sense—a single point of contact, various other suggestions have been made—what is the FSOC doing? I mean, it is the law of the land now. Are you people meeting?

It seems to me this was a classic case—we did not anticipate this one, but here we have, by all of your admitting, we have potentially a systemically risky problem that can put our economy once again in a tailspin. And the issue is, why are you not meeting on this thing? Why am I not reading about this Commission that we formed specifically for a purpose like this getting together and doing anything about it? What is going on?

Mr. WALSH. In our last FSOC meeting, we had a discussion in the private session of the foreclosure issue and then there was a presentation by Assistant Secretary Barr in the public session on the state of play, and we have a number of efforts underway. It is certainly something that has been taken up by the Council, but I think with the thought that we need to complete the work that is underway, which is due to be completed within the next month in the institutions and then brought back to the Council at its January meeting. So it is certainly something that has been taken on by——

Chairman DODD. Well, John, did you talk about—for instance, Sheila Bair made some recommendations. Dan has made some suggestions. Were those talked about in that meeting, these ideas, or are we hearing them for the first time here today?

Mr. WALSH. I do not think that we are hearing ideas for the first time, but I would characterize the discussions as being at a more general kind of systemic level, at least in that first discussion that we held. Once we have details of the nature of the problems, we will move on to solutions.

Chairman DODD. I apologize. I have two of my colleagues who have not asked questions. But also, I realize that five of the Members of the ten Members are sitting at this table, and again, I have raised this at the past in other hearings. If I could have conjured up a fact situation—I did not think we would see one this quickly, quite candidly, when the law was signed a few weeks ago, that I would be sitting here with a bunch of witnesses talking about a systemic problem, and yet I do not hear much out of this very entity we created in that bill to exactly provide the kind of answers that Jim Bunning has raised.

And I do not expect miracles out of it. Merely the fact that you all meet does not necessarily mean you are going to have an answer to a very complex problem. But, good Lord, I would expect something coming out of this operation other than what presently is the case. What better case could you have than this one to demonstrate the value of having a Commission like this?

Senator Kohl.

Senator KOHL. Thank you very much, Mr. Chairman. Like every other member——

Chairman DODD. Sorry, I apologize. Herb, Evan was here before you.

Senator BAYH. I will be mercifully brief, Herb. Thank you. You are very kind.

First, Chairman, let me thank you, as the others have, for your service. I could not help but note that with your changing circumstances, mine, and Senator Bennet's, the caucus of those of us who have followed our fathers into the Senate is going to be somewhat diminished, so we are going to have to count on Senator Pryor and——

Chairman DODD. Mark Pryor has got it all on his shoulders now.

Senator BAYH. I had no idea until I was talking to Senator Bennet yesterday about his father's long commitment to public service, so although not in the Senate, he will carry on in like spirit. But it has been a pleasure serving with you, and although our time here will come to a conclusion, our friendship will not. So thank you.

And thanks to all of you for your service to the public. I know that you sacrifice in many ways personally, and I just want to—and particularly during the last couple of years and all we have been through, I am sure you have been putting in yeoman's hours, and I want to thank you and your families for your devotion to our country and to meeting the challenges that face America.

I just have two or three quick questions. Mr. Tarullo, I would like to start with you, and let me just give you some introductory comments. We avoided the worst possible outcome with the downturn. The Fed, though, is now engaged in some rather extraordinary efforts, which I support, to prevent a lapse back into a more sluggish economy. I am referring to the quantitative easing. And yet we have other drags on the economy. We have lack of consumer confidence. They are retrenching. Businesses are sitting on a couple trillion dollars because of their lack of clarity about future final demand. We have some of the problems of—the sovereign debt problems in Europe may have caused more sluggish growth there. China may be worried about increased inflation, so they may be raising their interest rate. There are a variety of things that may serve as a drag upon the economy.

Where I am going with all this is obviously real estate has been a huge drag on the economy. We have been hoping that this clearing process would take place, that we would get footing under the real estate sector and that that could then not be a drag but perhaps contribute to economic growth going forward. And yet the dragging out of this whole process runs the risk of retarding that.

From a macroeconomic standpoint, do you have an opinion about what kind of risk this presents to the overall economy, the fact that this will be a slower process and the clearing will take more time and, therefore, be less certainty in the real estate market?

Mr. TARULLO. So, Senator, at this juncture our internal forecasts are for housing prices being stable to maybe slightly declining, depending on which forecaster you talk to over the course of the next year. That obviously is not providing an impetus to growth, and as Senator Bennet was suggesting earlier—he did not use this term, but I will—there are multiple ways in which the housing market can clear, some with greater costs, more neighborhood problems, more lost value and foreclosures, lower-valued homes because of deterioration and the like; some with fewer costs. There are going to be costs in any case, and as Sheila said, we are not going to avoid all foreclosures by a long shot. But I do think that if we are to get housing to be a net addition to GDP growth, we are going to need to deal with the overhang of foreclosed homes which are undoubtedly having——

Senator BAYH. The sooner we clear, the better?

Mr. TARULLO. Absolutely.

Senator BAYH. More certainty.

Mr. TARULLO. Depressing effect on the market, as——

Senator BAYH. Home prices can start rising again, people can be confident in purchasing——

Mr. TARULLO. Right now, Senator, if you just look objectively, based on past experience, conditions—finance and other conditions for home buying such as pricing and credit—are actually quite good. But home buying is obviously not nearly what people hope it will be. Well, why is that? It is for a couple of reasons. One, people may be uncertain about their own economic situations. Two, they may think housing prices are going to decline some more. And so until we strengthen the economy to help deal with number one and clear the market to deal with number two, we are going to have—we are not going to get——

Senator BAYH. And the more protracted this foreclosure problem, the more that delays——

Mr. TARULLO. It is an additional——

Senator BAYH.——recovery.

Mr. TARULLO.——source of uncertainty.

Senator BAYH. Right. And with regard to the put-back problem, you mentioned that for a couple of institutions this may be a material issue. You said that there was a variation in the estimates of a factor of three or four, which is a huge swing.

Mr. TARULLO. Right.

Senator BAYH. But for a couple of them, which I assume must be, you know, among the bigger ones, this may be a problem for them. If they become significantly affected by this, does that present a systemic risk of some kind?

Mr. TARULLO. First, I want to again underscore the tentativeness of everything that I am saying about examinations or put-back analysis. But, second, I would say this is why we are trying to get ahead of the issue and do it in the context of an overall capital plan. So to the degree that any institution needs to be reserving more, needs to be doing capital preservation, that we are able to give that kind of guidance in a timely fashion.

Senator BAYH. Well, and if they have to be focused on capital preservation, then obviously they are not lending, and that is yet another drag upon the recovery, isn't it?

Mr. TARULLO. Well, sure. At this juncture I wish that capital requirements were the principal drag upon lending. They do not seem to be. The demand factors that you mentioned earlier seem to be playing a greater role. But at some point they could be, sure.

Senator BAYH. Right. My last question has to do with I think what many people are asking themselves, Chairman. When they pick up the paper and they see—there is an understandable sense of outrage if someone who has been undeservedly foreclosed upon, if the underlying merits did not justify that person's home being taken away from him, people say, "This is outrageous. How can this possibly happen?"

At the same time you read these articles, and it would appear that a fair amount of this are just technical paper problems that ultimately will be resolved. And so my question is: Do any of you have any sense about the percentage of these cases that are miscarriages of justice, for lack of a better term, and how many of them are purely technical in nature and simply postponing the day of reckoning that will inevitably come?

Mr. WALSH. Well, again, we keep mentioning the fact that we are still in the middle of these exams, but the indication——

Senator BAYH. Based upon what you have seen to date.

Mr. WALSH. Right, but the indications that are coming in are that there are not—we are not seeing many cases where the wrong person has been identified, they were current on a mortgage or kind of working under a modification under which they were performing and that sort of thing. These are kind of long-dated foreclosure processes taking place where the problems are more technical. But, I mean, the fact of the matter is there are laws that require certain things to be done, and if there is a violation of law, then that is unacceptable and you have to cure that problem and remedy that situation.

So even if the problems are more kind of technical in that sense, they are legal deficiencies, they have to be fixed. They are not legal foreclosures unless those problems——

Senator BAYH. Well, and those requirements are there for a reason. The reason for my two questions—and then I want to turn it over to Senator Kohl, who has been very patient—is that we are paying a macroeconomic price for the delay in resolving this issue. As much as those of us on this side of the aisle look for a pain-free resolution—on this side of the dais look for a pain-free resolution—that is what politicians usually do. Economists remind us that is not possible at the end of the day. So the more efficiently we can resolve this, while still—you know, even if only one person has been unjustly foreclosed on, that is one person too many. So we have got to focus on how do you keep that from happening but do that in the most efficient way possible so we can allow the process to take place and avoid the overall drag to the economy that causes every American to suffer. I guess that is the underlying purpose of my two questions.

And the final comment—and then, Chairman, thank you again—I really encourage you to look at the misalignment of incentives. If we are going to avoid a repetition—there is a wonderful saying in law school from many years ago. It is a problem susceptible of repetition and yet evading review. We do not want that here. This is susceptible of repetition if we do not appropriately align the incentives. That is the best way to avoid getting back into this morass again. So I would encourage your focus on that.

Again, thank you for your service. Herb, thank you for your patience. And, Chairman, it has been a pleasure.

Chairman DODD. Thank you very much. I want to thank you for your patience and your work on the Committee as well. You have been a great asset to this effort over the last few years, and I am very grateful to you for that.

Let me just say, by the way, in my last monologue there about the Financial Services Oversight Commission, this is a question for the Secretary of the Treasury. He is the Chairman of this Commission, and so while I have asked—sort of raised the issue to all of you at the table, the question goes back to the Secretary, and I would appreciate if you would carry it back to him. I would like to know what is going on right here. Again, I do not expect miracle answers because you merely convene meetings. But it seems to me, again, the idea of getting the collective wisdom of people around this table, this table that is in front of us as well as others, could really help, in my view. So please convey that message.

Ms. CALDWELL. OK.

Chairman DODD. Senator Kohl.

Senator KOHL. Thank you very much, Mr. Chairman. Like everybody else on this Committee, I would like to offer my praise to you. It has been a pleasure and an honor to serve with you, and in my judgment, you are one of the very best Senators that the United States has ever had. So thank you for everything you have done.

Chairman DODD. Thank you.

Senator KOHL. Chairman Bair, I would like to talk to you. In addition to the current home foreclosure crisis, I am also concerned about two other crises potentially: farm lending and commercial real estate lending. According to the FDIC, farmers are falling behind on their loans at a 17-year high. Oftentimes collateral for farm operating loans is the farm itself. And so if a farmer defaults on an operating loan, not only are they at risk of losing their livelihood but also their home. Because of the economy and because some farm loans are indeed in trouble, several banks are telling us that regulators are seeing farm loans as suspect and discouraging community banks from carrying farm loans. This attitude is hurting rural America without making the banking system any safer.

What is the FDIC doing to work with banks to make sure farmers have adequate access to credit? Would FDIC consider issuing guidance on farm loans similar to the commercial real estate guidance that was issued last year?

Ms. BAIR. Well, Senator, thank you for that question. I think parts of the AG sector are obviously quite strong, but other parts, particularly the dairy industry, have been having some trouble, and we appreciate that. We do have guidance encouraging prudent lending and loan restructuring activities applying to small businesses generally and commercial loans generally. But I would be very open to doing something specific to lending. I think that is a point well taken, and there are parts of it that are troubled, and I think providing some clarification about our expectations would be something we would be very open to.

Senator KOHL. So I heard you to say that you are willing to discuss——

Ms. BAIR. We will be happy to do this, yes. Yes.

Senator KOHL.——specific guidance on farm loans.

Ms. BAIR. Absolutely. Absolutely.

Senator KOHL. Well, that is great to hear. Thank you.

Ms. Bair, because of the decrease in real estate prices, many commercial borrowers will not be able to refinance, possibly causing mass foreclosures and hurting banks nationwide. Community banks are known to have large real estate portfolios and will likely be hit hardest by this downturn. Community bankers are not certain how regulators will treat commercial loans that they have on their books, and this makes it very hard for them to lend to small businesses.

Last year, FDIC and other regulators came up with guidelines for when a bank can modify a commercial real estate loan. These guidelines said that the lenders would not be penalized by examiners for pursuing prudent workout efforts with their borrowers. I have heard from bankers that the regulatory examiners are not always following these guidelines. What can be done to bridge the gulf between what is written here in Washington and what is actually happening at the local level? Is FDIC serious about giving banks and borrowers a chance to work out these loans without freezing a bank's ability to make other loans?

Ms. BAIR. Well, yes, for commercial real estate loans, we have very specific guidance that we issued with the other regulators, encouraging prudent loan workouts. We encourage that strongly, just as we have encouraged workouts of residential loans as well.

If the collateral has gone down, that does not immediately mean that the loan needs to be criticized. If it is current, if the borrower has the capacity to keep making payments, we specifically told our examiners that they should not criticize the loan. If the borrower runs into trouble, we want it restructured. Obviously that needs to be disclosed, and if there is some loss taken on the restructuring, that needs to be recognized. That is an accounting rule. Even if we wanted that to not be the case, it would still be the case under the accounting rules. But we have tried to exercise a lot of flexibility and provide a lot of guidance in this area, but it is just very difficult right now. Parts of the country, particularly in several parts of the country, commercial real estate still has some troubles.

The good news is that balance sheets are getting cleaned up, the construction development loans in particular, those balances have been coming down, and the credit quality of the delinquencies and charge-offs are improving. So we are emerging from this. But for some banks in particular that have heavy concentrations of troubled loans, they need to maintain and conserve capital and reserve heavily against expected losses. That can constrain their balance sheet capacity to lend. That is driven by the fact that they have troubled loans, not by the fact that there is an overly harsh supervisory process. But we have tried to be very flexible and prudent and continue to convey to community banks we want them to lend. As I indicated earlier, community banks' loan balances have remained constant. Actually for the banks with $1 billion in assets and smaller, the loan balances have actually increased during this crisis. So community banks as a group have been lending. They are the strongest group in terms of size that have been lending through this crisis, and I think that should be acknowledged and appreciated for what they have been doing.

So, again, I will make the same offer I gave Senator Bunning. If there are specific institutions that feel that our policies in Washington have not been consistently applied, we would be happy to take a look at those. We welcome that. We have an ombudsman that is equipped to do just that. It is not a bad thing. We encourage that. We want to make sure our policies are appropriately applied.

But, again, I do not want to raise expectations. There is just a lot of troubled commercial real estate loans out there, and it is going to take a while to work through them.

Senator KOHL. Thank you very much.

Ms. BAIR. You are welcome.

Senator KOHL. Thank you, Mr. Chairman.

Chairman DODD. Thank you, Senator, very, very much, and good questions. I am going to leave the record open for additional questions, but we do have a second panel, and I want to give them a chance to be heard.

I was going to just quickly ask Dan Tarullo—Governor Tarullo raised the issue of standards, which I think is a terrific idea, personally. I obviously will not be around to try to move that along for you, but I like the idea. But I wanted to get just a quick acknowledgment or recognition whether or not just at first blush—and I would expect obviously you want some more details. To the rest of you, is that an idea—from Treasury down to FHFA, do you like that idea? Is that something you would agree with, you think you might agree with or not? I am just curious.

Ms. CALDWELL. Servicing standards?

Chairman DODD. Yes.

Ms. CALDWELL. Yes——

Chairman DODD. Recommendations to Governor Tarullo.

Ms. CALDWELL. It is something we support, and we have tried—as you know, when HAMP was set up, it was set up in part to set some servicing standards for the industry.

Chairman DODD. Sheila, any thoughts about that?

Ms. BAIR. Yes, very much so. We have tried to address this through our safe harbor for banks and would like it to be more broadly applied, perhaps through the rulemaking process that is going on right now.

Chairman DODD. John?

Mr. WALSH. Certainly given all that we have seen, we need to give serious thought to the model here and whether we can improve. There is this question of incentives. Are there perverse incentives that are operating? Can they be better aligned? It certainly is a good time to give that look.

Chairman DODD. Mr. DeMarco?

Mr. DEMARCO. Mr. Chairman, as this Committee takes up housing finance reform next month, I hope that part of that is absolutely standards, and go beyond servicing standards, and suggest that there are a range of things in the mortgage industry for which assuring where and how standards are established, overseen, and enforced should be part of that discussion.

Chairman DODD. Tim Johnson will be chairing the Committee come January. He had to leave to go to a conference call, but I have checked with his staff on this. Let me make a request of all of you here to submit some very—more than just kind of the suggestions and ideas in testimony. And, Dan, obviously, with this—we would like to get maybe some very specific ideas. Maybe this is something that the Financial Services Oversight Commission as a commission might submit to us, some legislative ideas and language that could be a part of this Committee's consideration over the next month or so. It would be very, very helpful. So I will make that request of all of you and, again, through the Treasury suggest that maybe that Oversight Commission might not be a bad place to come up with these ideas to make a single presentation of a number of ideas that will allow us to make this more efficient and a single point of contact. But, Sheila, you have raised a number of ideas that I think have been terrific as well.

So I thank all of you, and let me echo Senator Bayh's comments as well since this will be my last opportunity for this particular panel to say thank you. I am very grateful to all of you. I have enjoyed immensely working with Treasury and FDIC and obviously the Board of Governors and OCC, and I want to commend again FHFA. You have done a wonderful job. People do not realize the conservatorship that you have taken on, and really without you there and without the housing financing system, we would be in a lot deeper problem. I think most people with knowledge of the issues recognize that. So I want to take this opportunity to thank you for the work that you and your staff are doing there as well. And, obviously, the Committee will look forward to working with you on this as they bring up the whole issue of housing finance reforms. So I thank all of you very, very much.

Mr. DEMARCO. Thank you, Mr. Chairman, and congratulations.

Chairman DODD. Thank you very much.

Let me invite our second panel to come on up as the first panel departs. I will introduce you as chairs are being moved around so we get right to it.

Terry Edwards is the Executive Vice President of Credit Portfolio Management for Fannie Mae. In this capacity, he is directly responsible for Fannie Mae's foreclosure prevention, loss mitigation activities for the single family book business. His duties also include executing the Making Home Affordable for Fannie Mae, and we thank him.

Donald Bisenius is the Executive Vice President of Single Family Credit Guarantee Business for Freddie Mac. In this position, he oversees the sourcing, pricing, and securitization of new business, as well as the strategic business process and technology redesign for single family credit guarantees. He has been with Freddie Mac since 1992 and is a member of Freddie Mac's Management Committee.

Tom Deutsch is the Executive Director of the American Securitization Forum. ASF is an organization that works to develop a consensus, a frame of thought, of legal, regulatory, accounting, and legislative activities for the securitization industry. It represents both servicers and investors. That is an interesting juggling act, I might point out. I am rather interested to hear his comments.

And, last, Professor Kurt Eggert is professor of law at Chapman University School of Law. His expertise is in mortgage and lending issues, predatory lending, consumer protection, and securitization. And before becoming a law professor, Mr. Eggert was a member of the Federal Reserve Board's Consumer Advisory Council where for 2 years he chaired the Subcommittee on Consumer Credit.

So, again, I really am grateful to all of you for sitting through the last couple of hours. I hope it was somewhat helpful. And I will say to you what I said to the last panel. Your prepared statements will all be part of the record. I would urge you if you could to try and at least paraphrase your testimony for us here today, and then we will get to some questions for you. But I am very grateful to all of you for your willingness to participate in this second hearing on this very important and complicated subject matter, as we, I think, are all acknowledging here. We all like things to be efficient and move quickly, get resolution for people, clarity for people—either we can work something out for you or we cannot—so that we deal with all the issues that Senator Merkley and Senator Evan Bayh and others have raised as a result of this ongoing and growing problem, it seems, at least temporarily.

So we will begin in the order that I have introduced you. Mr. Edwards, thank you for being with us.

STATEMENT OF TERENCE EDWARDS, EXECUTIVE VICE PRESIDENT, CREDIT PORTFOLIO MANAGEMENT, FANNIE MAE

Mr. EDWARDS. Thank you, Chairman Dodd, Members of the Committee. Thank you for the opportunity to testify today. My name is Terry Edwards, and I am Executive Vice President for Credit Portfolio Management at Fannie Mae. This includes foreclosure prevention and servicing oversight, which we have spent a lot of time on today.

Fannie Mae is focused on resolving the mortgage crisis facing our country. Every day our people come to work with clear objectives: to keep mortgage funds flowing, to do everything possible to help families avoid foreclosure, while being responsible stewards of taxpayer money.

The good news is these goals are aligned. Keeping people in their homes saves taxpayers' money, as does working with people to exit the home without the pain of foreclosure of either a short sale or a deed in lieu of foreclosure.

Since the start of 2009, we have helped more than 600,000 struggling Fannie Mae families avoid foreclosure. This number includes 160,000 HAMP mods and 250,000 proprietary Fannie Mae mods.

But the current foreclosure crisis has been difficult and unprecedented, and we are far from done. The U.S. housing finance system was not set up to handle this tidal wave of mortgage defaults, and loan servicers, who have the front-line responsibility to work with borrowers who need help have acknowledged they are struggling to keep up. So Fannie Mae has been taking aggressive actions to ensure borrowers get the help they need.

Although servicers are the primary contact with borrowers, we have worked to expand our borrower outreach and education efforts so that homeowners who are in trouble know how to seek help, understand their options, work with their servicers, and avoid scammers. These efforts including launching our *KnowYourOptions.com* Web site and mortgage help centers and partnerships with housing counselors in hard-hit communities across the country. We have developed a series of workout options for servicers to help struggling families keep their homes. All of these workout options now dovetail with HAMP, meaning if the servicer has collected the documentation required for HAMP and the borrower is not eligible for HAMP, more than likely they are eligible for a Fannie Mae mod. And if home retention is not possible, we offer servicers incentives to help homeowners exist through short sales and deed in lieu, reducing the burden on borrowers and taxpayers. Our servicers do not get any incentives for foreclosures.

We are working every day with servicers to help them improve their performance, and we enforce our contract with them when they fall short. Our teams meet with senior servicing leadership on a regular and frequent basis to discuss the strengths and weaknesses of their operations, best practices that we are aware of that we think can help, challenges they are facing, plus give us ideas—plus we ask them for ideas where Fannie Mae can make their jobs easier so they can serve homeowners.

I have submitted written testimony for the record that provides a fuller description of our foreclosure prevention efforts to date, but I would like to touch on two recent issues here.

The first involves servicer completion of foreclosure affidavits. Fannie Mae's guidelines require that servicers comply with all applicable laws and regulations in the foreclosure process. In the wake of reports that some servicers did not follow procedures, we have instructed our servicers to review their policies and procedures regarding affidavits, verifications, and other legal documents in connection with the foreclosure process. We are also coordinating with our regulator, FHFA, to seek appropriate corrective actions. As servicers said in recent hearings, they are working hard to fix the issue.

The second issue has been called dual tracking, where a borrower receives a foreclosure notice during the loan modification process. To clarify, during the critical early stages of delinquency, Fannie Mae has a one-track process. Servicers have 3 months, and sometimes longer, to process a loan modification before starting the foreclosure process. In addition, our research shows that borrowers are more likely to succeed if a modification process begins early. So we expect our servicers to put forth the maximum level of effort to communicate with the borrower during the first 90 days of delinquency. This means staffing up and implementing the single point of contact you have heard servicers talk about. We are encouraged because in our meetings with servicers, they say that they are on board and committed to adding staff to put the single point of contact in place.

In closing, this housing crisis cannot be solved overnight, and we are all frustrated with the time it has taken to get a smooth operating process in place for families facing very difficult circumstances. Fannie Mae is committed to doing everything we can to support the market and to ensure that servicers do their job in helping struggling borrowers. I look forward to discussing our work with the Committee.

Thank you.

Chairman DODD. Thank you very much.

Mr. Bisenius.

STATEMENT OF DONALD BISENIUS, EXECUTIVE VICE PRESIDENT, SINGLE FAMILY CREDIT GUARANTEE BUSINESS, FREDDIE MAC

Mr. BISENIUS. Chairman Dodd, Members of the Committee, thank you for inviting me to speak here today. I am Don Bisenius, head of Freddie Mac's Single Family Credit Guarantee Business. I oversee the sourcing, pricing, securitization, and performance of single-family mortgages we purchase.

Today's hearing raises important issues about the integrity of the mortgage origination, securitization, and servicing practices. As detailed in my written testimony, I would like to highlight the following points:

First, let me start by saying Freddie Mac expects servicers of our loans to treat borrowers fairly, with respect, and in full compliance with all applicable laws, regulations, and Freddie Mac policies. No homeowner with a mortgage owned or guaranteed by Freddie Mac should ever worry about losing his or her home to an unnecessary or wrongful foreclosure.

Freddie Mac currently owns or guarantees approximately 12.4 million single-family mortgages. In both the acquisition and ongoing servicing of these loans, Freddie Mac relies on sellers and servicers. We do not directly originate loans, and we do not directly service loans. Rather, Freddie Mac provides guidelines for the origination and servicing of our loans and contracts with sellers and servicers to carry out these operations. Companies conducting these activities represent and warrant to us that they are following our contractual requirements. Freddie Mac has ongoing monitoring programs in place to test compliance with these requirements. Failure to fulfill these obligations creates a liability for either the originator or the servicer, including the possibility that they will be required to repurchase the loan.

Second, Freddie Mac has long had policies and initiatives in place to help financially troubled borrowers avoid foreclosures. In response to the unprecedented mortgage default crisis, we have created additional servicer incentives and home retention options. In addition to the $5 billion that Freddie Mac pays servicers each year for managing the servicing process, we offer additional financial incentives for servicers to help borrowers keep their homes.

Third, while Freddie Mac currently owns almost 25 percent of all single-family mortgages outstanding in this country, we own fewer than 500,000 seriously delinquent mortgages compared to the approximately 5 million seriously delinquent mortgages nationwide. Our ability to assist troubled borrowers is limited to this 10-percent share of the delinquent borrower population.

Having said that, I want to be very clear. We have redoubled our efforts to keep borrowers in their homes. Since the beginning of 2009, we have helped nearly 370,000 families avoid foreclosure. Through the first 9 months of 2010 alone, nearly 211,000 delinquent borrowers with Freddie Mac mortgages avoided foreclosure. That is nearly twice the 114,000 who were foreclosed upon.

Finally, the length of time for the average foreclosure of a Freddie Mac loan indicates that borrowers are not being rushed through the foreclosure process. We require our servicers to seek to resolve borrower delinquencies through a variety of foreclosure alternatives, including forbearance, repayment plans, loan modifications, and short sales. If the borrower's delinquency cannot be cured by these methods, servicers must move forward with the foreclosure to minimize further financial loss and risk to the taxpayer. Currently, the nationwide average for completion of foreclosures on a delinquent mortgage owned or guaranteed by Freddie Mac is 449 days, and borrowers whose properties are foreclosed upon are behind on their mortgage payments well over a year.

Our guide does give servicers the authority to stop or suspend a foreclosure action whenever there is an opportunity for a viable workout. We are aware that the existing processes are confusing to some borrowers. We are working with the industry to find ways to improve communications and minimize any borrower confusion.

As my testimony makes clear, Freddie Mac has put in place policies, procedures, and financial incentives to help borrowers avoid foreclosures. We continue to work with our conservator and servicers to enhance these efforts and improve their execution.

I will be happy to answer any questions.

Chairman DODD. Thank you very much, Mr. Bisenius.

Mr. Deutsch, how are you? Thank you for being here.

STATEMENT OF TOM DEUTSCH, EXECUTIVE DIRECTOR, AMERICAN SECURITIZATION FORUM

Mr. DEUTSCH. Thank you. Chairman Dodd, Ranking Member Shelby, Members of the Committee, my name is Tom Deutsch, and as the Executive Director of the American Securitization Forum, I appreciate the opportunity to participate here today on behalf of the 330 ASF member institutions, including those who originate the collateral, structure the transactions, serve as trustees, trade the bonds, service the loans, and invest the capital in the preponderance of mortgage and asset-backed securities in the United States.

In my prepared statement, I highlight some of the key aspects of securitization as well as its critical importance to the U.S. and global economy. Importantly for this hearing, there are nearly 55 million first-lien mortgages in America today that total approximately $9.75 trillion of outstanding mortgage debt. Approximately three-quarters of that debt, or about $7 trillion, resides in mortgage securitization trusts and are beneficially owned by institutional investors in the United States and around the world, such as pension funds, mutual funds, and insurance companies.

But in my remarks today, I seek to address the concerns raised by a few commentators that securitization trusts may not actually own the $7 trillion of mortgages that are contained within those trusts. For example, a recent Congressional Oversight Panel report has even suggested that these issues could create systemic risk to the banking sector if loans were not validly assigned to securitization trusts.

But the concerns that have been raised have not been supported by substantiation that there are, in fact, signs of systemic fails in the process of assignments. Indeed, the origins of these concerns is not clear. They are not the result of a series of new court cases supporting the legal arguments advanced, but instead appear to be largely the result of academic theories. In fact, even the Congressional Oversight Panel report suggests that, quote, "the panel takes no position on whether any of these arguments are valid or likely to succeed."

So all of the consequences that flow directly and solely from a single mistaken core premise, that is that the trust and ultimately investors do not generally own the $7 trillion of loans in the trusts, is discussed in great detail in my prepared remarks. This core premise is incorrect, and therefore the dire consequences of this faulty premise will not follow.

Just 2 weeks ago, the ASF issued a White Paper on the subject that is part of our written testimony that puts to rest many of the questions that have previously been raised about the ownership of the mortgage loans. In that White Paper, the ASF exhaustively studied traditional legal principles and processes, including the Uniform Commercial Code and substantial case history throughout every one of the 50 United States and the District of Columbia and found that traditional legal principles and processes are fully consistent with today's complex holding, assignment, and transfer methods for mortgage loans. In fact, 13 major U.S. law firms listed in Exhibit A to that ASF White Paper reviewed it and believe that the Executive Summary contained therein represents a fair summary of the legal principles presented.

Although the ASF White Paper assured many of the concerns that had previously been presented, some new concerns have been raised since that White Paper was published. For example, one commentator has proposed that securitizers have not met the contractual requirements for a complete or unbroken chain of endorsement. In our written testimony, we rebut this academic theory in great detail with analysis of the key contractual provisions, the intent of the contracting parties, industry custom, independent third-party trustee acceptance, as well as the relevant case law and UCC applicability. In particular, this argument overlooks the key fact that each separate step in the chain of transfers of ownership by each party, from the originator to the securitization trust, is fully documented by a separate contract.

The proposition itself, though, that the securitization legal professionals have uniformly opted out of the use of applicable laws, such as the UCC, to set up an even higher bar for transfers, but then subsequently and systematically ignore that higher bar, appear on the face to be illogical assertions and, in fact, as a legal analysis in our written testimony demonstrates, are patently false.

From time to time, though, mistakes in process are certain to occur, particularly in a market where 55 million mortgages are transferred and/or serviced in the worst housing market since the Great Depression, and that is one reason why, in particular, typical language in the governing contracts provides the opportunity to cure these mistakes to prove ownership.

In conclusion, the ASF greatly appreciates the invitation to appear before this Committee to share our views related to these current issues. I look forward to answering any questions that Committee Members may have. Thank you.

Chairman DODD. Thank you very much.

Professor, welcome.

STATEMENT OF KURT EGGERT, PROFESSOR OF LAW, CHAPMAN UNIVERSITY SCHOOL OF LAW

Mr. EGGERT. Thank you, Chairman Dodd. I appreciate the opportunity to testify today. As a professor, I feel a little overwhelmed by the luminaries around me, but I will try to do my best to shed some light on what I think is a serious problem.

In the first panel, I kept waiting to hear one of the regulators say, here is what we have done to sanction servicer misbehavior. We saw it and we acted and we did this. And I did not hear that. I hoped if I did not hear that, at least I would hear them say, well, here are the kinds of sanctions that we can do if servicers misbehave. I did not hear that, either. What I heard was, we are investigating it. We are on it. We hope to know more in a month or so and then we are going to do something.

My concern is, this is not a new problem. I wrote an article on servicer abuse in 2004, and if I wanted to update it at this point, what I would need to do is change the name of the servicers and add a zero to most of the statistics. And otherwise, everything I talked about in 2004 is still happening. We have had this problem for a long time. It is not just the result of the foreclosure crisis. It is not just the result of the added number of defaults. It is a systemic problem in the way that servicers are organized and regulated and we have to fix it. We did not fix it in 2002. We did not fix it in 2003. We have not fixed it yet and it is time to do it.

I say it is a systemic problem. I know that in the last version of this panel, there were questions about whether these were just anecdotal evidence of issues or whether there was proof that it was a larger problem. I would like to note that economists have been looking at this, have been looking to see, do servicers foreclose more if they are third-party servicers rather than if they are servicing stuff that they own. In other words, are borrowers more likely to get foreclosed if servicers are servicing on behalf of investors or themselves.

And what the economists have concluded—I mean, there is some disagreement on it, but it seems like the trend of the investigation is that there is a foreclosure bias by third-party servicers, that they are more likely to foreclose for investors than they are for themselves. That is an important fact. Christopher Mayer, an important economist, said that the empirical evidence is compelling on this point.

The next thing I would like to note is that things are getting worse. The servicing regulation industry has long been kind of unregulated. I think the Federal regulators at a certain point looked around and said, who has got the ball on this one? How much of this is mine? How much can I regulate? And they have not come up with a good answer for that.

HAMP is a, I think, is a very well intentioned program, but as we have heard, it is a voluntary program and it is a program that is based on all carrots and no stick, and in fact, baby carrots at that. So it addresses only a small part of loans that are being serviced and I have not heard of a single servicer who has been sanctioned by the HAMP program for misbehaving. I mean, maybe that has happened, but that has not been broadly broadcast.

So if HAMP is not doing it and the regulators are not doing it, then you have to say, well, maybe the market is doing it. Maybe investors are saying, we are going to make the servicers do the right thing. But if you look at it, investors have very little control over servicers. Servicers I read a recent quote from an investor who said, servicers treat us like the Thanksgiving turkey. They just decide where to carve.

And investors, I think, are getting tired of it, are now trying to figure out, how can we get together to force servicers to do the right thing, because it is important to note that this is not just a problem for borrowers. It is a problem for investors. Every time a servicer imposes bad junk fees on a borrower, every time a servicer forecloses when they should modify, there are two victims. There is the borrower and there is the investor who does not get the return that they should get.

So we need to—we have to address this if we want to have a robust mortgage market, which many people are saying we cannot just have the mortgage market run by the Government. We have to have a robust private market, and the only way to have that happen is to fix the servicer problem and now is the time.

Thank you.

Chairman DODD. Well, thank you very, very much, and let me—Senator Merkley and I are here together. In fact, Jeff, do you want to move up here? We are going to sit and be comfortable, so you are not going to be back in the corner there. You are going to be moving up anywhere here come January, so get used to those seats.

You framed my first question, for our two first witnesses in this panel, first Freddie and Fannie. During the debate on the issue of whether or not we should have had GSE reform as part of the financial reform package—I am not going to invite that kind of debate again, but nonetheless, there were reasons why we did at the time, but pointed out during those debates, and you can both correct me if I am wrong, but somewhere between 95 and 96, maybe an even higher percent of all mortgages are financed and backed by Fannie and Freddie. That number is pretty much right, am I correct?

Mr. BISENIUS. Well, that would include FHA, as well.

Chairman DODD. That is what I mean. But, roughly, those numbers are correct. Well, Professor Eggert has raised an interesting question and one that I would have in a sense that because of the power you have, and again, we talked about regulators doing this or finding out whether or not they do not have the authority, what Congress needs to give them to do it, but it would seem to me that just FHA and yourselves would have a tremendous ability on servicers, given how critically important you are to them, that were they to be stripped of GSE business, I suspect that might get their attention.

And so the question becomes, why not? Why have you not done more to insist upon servicer reform in dealing with these matters since you are directly affected by it, as well? Why have you not done this? Why would you not do that?

Mr. EDWARDS. So our approach has been to understand the problem, get behind the problem, and try to solve the problem.

Chairman DODD. Well, we know what the problem is.

Mr. EDWARDS. Well——

Chairman DODD. The question is, you have got power to do this, market power, I mean, to do this.

Mr. EDWARDS. We have been trying to do it with influence. We have been trying to define the problem for the servicers. As I said in my testimony, we——

Chairman DODD. If you told them you were going to strip those—you no longer are going to get GSE protection, do you not think they would jump back through hoops to respond to your concerns?

Mr. EDWARDS. In some instances, sir, Senator, we have moved servicing away from servicers who are not performing. We have moved hundreds of thousands of loans where servicers were not getting it done. They were at the bottom of the barrel, if you will, in terms of servicer performance and we moved servicers to where there was capacity in the industry. At the end of the day, this problem is a capacity problem. The servicers have not staffed up where they need to staff up and they have not fixed their process. The process that we have been suggesting since the beginning of the year is this approach that you have heard a lot about today, the single point of contact.

And the point is, servicers/originators, large financial institutions, have plenty of resources when you need a loan. When it comes time to—a difficult time, your most difficult time in your financial situation, when you potentially have to leave your house, the resources are not there to take care of the problem. And what we have suggested is the single point of contact where a counselor, in effect, puts their arms around the person who is in a jam and explains to them what is going on, what do you have to do to stay in your house. If we cannot keep you in your house, this is what needs to happen for a graceful exit. What is the best thing to do to manage your credit report. Literally counsel people on what they need to know and understand.

And the good news is we see our servicers starting to move there. It has taken far too long, but the large servicers are now using words that we have been using, single point of contact. We are hearing them say it. In meetings with us, they are saying that they are going there and we are—we know there is a solution. Time is our enemy and now it is a function of getting the resources in place so the solution can be fixed.

Chairman DODD. Well, I appreciate you saying that. I will give you a chance to respond, as well. Lost paperwork, misapplied payments, and conflicts of self-dealing, I mean, there are just a myriad of problems there. And again, we talk about market power, but, boy, there is no better market power than the two of you have, in my view, with FHA, in being able to influence this process, short of a regulatory and Congressional mandates.

What is the answer to this?

Mr. BISENIUS. I would offer just two additional observations in addition to what Terry said. One would be I think the market power you suggested has clearly come through on the front end of the business. Origination quality and performance has improved dramatically because of that dominance of the GSEs and FHA in the origination market.

Chairman DODD. Right.

Mr. BISENIUS. I think in the servicing market it has improved some, but as I noted in my testimony and as noted in the public facts, the amount of delinquent loans that are serviced by servicers for Freddie Mac or Fannie Mae is actually a small fraction of the total amount of delinquent loans.

On our particular book, we have seen significant improvement. The number of modifications, the number of HAMP modifications on the Freddie Mac portfolio is actually a pretty large percentage. I think if you combine it with the ones on the Fannie Mae portfolio, it is a large share of the HAMP modifications have occurred on the GSE portfolios themselves. So I think on our loans, we are beginning to see improvement in the performance. I do not know if we are seeing the same improvements on loans outside of——

Chairman DODD. Well, let me urge you to keep at that. I mean, again, I have made the point and it just seemed to me that Professor Eggert raised a good question. Short of the regulators doing their job, it seems to me that market power here, which a lot of people agree with, and I do, as well, where it exists, utilization of it can make a big difference.

Let me ask you, as well, something I wanted to ask the regulators, but we took a lot of time with as many Members who participated here and did not get to it, but in briefing with Fannie and Freddie earlier this week, it became apparent that the two of you have somewhat differing modification programs. Given the fact there is already too much confusion in the process, should you not adopt the same policies? Why are there not the same policies?

Mr. EDWARDS. We each have different books. We, Fannie and Freddie, do not talk. We are in the field with our servicers trying to——

Chairman DODD. That is not a great answer here.

Mr. EDWARDS. There are rules on——

Chairman DODD. Why are you not talking?

Mr. EDWARDS. We talk through our regulator, but we are not able to talk directly because of antitrust issues.

Chairman DODD. Well, do you talk to the regulator about this?

Mr. EDWARDS. Yes, absolutely.

Chairman DODD. And FHFA says, no, we are not going to let you have the same process?

Mr. EDWARDS. We each have our own different books and our books perform a little bit differently. We take great pride in what we have now done at Fannie Mae, meaning once you have all of the HAMP documentation in hand, you do not have to ask the borrower for a single other document in order to complete a Fannie Mae modification. We think that is a best practice and perhaps one that should be adopted. But

Mr. BISENIUS. I only had——

Chairman DODD. Well, I do not want to violate the law here, but let us say you are sitting next to each other.

[Laughter.]

Chairman DODD. You talk to me, but talk to him, OK? I will let you pretend here we are having a conversation together. Tell me why we are not doing this. I mean, the confusion, this seems like a fairly simple one we might resolve.

Mr. BISENIUS. So you raise an excellent point, and actually, we do work closely with FHFA, and in all those areas where we can align as closely as possible, we actually do. I think HAMP is a good example of that. I think the majority of our requirements under HAMP are identical.

Chairman DODD. All right. But outside of HAMP, why not in the other areas?

Mr. BISENIUS. I think they are relatively close. They are not identical. I think it is, in part, as Terry indicates, that there are some differences with individual services, individual loan types. But I think they are amazingly close in most aspects.

Chairman DODD. Well, all right. Let me jump to Senator Merkley. I did not mean to dominate here. But let me get Mr. Deutsch, and I say this respectfully, but I could not help but resist that you seem to be a bit conflicted yourself, and I do not mean that personally but as a representative of both mortgage servicers and investors. Just wearing your hat as a representative of investors, let me put that hat on your head right now if I can here. How serious a problem do you think the servicer conflicts of interest are with regards to, example, charging excess fees or force-placing insurance, and do you have any suggested solutions? You heard Professor Eggert, or you may have read his testimony, that servicers, and I am quoting him, "are loathe to seek put-backs of loans where the put-backs would come from their parent companies." I wonder if you agree with his comment in his testimony.

Mr. DEUTSCH. Again, with the hat of investor on——

Chairman DODD. Yes.

Mr. DEUTSCH. Again, with the hat of an investor on, I think our first lien investors are very concerned about servicer conflicts internally. They are very concerned about how loans are modified, and in particular how they are modified in relation to the second lien program. They have had significant concerns about how the 2MP program has performed. My understanding, the latest data I have seen is that 382 loans have gone through that program since its beginning. That number may have increased in the last month or two since the last data that I have seen. But investors are concerned about that conflict. That conflict obviously is seen much more prevalently now in a very down economy, particularly in the housing market, than we see in a normal time. So it certainly is strained by the existing housing market today.

Chairman DODD. Do you agree with the comment of Professor Eggert I quoted to you, that the servicers are loathe to see put-backs at the parent company?

Mr. DEUTSCH. Well, I do not think any originator would like to buy a put-back back. I mean, ultimately, they are buying something at par that is now either delinquent or defaulted, so it is worth less than par. So no economic institution——

Chairman DODD. But the alternative is worse, is it not?

Mr. DEUTSCH. Pardon?

Chairman DODD. The alternative of not getting anything back from it, it seems to me——

Mr. DEUTSCH. Oh, correct, but I think the banks who have sold the loans would prefer not to buy them back, and certainly investors would prefer them to be bought back if they are delinquent in default. I think it is one of the core issues in the market right now, is how do we appropriately sell off credit risk from the banks' balance sheets to effectively isolate that credit risk from the bank and at the same time make sure that the representations and warranties that are made to the investors, that those loans are actually the way they were originated in the manner that they were.

Chairman DODD. Well, who is standing up? I think Professor Eggert said it. You have got the investor and the homeowner that are here, and the two entities here that are being taken to the cleaners in the process. Professor Eggert, do you want to comment on this?

Mr. EGGERT. Well, I would like to first—Mr. Edwards said something very interesting which I have not heard many people say, which is we had some servicers who were not performing, so in essence, we fired them. They had servicers that they worked with that were not going up to snuff, so they fired the servicer. How different servicer behavior would be if more people could say that.

Have you ever heard an investor saying, we fired our servicer?

Mr. DEUTSCH. Yes.

Mr. EGGERT. No. How often?

Chairman DODD. Do they, Mr. Deutsch? Have you fired some?

Mr. DEUTSCH. Investors do have the ability to fire servicers. It is challenging under the pooling and servicing agreements. You need a certain mass of investors, whether it is 25 percent or more, to be able to fire a servicer, but that can occur if——

Chairman DODD. But it has not yet occurred?

Mr. DEUTSCH. It has occurred.

Chairman DODD. Oh, it has?

Mr. DEUTSCH. It has occurred in instances, and particularly—but it has not happened widespread because the question is who is a better servicer out there.

Chairman DODD. Yes. And the pooling and services agreements are—are they too rigid in that sense?

Mr. DEUTSCH. Well, the challenge of a pooling and servicing agreement is you have a mass, a diffuse set of investors in the marketplace——

Chairman DODD. Yes.

Mr. DEUTSCH.——that have bought into the securitization trust. How do you effectively have a captain of that group of investors who can charge and lead for that group of investors but at the same time not be conflicted and serve their own best interest as opposed to the other group of investors.

Chairman DODD. Let me turn to Senator Merkley. I have got a couple more, but let me turn to my colleague.

Senator MERKLEY. Thank you very much, Mr. Chair, and I will follow up on your questions related to the put-back with our folks, Mr. Edwards and Mr. Bisenius from Fannie and Freddie.

In the testimony we had earlier, Freddie and Fannie together have $13.3 billion of outstanding requests, put-back requests, if you will, repurchase requests. At what rate is that growing? If none of those were paid off, if that $13.3 billion sat there, what would the total be a year from now? Would we be looking at $20 billion? I want to get a sense of kind of a monthly or annual amount of put-back requests that are potentially—what is the flow rate, if you will?

Mr. BISENIUS. I do not know if I have the specific flow rate associated with that. What I would suggest is actually if we have looked over the last few quarters, the share of outstanding repurchases or put-backs from Freddie Mac has actually been declining. So we may well be kind of past the peak of mortgage put-backs and now on the downside of that. So for us, it has been declining at a fairly significant rate.

Senator MERKLEY. And that would not be because the number of folks falling into foreclosure action is declining, so to what do you attribute that?

Mr. BISENIUS. Well, I do think it is associated with the number of folks who are going seriously delinquent has begun to stabilize, and therefore the number of loans being reviewed and subsequent repurchase requests are going down. We have worked through a huge kind of pipeline of mortgage reviews and mortgage repurchases over the last 2 years. So I am simply suggesting that we are at the peak today, and I think it is declining over the—it has been declining over the last few quarters.

Senator MERKLEY. OK. So, ballpark, can you tell me between the two institutions or for your institution how many more repurchase—are we talking a billion dollars a month or are we talking about a billion dollars every 6 months?

Mr. BISENIUS. I think it would be hard for me to speculate at this point. We can do some analysis and provide those facts to you separately.

Senator MERKLEY. OK. And Mr. Edwards, can you clarify it from your perspective?

Mr. EDWARDS. Yes, Senator. So for the third quarter, we collected about $1.6 billion. We do not see that pace slowing down, and what we have said to—because we get asked this question all the time by our customers, our banks, where are we in this process, and our answer is we are about 40 percent of the way through the process. So we have got another 60 percent to go.

Senator MERKLEY. OK. So let me lay it out this way, then. If the four largest banks have reserves for repurchase of about $10 billion, and if we are at $13.3 billion and crudely between the two, perhaps $3 billion a quarter additional, and 40 percent of the way through the process, that means we might have the equivalent of a couple of more years at $3 billion a quarter. Just back-of-the-envelope math, an additional $24 billion plus the $13 billion we have now. Are we looking at something akin to, over the next 2 years, a total of $30 billion in requests against $10 billion in reserves?

Mr. EDWARDS. First and foremost, the way those reserves—when we talk about repurchases, we are talking about an unpaid principal balance. So original principal balance. So when a servicer buys one of those loans back, they do not need dollar-for-dollar reserves. That loan might be worth 60 or 70 cents on the dollar when they take it back, or if it has gone through foreclosure, it is more like 50 or 60 cents on the dollar. So you have to—we are talking apples and oranges here.

Mr. BISENIUS. Yes. I think in addition to that, one of the things I want to highlight about that outstanding number is that is the level of repurchase requests. It is not uncommon for an originator, once they get the repurchase request, to be able to provide information that leads us to rescind that repurchase request. So the original loan file gets sent in. We review it. We believe there is a defect. We request a repurchase. They see what the defect was and are able to cure that defect which means the loan is no longer subject to repurchase. So that really is a gross number from an exposure standpoint in addition to what Terry said.

Senator MERKLEY. So I would appreciate some follow-up from both of you in giving us some analysis of this issue, because essentially the questions I am raising are should this put-back situation be considered a serious problem that we should pay attention to now because it could be a very sizable systemic risk issue for Fannie and Freddie, a risk for specific financial institutions, a risk that may not have reserves to cover it, but is there a systemic risk on top of that, kind of the three components. So often, we are coming into the story down the road when it has exploded. If we are at the front end of this and we are trying to understand the problem, we need a little more analysis to be able to get our hands around it. That would be very helpful.

Mr. BISENIUS. I would be happy to provide that.

Senator MERKLEY. That would be——

Mr. EDWARDS. Senator, if I may, I want to put one other thing in context. There is a lot of talk about the number of put-backs from the GSEs. When you add up our put-backs in terms of percentage of loans sold to us, for each of the years 2005, 2006, 2007, 2008—those are the big years—we have not gone beyond 2 percent of the originations in any one particular year.

Senator MERKLEY. Thank you for noting that. And these numbers that I have been citing are just Fannie and Freddie, so there is a lot of other pressure on the financial institutions coming from put-backs coming from other quarters that would have to be part of a comprehensive understanding of this issue.

But let me turn to the dual-track issue. When my constituents were talking to the case workers on my team about the challenges of getting foreclosure notices, foreclosure phone calls, even foreclosure postings on their door in the process that they were in the middle of loan modifications, the explanations for a very long period of time were miscommunication within the bank, this unit, this unit. Not so long ago, a few weeks ago, we had testimony that essentially was along the lines of actually this is the consequence of a deliberate dual-track strategy and a couple of the major banks, B of A and Chase, testified that while they have the power to change that dual-track strategy and they recognize some of the shortfalls of it, they can only do so on loans that they have control over, but that a tremendous number of the loans they service are Fannie and Freddie loans, and that in that case, Fannie and Freddie are pushing very hard to pursue both tracks aggressively so that the foreclosure can take place as quickly as possible if the modification fails.

I guess that general perspective seems to be supported in the testimony that both of you have put forward just from your written testimony on where you both address the dual track, and here is the dilemma. Everyone benefits, in general, from a modification being successful. The investors benefit. Certainly the community benefits by having a family in that home. Certainly the children benefit from the stability of the family staying in that home. Everyone who has a stake in the surrounding community—it is not just those who live there, but the fact that the dropping home values are driving a national cycle that we have not seen the end of yet. That is all tied in together.

So all these incentives, and yet Daniel Tarullo testifying earlier noted that despite the preference of modifications over foreclosure as a national strategy, that the deck is stacked the other direction, and he says that several possible explanations for the prominence of foreclosures: Lack of service or capacity to execute modifications, financial incentives for servicers to foreclose, what appears to be easier execution of foreclosures relative to modifications, limits on authority of securitization trustees, and conflicts between primary and secondary lien holders. So kind of big picture, modifications make a lot of sense from a lot of perspectives, but the complexity of the mortgage marketplace results in a lot of foreclosures in lieu of aggressive pursuit of modifications.

And then we find Fannie and Freddie saying the same. Hey, folks, if you are servicing our loans, you have got to aggressively pursue foreclosure. And so families are completely stressed out and a substantial number—I do not really know the percent—but families start to get these foreclosure notices. Some of them are walking away from their homes because they cannot deal with the pressure of—they think they are trying to get a modification, but they have been on the phone four times. They have talked to four different people in the pursuit of that modification. They have submitted the paperwork three times. It has been lost repeatedly. They can never get the same story. They are told, make your payments, and they are told, we cannot pursue your modification unless you are a month late. Then somebody else says, no, we cannot pursue it unless you are 3 months late. And so in the middle of all that, then the foreclosure side starts pounding on their door and families, like we are not answering the phone anymore and we are not going to open the mail anymore and until the sheriff comes and moves us out, or we are just getting out of the house now.

There is something counterproductive from every quarter about this aggressive pursuit of foreclosures at the same time that a modification is in process. Is it not possible, because since folks are saying that it is really Fannie and Freddie that are really helping to drive this dual track, is it not possible to find a way to recognize the importance that foreclosure may be the ultimate path, but to suspend some of the features of your tracking down that path during a period where there is legitimate good faith effort by the servicer and by the family to get a modification in place, and could that not help overall with this picture?

So I guess I am asking each of you, Mr. Edwards and Mr. Bisenius.

Mr. BISENIUS. Let me offer a couple of thoughts around that, if I could, Senator. First off, the challenge that you highlight, I believe is very real and one that can lead to, as you suggest, kind of counterproductive results. It is in our interest to have our servicers work with borrowers to try to seek a non-foreclosure alternative, to seek a modification, to seek a repayment plan, to seek something other than a foreclosure. As I mentioned in my testimony, we actually provide financial incentives for them to do that and encourage them to do that.

The balancing act we feel, though, is if a non-foreclosure alternative cannot be found, every day, every month I wait to start that foreclosure process costs. It costs a lot. If you do back-of-envelope math, as I suggested in my written statement, it is $30 to $40 a day. If we have 300,000 loans sitting in foreclosure, that can start to run into the hundreds of millions of dollars a month from those delays.

We have to find a way to remove the confusion, because I understand it is a painful process and a confusing process. Simultaneously, though, I need to find a way to ensure that I am not adding more losses to the taxpayers as a result of our actions.

Senator MERKLEY. So before I turn to Mr. Edwards, let me just pursue that for a moment. And, by the way, I think I am way over my time, Mr. Chair——

Chairman DODD. That is OK.

Senator MERKLEY. Thank you. So essentially, you say when there is recognition that a modification cannot be completed, then we need to push through to foreclosure. I understand that. But what about a policy where you said, if this standard is met, a family has applied in good faith for a modification, they are in negotiation of that modification, there is perhaps a 120-day limit or a 90-day window or something, can you not just say, listen, suspend the foreclosure notifications and that track. Tell the customer that for the next 90 days or the next 120 days while this gets worked out, we are setting that aside. Recognize, Mr. and Mrs. Customer, that if it does not get worked out, that we will have to restart the foreclosure track. But create a window in which the whole emphasis of the institution, of the servicer institution, is upon getting that modification in place and done. Is something like that workable that could be done as a policy?

Mr. BISENIUS. So let me suggest one thing. It is our policy that if we have begun some type of a modification, some type of a work-out strategy, then we will not initiate the foreclosure proceedings until we can work through that. So that is our policy. The difference that we have, though, is as the servicer has tried to contact the borrower and made good faith effort to contact the borrower and yet the delinquency has extended, at a point, we begin that foreclosure process. Oftentimes, that is the initiator that now gets the borrower to be able to make contact with the servicer and some type of work-out option gets started. At this point, we have not delayed that. It is something we can look at, but if we have begun the foreclosure process, we think it is important to continue that.

Senator MERKLEY. Right. Well, I would love to continue this conversation because I think in some degrees we are passing each other, because we are really talking here—I think all the Members of this Committee have constituents who are in the modification process. We hear from them every single day, and yet they are getting those foreclosure notices. They are not folks who are ignoring your calls and not responding.

Mr. Edwards?

Mr. EDWARDS. Senator, you made a very key point in that the borrower/family is making a legitimate effort, but more importantly that the servicer is making a legitimate effort to effect the modification. And as I have said in my testimony, servicers are not staffed adequately. The issue is inadequate staffing, the reason for multiple phone calls, the reason that we all read and hear about. Why did I have to tell my story to different people over and over and over again?

And you made another key point, the stress on the family. Our work, our focus groups have said that once you get past three or 4 months of delinquency, borrowers start to—families emotionally start to detach from the home and they are not coming back and they are not seeking a modification.

We need to do everything we can to make sure the servicers follow up with their commitment to provide a single point of contact. Fannie's and Freddie's process is there is no foreclosure track during the first 90 days. There needs to be a legitimate effort by both the borrower and the servicer within those first 90 days. The servicers need to put forth a legitimate effort. They need more staffing. That will allow the system to run appropriately.

Senator MERKLEY. Thank you very much for your testimony, and I encourage every possible effort to try to make this modification track work better because it is an abysmal failure in terms of national policy right now and our economy and our families are going to—are suffering and will continue to suffer if we do not figure out how to do it better. Thank you.

Chairman DODD. Let me pick up on Senator Merkley's line of questioning. I am just thinking out loud here with you, and I wanted to ask you about—I presume you have seen or heard some of the suggestions that were made by Sheila Bair and Dan Tarullo regarding standards and, well, you have obviously embraced the notion of a single point of contact and others. But let me state the conclusion, and you disagree with me. Do you agree—I presume you agree with these suggestions being made, or do you disagree with any of the suggestions being made?

Mr. EDWARDS. Absolutely agree.

Mr. BISENIUS. I have not looked at as much detail to them. The point I would add to that one, Mr. Chairman, is Freddie Mac has very clear written standards on servicing. So it is not as though they are nebulous. They are very clear about——

Chairman DODD. Well, we are talking about national standards, in a sense. Mr. Deutsch?

Mr. DEUTSCH. I would have to look at——

Chairman DODD. Well, let me know what you think. I would like to hear back because you represent an organization.

Mr. EDWARDS. I think it is important to have two things. One is it is important to have national standards, but it is also important to have one regulatory agency that takes this on as its job with an eye to protecting consumers. And I think the new Bureau of Consumer Financial Protection, this should be its baby. It should say, we are taking over. We are going to write the regulations. We are going to make sure that there are standards, that standards are enforced, and that servicers who do not comply with the standards, who do not live up to the standards, will be sanctioned and might even lose their license to service. I mean, we have to get serious about that and that is the only way to do it.

Chairman DODD. It will be good for the investor and the borrower.

Let me ask something, because Jeff Merkley has raised an interesting set of questions regarding the dual tracking. It seemed to me that one of the major problems we saw underlying the mortgage crisis that led to the near financial collapse in the country was a lack of underwriting standards that went on through the subprime lending. And maybe—I hope I am not naive about this. I presume at some point, and obviously facts and circumstances can change, that person has lost a job. The income is not there. It could also be they did not get a job in the middle of all of this. But in addition to hoping something can turn around or there is maybe a work-out at a level that would allow that family to meet that obligation and stay in that home. It is obviously important.

Is there some capacity in all of this—because obviously, I think all of us agree, as well, look, if someone just is not going to be able to do this no matter how hard you try in all of this, it is better probably to move along because the other values of properties in that neighborhood suffer. All the other tangential problems that emerge get exacerbated by delaying, obviously, a situation. So striking that balance is not easy. None of us are suggesting you are going to find a perfect way to do this.

But I wonder if there is any consideration of making a determination as to whether or not there is, in a number of these cases, just no likelihood, given the economic circumstances, beyond the capacity of that family to meet an obligation. Do you consider that?

Mr. EDWARDS. First and foremost, for people who are unemployed——

Chairman DODD. Yes?

Mr. EDWARDS.——our first offering is 6 months of forbearance. So we do not require any payments for that 6-month period and hope that the individual will get employed. To the extent they get employed, and in all likelihood it is going to be at less of an income that they had earlier, we will first run them through HAMP, evaluate the documentation, and then determine whether or not a HAMP modification or a Fannie Mae modification is feasible.

Chairman DODD. Yes. I presume you consider other sources of income that may be coming in—family support, others that could be supporting that conclusion, as well. So it is not just a question of a job, necessarily. Is that true, or am I—can a homebuyer provide evidence that they have other sources of support economically that will allow them to meet a modified——

Mr. EDWARDS. Absolutely. Other sources of income would need to be documented——

Chairman DODD. Yes.

Mr. EDWARDS.——and then we would set the modification appropriately. Let me leave it at that.

Mr. BISENIUS. All I would add to that is we encourage our servicers to actually reach out to the borrower just a few days after that first missed payment in order to begin to evaluate the financial circumstances that the borrower has.

Chairman DODD. So you encourage them to do it. But again, I come back to the first question I asked you. Why do you not demand it of them? They need you. They do not survive without you.

Mr. BISENIUS. It is in our servicer guidelines. It is in our servicing contract that they reach out to borrowers in those first few days after it. So it is demanded as part of our contract.

Chairman DODD. I would like to see it be tougher than that.

Professor Eggert, I will give you the last word on this. Anything else you want to add to this conversation?

Mr. EGGERT. Well, I wanted to add something about the put-back issue, if I could.

Chairman DODD. Yes.

Mr. EGGERT. And I worry that during the course of the day, the discussion of the put-backs has all been in terms of safety and soundness of the financial institutions that would have to repurchase it. I think it is important to recognize that put-backs where there has been a breach of representations and warranties is an important market discipline for originators of loans. Lenders should not be selling loans and breaching their representations and warranties.

Chairman DODD. Yes.

Mr. EGGERT. And right now, what we are seeing is lenders fighting off put-backs, saying, oh, it is—you are just putting this back because the loan is in default, but we should not have to buy it back. You were a sophisticated investor. You knew what you were buying.

But if you do not enforce representations and warranties, the market breaks down. I mean, that is an important part of market discipline. I think it is important that Fannie and Freddie enforce representations and warranties and put back all loans that are appropriate.

Chairman DODD. Yes.

Mr. EGGERT. As a taxpayer, I think that is important, and also for market discipline, it is a crucial thing.

Chairman DODD. Well, thank you. There are other questions I was going to——

Mr. EDWARDS. Excuse me, Senator.

Chairman DODD. Yes?

Mr. EDWARDS. Can I make one final point?

Chairman DODD. Certainly, you may. Yes.

Mr. EDWARDS. I do not want to make any headlines here today, so earlier Professor Eggert indicated that Fannie Mae had fired servicers. When we moved this servicing, we actually got together and worked out an arrangement where the servicer agreed to move some of these loans to a place where we had better capacity. We did it in such a way that it was a win-win for Fannie Mae and the servicer and ultimately for the families.

Chairman DODD. Well, good. That is encouraging. More of that evidence would help us.

And I am going to submit—there are a couple of other questions that I have, but we have kept everyone a long time here.

Jeff, any additional comments you want to make at all, or——

Senator MERKLEY. I will just close with this comment, and that is that the perspective presented by major banks before this Committee was that they are suspending the dual track for loans that they carry, but they are being forced by Fannie and Freddie not to suspend the dual track. You all have come and testified, oh, no, we create this window, this 90 days. There is either a serious misunderstanding or a serious discrepancy, but I would just urge you to try to find a path that is as supportive of the modification process as the major banks are for their own portfolio loans. Despite your attestations that you are doing it, something seems amiss and could be improved.

Chairman DODD. It might be, and Jeff, again, we tried this 4 years ago, or 3 ½ years ago, where we talked about it in this room, where we gathered together a lot of the mortgage lenders to talk about this very issue, and we had a set of principles that we adopted in this room that went nowhere, unfortunately, despite the commitments to the contrary. And it might not be a bad idea to gather, and you could raise this with Tim or others, as a way of gathering both these lending institutions, the servicers in a room like this and sit down and have that kind of conversation, what is going on, because that gap that we are getting—in these hearings, we have one panel and then another panel. Getting people together and find out where the gaps are here that we are hearing in the testimony might be very valuable. That is just a suggestion.

I thank all of you. Thank you for being here. It is very gracious of you to participate in this. Obviously, this is a problem that is not going to be resolved in the short term, but one that we have got to get behind us for all the reasons that have been articulated today. So the Committee thanks you for your presence.

The Committee will stand adjourned.

[Whereupon, at 12:50 p.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF SENATOR RICHARD C. SHELBY

Thank you, Mr. Chairman, for holding a second hearing on this very important topic.

As I stated in my opening remarks at our last meeting, it is important to hear from our regulators.

They are responsible for overseeing financial institutions, detecting these types of problems and formulating credible solutions.

With that in mind, I look forward to hearing from them on when they first discovered these problems, how serious they believe they are, and how quickly they can be resolved.

Additionally, I am interested in hearing from the members of the Financial Stability Oversight Council. I would like to know how they believe that body has performed and whether it has a role to play in addressing these issues.

Thank you Mr. Chairman.

PREPARED STATEMENT OF SENATOR TIM JOHNSON

Thank you for calling this hearing, Mr. Chairman. There have been many disturbing media reports about careless foreclosure practices. During our last hearing on this topic, the Attorney General from Iowa, Mr. Miller, stated that the regulators' review of documents couldn't have caught the robo-signing problems.

However, I am interested in learning about the steps that have been taken to ensure that taxpayers and homeowners get a fair shake in this process. I was particularly disturbed by reports of homeowners who were in the process of a modification being foreclosed upon. The perception that the system is stacked against the individual will further erode confidence in our housing markets and delay stability not just for housing but potentially for the economy as a whole.

I look forward to hearing from our witnesses about the steps they are taking to ensure that servicing, modification and foreclosure guidelines are being followed.

PREPARED STATEMENT OF SENATOR DANIEL K. AKAKA

Thank you, Mr. Chairman. During our first hearing to examine shortcomings in the mortgage servicing industry, we heard directly from the servicers about the steps that they were taking to address recent servicing issues. It was helpful to hear our panel's recommendations to remedy the situation and provide long overdue relief to homeowners. I left concerned with the extent of the problem, but hopeful that the servicers would continue to work with Federal and State regulators toward a swift resolution.

Unfortunately, in the short time between our last hearing and today, I continue to hear from homeowners in Hawaii that are facing foreclosure and having difficulty working with servicers. Borrowers are still faced with unresponsive and obstructive mortgage servicers, and they continue to receive conflicting and inaccurate information when they contact their lenders and servicers for information about loan modifications and other loss mitigation options.

Borrowers rightly expect their mortgage lenders and servicers to work in good faith to help them keep their homes. Instead, servicers have flaunted their protocols and ignored contractual agreements in favor of foreclosures. It is our responsibility and that of our witnesses today to correct these problems in order to preserve homeownership and provide much needed relief to distressed borrowers.

This begins with ensuring that servicers are properly adhering to modification, refinance, and foreclosure procedures. Borrowers should expect servicers to be accessible, cooperative, and helpful through loss mitigation and foreclosure. Mortgage modifications and refinances must be significant and meaningful so that homeowners do not re-default or find themselves delinquent again several months later. When foreclosure is unavoidable, it should proceed in accordance with the law in order to avoid documentation defects and proof of title uncertainties that have become too common.

These failures among mortgage service providers also highlight the need for greater financial literacy in our country. A lack of financial literacy is problematic even before foreclosure. Many borrowers fell behind on their mortgage payments because they did not understand the terms and features of their loans and they failed to anticipate increases in their monthly payments. Others are facing foreclosure because they did not plan for unforeseen financial hardships and were unable to make their monthly payments when they lost their jobs. Homeowners that are delinquent on their mortgages are often unaware of the counseling and education resources that are available to assist them throughout the loss mitigation and foreclosure processes. Even after foreclosure, individuals need a better understanding of how to manage their other debt obligations, rebuild their credit once it has been damaged, and access alternative housing opportunities.

Mortgage lenders and servicers must be held accountable for their poor business practices, but we should also provide individuals with the skills and tools they need to protect themselves. I worked to establish and secure funding for a pilot program that provides access to pre-homeownership counseling services for prospective home-buyers. The program is one example of what must be done to prepare individuals for the financial responsibilities that come with homeownership. We must continue to invest in financial education and counseling services that can develop individuals into more empowered and responsible consumers, borrowers, and homeowners.

It is clear that more must be done to improve mortgage servicing practices and the effectiveness of Federal homeowner assistance initiatives. I thank the witnesses for joining us today and look forward to continuing to work together to improve homeowner protection and financial literacy. Thank, Mr. Chairman.

PREPARED STATEMENT OF SENATOR KAY BAILEY HUTCHISON

Thank you Chairman Dodd.

As we continue to investigate allegations of fraud in the foreclosure process, we must remember that these issues are only a part of even greater problems with our nation's broader mortgage finance system. While today we consider mortgage servicing and compliance with foreclosures laws, we must not neglect the need to address and restructure our mortgage finance system that to date has cost taxpayers more than $150 billion.

In October, Greg Abbott, the Attorney General of Texas, called on 30 mortgage loan servicing companies in our State to halt new home foreclosures, sales of foreclosed homes, and evictions of people living in foreclosed homes. The purpose of this plea was to determine whether or not any mortgage loan company employees had participated in unlawful practices.

The Attorney General's request was not made lightly. In fact, it was made after several national lenders, including Bank of America, JP Morgan Chase, and Ally Financial, halted foreclosures outside of Texas to determine whether their practices were sound. And Attorney General Abbott was not alone. Attorneys general and regulators in all 50 states have joined together to investigate home foreclosures procedures on allegations of fraudulent practices.

As we have all come to learn, the issue at hand is ″robosigning,″ a practice used by mortgage loan servicers to expedite foreclosure proceedings. Through this practice, employees signed and swore to thousands of loan documents and affidavits without so much as verifying the information in the document, or, in some cases, without reading the information.

In any economic climate, allegations of foreclosure fraud should never be taken lightly. However, these allegations are magnified in our nation's ongoing economic downturn. From July 2007 to August 2009, 5.3 million homeowners saw foreclosure proceeds begin, and 2.5 million of these homeowners ended up losing their homes. Over the past year, the rate of foreclosure has only accelerated, and we have seen predictions that the number of foreclosures across the country may reach 12 million before the economy recovers.

In Texas, one in every 738 housing units is a foreclosure property, compared with 1 in every 389 nationally. While Texas has fared better than many other states, and the foreclosure and delinquency rates have respectively slowed across our State in recent months, there is nothing to celebrate. Many of our neighbors in Texas and across the country have already endured a foreclosure, and the threat of delinquency and foreclosure looms for many others.

Addressing allegations of fraud in mortgage servicing is very important. It is my hope that this hearing will be enlightening and I welcome the testimony of these distinguished witnesses.

However, Mr. Chairman, in addressing mortgage servicing, we must not lose sight of the larger elephant in the room: the need to reform our broader residential mortgage finance system. While we need to ensure that mortgage loan servicing companies are adhering to the law in the foreclosure process, we must address what led to the crisis in the first place.

In the wake of this crisis, American taxpayers have poured more than $150 billion into Fannie Mae and Freddie Mac, the secondary mortgage giants who have traded their Government charter for Government control through Federal conservatorship. It is estimated that the total cost to taxpayers of this bailout for Fannie Mae and

Freddie Mac may reach as high as $259 billion. When the bailout of Fannie Mae and Freddie Mac is combined with the $700 billion Troubled Asset Relief Program ultimately used to inject capital into banks weighed down by bad mortgages, and Federal stimulus and spending packages aimed at lifting the tattered economy brought down by the mortgage crisis, taxpayers have fronted trillions of dollars. Taxpayers have paid an even greater amount in lost jobs, lost homes, and lost savings.

Despite the significant effects of the mortgage crisis, Congress has done nothing to address the mortgage finance system, except to throw Fannie Mae and Freddie Mac the lifeline of their bailout which we have seen grow to more than $150 billion and counting. Mr. Chairman, we must not wait any longer to investigate issues that have arisen as a result of the mortgage crisis. We must address the root causes of this crisis: Fannie Mae, Freddie Mac, and the rest of nation's flawed mortgage finance system.

PREPARED STATEMENT OF PHYLLIS CALDWELL

CHIEF OF HOMEOWNERSHIP PRESERVATION OFFICE
DEPARTMENT OF THE TREASURY

DECEMBER 1, 2010

Chairman Dodd, Ranking Member Shelby, and Members of the Committee, thank you for the opportunity to testify today regarding issues surrounding mortgage servicing. This testimony will cover two key areas: first, the steps we are taking to ensure that servicers participating in the Making Home Affordable (MHA) program are adhering to program guidelines in light of the recent foreclosure issues, and second, the accomplishments of MHA to date and its impact on mortgage servicing.

The reports of "robo-signing", faulty documentation and other improper foreclosure practices by mortgage servicers are unacceptable. If servicers have failed to comply with the law, they should be held accountable. The Administration is leading a coordinated interagency effort to investigate misconduct, protect homeowners and mitigate any long-term effects on the housing market. While Treasury does not have the authority to regulate the foreclosure practices of financial institutions, nor to ensure that those practices conform to the law, it is working closely with agencies that do have such authority.

The Financial Fraud Enforcement Task Force, a broad coalition of law enforcement, investigatory, and regulatory agencies that brings together more than 20 Federal agencies, 94 U.S. Attorneys Offices, and dozens of State and local partners, is working to ensure that foreclosure practices are thoroughly investigated and any criminal behavior is prosecuted. The Federal Housing Administration (FHA) has been reviewing servicers of loans it insures for compliance with loss mitigation requirements. Additionally, the Office of the Comptroller of the Currency has directed all large national bank servicers to review their foreclosure management processes—including file reviews, affidavit processing, and signatures—to ensure that the processes are fully compliant with all applicable State laws. The other independent banking regulatory agencies are doing similar reviews of institutions under their jurisdiction. Attached to my testimony is a fact sheet providing more detail concerning the activities of the coordinated interagency effort.

Because MHA and its first lien program, the Home Affordable Modification Program (HAMP), are pre-foreclosure programs, the recent reports of robo-signing of affidavits and improper foreclosure documentation do not directly affect the implementation of HAMP. But these documentation failures reflect the fact that servicers did not have the proper resources in place, nor did they have procedures and controls in place to prevent this crisis. As we have learned in implementing HAMP, servicers were historically structured and staffed to perform a limited role-primarily collecting payments. They did not have the systems, staffing, operational capacity or incentives to engage with homeowners on a large scale and offer meaningful relief from unaffordable mortgages.

The foreclosure problems underscore the continued critical importance of the Making Home Affordable Program launched by the Obama administration. Preventing avoidable foreclosures through modifications and other alternatives to foreclosure continues to be a critical national priority. Foreclosure is painful for homeowners; it is also costly to servicers and investors. Foreclosures dislocate families, disrupt the communities, and destabilize local housing markets. For this reason, the Obama administration launched the Making Home Affordable program in the spring of 2009, of which HAMP is a key component. HAMP is intended to prevent avoidable foreclosures by providing financial incentives to servicers, investors and borrowers to voluntarily undertake modifications of mortgages for responsible homeowners in a way that is affordable and sustainable over time. In cases where a modification is not possible, the participating servicers must consider other alternatives to foreclosure. As a result, throughout the last 20 months, we have worked to develop systems and procedures to ensure that responsible homeowners are offered meaningful modifications and other foreclosure alternatives. To remedy servicer shortcomings, we have urged servicers to rapidly increase staffing and improve customer service. We have developed specific guidelines and certifications on how and when borrowers must be evaluated for HAMP and other loss mitigation options prior to foreclosure initiation. We have also continued our compliance efforts to ensure borrowers are fairly evaluated and that servicers conduct their operations in accordance with Treasury guidelines. MHA has strong compliance mechanisms in place to ensure that servicers follow our program's guidelines.

HAMP Procedural Safeguards and Compliance Efforts

Treasury has built numerous procedural safeguards in HAMP to avoid foreclosure sales. Specifically, program guidelines require participating mortgage servicers of non-GSE loans to:

- Evaluate homeowners for HAMP modifications before referring them for foreclosure. The focus here is on early intervention. Servicers must reach out to all potentially eligible borrowers when they are only 2 months delinquent and there is a still a viable opportunity to save the loan;
- Suspend any foreclosure proceedings against homeowners who have applied for HAMP modifications, while their applications are pending;
- Evaluate whether homeowners who do not qualify for HAMP (or who have fallen out of HAMP) qualify for alternative loss mitigation programs or private modification programs;
- Evaluate whether homeowners who cannot obtain alternative modifications may qualify for a short sale or deed-in-lieu of foreclosure; and
- Provide a written explanation to any borrower who is not eligible for modification and delay foreclosure for at least 30 days to give the homeowner time to appeal.

Servicers may not proceed to foreclosure sale unless and until they have tried these alternatives. They must also first issue a written certification to their foreclosure attorney or trustee stating that "all available loss mitigation alternatives have been exhausted and a non-foreclosure option could not be reached." On October 6, Treasury clearly reminded servicers of non-GSE loans of this existing requirement that they are prohibited from conducting foreclosure sales until these pre-foreclosure certifications are executed. It should be noted that the GSEs have similar guidelines for their HAMP modifications.

The MHA compliance program is designed to ensure that servicers are meeting their obligations under the MHA servicer contracts for loans where Fannie Mae or Freddie Mac is not the investor, and uses a variety of compliance activities to assess servicers from different perspectives. Treasury has engaged a separate division of Freddie Mac, Making Home Affordable—Compliance (MHA–C), to perform these compliance activities. Employing a risk-based approach, compliance activities are performed ranging generally monthly for servicers with the largest percentages of potentially eligible borrowers, to at least twice annually for the smaller-sized servicers.

Our compliance activities focus on ensuring that homeowners are appropriately treated in accordance with MHA guidelines. As the program has evolved, servicers have adapted their processes to incorporate MHA programs. Treasury has implemented non-financial remedies that have shaped servicer behavior in order to address the most vital issue: the ultimate impact on the homeowner.

As information regarding irregularities in servicer foreclosure practices arose, Treasury acted swiftly and instructed MHA–C to review the ten largest servicers' internal policies and procedures for completing these pre-foreclosure certifications before initiating the foreclosure proceedings, and to assess a limited sample of foreclosure sales that have occurred since the effective date of the guidance. The results of the review are not yet available. However, if MHA–C identifies any incidents of non-compliance with HAMP guidelines, Treasury will direct servicers to take appropriate corrective action, which may include suspending foreclosure proceedings and re-evaluating the affected homeowners for HAMP, as well as undertaking changes to servicing processes to help ensure that HAMP guidelines are followed prior to initiating the foreclosure process.

HAMP's Accomplishments and Its Impact on the Mortgage Industry

To date, HAMP has achieved three critical goals: it has provided immediate relief to many struggling homeowners; it has used taxpayer resources efficiently; and it has helped transform the way the entire mortgage servicing industry operates. Twenty months into the program, close to 1.4 million homeowners have entered into HAMP trials and experienced temporary reductions in their mortgage payments. Of these, almost 520,000 homeowners converted to permanent modifications. These homeowners are experiencing a 36 percent median reduction in their mortgage payments-averaging more than $500 per month-amounting to a total, program-wide savings of nearly $3.7 billion annually for homeowners.

Early indications suggest that the re-default rate for permanent HAMP modifications is significantly lower than for historical private-sector modifications—a result of the program's focus on properly aligning incentives and achieving greater affordability. For HAMP modifications made in the fourth quarter of 2009, at 6 months, fewer than 10 percent of permanent modifications are 60+ days delinquent. According to the OCC's Mortgage Metrics Report, the comparable delinquency rates for non-HAMP modifications made in the same quarter were 22.4 percent. Regarding HAMP re-defaults, the OCC states, "These lower early post-modification delinquency rates may reflect HAMP's emphasis on the affordability of monthly payments and the requirements to verify income and complete a successful trial period."

Borrowers who do not ultimately qualify for HAMP modifications often receive alternative forms of assistance. Based on survey data from the eight largest servicers, approximately one-half of homeowners who apply for HAMP modifications but do not qualify have received some form of private-sector modification. Less than 10 percent have lost their homes through foreclosure sales.

HAMP uses taxpayer resources efficiently. HAMP's "pay-for-success" design utilizes a trial period to ensure that taxpayer-funded incentives are used only to support borrowers who are committed to staying in their homes and making monthly payments, and the investor retains the risk of the borrower re-defaulting into foreclosure. No taxpayer funds are paid to a servicer or an investor until a borrower has made three modified mortgage payments on time and in full. The majority of payments are made over a 3- to 5-year period only if the borrower continues to fulfill this responsibility. These safeguards ensure that spending is limited to high-quality modifications.

MHA Has Been a Catalyst—Setting the Benchmark for Sustainable Modifications

MHA has transformed the way the mortgage servicing industry deals with alternatives to foreclosure. Because of MHA, servicers have developed constructive private-sector options. Where there was once no consensus plan among loan servicers about how to respond to borrowers in need of assistance, HAMP established a universal affordability standard: a 31 percent debt-to-income ratio, which dramatically enhanced servicers' ability to reduce mortgage payments to sustainable levels while simultaneously providing the necessary justification to investors for the size and type of modification.

In the year following initiation of HAMP, home retention strategies changed dramatically. According to the OCC/ OTS Mortgage Metrics Report, in the first quarter of 2009, nearly half of mortgage modifications increased borrowers' monthly payments or left their payments unchanged. By the second quarter of 2010, 90 percent of mortgage modifications lowered payments for the borrower. This change means borrowers are receiving better solutions. Modifications with payment reductions perform materially better than modifications that increase payments or leave them unchanged.

Moreover, even holding the percentage payment reduction constant, the quality of modifications made by servicers appears to have improved since 2008. For modifications made in 2008, 15.8 percent of modifications that received a 20 percent payment reduction were 60 days or more delinquent 3 months into the modification. For modifications made in 2010, that delinquency rate has fallen almost in half, to 8.2 percent. The OCC's Mortgage Metrics Report from 2010:Q2 attributes the improvement in mortgage performance to "servicer emphasis on repayment sustainability and the borrower's ability to repay the debt."

Spurred by the catalyst of the HAMP program, the number of modification arrangements was nearly three times greater than the number of foreclosure completions between April 2009 and August 2010. More than 3.7 million modification arrangements were started, including the close to 1.4 million trial HAMP modification starts, more than 568,000 FHA loss mitigation and early delinquency interventions, and more than 1.6 million proprietary modifications by servicing members of the HOPE NOW Alliance.

Further, it is important to keep in mind that MHA is only one of many Administration housing efforts targeting these challenges: the Administration has also provided substantial support for the housing markets through support for Fannie Mae and Freddie Mac to help keep mortgage rates affordable; purchase of agency mortgage-backed securities; and an initiative to provide support and financing to State and local Housing Finance Agencies (HFAs). These HFAs provide, in turn, tens of thousands of affordable mortgages to first time homebuyers and help develop tens of thousands of affordable rental units for working families.

Responding to a Changing Housing Crisis

MHA was designed to be a versatile program. MHA includes a second lien modification program, a foreclosure alternatives program that promotes short sales and deeds-in-lieu of foreclosures, and an unemployment forbearance program. Treasury expanded HAMP to include FHA and Rural Development mortgage loans through the FHA–HAMP and RD–HAMP program, and also introduced a principal reduction option. Finally, Treasury introduced a program to allow the hardest-hit states to tailor housing assistance to their areas, and worked with FHA to introduce an option for homeowners with high negative equity to refinance into a new FHA loan if their lender agrees to reduce principal on the original loan by at least 10 percent.

Second Lien Modification Program

The Second Lien Modification Program (referred to as 2MP) requires that when a borrower's first lien is modified under HAMP and the servicer of the second lien is a 2MP participant, that servicer must offer to modify the borrower's second lien according to a defined protocol. 2MP provides for a lump sum payment from Treasury in exchange for full extinguishment of the second lien, or a reduced lump sum payment from Treasury in exchange for a partial extinguishment and modification of the borrower's remaining second lien. Although 2MP was initially met with reluctance from servicers and investors who did not want to recognize losses on their second lien portfolios, as of October 3, 2010, Treasury has signed up seventeen 2MP servicers, which includes the four largest mortgage servicers, who in aggregate service approximately 60 percent of outstanding second liens. The program uses a third-party data base to match second lien loans with first lien loans permanently modified under HAMP. Servicers are required to modify second lien loans within 120 days from the date the servicer receives the first lien and second lien matching information. The implementation of this data base began over the summer. Five 2MP Servicers have already begun matching modified first liens with their corresponding second liens, while the other twelve are in some phase of developing systems capacity to do so. Information on the second lien program will be included in upcoming Monthly Servicer Performance Reports as data becomes available.

Home Affordable Foreclosure Alternatives Program

Any modification program seeking to avoid preventable foreclosures has limits, HAMP included. HAMP does not, nor was it ever intended to, address every delinquent loan. Borrowers who do not qualify for HAMP may benefit from an alternative program that helps the borrower transition to more affordable housing and avoid the substantial costs of a foreclosure. Under HAFA, Treasury provides incentives for short sales and deeds-in-lieu of foreclosure for circumstances in which borrowers are unable to complete the HAMP modification process or decline a HAMP modification. Borrowers are eligible for a relocation assistance payment, and servicers receive an incentive for completing a short sale or deed-in-lieu of foreclosure. In addition, investors are paid additional incentives for allowing some short sale proceeds to be distributed to subordinate lien holders. The Home Affordable Foreclosure Alternatives (HAFA) Program became effective on April 5, 2010.

Unemployment Program

In March 2010, the Obama administration announced enhancements to HAMP aimed at unemployment problems by requiring servicers to provide temporary mortgage assistance to many unemployed homeowners. The Unemployment Program (UP) requires servicers to grant qualified unemployed borrowers a forbearance period during which their mortgage payments are temporarily reduced for a minimum of 3 months, and up to 6 months for some borrowers, while they look for a new job. Servicers are prohibited from initiating a foreclosure action or conducting a foreclosure sale (a) while the borrower is being evaluated for UP, (b) after a foreclosure plan notice is mailed, (c) during the UP forbearance or extension, or (d) while the borrower is being evaluated for or participating in HAMP or HAFA following the UP forbearance period. UP went in to effect August 1, 2010. Because no incentives are paid under UP, data reports will be based on servicer surveys.

Principal Reduction Alternative

The Administration announced further enhancements to HAMP in March 2010 by encouraging servicers to write down mortgage debt as part of a HAMP modification (the Principal Reduction Alternative, or PRA). Under PRA, servicers are required to evaluate the benefit of principal reduction and are encouraged to offer principal reduction whenever the net present value (NPV) result of a HAMP modification using PRA is greater than the NPV result without considering principal reduction. The principal reduction and the incentives based on the dollar value of the principal reduced will be earned by the borrower and investor based on a pay-for-success structure. Under the contract with each servicer, Treasury cannot compel a servicer to select PRA over the standard HAMP modification even if the NPV of PRA is greater than the NPV of regular HAMP. However, Treasury has required servicers to have written policies for PRA to help ensure that similarly situated borrowers are treated consistently. The program became operational October 1, 2010 and the four largest servicers have indicated an intention to offer PRA to homeowners.

FHA Refinance

Also in March 2010, the Administration announced adjustments to existing FHA refinance programs that permit lenders to provide additional refinancing options to homeowners who owe more than their homes are worth because of large declines in home prices in their local markets. This program, known as the FHA Short Refinance option, will provide more opportunities for qualifying mortgage loans to be restructured and refinanced into FHA-insured loans.

In order to qualify for this program, a homeowner must be current on their existing first lien mortgage; the homeowner must occupy the home as a primary residence and have a qualifying credit score; the mortgage owner must reduce the amount owed on the original loan by at least 10 percent; the new FHA loan must have a balance of no more than 97.75 percent of the current value of the home; and total mortgage debt for the borrower after the refinancing, including both the first lien mortgage and any other junior liens, cannot be greater than 115 percent of the current value of the home—giving homeowners a path to regain equity in their homes and affordable monthly payments. Program guidance was issued to participating FHA servicers in September 2010.

HFA Hardest-Hit Fund

On February 19, 2010, the Administration announced the Housing Finance Agency Innovation Fund for the Hardest Hit Housing Markets (HFA Hardest-Hit Fund) for State HFAs in the nation's hardest-hit housing markets to design innovative, locally targeted foreclosure prevention programs. In total, $7.6 billion has been allocated to 18 states (Alabama, Arizona, California, Florida, Georgia, Illinois, Indiana, Kentucky, Michigan, Mississippi, Nevada, New Jersey, North Carolina, Ohio, Oregon, Rhode Island, South Carolina, and Tennessee) and the District of Columbia under the HFA Hardest-Hit Fund. As of November 1, 2010, four states were either accepting applications or providing assistance (Arizona, Michigan, Ohio and Rhode Island). By the end of 2010 another three states are expected to begin providing assistance. The remaining states are expected to begin providing assistance in the first half of 2011.

Allocations under the HFA Hardest-Hit Fund were made using several different metrics. Some of the funds were allocated to states that have suffered average home price drops of more than 20 percent from their peak, while other funds were allocated to states with the highest concentration of their populations living in counties with unemployment rates greater than 12 percent or unemployment rates that were at or above the national average. In addition, some funds were allocated to all the states and jurisdictions already participating in the HFA Hardest-Hit Fund to expand the reach of their programs to help more struggling homeowners. The applicable HFAs designed the State programs themselves, tailoring the housing assistance to their local needs. A minimum of $2 billion of the funding is required to be used by states for targeted unemployment or under-employment programs that provide temporary assistance to eligible homeowners to help them pay their mortgages while they seek re-employment or additional employment or undertake job training. Treasury also required that all of the programs comply with the requirements of EESA, which include that they must be designed to prevent avoidable foreclosures. All of the funded program designs are posted online at *http://www.FinancialStability.gov/roadtostability/hardesthitfund.html.*

Transparency, Accountability, and Compliance

I would like to provide you with further detail regarding the compliance efforts regarding HAMP. To protect taxpayers and ensure that TARP dollars are directed toward promoting financial stability, Treasury established rigorous transparency and accountability measures for all of its programs, including all housing programs. In addition, every borrower is entitled to a clear explanation if he or she is determined to be ineligible for a HAMP modification. Treasury requires servicers to report the reason for modification denials in the HAMP system of record. MHA–C's compliance activities, through Second Look loan file reviews and other onsite assessments, evaluate the appropriateness of the denials as well as the timeliness and accuracy of the denial notification to the affected borrowers.

In order to improve transparency of the HAMP NPV model, which is a key component of the eligibility test for HAMP, Treasury increased public access to the NPV white paper, which explains the methodology used in the NPV model. To ensure accuracy and reliability, MHA–C conducts periodic audits of servicers' NPV practices. MHA–C conducts two types of reviews related to NPV. For those servicers that have re-coded the requirements of the NPV model in their processing systems, MHA–C conducts onsite and offsite reviews of model accuracy, model management, and data integrity and inputs. For those servicers using the MHA Servicer Portal, MHA–C conducts reviews of data integrity and inputs. Where non-compliance is found, Treasury requires servicers to take remedial actions, which can include re-evaluating borrowers with appropriate inputs, process changes, corrections to recoded NPV implementations, and, for servicers who have re-coded the NPV model, reverting back to the MHA Servicer Portal for loans with negative NPV results from the servicers' re-coded NPV model until necessary corrections have been re-evaluated by MHA–C. In addition, as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act, Treasury is preparing to establish a Web portal that borrowers can access to run a NPV analysis using input data regarding their own mortgages, and to provide to borrowers who are turned down for a HAMP modification the input data used in evaluating the application.

As stated above, servicers are subject to various other compliance activities, including periodic, onsite compliance reviews as well as onsite and offsite loan file reviews. These various compliance activities performed by MHA–C assess servicers' compliance with HAMP requirements. Treasury works closely with MHA–C to adapt and execute our risk based compliance activities quickly based on changes in the program as well as observed trends. The current assessment of the top ten servicers' adherence to our pre-foreclosure certifications and requirements is one example of how we adapt our compliance activities. MHA–C provides Treasury with the results from each of the various compliance activities conducted. Treasury performs quality reviews of these activities and evaluates the nature and scope of any instances of non-compliance, and assesses appropriate responses, including remedies, in a consistent manner. As stated earlier, during the beginning of the program, and as additional features (*e.g.,* the Second Lien Program) are introduced, Treasury's compliance activities and associated remedies focus on shaping servicers' behavior and improving processes as servicers ramp up or modify their implementation of HAMP. As the program and servicers' processes mature, financial remedies may become more appropriate and effective in reinforcing Treasury's compliance and performance expectations.

Looking Ahead for Housing

Servicers need to increase efforts in helping borrowers avoid foreclosure through modification, as well as other alternatives to foreclosure, such as short sales. Furthermore, as we have learned through HAMP, servicers must be held accountable for ensuring that their foreclosure processes have integrity and are used after all loss mitigation options have been exhausted. Treasury's main priority is to ensure that *first,* participating servicers are doing everything that they can to reach, evaluate, and start borrowers into HAMP modifications, *second,* if a HAMP modification is not possible, every servicer is properly evaluating each homeowner for all other potential options to prevent a foreclosure, including HAFA or one of their own modification programs, and *third,* servicers are utilizing programs such as UP or the HFA Hardest-Hit Fund to their fullest ability in order to prevent avoidable foreclosures.

Over the past 20 months, we have been actively engaged with stakeholders from across the housing sector to find ways to increase the pace of new HAMP modifications, improve the characteristics of those modifications, and improve the borrower experience. We sincerely appreciate the assistance that we have gotten from Members of Congress and the advocacy community in strengthening borrower protections, incentivizing principal reduction, and assisting the unemployed. And most importantly, we value the efforts that Members of Congress, counselors and advocates have made in holding servicers accountable.

Yet, as we deploy a comprehensive suite of loss mitigation options, we must remember, as the President noted, not every foreclosure can be prevented. Any broad-based solution must aim at achieving both an efficient and equitable allocation of resources. This means a balance must be struck between affording homeowners opportunities to avoid foreclosure while expeditiously easing the transition in those cases where homeownership is not an economically sustainable alternative. This is especially important in order to lay the foundation for future appreciation which will provide a meaningful path to sustainable homeownership.

In the coming months, we will begin to see the impacts of the newly launched MHA programs. These programs will reach more distressed homeowners and provide additional stability to the housing market going forward. In much the same way that HAMP's first lien modification program has provided a national blueprint for mortgage modifications, these new programs will continue to shape the mortgage servicing industry and act as a catalyst for industry standardization of short sale, refinance and principal reduction programs. The interplay of all these programs will provide a much more flexible response to changes in the housing market over the next 2 years.

THE WHITE HOUSE
Office of the Press Secretary

FOR IMMEDIATE RELEASE
October 20, 2010

FACT SHEET: Federal Government Efforts to Support Accountability, Stability and Clarity in the Housing Market

Today the Department of Housing and Urban Development, the Department of the Treasury, the Department of Justice, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Trade Commission, the Securities and Exchange Commission, the Federal Housing Finance Agency and the Office of Thrift Supervision met to discuss ongoing interagency action to support accountability, stability, and clarity in the housing market and residential mortgage backed securities market.

We are working together to review practices that do not comply with state foreclosure law or applicable federal laws, including taking the following actions:

- The Federal Housing Administration (FHA) has been reviewing servicers for compliance with loss mitigation requirements. These reviews are being broadened to include a larger range of processes, focusing in particular on servicer procedures during the final stages of the foreclosure process. These reviews are expected to be complete within nine weeks.

- The Financial Fraud Enforcement Task Force, led by the Department of Justice, has brought together more than 20 federal agencies, 94 US Attorney's Offices and dozens of state and local partners to share information about foreclosure and servicing practices. The Task Force's collaborative efforts are ensuring that the full resources of the federal and state regulatory and enforcement authorities are being brought to bear in addressing this issue.

- The Financial Fraud Enforcement Task Force has also been coordinating with State Attorneys General in their joint review of "robo-signing" practices in foreclosure cases.

- The Department of Justice, including through the Executive Office for U.S. Trustees, is also working with regulators to investigate and, where appropriate, litigate against servicers, their law firms, and third-party providers regarding their foreclosure and bankruptcy processes.

- The Federal Housing Finance Agency (FHFA) directed Fannie Mae and Freddie Mac to remind servicers of their contractual and legal responsibilities in foreclosure processing. On October 13, FHFA directed Fannie Mae and Freddie Mac to implement a policy framework for dealing with possible foreclosure process deficiencies that requires servicers to review their foreclosure processes and fix any processing problems they identify. The FHFA policy framework includes specific steps servicers should take to remedy mistakes in foreclosure affidavits so that the information contained in the affidavits is correct and that the affidavits are completed in compliance with applicable law.

- The Office of the Comptroller of the Currency (OCC) directed all large national bank servicers on September 29 to review their foreclosure management processes, including file review, affidavit processing and signatures, to ensure that the processes are fully compliant with all applicable state laws.

- The Office of the Comptroller of the Currency and the Federal Reserve System are jointly examining foreclosure and securitization practices at the nation's largest servicers. The examinations will include intensive review of the firms' policies, procedures, and internal controls related to loan modifications, foreclosures and securitizations. The reviews will also evaluate controls over the selection and management of third-party service providers.

- In coordination with the work of the other agencies, the Office of Thrift Supervision (OTS) is reviewing the mortgage related policies, foreclosure processes and staffing levels of the largest servicers it supervises. The OTS has gathered preliminary information through its regional offices about the servicer practices across the country. It also issued correspondence on October 8 to all savings associations involved in servicing residential mortgages requiring the immediate review of their actual practices associated with the execution of documents related to the foreclosure process.

- The Federal Deposit Insurance Corporation is participating in the reviews by the OCC, the Federal Reserve System, and the OTS of the foreclosure and securitization practices of the largest mortgage servicers in its role as back-up supervisor. The FDIC also is verifying that the servicers it supervises do not exhibit the problems that others have identified as well as reviewing the processes used by servicers of loans subject to loss share agreements and other loans from receiverships of failed banks. The regulators are also evaluating foreclosure and securitization practices in electronic registration systems.

- The Federal Trade Commission (FTC) is monitoring servicers under existing public orders to confirm proper servicing and foreclosure processes, is conducting reviews in line with past servicing abuses and monitoring the market closely for any fraud or foreclosure scams.

- The US Treasury has implemented a strong compliance framework for the Home Affordable Modification Program (HAMP) servicers. On October 6, Treasury issued a notice to HAMP servicers reminding them of their requirement to comply with all applicable state and federal laws, as well as a reminder that prior to foreclosure sale, servicers must certify to the foreclosure attorney or trustee that all loss mitigation options have been considered and exhausted. Treasury also recently instructed its HAMP compliance agent to review internal policies, procedures, and processes for completing the pre-foreclosure certifications at the ten largest servicers.

- In addition to its role enforcing the federal securities laws, the Securities and Exchange Commission (SEC) has issued proposed rules that would provide greater transparency and disclosures in the securitization market and provide investors with additional tools to evaluate actions in the securitization market.

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PREPARED STATEMENT OF SHEILA C. BAIR.

CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

DECEMBER 1, 2010

Chairman Dodd, Ranking Member Shelby and Members of the Committee, thank you for requesting the views of the Federal Deposit Insurance Corporation on deficiencies in mortgage servicing and their broader potential impact on the financial system. It is unfortunate that problems in mortgage servicing and foreclosure prevention continue to require the scrutiny of this Committee. While "robo-signing" is the latest issue, this problem is symptomatic of persistent shortcomings in the foreclosure prevention efforts of our nation's largest mortgage servicers. As such, I believe that major changes are required to stabilize our housing markets and prevent unnecessary foreclosures.

The FDIC continues to review the mortgage servicing operations at banks we supervise and also those institutions that have purchased failed-bank loans under loss share agreements with the FDIC. To date, our review has revealed no evidence that FDIC-supervised State-chartered banks directly engage in robo-signing, and it also appears that they have limited indirect exposure through third-party relationships with servicers that have engaged in this practice. However, we remain concerned about the ramifications of deficiencies in foreclosure documentation among the largest servicers, most of which we insure. We will continue to work with the primary supervisors of these servicers through our backup examination authority. In addition, we are coordinating our work with the State Attorneys General (AG) and the Financial Fraud Enforcement Task Force—a broad coalition of Federal, State, and local law enforcement, regulatory, and investigatory agencies led by the Department of Justice—to support efforts for broad based and consistent resolution of servicing issues.

The robo-signing and foreclosure documentation issues are the natural result of the misaligned incentives that pervade the entire mortgage process. For instance, the traditional, fixed level of compensation for loan servicing has been wholly inadequate to cover the expenses required to implement high-touch and specialized servicing on the scale needed in recent years. Misaligned incentives have led to significant underinvestment in the systems, processes, training, and staffing necessary to effectively implement foreclosure prevention programs. Similarly, many servicers have failed to update their foreclosure process to reflect the increased demand and need for loan modifications. As a result, some homeowners have received conflicting messages from their servicers and have missed opportunities to avoid foreclosure. The failure to effectively implement loan modification programs can not only harm individual homeowners, but the resulting unnecessary foreclosures put downward pressure on home prices.

As serious as these issues are, a complete foreclosure moratorium is ill-advised, as it would unduly prolong those foreclosures that are necessary and justified, and would slow the recovery of housing markets. The regrettable truth is that many of the properties currently in the foreclosure process are either vacant or occupied by borrowers who simply cannot make even a significantly reduced payment and have been in arrears for an extended time.

My hope is that the newly established Financial Stability Oversight Council (FSOC) will take the lead in addressing the latest issues of foreclosure documentation deficiencies and proposing a sensible and broad-based approach to reforming mortgage servicer processes, promoting sustainable loan modifications and restoring legal certainty to the foreclosure process where it is appropriate and necessary.

In my testimony, I will begin with some background on the robo-signing and related foreclosure documentation problems and connect theses issues to other deficiencies in the mortgage servicing process. Second, I will discuss the FDIC's efforts to address identified servicing problems within our limited jurisdiction. Finally, I will discuss the central role that I believe the FSOC can play in facilitating broad agreements among major stakeholder groups that can help resolve some of these issues.

I. Robo-Signing and Foreclosure Documentation Problems and Shortfalls in Mortgage Servicing

The FDIC is concerned about two related, but separate, problems relating to foreclosure documentation. The first is referred to as "robo-signing," or the use of highly automated processes by some large servicers to generate affidavits in the foreclosure process without the affiant having reviewed facts contained in the affidavit or having the affiant's signature witnessed in accordance with State laws. Recent depositions of individuals involved in robo-signing have led to allegations of fraud based on contentions that these individuals signed thousands of documents without knowledge or verification of the information contained in the filed affidavits.

The second problem involves demonstrating the chain of title required to foreclose. Some servicers have not been able to establish their legal standing to foreclose because, under current industry practices, they may not be in possession of the necessary documentation required under State law. In many cases, a servicer is acting on behalf of a trustee of a pool of mortgages that have been securitized and sold to investors in a mortgage-backed securities (MBS) transaction. In MBS transactions, the promissory note and mortgage signed by the borrowers are held by a custodian on behalf of the securitization investors.

In many cases today, however, the mortgage held by the custodian indicates that legal title to the mortgage has been assigned from the original lender to the Mortgage Electronic Registration System (MERS), a system encompassing some 31 million active mortgage loans that was designed to facilitate the transfer of mortgage claims in the securitization process. Securitization often led to multiple transfers of the mortgage through MERS. Many of the issues raised about the authority of servicers to foreclose are a product of potential defects in these transfers and the requirements for proof of the servicer's authority. Where MERS is involved, foreclosures have been initiated either by MERS, as the legal holder of the lien, or by the servicer. In both cases, the foreclosing party must show that it has possession of the note and that its right to foreclose on the mortgage complies with State law.

Robo-signing and chain of title issues may create contingent liabilities for mortgage servicers. Investors who contend that servicers have not fulfilled their servicing responsibilities under the pooling and servicing agreements (PSAs) argue that they have grounds to reassign servicing rights. In addition, concerns have been raised by investors as to whether the transfer of loan documentation in some private MBS securitization trusts fully conform to the requirements established under applicable trust law and the PSAs governing these transactions. While the legal challenges under the representations and warranties trust requirements remain in their early stages, they could, if successful, result in the "putback" of large volumes of defaulted mortgages from securitization trusts to the originating institutions. The FDIC has been working with the FRB and the Comptroller of the Currency (OCC), in our backup capacity, to gather information from the large servicers to evaluate the potential financial impact of these adverse outcomes.

Long-Standing Weaknesses in Third-Party Mortgage Servicing

The weaknesses that have been identified in mortgage servicing practices during the mortgage crisis are a byproduct of both rapid growth in the number of problem loans and a compensation structure that is not well designed to deal with these loans. As recently as 2005, when average U.S. homes prices were still rising rapidly, fewer than 800,000 mortgage loans entered foreclosure on an annual basis.[1] By 2009, the annual total had more than tripled to over 2.8 million, and foreclosures through the first three quarters of 2010 are running at an annualized pace of more than 2.5 million. Moreover, the proportion of foreclosure proceedings actually resulting in the repossession and sale of collateral appears to have increased even more rapidly over this period in some of the hardest-hit markets. Data published by the Federal Housing Finance Agency show that the percent of total homes sales in California resulting from foreclosure-related distressed sales increased more than eightfold, to over 40 percent of all sales, between 2006 and 2008.[2]

The share of U.S. mortgage loans held or securitized by the Government-sponsored enterprises (GSEs) and private issuers of asset-backed securities has doubled over the past 25 years to represent fully two-thirds of the value of all mortgages currently outstanding.[3] One effect of this growth in securitization has been parallel growth in third-party mortgage servicing under PSA agreements. By definition, a large proportion of the mortgages sold or securitized end up serviced under PSAs.

The traditional structure of third-party mortgage servicing fees, put in place well before this crisis, has created perverse incentives to automate critical servicing activities and cut costs at the expense of the accuracy, reliability and currency of loan documents and information. Prior to the 1980s, the typical GSE mortgage pool paid a servicing fee of 37.5 basis points annually, or .375 percent of the outstanding principal balance of the mortgage pool. Since the 1980s, the typical servicing fee for prime loans has been 25 basis points. When Alt-A and subprime mortgages began

[1] FDIC estimate based on data from the Mortgage Bankers Association data and the American Housing Survey.

[2] "The Impact of Distressed Sales on Repeat-Transactions House Price Indexes," FHFA, May 27, 2009, *http://www.fhfa.gov/webfiles/2916/researchpaper_distress%5B1%5D.pdf.*

[3] Source: Federal Reserve Board, *Flow of Funds,* Table L.218.

to be securitized by private issuers in the late 1990s, the standard servicing fees for those loans were set higher, typically at 37.5 basis points for Alt-A loans and 50 basis points for subprime loans. While this fee structure provided a steady profit stream for servicers when the number of defaulted loans remained low, costs rose dramatically with the rise in mortgage defaults in the latter half of the last decade. As a result, some mortgage servicers began running operating losses on their servicing portfolios. One result of a compensation structure that did not account for the rise in problem loans was a built-in financial incentive to minimize the investment in back office processes necessary to support both foreclosure and modification. The other result was consolidation in the servicing industry. The market share of the top 5 mortgage servicers has nearly doubled since 2000, from 32 percent to almost 60 percent.[4] The purpose and effect of consolidation is to cut costs and achieve economies of scale, but also to increase automation.

Most PSAs allow for both foreclosure and modification as a remedy to default. But servicers have continuously been behind the curve in pursuing modification as an alternative to foreclosure. A survey of 13 mortgage servicers conducted by the State Foreclosure Prevention Working Group shows that the annual percent of all past due mortgages that are being modified has risen from just over 2 percent in late 2007 to a level just under 10 percent as of late 2009.[5] At the same time, the percentage of past due loans entering foreclosure each year has also steadily risen over this same time period, from 21 percent to 32 percent.

One example of the lack of focus on loss mitigation strategies is the uncoordinated manner in which many servicers have pursued modification and foreclosure at the same time. Under such a "dual-track" process, borrowers may be attempting to file the documentation needed to establish their qualifications for modification and waiting for a favorable response from the servicer, even while that servicer is at the same time executing the paperwork necessary to foreclose on the property. While in some cases it may be reasonable to begin conducting preliminary filings for seriously past due loans in states with long foreclosure timelines, it is vitally important that the modification process be brought to conclusion before a foreclosure sale is scheduled. Failure to coordinate the foreclosure process with the modification process risks confusing and frustrating homeowners and could result in unnecessary foreclosures.

As described in the concluding section, we recommend that servicers establish a single point of contact that can work with every distressed borrower and coordinate all activities taken by the servicer with regard to that particular case.

II. FDIC Efforts to Address Problems in Mortgage Servicing and Foreclosure Prevention

Since the early stages of the mortgage crisis, the FDIC has made a concerted effort to promote the early modification of problem mortgages as a first alternative that can spare investors the high losses associated with foreclosure, assist families experiencing acute financial distress, and help to stabilize housing markets where distressed sales have resulted in a lowering of home prices in a self-reinforcing cycle.

In 2007, when the dimensions of the subprime mortgage problem were just becoming widely known, I advocated in speeches, testimony and opinion articles that servicers not only had the right to carry out modifications that would protect subprime borrowers from unaffordable interest-rate resets, but that doing so would often benefit investors by enabling them to avoid foreclosure costs that could run as high as 40 percent or more of the value of the collateral. In addition, the FDIC, along with other Federal regulators jointly hosted a series of roundtables on the issues surrounding subprime mortgage securitizations to facilitate a better understanding of problems and identify workable solutions for rising delinquencies and defaults, including alternatives to foreclosure.

More recently, the FDIC has been actively involved both in investigating and addressing robo-signing and documentation issues at insured depository institutions and their affiliates, ensuring that its own loss-share partners are employing best practices in their servicing operations, and implementing reforms that will better align the financial incentives of servicers in future securitization deals.

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[4] Source: *Inside Mortgage Finance.*

[5] Analysis of Mortgage Servicing Performance," Data Report No. 4, January 2010, State Foreclosure Prevention Working Group, *http://www.ohioattorneygeneral.gov/ForeclosureReportJan2010.*

Supervisory Actions

The FDIC is exercising both its primary and backup authorities to actively address the issues that have emerged regarding banks' foreclosure and "robo-signing" practices. The FDIC is the primary Federal supervisor for nearly 5,000 State-chartered insured institutions, where we monitor compliance with safety and soundness and consumer protection requirements and pursue enforcement actions to address violations of law. While the FDIC is not the primary Federal regulator for the major loan servicers, our examiners are working onsite under our backup authority as part of an interagency horizontal review team at 12 of the 14 major mortgage servicers along with their primary Federal regulators. This interagency review is also evaluating the roles played by MERS and Lender Processing Services, a large data processor used by many mortgage servicers.

The FDIC is committed to active participation in horizontal reviews and other interagency efforts so we are able to have a comprehensive picture of the underlying causes of these problems and the lessons to be learned. The onsite reviews are finding that mortgage servicers display varying degrees of performance and quality controls. Program and operational deficiencies may be correctable in the normal course of business for some, while others may need more rigorous system changes. The level and adequacy of documentation also varies widely among servicers. Where chain of title is not sufficiently documented, servicers are being required to make changes to their processes and procedures. In addition, some servicers need to strengthen audit, third-party arrangements, and loss mitigation programs to cure lapses in operations. However, we do not believe that servicers should wait for the conclusion of the interagency effort to begin addressing known weaknesses in internal controls and risk management. Corrective actions on problems identified during a servicer's own review or the examiners' review should be addressed as soon as possible. We expect each servicer to properly review loan documents prior to initiating or conducting any foreclosure proceedings, to adhere to applicable laws and regulations, and to maintain appropriate policies, procedures and documentation. If necessary, the FDIC will encourage the use of formal or informal corrective programs to ensure timely action is taken.

Actions Taken as Receiver for Failed Institutions

In addition to our supervisory efforts, the FDIC is looking at the servicing practices of institutions acquiring failed institutions under loss-share agreements. To date there are $159.8 billion in loans and securities involved in FDIC loss share agreements, of which $56.7 billion (36 percent) are single family loans. However, the proportion of mortgage loans held by acquiring institutions that are covered by loss share agreements is in some cases very small. For example, at One West Bank, the successor to Indy Mac, only 8 percent of mortgages serviced fall under the FDIC loss share agreement.

An institution that acquires a single-family loss-share portfolio is required to implement a loan modification program, and also is required to consider borrowers for a loan modification and other loss mitigation alternatives prior to foreclosure. These requirements minimize the FDIC's loss share costs. The FDIC monitors the loss-share agreements through monthly and quarterly reporting by the acquiring bank and semiannual reviews of the acquiring bank. The FDIC has the right to deny or recover any loss share claim where the acquiring institution is unable to verify that a qualifying borrower was considered for loan modification and that the least costly loss mitigation alternative was pursued.

In connection with the recent foreclosure robo-signing revelations, the FDIC contacted all of its loss-share partners. All partners certified that they currently comply with all State and Federal foreclosure requirements. We are in the process of conducting a Loan Servicing Oversight audit of all loss-share partners with high volumes of single-family residential mortgage loans and foreclosures. The FDIC will deny any loss-share payments or seek reimbursement for any foreclosures not compliant with State laws or not fully remediated, including noncompliance with the loss-share agreements and loan modification requirements.

Regulatory Actions to Reform Mortgage Securitization

We also are taking steps to restore market discipline to our mortgage finance system by doing what we can to reform the securitization process. In July of this year, the FDIC sponsored its own securitization of $471 million of single-family mortgages. In our transaction, we addressed many of the deficiencies in existing securitizations. First, we ensured that the servicer will make every effort to work with borrowers in default, or where default is reasonably foreseeable. Second, the servicing arrangements in these structured loan transactions have been designed to address shortcomings in the traditional flat-rate structures for mortgage servicing fees. Our securitization pays a base dollar amount per loan per year, regardless of changes in the outstanding balance of that loan. In addition, the servicing fee is increased in the event the loan becomes more complex to service by falling past due or entering modification or foreclosure. This fee structure is much less likely to create incentives to slash costs and rely excessively on automated or substandard processes to wring a profit out of a troubled servicing portfolio. Third, we provided for independent, third party oversight by a Master Servicer. The Master Servicer monitors the Servicer's overall performance and evaluates the effectiveness of the Servicer's modification and loss mitigation strategies. And, fourth, we provided for the ability of the FDIC, as transaction sponsor, the Servicer and the Master Servicer to agree on adapting the servicing guidelines and protocols to unanticipated and significant changes in future market conditions.

The FDIC has also recently taken the initiative to establish standards for risk retention and other securitization practices by updating its rules for safe harbor protection with regard to the sale treatment of securitized assets in failed bank receiverships. Our final rule, approved in September, establishes standards for disclosure, loan quality, loan documentation, and the oversight of servicers. It will create a comprehensive set of incentives to assure that loans are made and managed in a way that achieves sustainable lending and maximizes value for all investors. In addition, the rule is fully consistent with the mandate under the Dodd-Frank Act to apply a 5 percent risk-retention requirement on all but the most conservatively underwritten loans when they are securitized.

We are currently working on an interagency basis to develop the Dodd-Frank Act standards for risk retention across several asset classes, including requirements for low risk "Qualifying Residential Mortgages," or QRMs, that will be exempt from risk retention. These rules allow us to establish a gold standard for securitization to encourage high-quality mortgages that are sustainable for the long term. This rulemaking process also provides a unique opportunity to better align the incentives of servicers with those of mortgage pool investors.

We believe that the QRM rules should authorize servicers to use best practices in mitigating losses through modification, require compensation structures that promote modifications, and direct servicers to act for the benefit of all investors. We also believe that the QRM rules should require servicers to disclose any ownership interest in other whole loans secured by the same real property, and to have in place processes to deal with any potential conflicts. Some conflicts arise from so-called "tranche warfare" that reflects the differing financial interests among the holders of various mortgage bond tranches. For example, an investor holding the residual tranche typically stands to benefit from a loan modification that prevents default. Conversely, the higher rated tranches might be better off if a servicer foreclosed on the property forcing losses to be realized at the expense of the residual tranche. A second type of conflict potentially arises when a single company services a first mortgage for an investor pool and the second mortgage for a different party, or for itself. Serious conflicts such as this must be addressed if we are to achieve meaningful long-term reform of the securitization process.

Therefore, the FDIC believes it would be extremely helpful if the definition of a QRM include servicing requirements that, among other things:

- grant servicers the authority and provide servicers compensation incentives to mitigate losses on residential mortgages by taking appropriate action to maximize the net present value of the mortgages for the benefit of all investors rather than the benefit of any particular class of investors;
- establish a pre-defined process to address any subordinate lien owned by the servicer or any affiliate of the servicers; and
- require disclosure by the servicer of any ownership interest of the servicer or any affiliate of the servicer in other whole loans secured by the same real property that secures a loan included in the pool.

Risk retention rules under the Dodd-Frank Act should also create financial incentives that promote effective loan servicing. The best way to accomplish this is to require issuers—particularly those who also are servicers—to retain an interest in the mortgage pool that is directly proportional to the value of the pool as a whole. Frequently referred to as a "vertical slice," this form of risk retention would take the form of a small, proportional share of every senior and subordinate tranche in the securitization, creating a combined financial interest that is not unduly tilted toward either senior or subordinate bondholders.

III. The FSOC Should Play a Central Role in Developing Solutions

What started a few months ago as technical documentation issues in the foreclosure process has grown into something more serious and potentially damaging to the nation's housing recovery and to some of our largest institutions. First, a transparent, functioning foreclosure process is unfortunately necessary to the recovery of our housing market and our economy. Second, the mortgage documentation problems cast a cloud of uncertainty over the ownership rights and obligations of mortgage borrowers and investors. Further, there are numerous private parties and government entities that may have significant claims against firms central to the mortgage markets.

While we do not see immediate systemic risk, the clear potential is there. The FSOC was established under the Dodd-Frank Act to deal with just this type of emerging risk. Its mandate includes identifying risks to financial stability and potential gaps in regulation and making recommendations for primary regulators and other policymakers to take action to mitigate those risks. As such, these issues represent just the type of problem the FSOC was designed to address. In addition, the difficulties that have been experienced to date in coordinating a Government policy response speak to the need for central role by the FSOC in negotiating workable solutions with the major parties that have a stake in the outcome.

The FSOC is in a unique position to provide needed clarity to the market by coordinating consistent interpretations of what standards should be applied to establishing the chain of title for mortgage loans and recognizing the true sale of mortgage loans in establishing private securitization trusts. The constituent agencies that make up the FSOC also have their own authorities that can be used to provide clarity of this type. Examples include rulings on standards that determine the tax-exempt status of mortgage trusts and standards for the recognition of true sale in a failed bank receivership, which the FDIC recently updated in its safe harbor regulation.

We need broad agreements between representatives of the major stakeholders affected by this issue so that the uncertainties associated with this issue can be resolved as quickly as possible. Outlined below are some of the principles I believe should be part of any broad agreement among the stakeholders to this issue.

1. *Establish a single point of contact for struggling homeowners.* Servicers should identify a single person to work with homeowners once it becomes evident the homeowner is in distress. This single point of contact must be appropriately authorized to provide current, accurate information about the status of the borrower's loan or loan modification application, as well as provide a sign-off that all loan modification efforts have failed before a foreclosure sale. This will go a long way toward eliminating the conflicts and miscommunications between loan modifications and foreclosures in today's dual-track system and will provide borrowers assurance that their application for modification is being considered in good faith.
2. *Expand and streamline private loan modification efforts to increase the number of successful modifications.* To accomplish this end, servicers should be required to intervene with troubled borrowers from the earliest stages of delinquency to increase the likelihood of success in foreclosure mitigation. Modifications under such programs should significantly reduce the monthly payment through reductions in the interest rate and principal balance, as needed, to make the mortgage affordable over the long term. Analysis of modifications undertaken in the FDIC program at Indy Mac Federal Bank has shown that modifying loans when they are in the early stages of delinquency and significantly reducing the monthly payment are both factors that promote sustainable modifications that perform well over time. In exchange for the creation of highly simplified modification programs, mortgage servicers should have a "safe harbor" that would give them assurance that their claims will be recognized if foreclosure becomes unavoidable. In addition, streamlined modification programs should be recognized as a best practice in adjudicating disputes with mortgage investors.
3. *Invest appropriate resources to maintain adequate numbers of well-trained staff.* Broad agreements should require servicers to hire and train sufficient numbers of staff to professionally process applications for loan modifications. Further, servicers should be required to improve information systems to help manage and support the workload associated with loan modifications.
4. *Strengthen quality control processes related to foreclosure and loan servicing activities.* Some servicers need to make fundamental changes to their practices and programs to fulfill their responsibilities and satisfy their legal obligations. Lax standards of care and failure to follow longstanding legal requirements cannot be tolerated. Regulators must vigorously exercise their supervisory tools to ensure that mortgage servicers operate to high standards. Servicers need to institute strong controls to address defective practices and enhance programs

to regain integrity of their operations. Where severe deficiencies are found, the servicers should be required to have independent third-party monitors evaluate their activities to ensure that process changes are fully implemented and effective. Servicers must also fully evaluate and account for their risks relating to their servicing activities, including any costs stemming from weaknesses in their operations.

5. *Resolve the challenges created by second liens.* Since the early stages of the mortgage crisis, second liens have been an obstacle to effective alternatives to foreclosure, including loan modification and short sales. We must tackle the second lien issue head on. One option is to require servicers to take a meaningful write-down of any second lien if a first mortgage loan is modified or approved for a short sale. All of the stakeholders must be willing to compromise if we are to find solutions to the foreclosure problem and lay the foundation for a recovery in our housing markets.

Conclusion

We must restore integrity to the mortgage servicing system. We need a mandate for dramatically simplified loan modifications so that unnecessary foreclosures can be avoided. Servicers need to establish a single point of contact to coordinate their communication with distressed borrowers. They also need to invest appropriate resources and strengthen quality control processes related to loan modification and foreclosure. We must finally tackle the second liens head on, by requiring servicers to impose meaningful write-downs on second lien holders when a first mortgage is modified or approved for a short sale.

This is the time for all parties to come together and arrive at broad agreements that will reduce uncertainty and lay the foundation for long-term stability in our mortgage and housing markets. The FSOC has a unique role to play in addressing the situation and can provide needed clarity on issues such as standards for recognizing true sale in securitization trusts.

Again, thank you for the opportunity to testify on this important issue. I look forward to your questions.

PREPARED STATEMENT OF DANIEL K. TARULLO

MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DECEMBER 1, 2010

Mr. Chairman, Ranking Member Shelby, and other Members of the Committee, thank you for your invitation to this morning's hearing on problems in mortgage servicing.

In the first portion of my testimony, I will explain our current understanding of the nature and extent of the deficiencies in mortgage documentation that have been so apparent in the robo-signing misconduct, as well as what the banking agencies are doing in support of a broader interagency effort to develop a full picture of these problems. I also want to address the issue of so-called put backs of mortgage-backed securities (MBS) to mortgage originators or securitization sponsors. Though only indirectly related to robo-signing and associated servicing flaws, financial exposure resulting from put backs could be more significant for some institutions than that from documentation flaws.

In the second portion of my testimony, I will turn to the question of appropriate policy responses—with respect to specific regulated financial institutions, to supervisory practices more generally, and to the structural problems we have observed in the mortgage servicing industry, including the discouragingly sluggish pace of mortgage modifications. This last point is a matter of concern not only because of its significance for the millions of American families who are unable to maintain their mortgage payments on homes that have lost considerable value in recent years, but also because of the importance from a macroeconomic perspective of realizing as quickly and efficiently as possible a clearing of housing prices, which would help create the conditions for a market recovery.

Mortgage Documentation and other Servicing Issues

Foreclosure is a legal process initiated to terminate a borrower's interest in a property and is permitted only when the borrower has defaulted on the debt obligation for a specified period. The process allows the lender to sell the property and use the proceeds to satisfy the borrower's unpaid debt to the extent it is secured by the property. Foreclosure requirements are generally established by State laws and each State has its own statutes, rules, and court decisions pertaining to foreclosures.

Some 23 states, known as judicial foreclosure states, require foreclosures to be reviewed and approved by a court. Nonjudicial foreclosure states have different processes for foreclosures that do not require the creditor to obtain court approval for a foreclosure, but instead impose varying waiting periods and documentation, filing, and notice requirements after a default occurs and before a foreclosure sale may take place. In nonjudicial foreclosure states, the homeowner typically has access to the court in a foreclosure matter only if the homeowner initiates a suit to stop the foreclosure process or seeks protection in a bankruptcy court.

Because mortgage servicers maintain the official accounting of all amounts paid and owed by borrowers, they serve as the critical link between borrowers and mortgage holders. In addition, servicers manage loan defaults, including the negotiation of loan modification and repayment plans with borrowers. Should the servicer decide to initiate foreclosure, it would often do so as the agent for third parties, such as securitization trusts. In this regard, servicers have responsibilities to investors holding residential MBS. Servicers also have responsibilities to borrowers to maintain accurate and complete records of payments received, amounts advanced, notifications made to borrowers, and changes of payment terms with respect to any mortgage modification discussions.

Foreclosure documentation typically requires an assertion that the agent bringing forth the action has the legal right to foreclose and that the loan is in default. The document filings contain details of the transactions and the amounts owed. These documents typically include attestations signed by individuals who have personal knowledge of the facts and who are properly authorized to make such assertions. In most jurisdictions, the documents must be signed by these individuals in the presence of a notary, following proper notarization procedures. Lenders and servicers are responsible for ensuring that the individuals who sign these documents are duly authorized and have appropriate knowledge of the facts and circumstances. In addition, lenders and servicers are responsible for ensuring the accuracy of records and the facts recited in the foreclosure documents.

State and local laws govern the recordation process for real estate transfers and mortgage filings and assignments. Given the multiple sales and assignments of mortgage loans that often occur, concerns have been raised regarding investors' or servicers' rights to initiate foreclosure actions. Although State-by-State practices vary considerably, generally the noteholder has the right to initiate foreclosure, once default has occurred, if an original note can be produced and the current holder's ownership is verified. If there is no controversy concerning ownership of the note, but rather an inability to locate original documents, processes usually allow for foreclosure to proceed, albeit at some cost and delay. If there is some question of ownership, the investor or servicer may be required to produce evidence of ownership before a foreclosure can proceed.

Since matters regarding real estate titles and foreclosures are generally governed by State law, State attorneys general are undertaking a joint review of lenders and servicers focusing on the reported problems in foreclosures. In addition, numerous Federal agencies have launched investigations, including the examinations in process by the Federal financial regulators.

The Office of the Comptroller of the Currency, the Office of Thrift Supervision, the Federal Deposit Insurance Corporation, and the Federal Reserve are conducting an in-depth review of practices at the largest mortgage servicing operations. The interagency examinations and reviews focus on foreclosure practices generally, but with an emphasis on the internal control breakdowns that led to inaccurate affidavits and other questionable legal documents being used in the foreclosure process. The agencies are reviewing firms' policies, procedures, and internal controls, including sampling loan files. We have also solicited the views of consumer organizations to help detect problems at specific servicers. The agencies expect the initial onsite portion of our work to be completed by the end of the year. The agencies plan to publish a summary overview in early 2011 that will describe the range of industry practices found in the examinations and identify weaknesses requiring remediation.

The Federal Reserve has supervisory and regulatory authority for bank holding companies and their nonbank subsidiaries, as well as for approximately 800 State-chartered banks that are members of the Federal Reserve System (State member banks), and certain other financial institutions and activities. We work with other Federal and State supervisory authorities to ensure the safety and soundness of the banking industry, foster the stability of the financial system, and provide for fair and equitable treatment of consumers in their financial transactions. The Federal Reserve is engaged in both regulation, which involves establishing the rules within which banking organizations must operate, and supervision, which involves reviewing the efforts of banking organizations to abide by those rules and remain, overall, in safe and sound condition.

The Federal Reserve serves as the primary Federal regulator for two of the 10 largest servicers affiliated with banking organizations, one a holding company affiliate and the other a State member bank. The Federal Reserve is participating with the other Federal banking agencies in examining the foreclosure policies and practices of the other large institutions. For additional information on foreclosure processes, we have sent a self-assessment questionnaire to other Federal Reserve-regulated institutions that engage in mortgage servicing but are not part of the interagency examination effort.

While quite preliminary, the banking agencies' findings from the supervisory review suggest significant weaknesses in risk-management, quality control, audit, and compliance practices as underlying factors contributing to the problems associated with mortgage servicing and foreclosure documentation. We have also found shortcomings in staff training, coordination among loan modification and foreclosure staff, and management and oversight of third-party service providers, including legal services. It is for this reason that we expanded the review to include an examination of pre-foreclosure loans, or those past due but not yet in the foreclosure process, and certain third-party service providers. As examiners identify weaknesses, they will require firms to take remedial action and, when necessary, require servicers to address resource shortfalls, training and coordination problems, and control failures.

It is important to recognize that the extent of these problems is not the same across all firms. Nonetheless, the problems are sufficiently widespread that they suggest structural problems in the mortgage servicing industry. The servicing industry overall has not been up to the challenge of handling the large volumes of distressed mortgages. The banking agencies have been focused for some time on the problems related to modifying mortgage loans and the large number of consumer complaints by homeowners seeking loan modifications. It has now become evident that significant parts of the servicing industry also failed to handle foreclosures properly.

While we are still in the process of determining the extent of these problems and the required supervisory response, it is clear that the industry will need to make substantial investments to improve its functioning in these areas and supervisors must ensure that these improvements occur. Moreover, fixing the problems in the mortgage servicing industry may also require thinking about some fundamental structural changes to the current mortgage system. I will discuss the issue of structural solutions to these issues in more detail later in my testimony.

Investor Repurchase Requests

The cost associated with foreclosure documentation problems, including robo-signing, are not the only potential liabilities facing financial institutions in the wake of the mortgage and housing crisis. As losses in MBS have been escalating, investors in MBS and purchasers of unsecuritized whole loans are more frequently exploring, and in some cases asserting, contractual and securities law claims against the parties that originated the loans, sold the loans, underwrote securities offerings, or had other roles in the process. The essence of these claims is that mortgages in the securitization pools, or sold as unsecuritized whole loans, did not conform to representations and warranties made about their quality—specifically that the loan applications contained misrepresentations or the underwriting was not in conformance with stated standards.

The potential liability associated with contract claims in securitizations is usually called put back risk because many of the relevant agreements permit the buyer of the mortgages to put them back to the seller at par. Buyers can demand that the seller or another party that makes representations repurchase the mortgages if defects are found in the underlying loan documentation or in the underwriting that conflict with the sale agreements. Although the representations and warranties in the various agreements vary considerably, they frequently require that the defect materially and adversely affect the value of the loan before put back rights can be exercised. At the time of the put back, the mortgage loan may have become seriously delinquent or entered into default. Because underperforming mortgages are typically valued substantially less than par, the put back transfers any potential loss from the buyer back to the original seller or mortgage securitizer.

Given the poor performance of the mortgage assets, investors, including the Government Sponsored Enterprises (GSEs), have sought to pursue put back claims through various legal avenues, including requesting that mortgage servicers provide underlying mortgage files and the requisite documents. A GSE will generally buy a loan out of an MBS pool when the loan becomes 120 days delinquent. The GSE will then conduct a review of the delinquent loan file, and if it finds that the loan did not comply with its underwriting standards, it will request that the loan be repurchased by the originator/seller or that the GSE be made whole on any credit losses incurred.

During the third quarter of 2010, Fannie Mae collected $1.6 billion in unpaid principal balance (UPB) from originators, and currently has $7.7 billion UPB in outstanding repurchase requests, $2.8 billion of which has been outstanding for more than 120 days. Freddie Mac has $5.6 billion UPB in outstanding repurchase requests, $1.8 billion of which has been outstanding for more than 120 days. As of the third quarter of 2010, the four largest banks held $9.7 billion in repurchase reserves, most of which is intended for GSE put backs.

There are also pending claims by some investors alleging that underwriters and sponsors of securitizations failed to comply with the Federal securities laws covering the offering documents and registration statements. These suits specifically reference descriptions of the risks to investors, the quality of assets in the securitization, the order in which investors would be paid, or other factors. Most of these lawsuits are in the early stages, and it is difficult to ascertain the probability that investors will be able to shift a substantial portion of the losses on defaulted mortgages back to the parties that sold the loans or underwrote the offerings.

While the full extent of put back exposure is for this reason hard to specify with precision, the risk has been known for some time and has been an ongoing focus of supervisory oversight at some institutions. However, in light of recent increased investor activity, the Federal Reserve has been conducting a detailed evaluation of put back risk to financial institutions. We are asking institutions that originated large numbers of mortgages or sponsored significant MBS to assess and provide for these risks as part of their overall capital planning process.

Supervisory Responses

The revelation of documentation flaws in foreclosure processes raise two kinds of questions for supervisors: First, what actions are appropriate and sufficient to respond to problems identified at specific regulated banking organizations? Second, what does the failure of supervisory examinations to uncover these flaws counsel for future supervisory practice?

With respect to the question of actions aimed at specific institutions, the Federal Reserve and the other Federal banking agencies have significant supervisory and enforcement tools that can be used to address certain types of deficiencies in the foreclosure and mortgage transfer process. For example, numerous enforcement tools are available to address safety and soundness issues such as inadequate controls and processes, weaknesses in risk-management and quality control, and certain types of compliance weaknesses in foreclosure operations. These tools include supervisory enforcement actions that require an institution to correct deficient operations in a prescribed period of time and Civil Money Penalties (CMPs) for egregious actions. The agencies may also lower examination ratings, which can result in limiting the permissible activities and affiliations of financial firms and trigger other supervisory reviews and limitations, and restrict the ability of institutions to expand. The agencies also have the authority to assess CMPs on individuals who are responsible for violations, to issue cease and desist orders on responsible individuals, or, if the statutory criteria are met, to remove them from banking. In addition, we may make referrals to law enforcement agencies, or require institutions to file Suspicious Activity Reports, as appropriate.

Although the examinations are not yet fully completed, based on what we have already learned, the Federal Reserve expects to use many or all of these tools through the course of our review of foreclosure and other mortgage matters. In particular, the Federal Reserve has already emphasized to the industry and to institutions we supervise the importance of addressing identified weaknesses in risk-management, quality control, audit, and compliance practices. The problems that are evident to date raise significant reputation and legal risk for the major mortgage servicers. These weaknesses require immediate remedial action. They will also affect the rating assigned by Federal Reserve supervisors to management of bank holding companies, even where the servicing activity was in a banking subsidiary of a holding company. In addition, the Federal banking agencies expect that employees are adequately trained and have sufficient resources to appropriately review the facts and circumstances of files when preparing documents, and that legal processes are fully and properly followed. Banking organizations also must ensure quality control for third-party service providers, including legal services.

With respect to future supervisory practice more generally, two points for increased emphasis are already apparent. First, this episode has underscored the importance of our using the new authority given the Federal Reserve in the Dodd-Frank Wall Street Reform and Consumer Protection Act to send our examiners into non-bank affiliates of large bank holding companies, including those in large institutions that have become bank holding companies only in the last couple of years.

Second, our experience suggests that the utility of examining and validating internal control processes within firms may extend beyond improvements to the specific processes subject to the exam. We have found that problems in foreclosure practices do not seem as pervasive in institutions in which we had previously examined other internal control processes, found shortcomings, and insisted on corrective action. While we would not draw strong conclusions from such a limited experience, it seems possible that a firm may improve its general approach to control processes once it has been required to remedy problems in discrete areas. If this relationship is borne out, it could be a significant advance in supervisory practice, insofar as resource constraints will always limit the number of supervisory examinations.

Possible Need for Structural Solutions

Beyond remedial or punitive measures directed at specific firms and future-oriented changes in supervisory practice, structural solutions may be needed to address the range of problems associated with mortgage servicing. Similarly, the foreclosure documentation problems are another reminder of the degree to which foreclosure has been preferred to mortgage modification, notwithstanding various efforts to change this imbalance. Here again, a more structural solution may be needed.

The explosive growth of securitization as a vehicle for financing mortgages was accompanied by the emergence of a sizable mortgage servicing industry—that is, a group of firms servicing mortgages that they did not own or, in many cases, that they had not originated. While there have surely been economies associated with this industry, there have also been chronic problems. It has been increasingly apparent that the inadequacy of servicer resources to deal with mortgage modifications—an area that was a point of supervisory emphasis—was actually a reflection of a larger inability to deal with the challenges entailed in servicing mortgages in many jurisdictions and dealing with a complicated investor base. For example, foreclosure procedures are specifically the province of real property law governed by the states, and can vary not only by State, but also within states and sometimes even within counties. With or without regulatory changes, it is quite probable that servicer fees to securitization trusts will increase to reflect the costs associated with the complexities of the contemporary mortgage model.

The impetus for change in the mortgage servicing industry is likely only to increase as the advantages of servicing rights for regulatory capital purposes become limited after the new Basel III requirements are implemented.[1] It is possible that servicing issues can be satisfactorily addressed through the actions of the various primary regulators. However, in light of the range of problems already encountered, and the prospect of further changes in the industry—including the possible migration of more servicing activity to non-banking organizations—it seems reasonable at least to consider whether a national set of standards for mortgage servicers may be warranted.

The case for concerted, coordinated action is much clearer with respect to the slow-moving pace of mortgage modifications. Regardless of the findings that emerge from the examinations underway, and remedial actions required to correct past mistakes, this episode has again drawn attention to what can only be described as a perverse set of incentives for homeowners with underwater mortgages. Homeowners who try to obtain a modification of the terms of their mortgages are all too frequently subject to delay and disappointment, while those who simply stop paying their mortgages have found that they can often stay in their homes rent free for a time before the foreclosure process moves ahead. Moreover, many homeowners believe, reportedly on the basis of communications from servicers, that the only way they can qualify for modifications is by stopping their mortgage payments and thus becoming delinquent.

Quite apart from the impact upon families who lose their homes, the dominance of foreclosures over modifications raises macroeconomic concerns. The number of foreclosures initiated on residential properties has soared from about 1 million in 2006, the year that house prices peaked, to 2.8 million last year. Over the first three quarters of this year, we have seen a further 2 million foreclosure filings, and an additional 2.3 million homes were in foreclosure at the end of September. All told, we expect about 2.5 million foreclosure filings this year and next year and about 2.4 million more in 2012. While our outlook is for filings to decline in coming years, they will remain high by historical standards. Currently, more than 4.5 million

[1] The proposed Basel III capital rules would simultaneously introduce a specific minimum common equity ratio and define "common equity" so as to limit or exclude consideration of items that may not provide the loss absorbing capacity that common equity is supposed to represent.

mortgage loans are 90 days or more past due or in foreclosure. These numbers compare to just 520,000 permanent loan modifications executed under the Treasury Department's Home Affordable Modification Program (HAMP) and an additional 1.6 million proprietary loan modifications by servicers participating in the HOPE NOW Alliance program.[2]

The Federal Reserve believes that in most cases the best way to assist struggling borrowers is a mortgage modification allowing them to retain their home with an affordable mortgage payment. In a housing market where values have declined so much, following a period in which all actors relied upon rising house prices to sustain mortgage practices, foreclosures simply do not make sense as a preferred response. Foreclosures are costly to all parties and more broadly to our economy. Lenders and investors incur financial losses arising from the litigation expenses associated with the foreclosure process and the loss on the defaulted mortgage when the foreclosed property sells at a liquidation price that is substantially less than the loan balance. Local governments must contend with lower property tax revenue and the ramifications of neglected properties that may threaten public safety. Additionally, neighbors and neighborhoods suffer potential spillover effects from foreclosure sales because foreclosures may reduce the attractiveness of the neighborhood or may signal to potential buyers a forthcoming decline in neighborhood quality. In the end, an overhang of homes awaiting foreclosure is unhealthy for the housing market and can delay a recovery in housing markets and the broader economy.

Several possible explanations have been suggested for the prominence of foreclosures: the lack of servicer capacity to execute modifications, purported financial incentives for servicers to foreclose rather than modify, what until recently appeared to be easier execution of foreclosures relative to modifications, limits on the authority of securitization trustees, and conflicts between primary and secondary lien holders. Whatever the merits and relative weights of these various explanations, the social costs of this situation are huge. It just cannot be the case that foreclosure is preferable to modification for a significant proportion of mortgages where the deadweight costs of foreclosure, including a distressed sale discount, are so high. While some banks and other industry participants have stepped forward to increase the rate of modifications relative to foreclosures, many have not done enough. We need renewed attention in many quarters of government and the financial industry, and among investors in mortgage-backed securities, to the lagging incidence of modifications.

Conclusion

In conclusion, I regret to say that the hangover from the housing bubble of this past decade is still very much with us, as revealed both in the inadequate capacity of mortgage servicers and the continued impact of foreclosed homes on the housing market. While bank regulatory agencies can and should respond to specific failings that are being identified in our interagency examination, there is a strong case to be made that broader solutions are needed both to address structural problems in the mortgage servicing industry and to accelerate the pace of mortgage modifications or other loss mitigation efforts. Thank you very much for your attention. I would be happy to answer any questions you might have.

[2] Written testimony of Phyllis Caldwell, Chief of Homeownership Preservation Office, U.S. Department of the Treasury, before the House Financial Services Subcommittee on Housing and Community Opportunity hearing on "Robo-Signing, Chain of Title, Loss Mitigation and Other Issues in Mortgage Servicing," November 18, 2010.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

DANIEL K. TARULLO
MEMBER OF THE BOARD

January 20, 2011

The Honorable Tim Johnson
United States Senate
Washington, D.C. 20510

Dear Senator:

In my testimony at the December 1, 2010, hearing of the Senate Banking Committee on mortgage servicing problems, I suggested that the pervasive problems in servicing practices called for establishment of comprehensive national standards that would apply to all servicers of residential mortgages in significant volumes, regardless of whether the servicer is a depository institution, a bank holding company affiliate, or another nonbank entity. This letter responds to Chairman Dodd's request at the hearing that I provide further detail on this proposal.

Our views on national servicing standards have been informed by the in-depth review of practices at large bank and bank-affiliated mortgage servicers conducted over the last several months by the federal banking agencies. The results of that review have reinforced the tentative conclusion I offered at the hearing--namely, that there were significant failures in risk-management, quality control, audit, and compliance practices. The review revealed shortcomings in staff training, coordination between loan modification and foreclosure staff, and oversight of third-party service providers such as law firms. These problems go beyond the deficiencies in loan modification processes, which had been a supervisory focus for some time, and were evident in essentially all aspects of mortgage servicing. While federal and state regulatory and law enforcement agencies will be taking appropriate action in response to specific problems at these individual servicers, it is important to set forth generally applicable standards that will cover all sizeable servicers.

From that perspective, such standards should apply to all mortgages administered by the covered servicers. That is, the standards should apply to mortgages whether securitized or held in portfolio, and whether originated privately or through government or government-sponsored channels. We have already begun discussions with other regulatory agencies on the substance and scope of national mortgage servicing standards. I have attached to this letter an outline of objectives and possible standards. This outline, which we will continue to refine and augment, reflects what we have learned from the coordinated supervisory examinations, inter-agency discussions at both the federal and state level, and observations by members of the public.

The Honorable Tim Johnson
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Most, if not all, of the kinds of standards contemplated in the attached outline could be adopted by regulatory agencies through rule-making under authority already legislated by Congress. However, there are some additional structural reforms for which existing authority may be lacking or incomplete, and where Congress might consider acting. Two examples of such reforms are (1) a fair, legally binding process for ensuring that a junior lien on a home can be modified in a timely manner in connection with modification of a delinquent first-lien mortgage on the same property, and (2) establishment of a national registry of all first- and junior-liens on residential property. With respect to the latter, while we foresee such a registry as complementing, rather than displacing, state and local requirements and systems, we believe that questions of structure and funding are appropriately addressed by Congress.

We look forward to working with the Committee as we continue to develop national mortgage servicing standards in cooperation with other regulatory agencies.

Sincerely,

Daniel K. Tarullo

Enclosure

Outline for the Establishment of Comprehensive National Standards

Objectives of National Standards

- Develop uniform standards for customer service that provide struggling homeowners reasonable opportunities to avoid foreclosure.
- Improve transparency in the mortgage servicing industry while ensuring that new standards do not unduly increase the cost of mortgage financing to consumers.
- Address shortcomings in servicer operations and internal controls that came to light during the crisis in order to ensure accuracy of information, proper handling of documentation, and adherence to state and federal laws.

Customer Service and Loan Modification Processes

- Provide troubled borrowers with a single, reliable, and accessible point of contact for all information and negotiations on their loans.
- Require early outreach, loan counseling, and foreclosure avoidance options for troubled borrowers to increase the likelihood that borrowers will be able to retain their homes.
- Disclose to borrowers material facts used by the servicer in making a loan modification decision, as well as the reason for a rejection. Require an appeal process for borrowers.
- Prohibit initiation of foreclosure when a borrower is successfully performing according to terms of a trial or permanent modification program.
- Require servicers to have systems for tracking all borrower documents and correspondence.
- Require the transfer of servicing for delinquent loans to a special servicing group with well-trained staff and comprehensive policies and procedures oriented towards troubled borrowers.
- Require prompt crediting of borrowers' payments first to interest and principal, including partial payments, with timely correction of any misapplications of such funds.

Operational and Internal Controls

- Establish standards for the filing, storage, assignment, and transfer of mortgage-related documents over the life of the loan.
- Require independent review of servicers' loan files for completeness shortly after issuance of securities backed by those loans and for compliance with representations and warranties with timely investor disclosure.
- Require effective policies, procedures and internal controls governing the selection, use and oversight of third-party vendors (e.g., outside law firms and sub-servicers).
- Prohibit commingling of homeowners' monthly mortgage payments with servicers' assets.

Transparency and Alignment of Servicer Incentives

- Provide incentives in servicing contracts and fee structure that provide incentives to maximize the net present value of the loan and increase staff resources when the number of troubled borrowers increases.
- Establish a framework that allows investors to remove in a timely manner a servicer that is performing poorly and/or is not in compliance with National Servicing Standards.
- Prohibit servicing contracts from allowing advances of unpaid principal or interest to investors.

Supervisory framework

- Ensure effective regulatory oversight of established standards.
- Establish penalties for servicers and other mortgage market participants that do not meet, or intentionally ignore, the proposed standards.

PREPARED STATEMENT OF JOHN WALSH *

ACTING COMPTROLLER OF THE CURRENCY
COMPTROLLER OF THE CURRENCY

DECEMBER 1, 2010

Introduction

Chairman Dodd, Ranking Member Shelby, and Members of the Committee, I appreciate this opportunity to discuss recently reported improprieties in the foreclosure processes used by several large mortgage servicers and actions that the Office of the Comptroller of the Currency (OCC) is taking to address these issues where they involve national banks. The occurrences of improperly executed documents and attestations raise concerns about the overall integrity of the foreclosure process. The loss of one's home is personally and financially traumatic for a borrower. Laws in each State establish the requirements and process by which that action may be taken. When that due process is not followed, it is not a technicality; it goes to the propriety of the foreclosure itself. The unacceptable practices that have been identified in the past several months warrant the thorough investigation that is now underway by the OCC, other Federal bank regulators, and other agencies, and demand an appropriate and vigorous response.

The OCC supervises all national banks and their operating subsidiaries, including their mortgage servicing operations. The servicing portfolios of the eight largest national bank mortgage servicers[1] account for approximately 63 percent of all mortgages outstanding in the United States—nearly 33.3 million loans totaling almost $5.8 trillion in principal balances as of June 30, 2010.

To date, six large national bank servicers have publicly acknowledged procedural deficiencies in their foreclosure processes. The lapses that have been reported represent a serious operational breakdown in foreclosure governance and controls that national banks should maintain. These lapses are unacceptable, and we are taking aggressive actions to hold national banks accountable, and to get these problems fixed. As soon as the problems at Ally Bank came to light, we directed the largest national bank mortgage servicers under our supervision to review their operations, to take corrective action to remedy identified problems, and to strengthen their foreclosure governance to prevent reoccurrences. At the same time, we initiated plans for intensive, onsite examinations of the eight largest national bank mortgage servicers. Through these examinations we are independently testing the adequacy of governance over their foreclosure processes to ensure foreclosures are completed in accordance with applicable legal requirements and that delinquency affidavits and claims that are the basis for the foreclosure are accurate.

As part of our examinations we also are reviewing samples of individual loan files where foreclosures have either been initiated or completed to test the validity of bank self assessments and corrective actions, and to determine whether troubled borrowers were considered for loss mitigation alternatives such as loan modifications prior to foreclosure. We have likewise instructed examiners to be alert to, and document, any practices such as misapplied payments, padded fees, and inappropriate application of forced placed insurance as part of these file reviews. Should we find evidence of such occurrences, we will take appropriate action. Our examinations are still on-going.

My testimony provides a brief discussion of how the OCC regulates national bank mortgage servicing operations, the recently publicized foreclosure problems, and our most recent findings on trends in modifications, alternatives to modifications, and foreclosures from the *OCC and OTS Mortgage Metrics Report.* I then describe the OCC's actions with respect to loan modifications and problems that have arisen in the foreclosure process.

OCC Supervision of Mortgage Servicers

The Committee's invitation letter requested that my testimony include an explanation of how the OCC regulates national bank mortgage servicing operations. Mortgage banking at the largest national banks is a high-volume, operationally intensive business that requires specialized supervision. The majority of the mortgage banking assets in the national banking system fall under our Large Bank Supervision program, characterized by a continuous onsite examiner presence that in-

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*Statement Required by 12 U.S.C. § 250:

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

[1] Bank of America, Citibank, JPMorgan Chase, HSBC, MetLife, PNC, Wells Fargo, and U.S. Bank.

cludes specialists in the mortgage banking, retail credit, consumer compliance, and operational risk areas. Our resident examiner teams are supplemented by subject matter specialists in our Policy, Legal, and Economics divisions, each of whom brings specialized expertise to supervision of our mortgage companies.

Direct supervision is largely based upon supervisory strategies developed for each institution that are risk-based and focused on the more complex issues. The first step is to identify the most significant risks and determine whether a bank has systems and controls to identify and manage exposures. Next, we assess the integrity and effectiveness of the bank's internal risk management systems and audit, with appropriate validation through transaction testing. This is accomplished through a combination of ongoing monitoring and targeted examinations. The targeted examinations validate that risk management systems and processes are functioning as expected and do not present significant supervisory concerns. Supervisory strategies will be revised, as necessary, to expediently address newly identified or emerging risks or concerns, whether at an individual bank or systemically across the banking system.

Examiners generally do not directly test standard business processes or practices, such as the validity of signed contracts, or the processes used to notarize documents or the actual physical presence of notes with document custodians, unless there is evidence of a material weakness or breakdown in governance and internal controls over these activities. In making such a determination, examiners will review ongoing quality control activities, internal or third-party audits, consumer complaints and relevant publicly available information. As warranted, our supervisory activities at individual banks will often be supplemented with horizontal reviews of targeted areas of heightened risk across a group of banks, as with the horizontal review of foreclosure processes currently underway.

Our supervisory conclusions, including any risk management deficiencies, are communicated directly to bank senior management. Thus, not only is there ongoing evaluation, but also a process for timely and effective corrective action when needed. If warranted, these concerns are communicated to management and the Board as "Matters Requiring Attention" ("MRAs") in supervisory communications. If these concerns are not appropriately addressed within a reasonable period, we have a variety of tools with which to respond, ranging from informal supervisory actions directing corrective measures to formal enforcement actions.

Current Foreclosure Problems

The current foreclosure problems represent another painful chapter of the recent financial crisis, stemming from a record number of borrower defaults which has strained servicer capacity to provide loss mitigation activities to troubled borrowers and ensure a large and growing number of foreclosures are properly processed.

The concerns about improper foreclosure practices initially centered on two issues that deal with the documentation required to effect foreclosure actions. The first issue involves requirements under some State laws for individuals to sign affidavits attesting personal knowledge of the accuracy and completion of required documentation essential to a valid foreclosure proceeding. The second issue is whether, in similar situations where required by State law, individual notaries may have violated procedures in notarizing documentation by, for example, notarizing the documents after they had been signed, rather than in the presence of the individual signing the affidavit. As the situation has evolved, concerns have broadened to include the accuracy of all information underlying the foreclosure process, and the physical possession and control over documents necessary to foreclose on a home. Our examinations are investigating all of these issues.

The signing and attestation of foreclosure documents are steps required by various State laws that govern the legal completion of a foreclosure proceeding-and as such, typically represent the final steps in what is a very lengthy and resource intensive process that banks undertake to deal with seriously delinquent borrowers. The time to complete a foreclosure process in most states can take 15 months or more and in many cases can be as long as 2 years. Foreclosure completion timelines are generally set by investors such as Fannie Mae and Freddie Mac, and there are penalties that they may impose on servicers that do not meet the timelines mandated by these investors.

The specific requirements and the legal standards applied for determining personal knowledge vary across judicial foreclosure states, and thus require servicers to ensure that their processes conform to individual State, or in some cases, local law. To assist with meeting these requirements, mortgage servicers often outsource some of the requisite legal work to law firms familiar with local standards and other third parties for input and review. Fannie Mae and Freddie Mac in fact require servicers to use law firms approved for particular geographies when preparing foreclosure filings. For large mortgage servicers that operate nationwide, this often has resulted in use of a significant number of third parties—lawyers and other service providers—and a panoply of documents used in their mortgage foreclosure processes: one large mortgage servicer has indicated that they use over 250 different affidavit forms. These operational challenges, however, do not absolve the banks from their responsibilities to have the appropriate staff, quality controls, and an effective audit process in place to ensure that documents are accurate and the foreclosure process is conducted in compliance with applicable State and local laws.

Servicers typically move forward with foreclosure proceedings only after thoroughly evaluating a borrower's eligibility for loan modifications and other alternatives, such as short sales or deed-in-lieu-of-foreclosures.[2] As a practical matter, many investors for whom loans are serviced, including Fannie Mae and Freddie Mac, require servicers to attempt loss mitigation actions, including modifications, prior to foreclosing on a home. The largest national bank mortgage servicers are participants in Treasury's Home Affordable Modification Program (HAMP) and are required to evaluate troubled borrowers to determine their eligibility for a HAMP modification. For borrowers that fail to qualify for a HAMP loan modification, servicers also typically consider whether the borrowers would qualify for a modification under their proprietary programs, which generally have more flexible criteria. In the vast majority of cases, it is only after these loan modification efforts have been exhausted that final foreclosure actions are taken.

Recent Trends in Mortgage Modifications and Foreclosure Activity

Since 2008, the OCC has collected loan level data from the large national banks we supervise and published this information in quarterly mortgage metrics reports. We have since expanded our data collection and reporting efforts and joined with the Office of Thrift Supervision (OTS) to publish data on the performance of loans and loan modifications, and to highlight trends in loss mitigation activities, foreclosures, and re-defaults occurring on mortgages serviced by large national banks and federally regulated thrifts. Our most recent report, released in September, provides data through second quarter 2010 for nearly 34 million first-lien mortgages, totaling nearly $6 trillion in outstanding balances—representing approximately 65 percent of all first-lien residential mortgages in the country.[3] Key trends from that report are summarized below.

Overall Mortgage Performance

As shown in Table 1, the percentage of current and performing mortgages remained unchanged from the previous quarter at 87.3 percent. The percentage of mortgages 30 to 59 days delinquent increased to 3.1 percent at the end of the second quarter of 2010, compared with 2.8 percent at the end of the previous quarter and 3.2 percent a year ago. The percentage of seriously delinquent mortgages[4] was 6.2 percent, a decrease of 5.3 percent from the previous quarter but up 16.1 percent from a year ago. Foreclosures in process were 3.4 percent of the total portfolio, a 1.4 percent decrease from the previous quarter but a 16.1 percent increase from a year ago.

[2] Short sales refer to sales of mortgaged properties at prices that net less than the total amount due on the loans. Servicers and borrowers negotiate repayment programs, forbearance, or forgiveness for any remaining deficiency on the debt. Short sales typically have less adverse impact than foreclosures on borrowers' credit records. Deed-in-lieu-of-foreclosure actions refer to actions in which borrowers transfer ownership of the properties (deeds) to servicers in full satisfaction of the outstanding mortgage debt to lessen the adverse impact of the debt on borrowers' credit records.

[3] A full copy of the *OCC and OTS Mortgage Metrics Report, Second Quarter 2010* is available at: *http://www.occ.gov/publications/publications-by-type/other-publications/mortgage-metrics-q2092010/mortgagemetrics-q2092010-pdf.pdf.*

[4] Seriously delinquent loans are those mortgages that are 60 or more days past due and all mortgages held by bankrupt borrowers whose payments are 30 or more days past due.

Table 1. Overall Portfolio Performance (Percentage of All Mortgages in the Portfolio)							
	6/30/09	9/30/09	12/31/09	3/31/10	6/30/10	1Q %Change	1Y %Change
Current and Performing	88.6%	87.2%	86.4%	87.3%	87.3%	0.1%*	-1.4%
30–59 Days Delinquent	3.2%	3.4%	3.4%	2.8%	3.1%	11.0%	-3.5%
Seriously Delinquent	5.3%	6.2%	7.1%	6.5%	6.2%	-5.3%	16.1%
Foreclosures in Process	2.9%	3.2%	3.2%	3.5%	3.4%	-1.4%	16.1%
Overall Portfolio Performance (Number of Mortgages in the Portfolio)							
Current and Performing	29,962,265	29,666,568	29,217,743	29,574,957	29,483,014	-0.3%	-1.6%
30–59 Days Delinquent	1,078,663	1,154,825	1,138,822	939,306	1,038,422	10.6%	-3.7%
Seriously Delinquent	1,798,532	2,111,588	2,388,938	2,210,393	2,083,585	-5.7%	15.8%
Foreclosures in Process	992,554	1,091,620	1,079,386	1,170,785	1,149,770	-1.8%	15.8%

Home Retention Actions

As shown in Table 2, servicers implemented 902,800 permanent loan modifications (shown as "Other Modifications" and "HAMP Modifications") over the past five quarters with HAMP modifications accounting for approximately 26 percent of this total. During the second quarter 2010, servicers initiated or implemented 504,292 home retention actions. This included 273,419 HAMP and other permanent loan modifications, an increase of 18.1 percent from the first quarter of 2010. Loan modifications implemented in second quarter 2010 represent 13.1 percent of seriously delinquent borrowers, up from 7.9 percent in the second quarter 2009. While the number of permanent modifications increased, the number of trial modifications and other payment plans declined as servicers worked through their portfolio of seriously delinquent mortgages to determine borrower eligibility under HAMP and each servicer's own proprietary loan modification programs.

Table 2. Number of New Home Retention Actions							
	6/30/09	9/30/09	12/31/09	3/31/10	6/30/10	1Q %Change	1Y % Change
Other Modifications	142,362	130,464	103,617	131,207	164,473	25.4%	15.5%
HAMP Modifications	--	783	20,679	100,269	108,946	8.7%	--
Other Trial Period Plans	64,201	127,902	96,048	101,764	73,673	-27.6%	14.8%
HAMP Trial Period Plans	79,994	272,709	259,015	188,503	64,666	-65.7%	-19.2%
Payment Plans	131,974	163,551	121,722	120,587	92,534	-23.3%	-29.9%
Total	418,531	695,409	601,081	642,330	504,292	-21.5%	20.5%

Changes to Borrowers' Monthly Payments Resulting From Modifications

Early in the mortgage crisis, servicers' informal payment plans and loan modifications were done in low volume and often resulted in mortgage payments that increased or did not change. This traditional approach to loss mitigation gave delinquent borrowers experiencing temporary financial problems a chance to catch-up on making their loan payments. However, as the mortgage crisis deepened, unemployment climbed, and the number of delinquent borrowers increased to unprecedented levels, it became clear that more formal and permanent modifications were needed. The OCC's mortgage metrics data provided factual evidence that loan modifications completed in 2008 were experiencing high re-default rates. As a result of those high re-default rates, in March 2009, the OCC directed the largest national banks to take corrective action to implement loan modification programs designed to achieve more sustainable modifications.

As a result, servicers have focused efforts on improving the quality of their loan modifications and the performance of those modifications over time. This is evidenced by the increase in modifications that are reducing borrowers' monthly mortgage payments and the corresponding decline in re-defaults (as measured by serious delinquencies) subsequent to modification since the OCC's direction to servicers in 2009. As shown in Table 3, mortgage modifications that lowered monthly principal and interest payments increased to more than 90 percent of all modifications during the second quarter 2010. The emphasis on payment affordability and sustainability has resulted in a 62 percent increase in the average monthly savings in mortgage payments from mortgage modifications from a year ago. As shown in Table 4, modifications made during the second quarter of 2010 reduced monthly payments by an average of $427. Further, 56 percent of the modifications made during the second quarter reduced the borrower's monthly payment by 20 percent or more, representing an average savings to the consumer of $698 a month. These actions for more sustainable payments are also reflected in lower re-default rates for more recently modified loans. Modifications made after the end of the first quarter of 2009 have experienced about half the re-default rates of modifications made prior to that time.[5]

[5] *See OCC and OTS Mortgage Metrics, Second Quarter,* page 7.

Table 3. Changes in Monthly Principal and Interest Payments Resulting from Modifications

(Percentage of Modifications)*

	6/30/09	9/30/09	12/31/09	3/31/10	6/30/10	1Q %Change	1Y %Change
Decreased by 20% or More	38.8%	37.0%	41.8%	54.9%	56.4%	2.9%	45.5%
Decreased by 10% to Less than 20%	19.6%	18.3%	19.1%	17.7%	17.6%	-0.4%	-10.2%
Decreased Less than 10%	19.9%	24.4%	21.1%	14.9%	16.1%	8.1%	-19.3%
Subtotal for Decreased	**78.3%**	**79.7%**	**82.0%**	**87.4%**	**90.1%**	**3.1%**	**15.1%**
Unchanged	4.3%	3.6%	4.8%	2.7%	1.9%	-30.8%	-55.8%
Increased	17.4%	16.8%	13.2%	9.9%	8.0%	-18.9%	-54.0%
Subtotal for Unchanged and Increased	**21.7%**	**20.3%**	**18.0%**	**12.6%**	**9.9%**	**-21.4%**	**-54.4%**
Total	100.0%	100.0%	100.0%	100.0%	100.0%		
(Number of Modifications)							
Decreased by 20% or More	54,860	48,151	51,036	126,379	153,730	21.6%	180.2%
Decreased by 10% to Less than 20%	27,691	23,786	23,338	40,663	47,875	17.7%	72.9%
Decreased Less than 10%	28,213	31,707	25,748	34,271	43,827	27.9%	55.3%
Subtotal for Decreased	110,764	**103,644**	100,122	201,313	245,432	21.9%	121.6%
Unchanged	6,038	4,630	5,822	6,273	5,136	-18.1%	-14.9%
Increased	24,665	21,829	16,142	22,750	21,831	-4.0%	-11.5%
Subtotal for Unchanged and Increased	30,703	**26,459**	21,964	29,023	26,967	-7.1%	-12.2%
Total	141,467	130,103	122,086	230,336	272,399	18.3%	92.6%

*Payment change information was not reported on 895 modifications in the second quarter of 2009; 1,144 in the third quarter of 2009; 2,210 in the fourth quarter of 2009; 1,140 in the first quarter of 2010; and 1,020 in the second quarter of 2010.

Table 4. Average Change in Monthly Payments Resulting from Modifications

All Modifications

	6/30/09	9/30/09	12/31/09	3/31/10	6/30/10	1Q %Change	1Y %Change
Decreased by 20% or More	$617	$623	$626	$664	$698	5.0%	13.1%
Decreased by 10% to Less than 20%	$193	$196	$185	$189	$187	1.2%	-2.9%
Decreased Less than 10%	$61	$55	$62	$67	$68	0.8%	11.7%
Unchanged	--	--	--	--	--	--	--
Increased	$145	$146	$153	$163	$132	-19.0%	-8.7%
Overall	$264	$258	$290	$392	$427	8.9%	61.8%

Home Forfeiture Actions—Short Sales, Deed-in-Lieu-of-Foreclosures, and Foreclosures

As previously noted, mortgage servicers generally do not proceed with home forfeiture actions until they have evaluated the borrower's eligibility for a loan modification that would allow the borrower to stay in his or her home. Unfortunately, loan modification programs cannot help borrowers who simply cannot make even reduced mortgage payments. In these cases, servicers turn to home forfeiture actions to protect the interests of lenders and investors.

Completed home forfeiture actions—foreclosure sales, short sales, and deed-in-lieu-of-foreclosure actions—totaled 221,474 during the second quarter, an increase of 14.2 percent from the previous quarter (see Table 5). Short sales and deed-in-lieu-of-foreclosure actions increased significantly during the quarter, but they remain only 26 percent of home forfeiture actions overall. While home forfeiture actions increased in the second quarter, servicers implemented about 2.3 times more home retention actions—loan modifications, trial period plans, and payment plans—than total home forfeiture actions.

Table 5. **Completed Foreclosures and Other Home Forfeiture Actions**

	6/30/09	9/30/09	12/31/09	3/31/10	6/30/10	1Q %Change	1Y %Change
Completed Foreclosures	106,004	118,606	128,859	152,654	162,812	6.7%	53.6%
New Short Sales	25,128	30,766	37,583	40,043	56,926	42.2%	126.5%
New Deed-in-Lieu-of-Foreclosure Actions	1,120	1,233	1,054	1,185	1,736	46.5%	55.0%
Total	132,252	150,605	167,496	193,882	221,474	14.2%	67.5%
Newly Initiated Home Retention Actions Relative to Completed Foreclosures and Other Home Forfeiture Actions	316.5%	461.7%	358.9%	331.3%	227.7%	-31.3%	-28.1%

The number of newly initiated foreclosures decreased by 21.2 percent, to 292,072, during the second quarter of 2010, the lowest level in more than a year. The lower number is partly attributable to the increase in permanent modifications made during the quarter. In addition, HAMP guidelines now preclude the servicer from initiating a foreclosure action until the borrower has been determined to be ineligible for a HAMP modification. Similarly, the number of loans in process of foreclosure decreased by 1.8 percent from the previous quarter to 1,149,770, reflecting the increases in permanent modifications and completed foreclosures during the quarter as well as the drop in newly initiated foreclosure actions. Notwithstanding these positive trends, we expect the number of foreclosure actions will remain elevated as the large inventory of seriously delinquent loans and loans in process of foreclosure works through the system.

Table 6. Number of Newly Initiated Foreclosures and Foreclosures in Process							
Number of Newly Initiated Foreclosures							
	6/30/09	9/30/09	12/31/09	3/31/10	6/30/10	1Q %Change	1Y %Change
Total	369,226	369,209	312,520	370,536	292,072	-21.2%	-20.9%
Number of Foreclosures in Process							
Total	992,554	1,091,620	1,079,386	1,170,785	1,149,770	-1.8%	15.8%

OCC Supervisory Efforts

Emphasis on Sustainable Loan Modifications and Accurate Financial Reporting

As the volume of problem loans surged to record levels and has worked its way through the financial system, servicers have struggled to maintain the needed capacity and resources to effectively deal with the number of consumers who require assistance. We have used our examination process and our Customer Assistance Group (CAG) to address issues as they have arisen.

Our primary supervisory focus in assessing how servicers work with borrowers experiencing payment problems over the past 2 years has centered on their efforts to offer sustainable loan modifications that avoid foreclosure and allow troubled borrowers to remain in their homes. As previously noted, when our mortgage metrics data showed that an inordinately high percentage of loan modifications made in 2008 were re-defaulting, we directed large national bank mortgage servicers to take corrective action and revise their loan modification programs to produce loan modifications that resulted in more sustainable loan payments. In most cases, this requires concessions on the terms of the loan, rather than simply granting a borrower a payment deferral that capitalizes arrearages, which was typical in many traditional modifications. In addition, in our supervision of national bank mortgage servicers we have issued numerous "Matters Requiring Attention," requiring improvements in servicers' loan modification operations and staffing.

Some observers have stated that mortgage servicers have an inherent conflict of interest in working with borrowers to modify a first lien where the servicer holds the second lien on the property. In general, all other creditors benefit from a modification of the first lien since the modification puts the borrower in a stronger cash-flow position, and makes the borrower more likely to be able to make payments on other debts. A conflict of interest could arise if the second lien holder were trying to overstate the second lien's carrying value (and under-allocate loan loss reserves) for a troubled borrower. The OCC has addressed this potential conflict by directing that second lien holders must take steps necessary to understand any potential issues with the first lien and ensure that carrying values and loan loss reserve levels reflect all risk in the transaction—including any problems the borrower might be having on the first lien, even if the second lien is performing as agreed.

The volume of current and performing second liens held by national banks behind delinquent or modified first liens remains relatively small. The OCC analyzed second liens held by national banks and matched more than 60 percent of them ($293 billion) to first-lien mortgages. Of these 5,000,000 matched second mortgages, about 6 percent, or 235,000, were current and performing but behind delinquent or modified first liens. The balance of those current and performing second liens behind delinquent or modified first mortgages totaled less than $18 billion. The OCC has directed national banks that hold such performing second liens to properly reflect the associated credit impairment for those second liens through an increase in the allowance for loan losses, or in many cases, a charge-off of the loan where appropriate.

Oversight of and Responses to Foreclosure Documentation Issues

When reviewing a bank's foreclosure governance process, such as practices involved with the preparation and filing of affidavits for foreclosure proceedings, examiners determine if the bank has appropriate policies, procedures, and internal controls in place to ensure the accuracy of information relied upon in the foreclosure process and compliance with Federal and State laws. An appropriate governance process would include the testing of those policies and procedures through periodic internal audits and the bank's on-going quality control function. In this instance, neither internal quality control, internal or third party audits at the largest servicers, nor our CAG data revealed that foreclosure document processing was an area of concern.

When the problems at Ally Bank—an institution that is not supervised by the OCC—became public, the OCC took immediate action to determine if procedural breakdowns at national bank servicers could be resulting in similar foreclosure affidavit problems. On September 29, 2010, we ordered the eight largest national bank servicers to conduct a comprehensive self-assessment of their foreclosure management processes, including file review and affidavit processing and signature. We also made clear that where deficiencies were identified, the servicers needed to take prompt action to remedy any improper documentation, including as applicable, making appropriate re-filings with local courts. Equally important, we also directed banks to strengthen foreclosure governance to ensure the accuracy of the information relied upon in the foreclosure process and prevent re-occurrences of documentation problems.

Concurrent with this directive, we began planning onsite examinations at each of these large servicers and their mortgage servicing operational centers. Our objectives are to independently test and verify the adequacy and integrity of bank self-assessments and corrective actions; the adequacy and effectiveness of governance over servicer foreclosure processes to ensure foreclosures are completed in accordance with applicable legal requirements and that affidavits and claims are accurate; and to determine whether troubled borrowers were considered for loss mitigation alternatives such as loan modifications prior to foreclosure.

These examinations are now underway at each of the eight servicers. The Federal Reserve Board (FRB) and Federal Deposit Insurance Corporation (FDIC) are participating in these examinations. The examination teams include examiners from the OCC, FRB, and FDIC. The OCC has approximately 100 examiners working on this effort. Legal support is provided by staff attorneys from both the OCC and FRB. We have established an interagency foreclosure review team to provide oversight and direction to onsite examination teams to ensure consistency in our examination work.

As noted above, a key objective of our examinations is to determine the adequacy and effectiveness of governance over the foreclosure process. The scope of work to assess governance is extensive and includes an assessment of each servicer's foreclosure policies and procedures, organizational structure and staffing, vendor management, quality control and audit, loan documentation including custodial document management, and foreclosure work flow processes. As part of these reviews, examiners are conducting interviews with personnel involved in the preparation, review, and signing of foreclosure documents. Our objective in conducting these interviews is to understand current and past practices with respect to preparation of foreclosure documents, whether the staff conducting these functions had sufficient knowledge and training, including training in relevant requirements, to effectively complete and sign-off on foreclosure affidavits, and to help assess the underlying cause of any identified deficiencies.

Examiners will also be reviewing samples of individual borrower foreclosure files from judicial and non-judicial states that include both in-process and completed foreclosures. In reviewing these files, examiners will determine whether foreclosed borrowers were appropriately considered for alternative loss mitigation actions such as a loan modification. Examiners will also check for the following:

- A documented audit trail that demonstrates that data and information (*e.g.,* amount of indebtedness and fees) in foreclosure affidavits and claims are accurate and comply with State laws;
- Possession and control over the underlying, critical loan documents such as original note, mortgage, and deed of trust to support legal foreclosure proceedings; and
- Evidence that the affidavit and documents were independently and appropriately reviewed, and that proper signatures were obtained.

In addition to these loan file reviews, examiners will review the nature, volume, and resolution of foreclosure-related complaints. These will include complaints received by the OCC's Customer Assistance Group as well as complaints received by the banks.

Finally, examiners will assess the adequacy of each bank's analysis and financial reporting for the potential adverse impact on the bank's balance sheet and capital that may arise from the increased time and costs needed to correct any procedural errors; losses (if any) resulting from inability to access collateral; and expected litigation costs. We are directing banks to maintain adequate reserves for potential losses and other contingencies and to make appropriate disclosures, consistent with applicable Securities and Exchange Commission disclosure rules.

Using our authority under the Bank Service Company Act, we also are conducting interagency examinations of two major non-bank mortgage service providers. The OCC, in coordination with the FRB, FDIC, and Federal Housing Finance Agency, is leading an onsite examination of the Mortgage Electronic Registration System (MERS). A key objective of the MERS examination is to assess MERS corporate governance, control systems, and accuracy and timeliness of information maintained in the MERS system. Examiners assigned to MERS will also visit onsite foreclosure examinations in process at the largest mortgage servicers to determine how servicers are fulfilling their roles and responsibilities relative to MERS.

We are also participating in an examination being led by the FRB of Lender Processing Services, Inc., which provides third-party foreclosure services to banks. We expect to have most of our onsite examination work completed by mid to late December. We then plan to aggregate and analyze the data and information from each of these examinations to determine whether or what additional supervisory and regulatory actions may be needed. We are targeting to have our analysis completed by the end of January.

We recognize that the problems associated with foreclosure processes and documentation have raised broader questions about the potential effect on the mortgage market in general and the financial impact on individual institutions that may result from litigation or other actions by borrowers and investors. Obviously, for a host of reasons—from fair treatment of borrowers to the fundamentals of the mortgage marketplace—mortgage servicers must get this right. We are directing banks to take corrective action where we find errors or deficiencies, and we have an array of informal and formal enforcement actions and penalties that we will impose if warranted. These range from informal memoranda of understanding to civil money penalties, removals from banking, and criminal referrals.

Conclusion

The OCC is focused on identifying and rectifying problems so that the basic function and integrity of the foreclosure process is restored; the rights of all homeowners subject to the foreclosure process are protected; and the basic functioning of the U.S. mortgage market is stabilized. As we move forward we will continue to cooperate with the many inquiries and investigations that are taking place and provide updates to the Congress.

OFFICE OF THE COMPTROLLER OF THE CURRENCY OUTLINE FOR UNIFORM SERVICING STANDARDS

General Standards

Servicers should act responsibly and adhere to the highest standards of professionalism in their dealings with borrowers. These include:

- Safeguarding and accounting for borrower's funds;
- Acting in accordance with the underlying contractual documents in servicing the loan;
- Striving to act in the best interest of the owner of the loan and the borrower in servicing the loan, including by pursuing loss mitigation options as appropriate;
- Maintaining trained personnel appropriate to servicing workload;
- Maintaining compensation schedules for staff and third party vendors that promote adherence to these standards;
- Maintaining compensation schedules that provide effective incentives to work with troubled borrowers, including early outreach and counseling; to pursue loss mitigation and foreclosure avoidance strategies, to maximize the net present value of the loan; and to maintain adequate levels of appropriately trained staff to respond to current and anticipated demand, including to respond to increases in loan delinquencies.
- Maintaining fee schedules that are reasonable and appropriate to the type, level and cost of the service that is provided, or purpose of the fee;
- Providing timely information to the borrower about the account, including periodic statements of the account;
- Providing timely and comprehensive information to borrowers on matters related to the account, including in response to borrower requests for information

or complaints and, as appropriate, about loan counseling and loss mitigation options and services;

- Force-placing hazard, homeowners, or flood insurance on a mortgaged property only when required, to the extent required, and in the amount required after reasonable advance notice to the borrower;
- Adopting internal controls appropriate to the nature and complexity of the servicing operations and conducting periodic assessments to ensure adherence to these standards; and
- Avoiding conflicts of interest.

Payments

Servicers should adopt and adhere to reasonable procedures for handling borrower payments, including:

- Clearly describing the payment amount, and the date, time, and location for payments to be received under the terms of the loan agreement;
- Imposing reasonable cutoff times;
- Crediting payments in a prompt and timely manner, ordinarily on the date of receipt;
- Applying payments, including partial payments, to scheduled principal and interest, before they are applied to fees;
- Avoiding payment allocation processes designed primarily to increase fee income;
- Not imposing late or delinquency fees when the delinquency is attributable solely to nonpayment of late or delinquency fees on an earlier payment;
- Notifying a borrower of the fact that, and reasons why, any payment may not have been credited to the account and how the borrower may make the loan current;
- Correcting any misapplication of borrower funds in a prompt and timely manner;
- Not commingling borrowers' payments with the servicer's own funds except for the time needed to process and clear borrower payments;
- Adopting reasonable policies and procedures for handling payment overages and shortages; and
- Conducting periodic audits of payment processing functions.

Borrower Notices

Servicers should provide borrowers with full and accurate information about their accounts and payment records, including by providing the following notices:

- *Periodic and annual statements*—Servicers should provide borrowers with monthly and annual statements of the borrower's account activity for the preceding period, including information about total amount due; payments of principal and interest; remaining principal balance; itemization of any late or other fees imposed; escrow payments, balances, and deficiencies; any advances made, such as for force-placed insurance; and remaining term of the loan.
- *Payment history*—Upon request, servicers should provide borrowers within a reasonable time of the request, a statement of the recent payment history of the loan.
- *Mortgage servicing transfer*—Servicers should provide borrowers with appropriate account and contact information upon transfer of servicing.
- *Payoff statement*—Upon request, servicers should provide borrowers within a reasonable time of the request, a statement of the total amount required to pay off the loan as of a specified date.
- *Late payment notice*—Servicers should send borrowers a payment reminder notice after a payment is past due, unpaid, and a late fee has been imposed. Servicers need not send separate notices for each consecutive month in which the loan remains unpaid.
- *Schedule of fees*—Servicers should provide reasonable disclosure of a current schedule of standard or common fees it may impose. Service fees should be imposed only as authorized in the loan instruments and applicable law or where the consumer expressly requests a specific service at that fee;
- *Delinquencies, loss mitigation, and foreclosure notices*—Servicers should provide borrowers with timely information in the event of a delinquency or default about loss mitigation options offered by the servicers, as well as clear and un-

derstandable notices about the pendency of loan modification and foreclosure proceedings. Such information includes the following:

- The nature and extent of any delinquency;
- A list of documentation or other information and any third party approvals the borrower must provide;
- The anticipated or average length of time it may take to process any loss mitigation option or loan modification; and
- The actions the servicer, lender, or owner of the loan may take during the applicable process, such as the circumstances in which the borrower may receive collection and/or foreclosure notices and in which any foreclosure action may be stayed.

Borrower Complaints and Inquiries

Servicers should act promptly and reasonably in responding to borrower inquiries, requests, and complaints, including by taking the following actions:

- Maintaining adequate levels of trained customer service personnel to handle complaints and inquiries;
- Providing an address and toll-free number for such complaints and inquiries;
- Providing contact information for the owner of the loan;
- Providing a single and easily accessible point of contact for special inquiries, information and services, such as loss mitigation and loan modifications services, and for delinquent and at risk borrowers; and
- Responding and resolving borrower inquiries and complaints in a prompt and appropriate manner;
- Providing an avenue for escalation or appeal of any disputes;
- Correcting customer accounts, correcting credit report information, and making refunds, as applicable; and
- Maintaining adequate tracking information for such inquiries and complaints.

Delinquencies, Loss Mitigation, Loan Modifications, and Foreclosure Abeyance

Delinquent loans—Servicers should follow an appropriate set of special protocols for servicing delinquent loans that include:

- Promptly alerting the appropriate functional unit(s) that a loan is delinquent;
- Working with borrowers at risk of foreclosure, including early outreach and counseling;
- Employing specially trained staff to work with delinquent loans and borrowers;
- Implementing appropriate procedures regarding notices of delinquencies, assessing late charges, handling partial payments, maintaining collection records, and reporting to credit bureaus;
- Pursuing loss mitigation and foreclosure prevention measures;
- Ensuring compliance with legal requirements;
- Providing for quality assurance review of decisions concerning loss mitigation options or commencement of foreclosure actions.

Loss mitigation—Servicers should make reasonable and good faith efforts, consistent with customary business standards and in accordance with applicable laws and contracts, to engage in loss mitigation activities and foreclosure prevention for delinquent loans, where appropriate. Such activities include considering a deed-in-lieu of foreclosure; forbearance; and short sale.

Loan modification procedures—Servicers also should make reasonable and good faith efforts, in accordance with specific protocols established by contract and with applicable laws, to modify loans to provide affordable and sustainable payments when:

- The borrower is in default or at imminent risk of default on a loan due to financial hardship and is unable to maintain the payments or is unable to make up any delinquent payments, and
- The net present value of cash-flows from the modified loan will exceed that expected from foreclosure.

Servicers should implement appropriate procedures to ensure that documents provided by borrowers and third parties are appropriately maintained and tracked and that borrowers generally will not be required to resubmit the same documented information that has already been provided; that such requests are acknowledged, processed, and evaluated in a timely manner; and that borrowers are notified promptly of the approval or denial of their modification requests or of the need for additional information. Such procedures include:

- Acknowledging receipt of requests for loan modifications and providing information about the designated point of contact for further communications about the request or for appeals;
- Reviewing such requests for documentary sufficiency and notifying a borrower if an application or request is incomplete and describing any additional information that is necessary to complete any application or otherwise enable an evaluation of the borrower's loan modification request;
- Implementing procedures and systems to ensure that reasonable steps are taken, without undue delay, to procure and safeguard all information needed to evaluate and act on a consumer's request for a mortgage modification;
- Completing the evaluation of the borrower's eligibility for a loan modification or other loss mitigation option;
- Notifying the borrower of approval of any modified loan terms being offered or, if applicable, the reasons for denial, such as information on the NPV calculation, and where to obtain additional information or information about housing counseling assistance;
- Implementing and maintaining reasonable procedures and sufficient staffing to ensure full compliance with policies, procedures, and timelines affecting loan modification requests;
- Ensuring that borrowers are not required to waive any claims or defenses as a condition of a loan modification; and
- Implementing policies and procedures to notify foreclosure attorneys and trustees regarding a borrower's status for consideration of a loss mitigation option, including whether the borrower has requested and is being considered for loss mitigation and whether the borrower is in a trial or permanent loan modification and is not in default under the agreement.

Foreclosure abeyance—Servicers should avoid taking steps to foreclose on a property, including referring a mortgage to foreclosure, continuing the foreclosure process—whether judicial or non-judicial, conducting a scheduled mortgage foreclosure sale, or incurring costs for foreclosure-related services that will be imposed on the borrower, if the borrower is in a trial or permanent modification and is not in default under the modification agreement. A servicer may initiate or proceed with the foreclosure process when:

- The borrower has declined to pursue loss mitigation or loan modification actions;
- The borrower is not responding to reasonable requests for information or outreach related to loss mitigation or loan modification efforts;
- The borrower has not submitted information necessary to evaluate the borrower for a loan modification;
- The borrower has been determined to be ineligible for a loan modification; or
- The borrower is in default under the terms of a trial or permanent modification period plan.

Acting in accordance with guidelines, directives, and notice requirements developed by the U.S. Department of Treasury and in effect for the Home Affordable Mortgage Program (HAMP) will be deemed to meet these standards for loss mitigation, loan modification and foreclosure prevention.

Foreclosure Governance

Servicers should adhere to reasonable procedures in managing the foreclosure process including with respect to compliance with legal standards and documentation requirements, oversight of third parties, staffing and training, and audits. In general, servicers should institute controls and procedures that will ensure that foreclosures occur only when appropriate and taking into account the status of any foreclosure abeyance actions, the facts are documented to support the action, and in compliance with applicable laws and investor requirements.

Compliance with legal requirements—Servicers should ensure compliance with State law requirements when preparing foreclosure affidavits and claims.

Documentation procedures—Servicers should ensure maintenance of sufficient documentation and servicing systems to support foreclosure decisions and actions. For example, servicers should adopt internal controls and procedures to ensure:

- The accuracy and completeness of the borrower's loan history;
- The accuracy and completeness of representations to courts and other parties in connection with foreclosure or bankruptcy proceedings;
- Compliance with legal requirements;
- Retention of documents that support the foreclosure action in a centralized records system; and
- Remediation of any errors, misrepresentations, or other deficiencies including, for example, correcting errors in a borrower's account.

Third party/vendor management—Servicers should ensure appropriate oversight of third party vendors, including outside legal counsel, by:

- Performing minimum due diligence on the vendor's qualifications, expertise and capacity; reputation and complaints; information security; business continuity; and viability;
- Conducting capacity and concentration analysis of external law firms;
- Ensuring adequacy of third party staffing levels, training, work quality, and workload balancing;
- Ensuring that contracts provide for adequate oversight, including audits and termination upon default, and require third party adherence to these standards;
- Maintaining and evaluating reports on third party compliance with contractual obligations;
- Reviewing any customer complaints about the services of the third party;
- Conducting qualitative assessments and audits of third party work for timeliness and accuracy of filings and completed actions, including foreclosure processes and documentation. External law firms should be treated as third party vendors and standards appropriate for oversight of third party vendors should be applied to such firms; and
- Following up on any performance failures in a timely manner.

Staffing and training—Servicers should ensure adequate staffing levels and training, including:

- Ensuring staffing levels that are appropriate to the current and projected volumes, workload, and technical requirements of foreclosures;
- Providing comprehensive technical training for staff, notaries, and affiants and signors, sufficient to the nature and levels of foreclosure work; and
- Emphasizing accuracy and completeness of work in staff performance, not solely production and volume.

Quality control and audit—Servicers should ensure comprehensive quality control and audit coverage, including:

- Obtaining annual independent attestations of compliance with quality assurance plans;
- Ensuring independent oversight of the foreclosure process;
- Ensuring adequate assessments of all aspects of the foreclosure process, including through reporting metrics that identify trends and potential problems;
- Assessing loan modification and loss mitigation efforts, appropriateness of fees and charges to borrowers, and application of payments and credits;
- Ensuring that foreclosure filing documents and fees, costs, and indebtedness associated with the foreclosure are accurate;
- Evaluating controls and processes used by third party vendors and law firms;
- Evaluating foreclosure-related consumer complaints for indications of any systemic problems; and
- Identifying non-compliance with State laws or rules concerning completion, filing, and notarization of foreclosure affidavits and claims.

PREPARED STATEMENT OF EDWARD J. DEMARCO

ACTING DIRECTOR, FEDERAL HOUSING FINANCE AGENCY

DECEMBER 1, 2010

Introduction

Chairman Dodd, Ranking Member Shelby and Members of the Committee, thank you for inviting me to speak with you today about weaknesses in the foreclosure process. The recently identified deficiencies in the preparation and handling of legal documents to carry out foreclosures are unacceptable. While those deficiencies undoubtedly reflect strains on a system that is operating beyond capacity and was never designed to handle the volume of nonperforming loans that we are seeing today, they also represent a breakdown in corporate internal controls and the integrity of mortgage servicing and foreclosure processing. Servicers and others within the industry may have attempted to expand the resources available to deliver appropriate loss mitigation services, including timely and accurate foreclosure processing, but in some instances those efforts have been inadequate.

Since this latest set of difficulties was identified, I have had a team of managers and staff from the Federal Housing Finance Agency (FHFA) working closely with Fannie Mae and Freddie Mac (the Enterprises) to gauge the full scope of the foreclosure processing problem and to move forward on foreclosures where appropriate. Our goals are two-fold: to ensure that foreclosure processing is done in accordance with the servicer contract and applicable laws, and to protect taxpayers from further losses on defaulted mortgages. Moving forward on foreclosures where appropriate limits taxpayer losses and contributes to the ultimate recovery of domestic housing markets. Of course, before any foreclosure is completed, we expect servicers to exhaust all alternatives.

With those objectives in mind, I will review the actions that FHFA has taken to date, as well as those underway. Before doing so, I will provide context for understanding the problems that have arisen, including consideration of:

- the role of the servicers, attorneys, and their contractual relationship with the Enterprises when performing loss mitigation and foreclosures and
- the complexities of the system in which State and local laws create a diverse range of requirements that can extend foreclosure timelines, leaving homeowners and homebuyers in limbo, putting home values at risk in neighborhoods with abandoned or vacant properties and slowing the recovery of the housing market.

Today, Fannie Mae and Freddie Mac own or guarantee 30 million mortgages; of those, more than 1.3 million are more than 90 days seriously delinquent. As I have reported to the Committee on prior occasions, the Enterprises have sought to minimize losses on delinquent mortgages by offering distressed borrowers loan modifications, repayment plans, or forbearance. These loss mitigation techniques reduce the Enterprises' losses on delinquent mortgages and help homeowners retain their homes. Servicers of Enterprise mortgages know that these loss mitigation options are the first response to a homeowner who falls behind on their mortgage payments.

Yet, for some delinquent borrowers, their mortgage payments are simply not affordable due to unemployment or other hardship and a loan modification is not a workable solution. In other cases, homeowners have decided not to continue payment on their mortgages, perhaps because of the decline in value of their house or because personal circumstances have changed their desire or ability to retain their home. For these cases, the Enterprises offer foreclosure alternatives in the form of short sales and deeds-in-lieu of foreclosure. Such foreclosure alternatives generally are better for the homeowner, the neighborhood, and the Enterprise. Despite these options for a graceful exit from a home, foreclosure remains the final and necessary option in many cases.

The sheer volume of delinquent homeowners has put intense pressure on servicers, including their loan workout efforts and their foreclosure processes. Other hearings and studies have analyzed how and why this has happened. The subject of this hearing and our challenge today is to identify the full scope and implications of foreclosure processing problems and to improve the integrity of the foreclosure process at servicers and related parties that are failing to perform to required standards.

Breakdowns in the Foreclosure Process and FHFA's Initial Response

As reports of foreclosure documentation deficiencies emerged at several major servicers, FHFA sought to ascertain the full scope and nature of the problem. On October 1, I issued a statement that said, in part:

> FHFA, as conservator for Fannie Mae and Freddie Mac, supports efforts by the Enterprises to remind servicers and other parties engaged in processing foreclosures to do so in accordance with their seller-servicer agreements and applicable laws and regulations. Where deficiencies have been identified, FHFA has directed the Enterprises to work collectively to develop and implement a consistent approach to address any problems. In addition, FHFA is coordinating with appropriate regulators on this issue. Our goal is to assure the integrity of the foreclosure process and to see that any corrections

in processes be tailored to the problem, protecting the rights of borrowers and investors without causing any undue disruption to the mortgage markets.

On October 13, FHFA built upon its earlier statement by providing the Enterprises and servicers a four-point policy framework for handling foreclosure process deficiencies, including specific steps FHFA expects them to take to assess and remedy the problems. The four points are simply stated:

1. Verify that the foreclosure process is working properly;
2. Remediate any deficiencies identified in foreclosure processing;
3. Refer suspicions of fraudulent activity; and
4. Avoid delay in processing foreclosures in the absence of identified problems.

Pursuant to that guidance, the Enterprises continue to gather information on the full nature and extent of servicer problems. Since then, only a small number of servicers have reported back to the Enterprises as having some problem with their foreclosure processing that needs to be addressed. Still, these firms represent a sizable portion of the Enterprises combined books of business. The issues identified to-date range in size and scope, and may not affect every delinquent mortgage that a particular servicer is handling. Thus, it is difficult to say just how many delinquent Enterprise mortgages may be affected and the degree of difficulty in remediating the deficiencies. The Enterprises are currently working directly with their servicers to ensure that all loans are handled properly and corrections and refiling of paperwork are completed where necessary and appropriate. Because the file reviews are being performed case-by-case, the full evaluation will take a substantial amount of time and resources.

As made clear in FHFA's October 13th policy framework, if wrongful acts in foreclosure processing are discovered, the appropriate remedies should be undertaken by servicers, regulators, and law enforcement. Simply put, it is not acceptable that servicers and other parties involved in foreclosure processing may not have adhered to State and local laws. As Conservator of the Enterprises, FHFA expects all companies servicing Enterprise mortgages to fulfill their contractual responsibilities, which include compliance with both the Enterprises' seller/servicer guides and applicable law. We expect the same of other parties as well, including law firms working on foreclosure processing of Enterprise loans. Finally, to reinforce the duties undertaken by servicers, the Enterprises have indicated that they may pursue remedies for contractual violations.

The Role of the Servicer

When an Enterprise purchases a mortgage from an originating lender, it contracts with that lender or another bank or financial institution to service the loan. The servicer is the main communication point for the borrower, accepting all payments and crediting the borrower's account.

When homeowners get behind in payments, the servicer is expected to work with the delinquent borrower to set up a repayment plan, modify the loan, or, if foreclosure alternatives are not viable, begin foreclosure proceedings. Although the Enterprises hold the actual promissory notes through document custodians who maintain these records separate from the servicers, Fannie Mae and Freddie Mac do not themselves accept or process payments or move to modify or foreclose.

For their work, the servicers get paid by the Enterprises and, under the terms of their contracts, each servicer is obligated to follow the procedures established by the Enterprise, including compliance with all appropriate laws. The Enterprises also provide policy guidelines to their seller/servicers. A servicer is contractually bound to comply with this guidance; however, the Enterprises do not review loan files for each and every mortgage they guarantee or purchase. Instead, the Enterprises rely on a representation and warranty (rep and warrant) model under which the loan originator and loan servicer commit that the loan origination and servicing complies with the Enterprise's seller/servicer guide. Under the terms of the servicer contracts, the Enterprises can require the servicer to pay damages if the servicer does not follow the seller/servicer guidelines or force the servicer to buy back the loan if the loan fails to meet the Enterprises' eligibility guidelines.

The majority of Enterprise loans are serviced by a few very large banks. However, there are hundreds of servicers that hold contracts with each Enterprise; many are relatively small institutions. Each servicer typically works on behalf of many investors, including trustees for private label securities, and must follow the procedures and processes set forth in each investor contract. As I will describe further below, we are working with other government agencies to review foreclosure servicing practices and operations, and where we find firms with operational deficiencies, these must be remedied.

Attorneys Specializing in Foreclosure Processing

In order to complete foreclosures, particularly in judicial foreclosure states, servicers often contract with law firms from the Enterprises' approved attorney networks (for servicers of one Enterprise this is required, for the other, it is optional to use the approved network). These law firms have been evaluated by the Enterprises before being added to that Enterprise's attorney network. By adding a firm to its network, the Enterprise has concluded the firm has sufficient capacity and expertise to assist a servicer in need of foreclosure processing services. Recently the capacity of some of these law firms has also been strained by the volume of foreclosures and the burden on the court systems. In light of processing problems we are discussing today, it is evident that both Enterprises must take steps to improve their selection and oversight of the attorneys in their networks.

State Foreclosure Processes and Foreclosure Timelines

Foreclosure proceedings and requirements are established at the State level. Almost half of the states have a judicial foreclosure process that relies on the court system. By contrast, foreclosures in non-judicial states are managed according to State and local laws but handled outside of the court system.

Both systems have protections for homeowners, and to a large extent the essential paperwork and documentation elements are the same across all states, although particular requirements vary from jurisdiction to jurisdiction. In judicial foreclosure states, individual judges may set specific requirements within their courtrooms that are in addition to, or differ from, terms established by other judges in that State. Servicers and law firms involved in processing foreclosures must be aware of and responsive to such particular requirements.

Both judicial and non-judicial states are experiencing growing numbers of foreclosures, which are contributing to long delays between a borrower's default and the completion of an associated foreclosure.

Currently, the time from start to completion of a foreclosure for Enterprise loans in non-judicial states typically takes 6 months to a year. In judicial foreclosure states, it takes even longer, often 6 months longer than in non-judicial states and in certain judicial states the difference is even greater. Bear in mind, these foreclosure periods begin *after* the loan becomes seriously delinquent, typically about 4 months.

Some reasonable delays in the foreclosure process have been expected, appropriately so over the past 2 years, as new loss mitigation programs, such as loan modifications, have been introduced. These programs have often been accompanied by temporary foreclosure moratoria so that homeowners in the foreclosure process could be assessed for a modification. Servicers are obligated to follow Enterprise guidelines, including evaluating homeowners' for eligibility for the various foreclosure mitigation programs I described earlier.

While FHFA remains committed to ensuring borrowers are presented with foreclosure alternatives, it is important to remember that FHFA has a legal obligation as Conservator to preserve and conserve the Enterprises' assets. As I have said before, this means minimizing losses on delinquent mortgages. Clearly, foreclosure alternatives, including loan modifications, can reduce losses relative to foreclosure and benefit homeowners and neighborhoods, adding some measure of stability to local housing markets. But when these alternatives do not work, timely and accurate foreclosure processing is critical for minimizing taxpayer losses. The direct effect on taxpayers is thus: when an Enterprise-guaranteed mortgage is delinquent 4 months, the Enterprise removes the mortgage from the mortgage-backed security in which it was funded, paying off the security investors at par. The delinquent mortgage then goes on the balance sheet of the Enterprise, funded with debt issued by the Enterprise, debt supported by the Treasury Department's Senior Preferred Stock Purchase Agreement. While awaiting foreclosure (or some foreclosure alternative), that loan is generating no revenue because the borrower has stopped paying, but the Enterprise must keep paying interest on the debt supporting the mortgage. The cost of the delay is why it is critical to FHFA's responsibilities as Conservator to ensure timely processing of foreclosure actions—the cost is ultimately borne by the taxpayer.

When a homeowner falls behind on their mortgage payments, servicers operate on a single track, working through loss mitigation options with the homeowner, typically beginning with the HAMP program and followed by other loan modification programs or other foreclosure alternatives. When all loss mitigation alternatives have been exhausted, the servicers are expected to initiate the foreclosure process.

Furthermore, the Enterprises have instructed servicers to suspend foreclosure processing when loss mitigation activities reach certain milestones. At times, simultaneous actions are necessary because of the long timeframes of the foreclosure process and because borrowers are not always responsive to foreclosure alternative offers.

While the Enterprises have established foreclosure time limits in their seller/servicer guides, no servicers have been penalized in recent years for exceeding those limits, largely because State and local legal requirements, loan modification efforts, the unprecedented volume, and various foreclosure moratoria have greatly contributed to delays. During this year, FHFA has been working with each Enterprise to improve servicers' adherence to these timelines, and to apply penalties where justified, but the recent set of issues have further complicated that effort.

Deficiencies in the foreclosure process, including problems with affidavits, notaries, and improper practices, appear to be the result of inadequate resources for and oversight of servicing operations. The pressure from high volumes of foreclosures working through the system has surfaced fault lines in the foreclosure process that remain the responsibility of management at these companies to identify and fix.

Other Actions Being Taken & Matters for Consideration

All of us—regulators, lawmakers, investors, and the general public—want answers to the questions raised by this most recent breakdown in our housing finance market and we want them now. Much work is underway to assess the characteristics, extent, and location of these problems and conclusions must await the completion of this work. Regulatory agencies including FHFA are carrying out important examination activities that will better inform the issue. Thus, identification of further actions or regulatory responses must await the results of these examinations and evaluation of the information developed.

My colleagues can speak to the examination activities they are leading, some of which include FHFA participation. In particular, FHFA is participating in a multiagency examination of the Mortgage Electronic Registration Systems (MERS). FHFA is reviewing the Enterprises' practices with regard to oversight of their counterparties, which have been lacking in the past. Neither FHFA nor the Enterprises have any regulatory authority with regard to mortgage servicers. FHFA's authority is limited to the Enterprises and, as I have noted, the Enterprises' relationships with mortgage servicers are contractual, not regulatory.

I do not support a blanket moratorium on foreclosures. The adverse consequences of a moratorium outweigh the argued benefits. The costs to neighborhoods, taxpayers, and investors would be enormous. Our focus should be on fixing problems where they are found and then moving forward expeditiously with foreclosure proceedings where foreclosure alternatives have been exhausted and where no process deficiencies have been identified or they have been remedied. Delay is costing taxpayers money and creates undesirable incentives for homeowners to stop paying their contracted mortgage obligations.

To date, Fannie Mae and Freddie Mac, as well as other parts of the housing finance industry, have relied on a rep and warrant model, whereby one party commits to follow a set of standards and the other party trusts that commitment, unless and until a clear violation or breach is identified. FHFA is reviewing the Enterprises' practices in enforcing reps and warrants and FHFA expects adherence to those contract terms with regard to mortgages they purchase and with regard to mortgage servicing.

You have asked me to explain the Enterprises' policies regarding repurchases of loans the companies believe to have been originated in violation of representations and warranties and the volume of loans you expect will be put back to the originators or other parties as well as what the FHFA is doing to oversee this process and the implications for the financial conditions of the Enterprises.

With regard to mortgage repurchases, I have also been clear that the Enterprises should actively enforce lender compliance with their contractual obligations, which includes pursuing repurchases from those institutions whose loans did not meet the Enterprises' underwriting and eligibility guidelines. Lenders are obligated by the representations and warranties they made to the Enterprises to repurchase loans that did not meet contractual selling requirements.

The Enterprises have continued to make progress in enforcing lenders' representation and warranty obligations, but outstanding repurchase requests continue to be of concern to FHFA. During 2009, the Enterprises' lenders repurchased $8.7 billion of single-family mortgages, and slightly higher volumes are being repurchased in 2010. However, as of the end of the third quarter 2010, Fannie Mae had $7.7 billion in outstanding repurchase requests, and Freddie Mac had $5.6 billion in outstanding repurchase requests.

More than one-third of these repurchase requests have been outstanding for more than 90 days. Many of the lenders with aged, outstanding repurchase requests are among the largest financial institutions in the United States. The delays by lenders in repurchasing these loans are a significant concern to FHFA. There are ongoing discussions between the Enterprises and lenders to reach a workable solution and FHFA is examining its options should these requests not be resolved in the normal course of business.

FHFA remains committed to working with fellow regulators to enhance our oversight of the foreclosure process and to ensure market participants adhere to State and Federal laws. To further our efforts at bringing stability to housing finance, our approach needs to continue to focus on offering troubled homeowners an opportunity to remedy their payment difficulties. Failing that, homeowners should be offered foreclosure alternatives but, after that, foreclosure must proceed in a legal and timely manner for the sake of neighborhoods, investors, and taxpayers.

Thank you for this opportunity to testify. I would be glad to answer any questions.

PREPARED STATEMENT OF TERENCE EDWARDS

EXECUTIVE VICE PRESIDENT

CREDIT PORTFOLIO MANAGEMENT, FANNIE MAE

DECEMBER 1, 2010

Chairman Dodd, Ranking Member Shelby, Members of the Committee, thank you for the opportunity to testify today. My name is Terry Edwards, and I serve as Executive Vice President for Credit Portfolio Management at Fannie Mae, which involves foreclosure prevention and servicing oversight.

I came to Fannie Mae in 2009 from PHH Corporation, where I served for three decades in a variety of executive roles, including as President and CEO of PHH Mortgage, one of the nation's top ten mortgage servicers. My experience with PHH gives me a unique perspective on Fannie Mae's expectations for servicers and an understanding of servicer operations.

Let me begin by underscoring Fannie Mae's commitment to providing liquidity, stability and affordability to America's housing market, and our appreciation for the Government's support that allows us to carry out our mission and mandate.

We fulfill our mission and mandate by purchasing or securitizing mortgage loans originated by lenders in the primary mortgage market. Since the start of 2009, Fannie Mae has provided over $1 trillion in funding for nearly 5 million loans for home purchase, refinancing and rental housing.

As private securitization of mortgages has pulled back dramatically over the past 2 years, Fannie Mae recognizes that our commitment to serve the market is critical.

We are also intensely focused on doing everything we can to address the foreclosure crisis and keep people in their homes. That includes taking affirmative steps to ensure that mortgage servicers carry out their responsibilities under our mortgage servicing contracts and guidelines—especially in helping borrowers pursue our foreclosure prevention alternatives and properly handling the foreclosure process.

Preventing foreclosures is a top priority for Fannie Mae. Foreclosures hurt families and destabilize communities. Neighborhoods deteriorate when properties are abandoned or neglected. Vacant homes depress nearby property values. Condominium and homeowner associations are not paid, creating hardships for those communities. And loans that result in foreclosure typically cost taxpayers tens of thousands of dollars.

So our first focus is on keeping borrowers in their homes or providing foreclosure alternatives, and we are making measurable progress. Since the start of 2009, more than 600,000 borrowers with loans owned or guaranteed by Fannie Mae received workouts through either Treasury's Home Affordable Modification Program or our own additional foreclosure-prevention programs.

The foreclosure-prevention and resolution operations I lead include nearly 1,200 personnel dedicated to working with servicers to help borrowers avoid foreclosure and stabilizing communities by putting foreclosed homes back into service.

We are sparing no efforts in helping servicers process hundreds of modifications every working day. Not since the Great Depression have so many people fallen behind on their mortgages. We have learned a lot along the way.

In addressing our response to the foreclosure crisis, I want to underscore that Fannie Mae does not service loans. We rely on the loan servicing divisions of major banks and other financial institutions as the primary front-line operators and points of contact with the borrowers. We pay servicers significant fees during the life of a loan to work with borrowers. Servicers are required under our servicing contracts to help borrowers in trouble, not just collect payments.

But as many servicers have acknowledged, they have struggled to keep up with the volume of delinquent loans. This is frustrating to borrowers. It is unacceptable to Fannie Mae. We are taking significant steps to improve servicer performance and enforce their contractual obligations to help borrowers.

I also wish to note that while Fannie Mae owns or guarantees more than 35 percent of the single-family mortgages in America, we have a significantly smaller percentage of borrowers who are seriously delinquent than the industry does as a whole—roughly 4.5 percent of our borrowers are 90 days or more behind on their payments, as compared to the serious delinquency rate of nearly 9 percent across the industry. Still, by historical standards our serious delinquency rate represents an extremely large number of borrowers facing difficult circumstances, so we continue to focus significant efforts on addressing this situation.

In my testimony, I will describe our foreclosure-prevention programs and efforts to ensure loan servicers do everything possible to help struggling borrowers and prevent needless foreclosures. I will also touch on our efforts to work with servicers as they address and remedy the foreclosure processing issues that have come to light in recent weeks.

Foreclosure prevention process

Since the start of the housing crisis, Fannie Mae has adopted a wide range of foreclosure prevention initiatives that are the responsibility of our servicers to implement.

These initiatives include the Treasury Department's Home Affordable Modification Program, or HAMP. We also have provided additional solutions for servicers to offer Fannie Mae borrowers when they do not qualify for the Treasury program.

Since the start of the Treasury program in February 2009, more than 160,000 struggling borrowers with Fannie Mae mortgages have received HAMP permanent modifications. And since the start of 2009, about 250,000 Fannie Mae borrowers have received our modifications outside of HAMP. So in total, we have helped more than 410,000 Fannie Mae borrowers modify their loans and stay in their homes.

We have continued to update and improve these borrower-help initiatives to incorporate what works, what borrowers need in order to take advantage of their options to keep their homes, and what servicers need in order to carry out their responsibilities.

We have a series of steps that we require servicers to take when borrowers fall behind on their mortgages and need help—and sometimes even before they miss a payment.

Let me briefly walk through these steps.

First, we require servicers to determine whether the borrower qualifies for a HAMP modification, which will take their monthly payment to a level where their first-lien mortgage debt-to-income ratio is 31 percent. These modifications can cut hundreds of dollars from their monthly loan payments. HAMP also offers modification for second-lien loans to bring the entire mortgage payment down to a more affordable level.

Then, if the borrower doesn't qualify for HAMP, we require the servicers to determine what kind of hardship the borrower is facing—is it a short-term hardship, caused by, for example, medical bills? Or is it a long-term hardship, such as a reduction in income?

If the borrower is facing a *short-term hardship,* then a servicer is required to offer forbearance or a repayment plan. We permit up to 6 months of payment relief for homeowners who are struggling to make their mortgage payments because of unemployment.

If the borrower is facing a *long-term hardship,* then we require servicers first to offer a HAMP modification. Then they may offer a non-HAMP modification that may take the borrower's debt-to-income ratio down to 24 percent without requiring the borrower to pay down bank credit cards and other debt.

If none of these modification plans can help the borrowers afford their loans, then servicers are required to offer the borrowers several options that will help the borrower to avoid foreclosure.

These foreclosure alternatives include short sales, where the lender permits the borrower to sell the property at a price that is less than the mortgage debt, and deeds-in-lieu of foreclosure, where the borrower essentially deeds the home back to the lender. For deeds-in-lieu, the borrower is also offered a financial incentive to help them relocate to alternative housing under these circumstances, and we offer to rent homes back to borrowers.

While it can be difficult for homeowners to relinquish their homes through short sales or deeds-in-lieu of foreclosure, these options ultimately are much better for the borrower over the long run than foreclosure. The borrower is taking action rather than getting locked out of the home, there is less impact on the borrower's credit, and the borrower increases his ability to finance a home in the future.

For example, Fannie Mae has changed our underwriting guidelines for borrowers who work with their servicers and take advantage of our foreclosure alternatives. If they do, they could qualify for a new Fannie Mae-backed mortgage in 2 to 3 years.

We were also the first to put policies in place to protect renters—more than 6,000 of whom have been able to continue to live and rent their homes or apartments.

We provide financial incentives to servicers who are successful in getting a borrower to enter into a foreclosure-alternative program. We do not pay any incentive fees unless the servicer completes a workout.

An important element of these foreclosure-prevention alternatives is robust borrower-outreach and education. It is in everyone's best interest to ensure borrowers understand their options and take advantage of the help that is available. This outreach and education can help borrowers work more effectively with their servicers and avoid scams that unfortunately have arisen in this difficult time.

Even though the servicers are responsible for borrower contact, Fannie Mae has rolled out a number of initiatives to help borrowers understand their options and take advantage of available foreclosure alternative programs when working with servicers. Let me name just a few of these initiatives:

In August this year, we launched *KnowYourOptions.com*—a consumer Web site that explains every option we have available to avoid foreclosure in both English and Spanish. This interactive Web site urges the borrower to take action and provides contact information for U.S. Housing and Urban Development-approved housing counselors and mortgage servicers. So far the site has had over 100,000 unique visitors and has been well-received by independent reviewers and industry experts.

We're opening Fannie Mae Mortgage Help Centers where we are experiencing seriously delinquent loans in the hardest hit markets around the country. These Centers enable Fannie Mae borrowers to walk in and receive counseling, provide documentation of their hardship and financial documentation to allow them to be considered for a modification without the fear of the documents getting lost. We also establish a single point of contact to work with the borrower until his or her situation is resolved. We've opened these centers so far in Miami, Chicago, Atlanta, Los Angeles and Phoenix, and have plans to open more centers in Dallas, Philadelphia, Jacksonville and Tampa.

We also have arrangements with counseling agencies—in Orlando and Homestead, Florida, Cleveland, Las Vegas, Detroit and Fort Worth—that work on our behalf to counsel borrowers and assist with preparation of modification related documents, all with a single point of contact. We anticipate expanding these efforts even further over the coming months.

In addition, we've joined with Treasury to hold borrower outreach events nationwide in hard-hit communities. So far we've supported Treasury's events in 49 cities and had nearly 50,000 visitors.

We're also taking steps to make sure Fannie Mae borrowers who do reach out to their loan servicers get the response and help they need.

In the event that Fannie Mae borrowers feel their servicers are not properly addressing their mortgage needs, they can contact Fannie Mae's call center where cases are reviewed by our "Second Look" team.

We have learned from experience during the past 2 years that hand offs in the workout process lead to borrower confusion and costly delays. We have informed servicers of what we have learned and a few of them are voluntarily moving to deploy a single-point-of-contact model. We're in the process of changing our policy to require all servicers to use this approach. Our efforts to help borrowers are gaining traction. Since the start of 2009, we've helped more than 600,000 Fannie Mae borrowers avoid foreclosure by completing more than 410,000 modifications; 90,000 repayment plans, forbearance plans and other help for temporary hardships; and nearly 100,000 foreclosure alternatives—short sales and deeds-in-lieu of foreclosure.

While these foreclosure prevention measures are intended to include every borrower that needs help, unfortunately not every borrower can be helped.

Some borrowers simply do not reach out for help despite all efforts to educate them about their options and make right-party contact. Some properties are owned by investors who got overextended. Some borrowers simply carry too much non-mortgage debt or do not have sufficient income to make even modified mortgage payments.

In spite of all our efforts to keep people in their homes, unfortunately there will be foreclosures.

When there is no choice but to foreclose on a mortgage, once the property comes onto our inventory, we work expeditiously to maintain and repair the properties and sell them to new homeowners. Our policy is to first find people who will live in the homes because owner occupancy tends to help stabilize neighborhoods.

One of our neighborhood stabilization initiatives is called "First Look." It gives buyers who intend to live in the homes, and public entities that want to create affordable housing, a 15-day head-start on buying the properties before investors can buy them. We also offer both the buyers and the real estate agents financial incentives in these owner-occupant transactions. Our Web site listing of homes in our inventory, called *Homepath.com,* includes a countdown number on each property indicating how many days remain in the First Look grace period.

Since inception through October of this year, we have sold more than 35,000 Fannie Mae properties through First Look, and we plan to ramp up that number in the coming year.

In summary, we're taking aggressive steps to ensure that servicers provide borrowers with alternatives to foreclosures and reduce the impact of the housing and economic crisis on families, communities, the economy and taxpayers. Foreclosure prevention is a top priority for our company. We have much work ahead of us, and we are fully committed to getting it done.

Servicer assistance, accountability and enforcement

Let me now return to the critical role of servicers in this process.

As I noted earlier, our success depends on the efforts of the banks and financial institutions in the mortgage servicing industry. Their role is a critical element in addressing the foreclosure crisis and in some of the issues that have arisen recently.

In describing the role of servicers, I would like to quote the Acting Director of the Federal Housing Finance Agency (FHFA), Edward DeMarco, in his Congressional testimony on November 18, 2010. He stated:

> When an Enterprise purchases a mortgage from an originating lender, it contracts with that lender or another bank or financial institution to service the loan. The servicer is the main communication point for the borrower, accepting all payments and crediting the borrower's account.
>
> When homeowners get behind in payments, the servicer is expected to work with the delinquent borrower to set up a repayment plan, modify the loan, or, if foreclosure alternatives are not viable, begin foreclosure proceedings. Although the Enterprises hold the actual promissory notes through document custodians who maintain these records separate from the servicers, Fannie Mae and Freddie Mac do not themselves accept or process payments or move to modify or foreclose.
>
> For their work, the servicers get paid by the Enterprises and, under the terms of their contracts, each servicer is obligated to follow the procedures established by the Enterprise, including compliance with all appropriate laws.

To put it another way, Fannie Mae has a vested interest in ensuring that our borrowers get help. But we must rely on our loan servicers, who have a binding, contractual obligation to meet our servicing guidelines and help borrowers take advantage of our foreclosure-prevention options.

Servicers have acknowledged that they have struggled to carry out their role and keep up with the volume of borrowers who need help. Fannie Mae continues to take a number of steps to help servicers meet our guidelines and get the job done.

First, we pay servicers an incentive based on the type and number of modifications they successfully complete. Let me reiterate my earlier statement—servicers receive an incentive *only* if they complete a workout—we do not provide any financial incentive to foreclose.

Second, we have about 200 Fannie Mae personnel dedicated to managing our servicer relationships. Many are on the ground at servicer shops working with their personnel to answer questions, help them understand our guidelines and options for borrowers and to escalate issues as they arise.

Third, we conduct monthly meetings with leadership of servicers. We provide extensive training through live Web seminars, recorded tutorials, checklists and job aids. We are in constant contact with our servicers, listening to their suggestions and offering our own as to how the process can be made better.

In short, we strive to do everything possible to ensure that our servicers carry out their responsibilities to help struggling borrowers.

We also hold servicers accountable for carrying out their responsibilities. We evaluate individual servicers' strengths and weaknesses on a monthly basis. In some cases when our servicers cannot meet their obligations, we will transfer the servicing to specialty servicers that can do the job more efficiently and effectively.

Finally, I would like to address the issue known as "dual tracking"—where borrowers may receive foreclosure notices while their loan modification applications are in process.

Let me clarify Fannie Mae's policy. Borrowers are on a single track—the home-retention workout track—until they are more than 3 months behind on their mortgages. During this 3-month period, which can be even longer if a modification is in progress, our servicing guide permits servicers to delay putting a loan into the foreclosure process. Servicers may begin the foreclosure process in fewer days if the borrower is not communicating regarding a modification or foreclosure alternative.

We set a timeline for the servicers for an important reason—the modification or workout process needs to be completed in a timely way. The longer the process takes, and the further in arrears the borrower becomes, the less likely it is that the borrower will succeed with a modification—and the greater potential there is for loss to Fannie Mae and the U.S. taxpayer.

We know from our research that loans worked out earlier, rather than later, in the process are much more likely to succeed. On the other hand, each payment the borrower misses increases the likelihood of foreclosure.

To summarize our approach to servicers and borrowers, the home-retention process functions properly when all participants in the process do their parts:

The borrower needs to reach out to the servicer as soon as he or she has a hardship. The borrower also needs to answer and return calls from the servicer and provide all of the financial and hardship documentation the servicer needs to verify the borrower's situation.

The servicer needs to assign one person for the borrower to work with who is accountable for that borrower until a resolution is reached.

And Fannie Mae provides an array of solutions the servicer can offer the borrower, balancing the need to help as many borrowers as possible while being responsible stewards of public funds.

Foreclosure process issues

Finally today, let me address what Fannie Mae is doing about the foreclosure process issues that the Committee has reviewed during recent hearings, including servicers misapplying payments, losing documents, and most recently using "robo-signers" to execute foreclosure-related affidavits.

When servicers do not properly follow Fannie Mae guidelines and meet their contractual obligations, we take those failures very seriously, and we act to address them.

With respect to the recent foreclosure affidavit issue, Fannie Mae's guidelines require that servicers comply with all applicable laws and regulations when foreclosing on a property securing a loan that we own. Specifically, servicers are required under law to submit affidavits in connection with foreclosure proceedings in a number of states, primarily those that have a judicial foreclosure process. These affidavits are subject to the law of individual states, which generally requires the signer to State in the affidavit that he/she has "personal knowledge" of the facts set forth in the affidavit. The affidavit typically must be signed in the presence of a notary.

Following reports that some servicers did not follow proper procedures in the administration of the foreclosure process, we have taken a number of remedial steps:

We have issued guidance to our servicers instructing them to review their policies and procedures relating to the execution of affidavits, verifications, and other legal documents in connection with the foreclosure process.

We are also coordinating with FHFA to seek appropriate corrective actions that are in line with the four-point policy framework issued by FHFA on October 13, 2010, which calls for actions to 1) verify the process; 2) remediate the actual problem; 3) refer suspicion of fraudulent activity; and, 4) avoid delay.

We are tracking delays in order to be in a position to demand indemnification from servicers that breach the requirements. We are in continuous contact with servicers in order to track and oversee their progress.

We have a number of remedies we may exercise against servicers that do not service loans in accordance with our requirements. We have the right to require servicers to repurchase the loans they improperly serviced, or to pay us damages based on delays caused by their actions. We have reiterated with servicers their contractual obligations to us for failing to comply with applicable laws and the foreclosure process delays. We are preparing to pursue servicers for compensatory fees for the costly delays we and the taxpayers are incurring as a result of their failure to meet their servicing responsibilities.

On another front, we are closely monitoring the work performed by our Retained Attorney Network. This is a network of law firms across the Nation that we have approved to handle our foreclosure proceedings. We established the network in 1997. In 2008 we expanded the network and made it mandatory for the handling of Fannie Mae foreclosure cases in 31 jurisdictions. We are now expanding it to all 50 states.

Having the retained attorney network allows us to improve our oversight and management of both the servicers and the attorneys' actions during the default process. The network provides the framework to hold the attorneys accountable for their performance while giving us the authority to provide guidance to the firms, implement new policies and cost-saving structures, and audit actions by the firms.

Firms are selected based on their experience, commitment to diversity and in many cases based on recommendations by servicers.

We expect all cases to be handled in accordance with local law and practice, as well as the ethics rules of the applicable bar association. When we become aware that the law firms fall short of our standards or these requirements, we take action.

For example, through an internal review of some of the firms handling the foreclosure process for our servicers in Florida, we confirmed allegations of issues with one of the law firms in our network. Working with FHFA, we terminated our relationship with that firm. Simultaneously, we expanded our approved attorney network in Florida to address capacity needs. We're also enhancing oversight of our approved attorney network.

It is important to note that servicers, in their contractual duties to manage the foreclosure process, are required to oversee the day-to-day activities of the law firms handling our foreclosure and bankruptcy cases. We have taken a number of steps this year to establish a more robust regimen for monitoring our approved attorney network to ensure compliance with proper procedures and operations.

These steps include frequent onsite monitoring and in-depth training. We currently have more than 40 Fannie Mae personnel assigned to monitoring the network.

This year, we hired a third-party law firm to perform audits of the firms in our approved network on a regular basis. We focused those audits on items such as proper pleading of ownership of the loan and compliance with local practice with respect to charging of fees and costs. The third-party firm has completed preliminary audits of the Florida firms and also those in California, and is in the process of auditing the Georgia, New York and Michigan retained attorney firms. We also hired an additional third-party firm to review the foreclosure process generally to identify any high risk areas where we face legal, financial, or reputational risk. The third-party firm will examine all inputs to the foreclosure process for which the firms are receiving data and documentation from external stakeholders. Our oversight and audit function will continue to evolve as we identify issues and develop best practices.

Let me make a final point about the foreclosure process and the role of attorneys and servicers. Completion of the foreclosure process involves the coordination between the mortgage servicer and the foreclosure attorney. Fannie Mae set policies and guidelines to which both parties must adhere. In cases where the servicer fails to perform, Fannie Mae would be entitled to damages related to the delays. Our strategy has been to work with the servicer and the attorney to encourage them to perform.

We have found that we can be most helpful when there is a commitment from the servicer's management to perform and there is adequate staffing. We are urging our servicers to strengthen both management commitment and staffing.

Securitization Trusts—Chain of Title

There have been reports of various issues involving private-label securities, including mortgage document chain of title issues that call into question whether the foreclosing party had proper legal authority to foreclose. We do not believe that this problem exists for Fannie Mae securities.

The manner in which Fannie Mae requires sellers to transfer mortgage notes and mortgages to our company, and in which we further transfer those mortgage loans to MBS trusts, is based on established law. Fannie Mae's practice with regard to the transfer of mortgage notes is designed to ensure an unbroken chain of assignments to Fannie Mae from the originating lender.

In addition, Fannie Mae requires that the original note be delivered to Fannie Mae-approved custodians. As part of the acquisition process, the custodian certifies that the note has been received, contains the proper endorsement, and that other additional requirements have been met. The custodian maintains the note and related documents on Fannie Mae's behalf in a vault meeting specific fire and security requirements.

Repurchases

The Committee also has asked about our loan repurchase requests to lenders. We conduct reviews of delinquent loans and, when we discover loans that do not meet our underwriting and eligibility requirements, we require lenders to repurchase these loans or compensate us for losses sustained on the loans. We also require lenders to repurchase or compensate us for loans for which the mortgage insurer rescinds coverage.

In 2009 and during the first 9 months of 2010, the number of repurchase and reimbursement requests remained high. During the third quarter of 2010, lenders repurchased from us or reimbursed us for losses on approximately $1.6 billion in loans, measured by unpaid principal balance, pursuant to their contractual obligations.

As of September 30 of this year, we had outstanding requests for lenders to repurchase from us or reimburse us for losses on $7.7 billion in loans, of which 36 percent had been outstanding for more than 120 days.

Many servicers work with us to resolve repurchase requests. When they do not, we are working to recover these payments in accordance with our contractual rights.

Conclusion

In conclusion, Fannie Mae is committed to balancing its dual role—to help struggling homeowners avoid foreclosure, and be responsible stewards of the public funds that support our work and make it possible to reduce foreclosures.

The good news is that the more foreclosures we can prevent, the more taxpayer funds we can save.

To date, we have helped hundreds of thousands of struggling homeowners across the country stay in their homes or avoid foreclosure. This progress shows that foreclosure prevention efforts can and do work. And when they do, it is victory for everyone—the homeowner, the neighborhood, the industry and the nation. We also recognize, however, that not every foreclosure can be avoided.

If we can motivate borrowers to work with their servicers, get servicers to help them through the broad range of solutions available today, we can help more families keep their homes and work through this very challenging housing crisis.

That is Fannie Mae's job. We know we have much more work to do, and we are committed to getting it done. We welcome and appreciate the thoughts and guidance of the Committee, as we move forward with our vital mission to help America's housing market.

PREPARED STATEMENT OF DONALD BISENIUS

EXECUTIVE VICE PRESIDENT

SINGLE FAMILY CREDIT GUARANTEE BUSINESS, FREDDIE MAC

DECEMBER 1, 2010

Chairman Dodd, Ranking Member Shelby, and Members of the Committee: thank you for inviting me to speak today on servicing and foreclosure issues. I am Don Bisenius, head of Freddie Mac's Single Family Credit Guarantee Business. I have been with Freddie Mac since 1992. In my current role, I oversee the sourcing, pricing, securitization and performance of single-family mortgages we purchase.

Today's hearing raises important issues about the integrity of the mortgage origination, securitization and servicing processes. To understand Freddie Mac's role in these processes, the Committee should consider the following:

- Freddie Mac currently owns and guarantees approximately 12.4 million single-family mortgages. In both the acquisition and ongoing servicing of these loans, Freddie Mac relies on its sellers and servicers. We don't originate loans, and we don't service loans. Rather, Freddie Mac provides guidelines for the origination and servicing of our loans, and contracts with sellers and servicers to carry out these operations. Institutions conducting these activities with respect to Freddie Mac loans represent and warrant to us that they are following our contractual requirements. Failure to fulfill these obligations creates a liability for either the originator or the servicer, including the possibility that they will be required to repurchase the loan. Freddie Mac actively requires repurchases of mortgages sold to us in violation of representations and warranties, as appropriate. We pay the servicing industry about $5 billion per year to service our mortgages.

- Freddie Mac expects servicers of our loans to treat borrowers fairly, with respect, and in full compliance with all applicable laws, regulations and Freddie Mac policies. No homeowner with a mortgage owned or guaranteed by Freddie Mac should ever worry about losing his or her home to an unnecessary or wrongful foreclosure.
- While Freddie Mac currently owns almost 25 percent of total single-family mortgages outstanding in our nation, we own less than 10 percent of seriously delinquent loans (90 days or more past due). Freddie Mac owns fewer than 500,000 seriously delinquent mortgages, compared to approximately 5 million across the mortgage industry. Freddie Mac's disproportionately small share of seriously delinquent mortgages directly results from our low mortgage delinquency rates relative to the mortgage industry as a whole. As of September 30, 2010, our single-family serious delinquency rate was 3.8 percent—less than one-half of the mortgage industry average of 8.7 percent. Our ability to assist troubled borrowers is limited to this small share of seriously delinquent loans we own.
- Freddie Mac has long had policies and initiatives in place to help financially troubled borrowers avoid foreclosure. In response to the unprecedented mortgage default crisis, we have created additional servicer incentives and loss mitigation options. In addition to $5 billion that Freddie Mac pays servicers each year for managing the servicing process, we offer additional financial incentives for servicers to avoid foreclosure, pay credit counselors to work with at-risk borrowers, and even had an initiative for door-to-door contact of borrowers who are behind on their mortgage payments to inform them of options for resolving their delinquency. Since the beginning of 2009, we have helped nearly 370,000 families avoid foreclosure. Through the first 9 months of 2010 alone, nearly 211,000 delinquent borrowers with Freddie Mac-owned or guaranteed mortgages avoided foreclosure—nearly twice the 114,000 who were foreclosed on. The number of loan modifications alone during the first 9 months of this year (132,000) exceeded foreclosures. At the same time, we recognize more remains to be done to help at-risk families.
- The length of time for the average foreclosure of a Freddie Mac loan indicates that borrowers are not being rushed through the foreclosure process. We require our servicers to seek to resolve borrower delinquencies through a variety of foreclosure alternatives offered by both the Obama administration's Making Home Affordable Program and Freddie Mac's traditional foreclosure avoidance initiatives. However, if the borrower's delinquency cannot be cured by these methods, servicers must move ahead with foreclosure to minimize further financial risk to taxpayers. Currently the nationwide average for completion of a foreclosure on a delinquent mortgage owned or guaranteed by Freddie Mac is 449 days, and borrowers whose properties are foreclosed are behind on their payments, on average, well over 1 year.

Freddie Mac's support of the housing market during the crisis

Freddie Mac is both mindful and appreciative of the Federal financial support we have received, and as an institution in conservatorship, we are highly focused on being good stewards of this support. Accordingly, I would like to begin by briefly summarizing how, throughout the worst housing and financial crises since the Great Depression, Freddie Mac has provided a stable and constant source of mortgage funding for our nation. From the beginning of 2009 through October 2010, Freddie Mac purchased or guaranteed $864 billion in mortgage loans and mortgage-backed securities. Our purchases have helped 3.9 million American families own or rent a home. This includes 2.7 million homeowning families who have been able to refinance into lower rate mortgages—saving those families $5.2 billion annually.

Together with Fannie Mae, we have provided the vast majority of conventional mortgage liquidity during the past 2 years as other sources of capital have left the market. With continued weakness in the housing sector, our support remains critical. During the third quarter of 2010, Freddie Mac and Fannie Mae purchased or guaranteed about 70 percent of mortgage originations. FHA comprised most of the remainder of the market.

As we have maintained liquidity in the residential mortgage market, we believe the credit quality of the single-family loans acquired in 2009 and the first 9 months of 2010 (excluding relief refinance mortgages) is better than that of loans acquired from 2005 through 2008 as measured by original LTV ratios, FICO scores, and income documentation standards. We are working together with our regulator and conservator, the Federal Housing Finance Agency (FHFA), and our mortgage lending partners to strengthen the foundation of responsible lending practices to produce better quality loans. Our goal is to create sustainable homeownership opportunities for America's families, ensure fewer unexpected costs for our lenders, drive better loan performance, and reduce Freddie Mac's dependence on taxpayer dollars. While these and other changes involve costs for the lender—and in some cases, tighter credit requirements for borrowers—we believe they are essential to placing the housing finance system on a better foundation going forward.

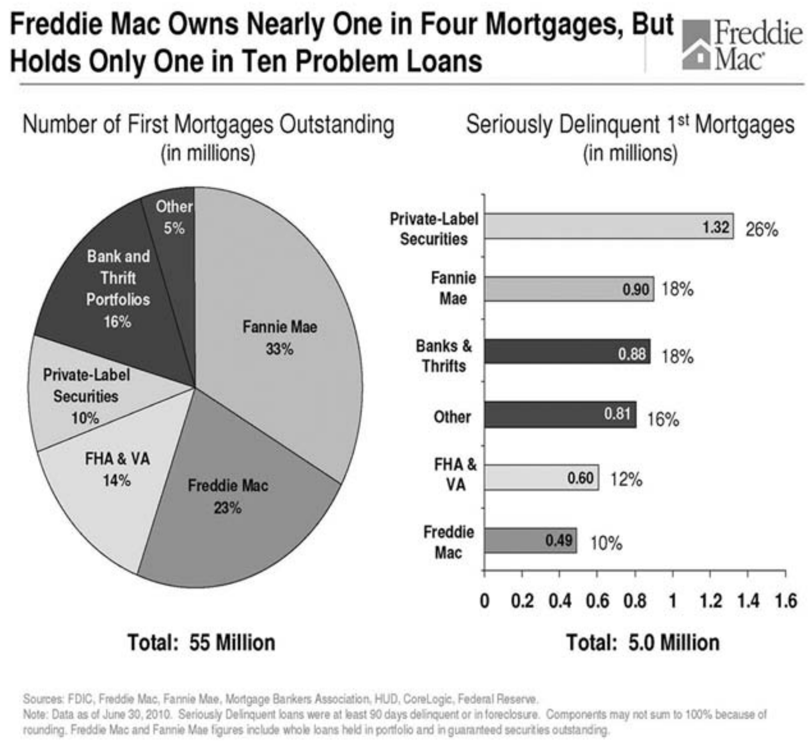
Freddie Mac continues to help families avoid foreclosure

Helping financially troubled families avoid foreclosure is the right thing to do for homeowners and communities, and it reduces losses to Freddie Mac. Since the beginning of 2009, we have helped nearly 370,000 families facing financial hardship to keep their homes or sell their properties, through both our own foreclosure avoidance initiatives and the Making Home Affordable (MHA) programs, such as the Home Affordable Modification Program (HAMP). During the first 9 months of this year, more than 121,000 Freddie Mac-owned loans were modified through HAMP.

Additionally, we have enabled nearly 223,000 homeowners to refinance into lower-cost mortgages through MHA's Home Affordable Refinance Program (HARP). HARP was designed to assist borrowers who have remained current on their mortgage obligations but have been unable to refinance because the values of their homes have declined. Borrowers with mortgages up to 125 percent of the current value of their homes are eligible for refinancing through HARP. The program enables financially stressed borrowers to reduce their monthly mortgage payments by refinancing into lower rate mortgages, fixed-rate mortgages, or mortgages with longer terms. As a result of HARP, fewer borrowers fall behind in their mortgage payments in the first place.

We provide our servicers with a variety of financial incentives to resolve borrower defaults by means other than foreclosure, including forbearance, repayment plans, loan modifications, short payoffs, make-whole pre-foreclosure sales and deeds-in-lieu of foreclosure. The result is that during the first 9 months of 2010, delinquent borrowers with Freddie Mac-owned or guaranteed mortgages were more likely to receive loan modifications (132,000) than to lose their homes to foreclosure (114,000). Nearly 211,000 borrowers in total avoided foreclosure during the first 9 months of this year—184,000 through home retention actions including modifications, repayment plans and forbearance agreements, and 27,000 through short sales and deed-in-lieu transactions. Freddie Mac has long been recognized as an industry leader in identifying and addressing delinquencies before they become foreclosures, and in devising ways to identify, contact and help delinquent borrowers navigate the loss mitigation process. In addition to helping borrowers through our loss mitigation tools, for years, we have worked closely with national nonprofits to educate borrowers about foreclosure prevention and mortgage fraud. We support these efforts through a number of online resources, including an award-winning financial literacy curriculum. We have also sponsored targeted marketing campaigns, in-home counseling, walk-in community events and permanent help centers. Our goal is to foster a strong communication link between the borrower and the servicer, which is critical to successful home retention and loss mitigation.

As noted earlier, Freddie Mac's ability to stem the tide of foreclosures on our own is limited, simply because we own a small proportion of seriously delinquent mortgages. As the chart below shows, Freddie Mac owns or guarantees nearly one-quarter of outstanding first mortgages but only one-tenth of seriously delinquent loans. Freddie Mac's disproportionately small share of seriously delinquent mortgages directly results from our low mortgage delinquency rates relative to the mortgage industry as a whole. As of September 30, 2010, our single-family serious delinquency rate was 3.8 percent—less than one-half of mortgage industry average of 8.7 percent. When loans owned or guaranteed by Freddie Mac and Fannie Mae are excluded, the industry's serious delinquency rate rises into double digits.



The role of Freddie Mac's servicers and our relationship with them

Like most other mortgage investors, Freddie Mac is not a servicer. Instead, we contract with either the mortgage originator or another financial institution to service the mortgages we purchase. In general, servicers collect loan payments from the borrowers and remit them to Freddie Mac each month. They are paid for their services on a monthly basis by retaining the difference between the interest rate on the note and the interest rate paid to Freddie Mac. This difference, commonly known as the "servicing spread," averages one-quarter of 1 percent (25 basis points). In the aggregate, the servicing industry is paid about $5 billion per year to service Freddie Mac-owned or guaranteed mortgages.

As discussed above, servicers' duties also include working with borrowers who fall behind in making payments on their mortgages. In the event that loss mitigation efforts are unsuccessful and there is no reasonable likelihood of curing the borrower's delinquency by means other than foreclosure, servicers must finalize foreclosure in accordance with our timelines and begin helping the borrower transition out of homeownership. At that point, we must place greater emphasis on minimizing further financial risk to taxpayers. In recent years, our foreclosure timelines have been extended to allow for additional months of loss mitigation activities, and under current standards, borrowers who lose their homes to foreclosure are behind on their payments, on average, well over a year prior to the completion of a foreclosure sale.

Freddie Mac sets forth a comprehensive set of requirements for servicers in our Seller/Servicer Guide ("the Guide"). The Guide provides detailed instructions and guidelines for servicing both performing and non-performing mortgages, including the compensation and incentives paid to servicers. Notably, the Guide also requires servicers to fully comply with all applicable laws relating to the mortgages they service.

Freddie Mac owns or guarantees millions of mortgages, and we rely primarily upon the contractual representations and warranties provided by servicers that their activities and actions are in full compliance with our requirements. We conduct targeted reviews of servicers that focus on evaluating processes, procedures, and controls. We also have a dedicated team that provides support and guidance to servicers as needed.

If a servicer is found to be in violation of the Guide, we have a number of remedies at our disposal. Our response in most cases is to require servicers to correct identified violations of Guide requirements and/or deficiencies in their operations, and to reimburse us or indemnify us for our losses. As circumstances warrant, we also have the option of imposing financial penalties on servicers, issuing a repurchase request for the loan, or, in extreme cases, suspending or terminating a servicer's contract to service Freddie Macowned mortgages and transferring the loans to other servicers.

Requiring servicers to meet their obligations under HAMP

Freddie Mac requires that servicers seek a HAMP modification for HAMP-eligible delinquent borrowers with Freddie Mac-owned loans before foreclosing on the property. To monitor servicers' compliance with this obligation, Freddie Mac conducts operational reviews of selected servicers. In these reviews, Freddie Mac conducts interviews with the appropriate servicer employees, and then tests a sample of loans in various stages of default. Freddie Mac requests and reviews the applicable records (collection, loss mitigation, foreclosure, bankruptcy) for each sample loan. We then determine whether the servicer properly determined eligibility and solicited the borrower for a HAMP modification and whether the servicer followed the correct steps (including retaining applicable documentation) throughout the process.

Freddie Mac's response to foreclosure process deficiencies

Recent reports of improperly executed affidavits and faulty notarizations have raised serious concerns about the integrity of the foreclosure process. Freddie Mac is deeply concerned by these reports and, in coordination with FHFA, we are working with our servicers to address these issues.

On October 1, we instructed all our servicers to review their processes to determine whether documents used in foreclosures on Freddie Mac-owned mortgages are being executed in accordance with applicable laws. We are requiring servicers who have identified deficiencies in their foreclosure documentation to remediate the deficiencies. We also are continuing to determine the extent and scope of this problem, including the total number of loans that may be affected. It is critical to note, however, that all servicers who have identified documentation problems have determined the underlying information within the documents is correct, *i.e.,* the indebtedness amounts as presented to the court in each case in support of the foreclosure are accurate. The problem appears to have largely been that the individual executing the affidavit did not have personal knowledge of the facts described in the affidavit even though the affidavit said he or she had such knowledge.

Freddie Mac will continue to work with FHFA and our servicers to require that the foreclosure process is conducted appropriately and in compliance with applicable laws, and that borrowers' rights are fully protected.

Freddie Mac's use of law firms in foreclosure proceedings

In 1994, Freddie Mac established our Designated Counsel Program to manage the costs and quality of essential legal services involved in taking a property through foreclosure. Today, the program operates in 20 states.

Law firms are selected for inclusion in the program based on their demonstrated abilities to handle foreclosures and other legal work in a professional, efficient and cost-effective manner. We expect our lawyers to conduct their practices in accordance with applicable legal and ethical requirements.

In response to recent reports that some law firms handling foreclosure cases may have failed to follow appropriate legal standards in preparing or filing documents used in the prosecution of foreclosure cases, Freddie Mac on October 15 directed all firms in the Designated Counsel Program to review their processes regarding the preparation and execution of such documents and the integrity of the contents of those documents, and to notify Freddie Mac of any deficiencies found. Our reviews of these firms remain ongoing.

Freddie Mac recently terminated the participation of the Law Offices of David J. Stern, P.A., in the Designated Counsel Program, resulting from our review of the firm's processes following reports of certain deficiencies in its operations. We have instructed our servicers to no longer refer cases to the firm, and we have placed cases previously assigned to this firm with new counsel.

Document custody

Concerns have been raised about the custody of mortgage notes and other documents. When a mortgage is sold to Freddie Mac, the seller must deliver the original note for each mortgage loan, together with any power of attorney or modifying instrument (such as a modification agreement, conversion agreement, assumption of liability or release of liability agreement), to a document custodian, which holds the documents in trust for Freddie Mac. Currently, Freddie Mac uses approximately 125 document custodians, with much of the volume concentrated in a relatively small number of large companies.

Our Guide sets forth eligibility standards and various other requirements for document custodians. Each document custodian enters into a tri-party custodial agreement with Freddie Mac and the servicer that is servicing a mortgage for which the custodian holds note files. Each document custodian files an annual certification report to Freddie Mac, and is required to notify Freddie Mac between reports of any significant personnel, operational or financial changes. Freddie Mac also conducts periodic onsite reviews of document custodial operations.

Dual track

Numerous concerns have been raised in this Committee and elsewhere about pursuing loan modifications or other alternatives to foreclosure while also moving forward with the foreclosure process. These concerns arise from widespread reports of delinquent borrowers receiving foreclosure notices from their servicers as they are being considered for loan modifications. As a result, some policymakers have expressed a desire to end this “dual track” process and allow servicers to initiate foreclosure actions only after all other resolution options have been exhausted. While we believe that borrowers who already are under significant stress arising from their financial situations should not be subjected to needless confusion, we also believe that unnecessary delays in an already lengthy foreclosure process would be counterproductive.

Contrary to popular impression, foreclosures are a very lengthy process, and Freddie Mac’s requirements do not result in rushing delinquent loans to foreclosure. Freddie Mac requires servicers to contact borrowers at the first indication of a problem, starting when a payment has not been received 10 days after the due date—20 days before the borrower becomes delinquent. Foreclosure proceedings are instituted 120 days following a missed payment, and under our guidelines servicers continue to consider borrowers for workouts until the foreclosure sale. Currently, the nationwide average number of days from the initiation of a foreclosure action to a foreclosure sale for a mortgage owned or guaranteed by Freddie Mac is 449 days. In states with judicial foreclosures, the average currently is 565 days.

Freddie Mac also gives servicers the authority to stop or suspend a foreclosure action whenever there is an opportunity for a viable workout, short sale or deed-in-lieu of foreclosure as a result of verifiable changes in the borrower’s financial situation. Our servicers have had this authority for more than 20 years.

The dual track process allows for a delicate balance between the need to minimize losses and protect communities while protecting borrower interests. Lengthy foreclosure delays impose substantial losses on Freddie Mac and taxpayers—by some estimates, $30–$40 per day and $10,000 to $15,000 per year for every defaulted loan. These costs do not include additional losses resulting from depreciation in the value of the property. Furthermore, delays in foreclosures can lead to increased property blight, reduced neighborhood property values, and loss of revenues for local governments, utilities and homeowners associations.

The dual track process enables commencement of the foreclosure process, so that in those cases in which non-foreclosure alternatives are determined to be not viable for the borrower, the servicer can move forward with the foreclosure as expeditiously as possible, reducing losses to Freddie Mac and, ultimately, taxpayers. It is important to note that the dual track process leaves sufficient time both before and after the initiation of a foreclosure action to explore foreclosure alternatives, and even after the foreclosure process begins, it remains in everyone’s interest—including Freddie Mac’s—to keep viable homeowners in their homes. For this reason, we believe it is not in the borrower’s interest for the process to drag on indefinitely. The longer the borrower’s delinquency goes uncured, the farther behind he or she gets and the harder it becomes to bring the loan current.

At the same time, I want to emphasize that we do recognize how confusing and distressing it can be for borrowers to receive what appear to be mixed messages from their servicers. We want to work with the industry to find a way to improve communication and minimize confusion for borrowers.

Conclusion

In conclusion, I would like to reiterate Freddie Mac's full commitment to seek alternatives to foreclosure; to require that financially troubled borrowers are treated in accordance with the law and set expectations for servicers to make every effort to treat borrowers fairly, with respect; and, most of all, make certain that no borrower with a mortgage owned or guaranteed by Freddie Mac should ever lose his or her home to an unnecessary or wrongful foreclosure.

Thank you again for this opportunity to testify today.

American SECURITIZATION FORUM®

Statement of:

Tom Deutsch
Executive Director
American Securitization Forum

Testimony before the:

United States Senate Committee on Banking, Housing and Urban Affairs

Hearing on:

Problems in Mortgage Servicing from Modification to Foreclosure, Part II

December 1, 2010

One World Financial Center, 30th Floor ▪ New York, NY 10281 ▪ 212.412.7100 ▪ www.americansecuritization.com

Chairman Dodd, Ranking Member Shelby, Members of the Committee, my name is Tom Deutsch and as the Executive Director of the American Securitization Forum, I appreciate the opportunity to testify here today on behalf of the 330 ASF member institutions who originate the collateral, structure the transactions, serve as trustees, trade the bonds, service the loans and invest the capital in the preponderance of residential mortgage- and asset-backed securities ("RMBS") and ("ABS") in the United States, including those backed entirely by private capital as well as those guaranteed by Ginnie Mae and the government sponsored enterprises ("GSEs") such as Fannie Mae and Freddie Mac.

In this testimony, we seek first to highlight some of the key aspects of securitization as well as its importance to the U.S. and global economy. Subsequently, we seek to address the concerns raised by a few commentators that the banking and housing markets may be subject to additional systemic risk because securitization trusts may not actually own the trillions of dollars of mortgages that are supposed to be contained within those trusts. In addition to introducing the white paper that ASF issued two weeks ago, we also examine a number of the new concerns that have been raised since the introduction of that white paper. In particular, we discuss and provide detailed background for four key components of valid loan transfers, including:

A. PSAs meet the requirement for a "complete" or "unbroken" chain of indorsement[1];

B. securitization trusts comply with New York trust law;

C. RMBS trusts effectively achieve REMIC status; and

D. mistakes do not affect validity of transfer.

[1] Note that the Uniform Commercial Code replaces the more common U.S. spelling of "endorsement" for the less common "indorsement." The UCC spelling is used throughout this testimony for consistency.

Ultimately, we find that the conventional process for loan transfers embodied in standard legal documentation for mortgage securitizations has been adequate and appropriate to transfer ownership of mortgage loans to the securitization trusts in accordance with applicable law and contract. Since loan transfers have generally been effective, all of the dire consequences that a few commentators have speculated on fade away, given the faulty premise that they start from. Moreover, a number of the concerns that have been raised that securitization professionals have uniformly opted out of use of laws such as the Uniform Commercial Code ("UCC") to set a higher bar for transfers, but then subsequently and systematically failed to meet that higher bar, appear on their face to be illogical assertions and patently false.

I. Role and Importance of Securitization to the Financial System and U.S. Economy

Securitization—generally speaking, the process of pooling and financing consumer and business assets in the capital markets by issuing securities, the payment on which depends primarily on the performance of those underlying assets—plays an essential role in the financial system and the broader U.S. economy. Over the past 40 years, securitization has grown from a relatively small and unknown segment of the financial markets to a mainstream source of credit and financing for individuals and businesses alike.

In recent years, the role that securitization has assumed in providing both consumers and businesses with credit is striking: currently, there is over $12 trillion of outstanding securitized assets, including RMBS, ABS and asset-backed commercial paper ("ABCP"). This represents a market nearly double the normal size of all outstanding marketable U.S. Treasury securities—

bonds, bills, notes, and TIPS combined.[2] Between 1990 and 2006, issuance of MBS grew at an annually compounded rate of 13%, from $259 billion to $2 trillion a year.[3] In the same time period, issuance of ABS secured by auto loans, credit cards, home equity loans, equipment loans, student loans and other assets, grew from $43 billion to $753 billion. In 2006, just before the downturn, nearly $2.9 trillion in RMBS and ABS were issued. As these data demonstrate, securitization is clearly an important sector of today's financial markets.

The importance of securitization becomes more evident by observing the significant proportion of consumer credit it has financed in the U.S. It is estimated that securitization has funded between 30% and 75% of lending in various markets, including an estimated 59% of outstanding home mortgages.[4] Securitization plays a critical role in non-mortgage consumer credit as well. Historically, banks securitized 50-60% of their credit card assets.[5] Meanwhile, in the auto industry, a substantial portion of automobile sales are financed through auto ABS.[6] Overall, recent data collected by the Federal Reserve Board show that securitization has provided over 25% of outstanding U.S. consumer credit.[7] Securitization also provides an important source of commercial mortgage loan financing throughout the U.S., through the issuance of commercial mortgage-backed securities ("CMBS").

[2] U.S. Department of the Treasury, "Monthly Statement of the Public Debt of the United States: August 31, 2009," (August 2009). < http://www.treasurydirect.gov/govt/reports/pd/mspd/2009/opds082009.pdf>.
[3] National Economic Research Associates, Inc. (NERA), "Study of the Impact of Securitization on Consumers, Investors, Financial Institutions and the Capital Markets," pg. 16 (June 2009). <http://www.americansecuritization.com/uploadedFiles/ASF_NERA_Report.pdf>.
[4] Citigroup, "Does the World Need Securitization?" pg. 10-11 (Dec. 2008). <http://www.americansecuritization.com/uploadedFiles/Citi121208_restart_securitization.pdf>.
[5] Ibid., pg. 10.
[6] Ibid., pg. 10.
[7] Federal Reserve Board of Governors, "G19: Consumer Credit," (September 2009). <http://www.federalreserve.gov/releases/g19/current/g19.htm>.

Over the years, securitization has grown in large measure because of the benefits and value it delivers to transaction participants and to the financial system. Among these benefits and value are the following:

1. *Efficiency and Cost of Financing.* By linking financing terms to the performance of a discrete asset or pool of assets, rather than to the future profitability or claims-paying potential of an operating company, securitization often provides a cheaper and more efficient form of financing than other types of equity or debt financing.

2. *Incremental Credit Creation.* By enabling capital to be recycled via securitization, lenders can obtain additional funding from the capital markets that can be used to support incremental credit creation. In contrast, loans that are made and held in a financial institution's portfolio occupy that capital until the loans are repaid.

3. *Credit Cost Reduction.* The economic efficiencies and increased liquidity available from securitization can serve to lower the cost of credit to consumers. Several academic studies have demonstrated this result. A recent study by National Economic Research Associates, Inc., concluded that securitization lowers the cost of consumer credit, reducing yield spreads across a range of products including residential mortgages, credit card receivables and automobile loans.[8]

4. *Liquidity Creation.* Securitization often offers issuers an alternative and cheaper form of financing than is available from traditional bank lending, or debt or equity financing. As

[8] National Economic Research Associates, Inc. (NERA), "Study of the Impact of Securitization on Consumers, Investors, Financial Institutions and the Capital Markets," (June 2009), pg. 16. <http://www.americansecuritization.com/uploadedFiles/ASF_NERA_Report.pdf>.

a result, securitization serves as an alternative and complementary form of liquidity creation within the capital markets and primary lending markets.

5. *Risk Transfer.* Securitization allows entities that originate credit risk to transfer that risk to other parties throughout the financial markets, thereby allocating that risk to parties willing to assume it.

6. *Customized Financing and Investment Products.* Securitization allows for precise and customized creation of financing and investment products tailored to the specific needs of both issuers and investors. For example, issuers can tailor securitization structures to meet their capital needs and preferences and diversify their sources of financing and liquidity. Investors can tailor securitized products to meet their specific credit, duration, diversification and other investment objectives.[9]

Recognizing these and other benefits, policymakers globally have taken steps to help encourage and facilitate the recovery of securitization activity. The G-7 finance ministers, representing the world's largest economies, declared that "the current situation calls for urgent and exceptional action...to restart the secondary markets for mortgages and other securitized assets."[10] The Department of the Treasury stated in March, 2009 that "while the intricacies of secondary markets and securitization...may be complex, these loans account for almost half of

[9] The vast majority of investors in the securitization market are institutional investors, including banks, insurance companies, mutual funds, money market funds, pension funds, hedge funds and other large pools of capital. Although these direct market participants are institutions, many of them—pension funds, mutual funds and insurance companies, in particular—invest on behalf of individuals, in addition to other account holders.
[10] G-7 Finance Ministers and Central Bank Governors Plan of Action (Oct. 10, 2008). <http://www.treas.gov/press/releases/hp1195.htm>.

the credit going to Main Street,"[11] underscoring the critical nature of securitization in today's economy. The Chairman of the Federal Reserve Board noted that securitization "provides originators much wider sources of funding than they could obtain through conventional sources, such as retail deposits" and also that "it substantially reduces the originator's exposure to interest rate, credit, prepayment, and other risks."[12] Echoing that statement, Federal Reserve Board Governor Elizabeth Duke stated that the "financial system has become dependent upon securitization as an important intermediation tool,"[13] and the International Monetary Fund (IMF) noted in its *Global Financial Stability Report* that "restarting private-label securitization markets, especially in the United States, is critical to limiting the fallout from the credit crisis and to the withdrawal of central bank and government interventions."[14] There is clear recognition in the official sector of the importance of the securitization process and the access to financing that it provides lenders, and of its importance to the availability of credit that ultimately flows to consumers, businesses and the real economy.

Restoration of function and confidence to the securitization markets is a particularly urgent need, in light of capital and liquidity constraints currently confronting financial institutions and markets globally. As mentioned above, at present nearly $12 trillion in U.S. assets are funded via securitization. With the process of bank de-leveraging and balance sheet

[11] U.S. Department of the Treasury, "Road to Stability: Consumer & Business Lending Initiative," (March 2009). <http://www.financialstability.gov/roadtostability/lendinginitiative.html>.
[12] Bernanke, Ben S., "Speech at the UC Berkeley/UCLA Symposium: The Mortgage Meltdown, the Economy, and Public Policy, Berkeley, California." *Board of Governors of the Federal Reserve System* (Oct. 2008). <http://www.federalreserve.gov/newsevents/speech/bernanke20081031a.htm>.
[13] Duke, Elizabeth A., "Speech at the AICPA National Conference on Banks and Savings Institutions, Washington, D.C." *Board of Governors of the Federal Reserve System* (Sept. 2009). <http://www.federalreserve.gov/newsevents/speech/duke20090914a.htm>.
[14] International Monetary Fund, "Restarting Securitization Markets: Policy Proposals and Pitfalls." *Global Financial Stability Report: Navigating the Financial Challenges Ahead* (Oct. 2009), pg.33. <http://www.imf.org/external/pubs/ft/gfsr/2009/02/pdf/text.pdf>.

reduction still underway, and with increased bank capital requirements on the horizon, such as those expected in Basel III, the funding capacity provided by securitization cannot be replaced with deposit-based financing alone in the current or foreseeable economic environment. In fact, the IMF estimated that a financing "gap" of $440 billion existed between total U.S. credit capacity available for the nonfinancial sector and U.S. total credit demand from that sector for the year 2009.[15] Moreover, non-bank finance companies, who have played an important role in providing financing to consumers and small businesses, are particularly reliant on securitization to fund their lending activities, since they do not have access to deposit-based funding. Small businesses, who employ approximately 50% of the nation's workforce, depend on securitization to supply credit that is used to pay employees, finance inventory and investment, and other business purposes. Furthermore, many jobs are made possible by securitization. For example, a lack of financing for mortgages hampers the housing industry; likewise, constriction of trade receivable financing can adversely affect employment opportunities in the manufacturing sector. To jump start the engine of growth and jobs, securitization is needed to help restore credit availability.

Simply put, the absence of a properly functioning securitization market, and the funding and liquidity this market has historically provided, adversely impacts consumers, businesses, financial markets and the broader economy. The recovery and restoration of confidence in securitization is therefore a necessary ingredient for economic growth to resume, and for that growth to continue on a sustained basis into the future.

[15] International Monetary Fund, "The Road to Recovery." *Global Financial Stability Report: Navigating the Financial Challenges Ahead* (Oct. 2009), pg. 29. <http://www.imf.org/external/pubs/ft/gfsr/2009/02/pdf/text.pdf>.

II. Transfers of Loans into the Secondary Mortgage Market

By way of background, there are approximately 55 million first lien mortgages outstanding in the United States today and an additional 25 million homes that have no mortgage attached to them. The debt outstanding for these 55 million mortgages is nearly $9.75 trillion dollars, of which approximately $7 trillion dollars resides in securitization trusts and are beneficially owned by institutional investors around the world. Approximately $5.5 trillion dollars of these loans are government guaranteed in Ginnie Mae and GSE RMBS, with an additional $1.5 trillion in outstanding private-label RMBS that has no government backstop. An additional $2.75 trillion dollars of mortgage debt is owned in the portfolios of commercial banks, savings institutions and insurance companies. In addition to the $9.75 trillion of outstanding first lien mortgages, approximately $1 trillion of second liens are currently outstanding in the United States.[16]

As part of the larger public discourse about the current state of the residential mortgage market and the increasing number of foreclosures in America, a surprising number of concerns have been raised in the last couple of months in the midst of the worst housing crisis since the Great Depression that question whether the common legal procedures that have been used to transfer residential mortgage loans into RMBS trusts were in fact legally valid. A number of different dire outcomes have been raised if loans weren't validly transferred, including borrower confusion as to who to pay their mortgage to, large bank losses, and further housing market

[16] Data compiled by Amherst Securities, based on information from the Federal Reserve Flow of Funds, Fannie Mae, Freddie Mac, Ginnie Mae and CoreLogic.

turmoil. A recent Congressional Oversight Panel Report ("COP Report")[17] has even suggested that these issues could create systemic risk concerns if loans weren't appropriately assigned to securitization trusts.

But the key incorrect premise that each of these dire outcomes relies upon is that the $7 trillion dollars of outstanding securitized mortgage debt has not in fact been systematically transferred in a legally sound manner. ASF believes these concerns are without merit and our membership is confident that these methods of transfer are sound and based on a well-established body of law governing the multi-trillion dollar secondary mortgage market. The conventional process for loan transfers embodied in standard legal documentation for mortgage securitizations has been adequate and appropriate to transfer ownership of mortgage loans to the securitization trusts in accordance with applicable law. This process is sufficient to establish ownership by the securitization trusts. Moreover the concerns that have been raised have not been supported by substantiation that there are in fact any material signs of systematic fails in the system. Indeed, the origin of these concerns is not clear: they are not the result of a series of court cases supporting the arguments advanced and appear to be largely the result of academic theories. In fact, even the COP Report states that "the Panel takes no position on whether any of these arguments are valid or likely to succeed."[18]

As part of our members' diligence into these public concerns, the ASF issued two weeks ago a white paper legal study entitled "Transfer and Assignment of Residential Mortgage Loans in the Secondary Mortgage Market" (the "ASF White Paper"), which is attached to this

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[17] Congressional Oversight Panel, *November Oversight Report, Examining the Consequences of Mortgage Irregularities for Financial Stability and Foreclosure Mitigation* (November 16, 2010) <http://cop.senate.gov/documents/cop-111610-report.pdf>.
[18] Ibid., pg. 25, footnote 75.

testimony as Attachment A. In the White Paper, the ASF exhaustively studied traditional legal principles and processes, including common law, the Uniform Commercial Code and substantial case history, and finds that traditional legal principles and processes, including the not codified common law rule that "the mortgage follows the note," are fully consistent with today's complex holding, assignment and transfer methods for mortgage loans, which are legally effective for participants in the secondary mortgage market to transfer mortgage loans. Thirteen major U.S. law firms noted in Exhibit A to the ASF White Paper reviewed the ASF White Paper and believe that the Executive Summary contained therein represents a fair summary of the legal principles presented. Although we believe the ASF White Paper answered a number of the concerns that had previously been raised, some new concerns have been raised since the ASF White Paper has been published. In this testimony, we address four of these new concerns.

A. PSAs Meet the Requirement for a "Complete" or "Unbroken" Chain of Indorsement

In testimony before the U.S. Senate Committee on Banking, Housing and Urban Affairs on November 16, 2010,[19] Mr. Adam J. Levitin, Associate Professor of Law at Georgetown University Law Center, commented that while he did not disagree with the statements in the ASF White Paper about how mortgage loans may be legally transferred pursuant to contract law and the UCC, he believes that the ASF White Paper does not address some additional arguments as to why mortgage loans might not have been legally transferred to RMBS trusts in many cases.

[19] Testimony of Professor Adam J. Levitin, U.S. Senate Committee on Banking, Housing and Urban Affairs Hearing, November 16, 2010.
http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=df8cb685-c1bf-4eea-941d-cf9d5173873a

These arguments are outlined in Mr. Levitin's testimony submitted to the Senate Committee for these hearings, and further in testimony submitted to the House Financial Services Committee, Subcommittee on Housing and Social Opportunity, on November 18, 2010.[20] We seek to address these concerns directly herein.

In his written testimony as well as his statements before the Senate Committee, Mr. Levitin does not rely on the decisions in any court cases but instead discusses standard provisions of documentation typically used to issue RMBS, which generally is in the form of a pooling and servicing agreement ("PSA"). A typical PSA includes a section requiring that legal documents for each pooled mortgage loan be delivered to the trustee, or to a custodian on the trustee's behalf. This provision typically requires delivery of the original mortgage note, which must bear the following indorsements: 1) either an indorsement in blank or an indorsement to the trustee, and 2) a 'complete' or 'unbroken' chain of indorsements from the originator or named payee to the person signing the indorsement in blank or to the trustee. The language does not specify who must sign the indorsement in 1). The language used in these typical provisions in any PSA uses either the word "complete" or "unbroken", with no apparent difference in intended meaning from deal to deal. The typical language does not state, nor does it imply, that a "complete" or "unbroken" chain means that all prior owners or holders of the note must appear as part of the chain. Nor does any judicial proceeding consider or uphold this novel opinion. Nor does Professor Levitin provide any third-party support for his interpretation of a typical PSA.

[20]Testimony of Professor Adam J. Levitin, House Financial Services Committee, Subcommittee on Housing and Social Opportunity Hearing, November 18, 2010 <http://financialservices.house.gov/Media/file/hearings/111/Levitin111810.pdf>.

In his testimony, Mr. Levitin suggests, but without providing any source of authority for his interpretation of contractual intent, that the typical PSA requirement for a "complete" chain of indorsements was intended to mean that there must be a separate indorsement from each and every person who was a prior owner of the note, including the originator, the securitization sponsor and the depositor. From his interpretation flows a number of seemingly logical but progressively more dire consequences, including:

i. the PSA was intended to supersede standard indorsement practice as codified in the UCC;
ii. the parties universally failed to comply with this requirement to show an expanded chain of indorsements;
iii. such failure violates the express terms of the PSA and therefore applicable trust law requires that transfers of the mortgage loans to the trust are void;
iv. therefore the trusts don't really own anything and the trusts furthermore violate REMIC requirements;
v. as a result the banks that sold the loans really still own them; and
vi. the banks must repay all investors in full.

All of these consequences flow, however, from a single mistaken core premise—that the typical PSA requirement for indorsements requires this expanded chain. As discussed below, this core premise is incorrect, and therefore the consequences of this premise do not follow.

The typical PSA requirement for a complete or unbroken chain of indorsements to the person signing the indorsement in blank means only that there be no gaps in the chain of indorsements, and that the chain of indorsements be sufficient to effect a transfer to the trust under applicable law. This provision would be interpreted in light of applicable law as well as customary indorsement practice, and the intent of the parties as evidenced by their contemporaneous conduct, all of which support the industry custom reading of a "complete" or "unbroken" chain.

As is clear in the ASF White Paper, for mortgage notes that are negotiable instruments, transfer may be made by negotiation in accordance with UCC Article 3, which requires an indorsement. Once a negotiable mortgage note has been endorsed in blank, negotiation may be effected by transfer of possession alone, until an indorsement has been made or completed in the name of a specific person. In other words, if there is an indorsement in blank, the note may be transferred to numerous successive parties without any need for a separate indorsement to each purchaser. Sales of mortgage notes may also be made pursuant to UCC Article 9, and such a sale is automatically perfected (without delivery of any mortgage note and with no requirement relating to any indorsement) as long as value is given in accordance with an agreement that specifies the mortgage loan to be conveyed, such as a loan schedule to a PSA.

In interpreting the typical PSA requirement for indorsements, we note that this requirement appears in the section that relates to transfer and delivery of the mortgage loans to the trustee. In this context, a "complete" or "unbroken" chain of indorsements is satisfied if the indorsements are sufficient to transfer all rights in and to the mortgage notes to the trustee under applicable law. Thus, for example, where the note was initially payable to originator A, then sold to securitization sponsor B, who transferred to depositor C who in turn is transferring the note to trustee D, a complete chain of indorsements could be: 1) an indorsement from A to B, followed by an indorsement by B in blank, or 2) an indorsement by A in blank. Either of those examples of indorsements, together with delivery of the note to D, would be sufficient to effect a negotiation and transfer to D, and therefore would be a "complete" or "unbroken" chain of indorsements as required by standard PSA language. Examples of an incomplete or broken chain would be as follows: 1) no indorsement by A, or 2) an indorsement by A to X, followed by an indorsement by B in blank. Importantly, for the purposes for which indorsement is required by the PSA (which are limited to evidencing the transfer and delivery of the mortgage loans to the trustee), an indorsement by A in blank <u>is no less sufficient or effective</u> than an indorsement from A to B, followed by an indorsement from B to C, followed by an indorsement from C to D. In other words, the typical PSA does not impose contractual requirements that exceed those contained in the UCC, which has been adopted by all fifty states and the District of Columbia, as it pertains to the transfer of an interest in a mortgage note.

Moreover, the intended meaning of the typical PSA requirement for indorsements is illustrated by the contemporaneous conduct of the parties to the transactions. Sellers into securitizations generally deliver physical mortgage notes with indorsements in formats (following the example above) such as 1) an indorsement from A to B, followed by an indorsement by B in blank, or 2) an indorsement by A in blank. It was not at all typical nor required to show an indorsement to or from the depositor (C in this example). Furthermore, independent, third-party trustees and custodians checking in mortgage notes believed that a note showing indorsements in these formats satisfied the requirement that there be a 'complete' or 'unbroken' chain of indorsements. This actual conduct demonstrates the intended meaning of the indorsement requirements.

Mr. Levitin argues that the intended meaning of the typical PSA requirement for indorsements is that the requirement for a 'complete' or 'unbroken' chain means that every prior holder needs to have a separate indorsement to that holder. In other words that, following the above example, there must be an indorsement from A to B, followed by an indorsement from B to C, followed by an indorsement from C to D. Yet there is no persuasive basis for the proposition that the parties intended that the typical PSA provisions required this expanded chain of indorsements, nor is there any case law to support Mr. Levitin's view.

Mr. Levitin argues that as a result of his interpretation the indorsement requirements intended an expanded chain of indorsements, and the parties therefore intended to contract around the UCC and impose upon themselves indorsement requirements that are in excess of what is required to satisfy applicable UCC provisions. It is unclear and seemingly unreasonable to practicing industry lawyers why parties to a transaction would contract around the UCC by imposing significant additional indorsement requirements upon themselves, and then to have systematically failed to observe those expanded requirements. On the other hand, it is very reasonable to interpret the PSA language as not having been intended to require this expanded chain of indorsements above and beyond UCC requirements for indorsements, where the actual indorsement practice satisfied the UCC requirements.

Mr. Levitin offers the following argument to support the interpretation that an expanded chain of indorsements was intended to be required under PSA contractual provisions:

> "The reason for this additional requirement is to provide a clear evidentiary basis for all of the transfers in the chain of title in order to remove any doubts about the bankruptcy remoteness of the assets transferred to the trust. Absent a complete chain of indorsements, it could be argued that the trust assets were transferred directly from the originator to the trust, raising the concern that if the originator filed for bankruptcy, the trust assets could be pulled back into the originator's bankruptcy estate."[21]

However, this argument overlooks the fact that each separate step in the chain of transfers of ownership by each party from the originator to the trust is fully documented by a separate contract. In other words, there is a contract covering the sale from A to B, and another contract covering the sale from B to C, and the PSA itself documents the sale from C to D. There is no need for an expanded chain of indorsements to make the chain of transfers of ownership any more plain and evident than it already is. And there is no basis for the proposition that the parties thought that an expanded chain of indorsements to override the UCC was necessary or useful for this purpose.

B. Securitization Trusts Comply with New York Trust Law

Because the parties did not intend for the expanded chain of indorsements to be contractually required under the PSA, the further argument that the transfers to the trusts were void under New York trust law also fails.

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[21] Testimony of Professor Adam J. Levitin, U.S. Senate Committee on Banking, Housing and Urban Affairs Hearing, November 16, 2010.
http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=df8cb685-c1bf-4eea-941d-cf9d5173873a

Professor Levitin cites New York E.P.T.L. Section 7.2-4 as authority for the concept that a transfer to a New York common law trust that is in contravention of the trust documents is void. However, that section actually refers to any "sale, conveyance or other act of the trustee *in contravention of the trust*" [emphasis added], not sales or conveyances *to the trust*. This section is intended to protect trust beneficiaries from unauthorized acts by the trustee. Cases interpreting this section relate to wrongful acts by trustees with respect to assets that have previously been transferred into the trust, such as acts that are illegal or which dissipate or impair assets of the trust. Moreover, this section contains an exception for any such acts that are authorized by any other provision of law. As we explained in the preceding section, the method used to convey the mortgage loans to the trustee is consistent with the UCC.

In his November 18 written testimony, it is stated that "transfers to New York common law trusts are governed by the common law of gifts." No authority is given for that statement, and we believe that this statement is not correct with respect to business or investment trusts, where transfers are made to the trust for consideration in commercial transactions, and not as gifts. The testimony then goes on to cite cases, which relate to the common law of gifts, for the proposition that assets must be transferred in a way "such that no one else could possibly claim ownership," and then reads the cases to impose on all transfers to New York common law trusts a requirement that "the mere recital of a transfer is insufficient to effectuate a transfer; there must be delivery in as perfect a manner as possible." The testimony goes on to argue that the contractual language in each PSA that transfers and conveys ownership of the mortgage loans to the trustee for the benefit of the investors is mere "recital" language that is ineffective in transfers to common law trusts, and further suggests that delivery of the note with an indorsement in blank is defective under this standard because it turns a note "into bearer paper to which others could easily lay claim."

The more recent of the cases cited in the testimony, Vincent v. Putnam, 248 N.Y. 76 (N.Y., 1928), involves a widow who received stocks and bonds by bequest from her husband, where the will provided that as to bequeathed remainder property that upon her death "shall remain at that time undisposed of", such property would pass to the husband's next of kin. The widow attempted to dispose of the stocks and bonds shortly before her own death by gift to one of her blood relatives. However, the only actions taken by the widow to effect the gift were to deliver the stock and bond certificates to her own attorney, with a verbal instruction to give them to her relative. This was not a transfer for consideration, and it was not a transfer to a common law trust. This case is about delivery of property to an agent of the donor, with an instruction to deliver the property to the intended donee, and the holding is that such delivery is not a completed gift. The "mere words" in this case, that were insufficient to effect a conveyance, were the verbal instruction to the widow's attorney to make the gift, which instruction could have been revoked at any time. We believe that the cases cited in the November 18 testimony do not support the proposition that transfers of property to a New York common law trust, for consideration in a commercial transaction, require a higher standard or more rigid set of transfer requirements than would apply in any transfer for value of such property in any other commercial transaction.

The notion that new legal decisions in all 50 states would be handed down with no legal precedence to nullify trillions of dollars of mortgage securitization transactions simply because the trusts acquired an interest in the pooled loans in accordance with applicable law but not in the manner that Mr. Levitin claims the trust documents require, appears on its face to be an unreasonable assertion. As noted above, we are confident that the standard processes of delivering loans into securitization trusts are proper as a matter of law and contract, and we are hard pressed to give any credence to an unsupported academic theory that the courts would thwart the intentions and expectations of the parties by voiding transfers of mortgage loans.

C. RMBS Trusts Effectively Achieve REMIC Status

A final issue that we would like to address in this section relates to Real Estate Mortgage Investment Conduits ("REMIC"), which is a tax election under federal income tax law frequently used for RMBS under which trusts backed by qualified mortgages can issue multiple classes of securities that are treated as debt, with the trust exempted from entity level taxation. One argument that has been advanced by a couple commentators is that if the mortgage loans were not validly transferred to the trust, any defect in the procedures used to make the transfer can now not be cured without violating regulations that prohibit transfers of qualified mortgages to a REMIC more than 90 days after it was created. We believe that this argument is without merit, because the argument that there were wholesale failures to properly convey ownership of mortgage loans to RMBS trusts are without merit as discussed above and in the ASF White Paper.

D. Mistakes Do Not Affect Validity of Transfer

The fact that the ASF White Paper finds that the standard industry practices are legally effective for participants in the secondary mortgage market to transfer mortgage loans does not mean that mistakes never happen. From time to time mistakes are certain to occur, particularly in a market where 55 million mortgages are transferred and/or serviced, and that is one reason why typical language in a PSA provides the opportunity to cure mistakes. It is important, however, to distinguish between document deficiencies that impair the validity of the transfer of mortgage loans, on the one hand, and the additional steps that may be necessary to enforce the loan documents against the borrowers, on the other hand. The three new concerns that we counter in this testimony call into question the validity of a mortgage loan transfer. We believe that these concerns are misplaced and that, in the ordinary course, document deficiencies on a one-off basis may delay foreclosure while the paperwork is corrected or completed but will not impair the initial transfer of the loan to the securitization trust.

In conclusion, the ASF greatly appreciates the invitation to appear before this Committee to share our views related to these current issues. I look forward to answering any questions the Committee may have.

Thank you.

ATTACHMENT A

ASF White Paper
Transfer and Assignment of Residential Mortgage Loans
in the Secondary Mortgage Market
November 16, 2010

Transfer and Assignment of Residential Mortgage Loans in the Secondary Mortgage Market

ASF WHITE PAPER SERIES

NOVEMBER 16, 2010

American Securitization Forum®

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Introduction

Recently, a few commentators have raised a number of legal theories questioning whether securitization trusts, either those created by private financial institutions or those created by government sponsored enterprises, such as Ginnie Mae, Fannie Mae or Freddie Mac, have valid legal title to the seven trillion dollars of mortgage notes in those trusts. In an effort to contribute thorough and well-researched legal analysis to the discussion of these theories, the American Securitization Forum ("ASF") issues the enclosed white paper entitled "Transfer and Assignment of Residential Mortgage Loans in the Secondary Mortgage Market" (the "White Paper"). The White Paper provides a detailed overview of the legal principles and processes by which mortgage loans are typically held, assigned, transferred and enforced in the secondary mortgage market and in the creation of mortgage-backed securities ("MBS"). These principles and processes have centuries-old origins, and they have continued to be sound and validated since the advent of MBS over forty years ago.

While the real property laws of each of the 50 U.S. states and the District of Columbia affect the method of foreclosing on a mortgage loan in default, the legal principles and processes discussed in this White Paper result, if followed, in a valid and enforceable transfer of mortgage notes and the underlying mortgages in each of these jurisdictions. To be thorough, the White Paper undertakes a review of both common law and the Uniform Commercial Code (the "UCC") in each of the 50 U.S. states and the District of Columbia. One of the most critical principles is that when ownership of a mortgage note is transferred in accordance with common securitization processes, ownership of the mortgage is also automatically transferred pursuant to the common law rule that "the mortgage follows the note." The rule that "the mortgage follows the note" dates back centuries and has been codified in the UCC. In essence, this means that the assignment of a mortgage to a trustee does not need to be recorded in real property records in order for it to be a valid and binding transfer.

In summary, these traditional legal principles and processes are fully consistent with today's complex holding, assignment and transfer methods for mortgage loans and those methods are legally effective for participants in the secondary mortgage market to transfer mortgage loans. Thirteen major U.S. law firms noted in Exhibit A have reviewed the White Paper and believe that the Executive Summary contained therein represents a fair summary of the legal principles presented. ASF wishes to thank each of these firms and the dozens of preeminent MBS attorneys who have contributed to the development of this White Paper.

Tom Deutsch

Tom Deutsch
Executive Director
American Securitization Forum

Executive Summary

1. Basic Principles

The two core legal documents in most residential mortgage loan transactions are the promissory note and the mortgage or deed of trust that secures the borrower's payment of the promissory note. In a typical "private-label" mortgage loan securitization, each mortgage loan is sold to a trust through a series of steps. A mortgage note and a mortgage may be sold, assigned and transferred several times between the time the mortgage loan is originated and the time the mortgage loan ends up with the trust. The legal principles that govern the assignment and transfer of mortgage notes and related mortgages are determined, in significant part, by the Uniform Commercial Code ("UCC"), which has been adopted by all 50 states and the District of Columbia.[1]

The residential mortgage notes in common usage typically are negotiable instruments. As a general matter, under the UCC, a negotiable mortgage note can be transferred from the transferor to the transferee through the indorsement[2] of the mortgage note and the transfer of possession of the note to the transferee or a custodian on behalf of the transferee. An assignment of the related mortgage is also typically delivered to the transferee or its custodian, except in cases where the related mortgage identifies the Mortgage Electronic Registration System ("MERS") as the mortgagee. Such assignments generally are in recordable form, but unrecorded, and are executed by the transferor without identifying a specific transferee – a so-called assignment "in blank." Intervening assignments, in some cases, may be recorded in the local real estate records.

In some mortgage loan transactions, MERS becomes the mortgagee of record as the nominee of the loan originator and its assignees in the local land records where the mortgage is recorded, either when the mortgage is first recorded or as a result of the recording of an assignment of mortgage to MERS. This means that MERS is listed as the record title holder of the mortgage. MERS' name does not appear on the mortgage note, and the beneficial interest in the mortgage remains with the loan originator or its assignee. The documents pursuant to which MERS acts as nominee make clear that MERS is acting in such capacity for the benefit of the loan originator or its assignee. When a mortgage loan is originated with MERS as the nominal mortgagee (or is assigned to MERS post-origination), MERS tracks all future mortgage loan and mortgage loan servicing transfers and other assignments of the mortgage loan unless and until ownership or servicing is transferred (or the mortgage loan is otherwise assigned) to an entity that is not a MERS member. In this way, MERS serves as a central system to track changes in ownership and servicing of the mortgage loan. Fannie Mae, Freddie Mac and Ginnie Mae, among other governmental entities, permit mortgage loans that they purchase or securitize to be registered with MERS.

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[1] References to the UCC are to the Official Text of the Model UCC, as revised, issued by the National Conference of Commissioners on Uniform State Laws.

[2] Note that the UCC replaces the more common U.S. spelling of "endorsement" for the less common "indorsement." The UCC spelling is used throughout this Executive Summary.

2. Transfer of Promissory Notes Secured by Mortgages

The law of negotiable instruments developed over the centuries as a way to encourage commerce and lending by making such instruments, including negotiable mortgage notes, as liquid and transferable as possible. The UCC, with state-specific variations, in significant part governs the assignment and transfer of mortgage notes. Article 3 of the UCC applies to the negotiation and transfer of a mortgage note that is a "negotiable instrument," as that term is defined in Article 3. In addition, Article 9 of the UCC applies to the sale of "promissory notes," a term that generally includes mortgage notes.

In addition, as a general matter, the securitization of a loan under a typical pooling and servicing agreement provides both for the negotiation of negotiable mortgage notes (by indorsement and transfer of possession to the securitization trustee or the custodian for the trustee) <u>and</u> for an outright sale and assignment of all of the mortgage notes and mortgages. Thus, whether the mortgage notes in a given securitization pool are deemed "negotiable" (as we believe most typically are) or "non-negotiable" will have little or no substantive effect under the UCC on the validity of the transfer of the notes. The typical securitization process effects valid transfers of the mortgage notes and related mortgages in accordance with the provisions of Articles 3 and 9 of the UCC.

Under the UCC, the transfer of a mortgage note that is a negotiable instrument is most commonly effected by (a) indorsing the note, which may be a blank indorsement that does not identify a person to whom the mortgage note is payable or a special indorsement that specifically identifies a person to whom the mortgage note is payable, and (b) delivering the note to the transferee (or an agent acting on behalf of the transferee). As residential mortgage notes in common usage typically are "negotiable instruments," this is the most common method to transfer the mortgage note. In addition, even without indorsement, the transfer can be effected by transferring possession under the UCC. Moreover, the sale of any mortgage note also effects the transfer of the mortgage under Article 9. Securitization agreements often provide both for (a) the indorsement and transfer of possession to the trustee or the custodian for the trustee, which would constitute a negotiation of the mortgage note under Article 3 of the UCC <u>and</u> (b) an outright sale and assignment of the mortgage note. Thus, regardless of whether the mortgage notes in a securitization trust are deemed "negotiable" or "non-negotiable," the securitization process generally includes a valid transfer of the mortgage notes to the trustee in accordance with the explicit requirements of the UCC.

In addition, Article 3 of the UCC permits a person without possession to enforce a negotiable mortgage note where the note has been lost, stolen, or destroyed. Courts have consistently affirmed the use of the salient provisions of the UCC to enforce lost, stolen or destroyed negotiable mortgage notes that are owned by a securitization trust when the trust or its agent has proved the terms of the mortgage notes and their right to enforce the mortgage notes.

3. Assignment and Transfer of Ownership of Mortgages

As stated above, when a mortgage loan is assigned and transferred as part of the securitization of the mortgage loan in the secondary market, both the mortgage note and the mortgage itself are typically sold, assigned, and physically transferred to the trustee that is acting on behalf of the MBS investors or a trustee-designated document custodian pursuant to a custody agreement. The assignment and transfer are usually documented in accordance with a pooling and servicing agreement.

When a mortgage note is transferred in accordance with common mortgage loan securitization processes, the mortgage is also automatically transferred to the mortgage note transferee pursuant to the general common law rule that "the mortgage follows the note." The rule that "the mortgage follows the note" has been codified in the UCC, but the rule's common law origins date back hundreds of years, long before the creation of the UCC. As stated in the official comments to UCC § 9-203(g), the section "codifies the common-law rule that a transfer of an obligation secured by a security interest or other lien on personal or real property also transfers the security interest or lien." UCC § 9-203 cmt. 9. All states follow this rule.[3]

In addition to the codification under UCC § 9-203(g), reported court cases in nearly every state and non-UCC statutory provisions in some states make clear that "the mortgage follows the note." Regarding the impact of these UCC provisions, one treatise states: "Article 9 makes it as plain as possible that the secured party need not record an assignment of mortgage, or anything else, in the real property records in order to perfect its rights in the mortgage." J. McDonnell and J. Smith, Secured Transactions Under the Uniform Commercial Code, § 16.09[3][b]. Indeed, courts in several states have affirmed and applied the "mortgage follows the note" rule in cases where the mortgage assignment was not recorded by the transferee and even when there was no actual separate written assignment of the mortgage.[4]

Common securitization practices are consistent with the general rule that "the mortgage follows the note": pursuant to the pooling and servicing agreement that governs an MBS, and the language of assignment typically contained in such an agreement, the mortgage note and the mortgage itself are sold, assigned, transferred and delivered to the trustee, and the transferor also typically delivers a written assignment of the mortgage that is in blank in recordable form. Courts have held that the language of sale and assignment contained in a pooling and servicing agreement, along with the corresponding transfer, sale, and delivery of the mortgage note and mortgage, are sufficient to transfer the mortgage to the transferee/trustee or its designee or nominee.

The creation of an interest in or lien on real property, including a mortgage, is governed by the non-UCC law of the state in which the property is located. Likewise, the enforceability of mortgages (including the right and method to foreclose) is subject to all of the conditions precedent and requirements that are set forth in the particular mortgage itself and in all applicable state and local laws. Those conditions precedent

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[3] However, in some states, such as Massachusetts and Minnesota, courts have held that the transfer of a mortgage note without an express transfer of the mortgage vests in the note holder only an equitable interest in the mortgage. This arrangement has been described as follows: the holder of the mortgage holds the legal title to the mortgage in constructive trust for the benefit of the mortgage note holder. In both states, however, case law suggests that foreclosure proceedings must be initiated by, or at least in the name of, the holder of the legal title in the mortgage.

[4] In most states, recording of an assignment of mortgage is generally not required to ensure the enforceability of the assignment of mortgage as between the assignor and assignee, and anyone with knowledge thereof. It is beyond the scope of this Executive Summary and the White Paper to discuss in detail the potential risks to the mortgage transferee of not recording a mortgage assignment. Those risks might include, among others, delaying the transferee's ability to foreclose on the mortgage, failing to receive notices that may go to the mortgagee of record, and otherwise leaving the assignee open to negligent or fraudulent actions or inactions by the mortgagee of record that could bind the mortgage transferee and impair the value or enforceability of the mortgage. Similarly, when an assignment of mortgage is not recorded, the assignor may be liable for certain obligations imposed upon a mortgagee of record, such as the obligation to provide a pay-off statement or mortgage release within a designated time period.

and procedural requirements vary from mortgage to mortgage and from state to state. Thus, ownership of a mortgage (i.e., without notice to the mortgagor or the public, without judicial proceedings (where required), without satisfaction of other conditions precedent or procedural requirements in the mortgage itself or in applicable state law), does not always give the holder of the mortgage the legal ability to foreclose on the mortgage. Though a discussion of the other necessary prerequisites to foreclosure is beyond the scope of this Executive Summary and the White Paper, the fact that other steps may need to be taken by the owner of a mortgage note, or the owner of a mortgage, is neither unique nor surprising in our legal and regulatory system and does not diminish an otherwise legally effective transfer of the mortgage note and mortgage.

The use of MERS as the nominee for the benefit of the trustee and other transferees in the mortgage loan securitization process has been a subject of litigation in recent years regarding a mortgage note holder's right to enforce a mortgage loan registered in MERS. Some cases address the authority or ability of MERS or transferees of MERS to foreclose on a mortgage for which MERS is or was the mortgagee of record. As a general matter, the assignment and transfer of a mortgage to MERS as nominee of and for the benefit of the beneficial owner of the mortgage does not adversely impact the right to foreclose on the mortgage. Decisions in many jurisdictions support this conclusion.

There are several minority decisions that, in some form, have taken issue with MERS. But none of these decisions, to our knowledge, has invalidated a mortgage for which MERS is the nominee, and none of these decisions has challenged MERS' ability to act as a central system to track changes in the ownership and servicing of mortgage loans.

Finally, it is important to recognize that the UCC does not displace traditional rules of agency law. Under general agency law, an agent has authority to act on behalf of its principal where the principal "manifests assent" to the agent "that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests assent or otherwise consents so to act." Accordingly, the UCC does not prevent MERS or others, including loan servicers, from acting as the agent for the note holder in connection with transfers of ownership in mortgage notes and mortgages. In short, principles of agency law provide MERS and loan servicers another legal basis for their respective roles in the transfer of mortgage notes and mortgages.

4. Conclusion

In summary, the longstanding and consistently applied rule in the United States is that, when a mortgage note is transferred, "the mortgage follows the note." When a mortgage note is transferred and delivered to a transferee in connection with the securitization of the mortgage loan pursuant to an MBS pooling and servicing agreement or similar agreement, the mortgage automatically follows and is transferred to the mortgage note transferee, notwithstanding that a third party, including an agent/nominee entity such as MERS, may remain as the mortgagee of record. Both common law and the UCC confirm and apply this rule, including in the context of mortgage loan securitizations.

Exhibit A

- Alston & Bird LLP
- Bingham McCutchen LLP
- Cadwalader, Wickersham & Taft LLP
- Dechert LLP
- Hunton & Williams LLP
- Katten Muchin Rosenman LLP
- K&L Gates LLP
- Lowenstein Sandler PC
- Mayer Brown LLP
- O'Melveny & Myers LLP
- Orrick, Herrington & Sutcliffe LLP
- Sidley Austin LLP
- SNR Denton US LLP

Transfer and Assignment of Residential Mortgage Loans in the Secondary Mortgage Market

The beginnings of the now multi-trillion dollar secondary market for residential mortgage loans date back to the federal government's creation of Fannie Mae in 1938. Since then, the complexity of the secondary mortgage market has increased, especially as a result of the rapid growth and market acceptance of mortgage-backed securities ("MBS") that began in the 1980s. In contrast, the legal principles and processes by which mortgage-related promissory notes and security instruments (mortgages and deeds of trust) are assigned and transferred have centuries-old origins. Now, in the midst of the worst economic and housing crisis since the 1930s, some are questioning whether the traditional state law principles and processes of assignment and transfer can be fully reconciled with today's complex holding, assignment and transfer systems for mortgage-related promissory notes and security instruments, and what methods are legally effective for participants in the secondary mortgage market to establish, maintain and transfer mortgage notes and security instruments.

This paper provides an overview of the legal principles and processes by which promissory notes and related mortgage security instruments are typically held, assigned, transferred and enforced in the secondary mortgage market in connection with loan securitizations and the creation of MBS.[1]

1. Basic Principles

The two core legal documents in most residential mortgage loan transactions are the promissory note and the mortgage or deed of trust that secures the borrower's payment of the promissory note. The promissory note contains a promise by the borrower to pay the lender a stated amount of money at a specified interest rate (which can be fixed or variable) by a certain date. The typical mortgage or deed of trust contains a grant of a mortgage lien or other security interest in the borrower's real property to the lender or, in a deed of trust, to a trustee for the benefit of the lender, to secure the borrower's obligations under the promissory note.[2]

In a typical "private-label" mortgage loan securitization, each mortgage loan, which is evidenced by a mortgage note and secured by a mortgage, is sold, assigned and transferred to a trust through a series of steps:

- The loan originator or a subsequent purchaser sells, assigns and transfers the mortgage loans to a "sponsor," which is typically a financial services company or a mortgage loan conduit or aggregator.
- The sponsor sells, assigns and transfers the mortgage loans to a "depositor," which in turn sells, assigns and transfers the mortgage loans to the trustee, which will hold the mortgage loans in trust for the benefit of the certificateholders.

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[1] Issues related to a party's right to foreclose or to engage in foreclosure-related activities are generally outside the scope of this paper.

[2] For ease of reference, "mortgage" will be used throughout much of this paper to refer to both mortgages and deeds of trust, and "mortgage note" will be used to refer to a promissory note that is secured by a mortgage.

- The trustee issues the MBS pursuant to a pooling and servicing agreement or trust agreement entered into by the depositor, the trustee and a master servicer or servicers.

- The trustee administers the pool assets, typically relying on the loan servicer to perform most of the administrative functions regarding the pool of mortgage loans. In addition, a document custodian is often designated to conduct a review of the mortgage loan documents pursuant to the requirements of the pooling and servicing agreement and to hold the mortgage loan documents for the loans included in the trust pool.

- In general, the loan documents are assigned and transferred from the depositor to the trustee through the indorsement of the mortgage note and the transfer of possession of the mortgage note to the trustee or a custodian on behalf of the trustee. An assignment of the related mortgage is also typically delivered to the transferee or its custodian, except in cases where the related mortgage identifies Mortgage Electronic Registration Systems ("MERS") as the mortgagee. Such assignments generally are in recordable form, but unrecorded, and are executed by the transferor without identifying a specific transferee – a so called assignment in blank.

- In some mortgage loan transactions, MERS becomes the mortgagee of record as the nominee of the loan originator and its assignee in the local land records where the mortgage is recorded, either when the mortgage is first recorded or as a result of the recording of an assignment of mortgage to MERS. This means that MERS is listed as the record title holder of the mortgage. MERS' name does not appear on the mortgage note, and the beneficial interest in the mortgage remains with the loan originator or its assignee. The documents pursuant to which MERS acts as nominee make clear that MERS is acting in such capacity for the benefit of the loan originator or its assignee. When a mortgage loan is originated with MERS as the nominal mortgagee (or is assigned to MERS post-origination), MERS tracks all future mortgage loan and loan servicing transfers and other assignments of the mortgage loan unless and until ownership or servicing is transferred (or the loan is otherwise assigned) to an entity that is not a MERS member. In this way, MERS serves as a central system to track changes in ownership and servicing of the loan. Fannie Mae, Freddie Mac and Ginnie Mae, among other governmental entities, permit loans that they purchase or securitize to be registered with MERS.

As part of the loan securitization process detailed above, a mortgage note and a mortgage may be sold, assigned and transferred several times from one entity to another. The legal principles that govern the assignment and transfer of mortgage notes and mortgages are generally determined by state law. See, e.g., In re Cook, 457 F.3d 561, 566 (6th Cir. 2006) (state law governed whether transferee had superior interest in promissory note secured by mortgage). As such, these principles can vary depending upon the state in which the assignor of the mortgage notes, the underlying property, or the relevant mortgage-related documents are located. The assignment and transfer of a mortgage note, on the one hand, and of a mortgage, on the other hand, are addressed separately below.

2. Transfer of Promissory Notes Secured by Mortgages

The residential mortgage notes in common use in the secondary mortgage market typically are negotiable instruments. The law of negotiable instruments developed over the centuries as a way to encourage commerce and lending by making such instruments, including negotiable mortgage notes, as liquid and transferable as possible. See, e.g., Overton v. Tyler, 3 Pa. 346, 347 (1846) ("[A] negotiable bill or note is a courier without luggage"); 2 Frederick M. Hart & William F. Willier, Negotiable Instruments Under the Uniform Commercial Code § 1.01 ("Negotiable instruments play such an important role in the modern commercial world that it is difficult to realize that the struggle for their existence could be as long and complex as it has been, yet the evolution of the concept took centuries."). Similarly, the standardization of the forms of mortgage notes and mortgages over the past thirty years or more has contributed to the liquidity and transferability of mortgage notes and the underlying mortgages. See Peter M. Carrozzo, Marketing the American Mortgage: The Emergency Home Finance Act of 1970, Standardization and the Secondary Market Revolution, 39 Real Prop. Prob. & Tr. J. 765, 799-800 (2004-2005) ("standardization of mortgage documents created marketable commodities. Once mechanisms were in place for the secondary market to operate, events rapidly moved toward the ultimate goal: the creation of a security which has as its base land [and] yet which will be as freely transferable as stocks and bonds" (internal quotation omitted)).

The Uniform Commercial Code ("UCC"), which, with state-specific variations, has been adopted as law by all 50 states and the District of Columbia, governs, in significant part, the transfer of mortgage notes.[3] Article 3 applies to the negotiation and transfer of a mortgage note that is a "negotiable instrument," as that term is defined in Article 3. See UCC §§ 3-102, 3-201, 3-203 and 3-204; see, e.g., Swindler v. Swindler, 355 S.C. 245, 250 (S.C. Ct. App. 2003) (Article 3 governs negotiable mortgage note). In addition, Article 9 applies to the sale of "promissory notes," a term that generally includes all mortgage notes (both negotiable and non-negotiable). See UCC §§ 1-201(b)(35) and 9-109(a)(3).[4]

The residential mortgage notes in common use today are typically negotiable instruments for UCC purposes. In addition, as a general matter, the securitization of a loan under a typical pooling and servicing agreement provides both for the negotiation of negotiable mortgage notes (by indorsement[5] and transfer of possession to the securitization trustee or the custodian for the trustee) and for an outright sale and assignment of all of the mortgage notes and related mortgages. Thus, whether the mortgage notes in a given securitization

[3] References to the UCC are to the Official Text of the Model UCC, as revised, issued by the National Conference of Commissioners on Uniform State Laws.

[4] While Article 9 does not directly govern a mortgage on real property, the fact that a mortgage note is itself secured by a mortgage on real property does not render Article 9 inapplicable to transfers of the mortgage note. See UCC § 9-109(b) ("The application of this article [9] to a security interest in a secured obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which this article does not apply.").

[5] Note that the UCC eschews the more common U.S. spelling of "endorsement" for the less common "indorsement." The UCC spelling is used throughout this paper.

pool are deemed "negotiable" (as we believe most typically are) or "non-negotiable" will have little or no substantive effect under the UCC on the validity of the transfer of the mortgage notes. The typical securitization process effects valid transfers of the mortgage notes and related mortgages in accordance with the provisions of Articles 3 and 9 of the UCC.[6]

What Constitutes a "Negotiable Instrument?"

A "negotiable instrument" is defined as:

> an unconditional promise or order to pay a fixed amount of money, with or without interest or other charges described in the promise or order, if it:
>
> (1) is payable to bearer or to order at the time it is issued or first comes into possession of a holder;
>
> (2) is payable on demand or at a definite time; and
>
> (3) does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money, but the promise or order may contain (i) an undertaking or power to give, maintain, or protect collateral to secure payment, (ii) an authorization or power to the holder to confess judgment or realize on or dispose of collateral, or (iii) a waiver of the benefit of any law intended for the advantage or protection of an obligor.

UCC § 3-104(a).

Reference in a mortgage note to a mortgage does not affect the mortgage note's status as a negotiable instrument. See UCC § 3-106(b) ("A promise or order is not made conditional [] by a reference to another writing for a statement of rights with respect to collateral, prepayment, or acceleration…."); see also Int'l Minerals & Chem. Corp. v. Matthews, 321 S.E.2d 545, 547 (N.C. Ct. App. 1984) ("referring to a mortgage or other collateral [in a mortgage note] does not impair negotiability" of the note); In re AppOnline.com, 285 B.R. 805, 815-16 (Bankr. E.D.N.Y. 2002) (reference in mortgage notes to underlying mortgages does not affect the negotiability of the notes).

The fact that a mortgage note contains a variable or adjustable interest rate also does not affect the mortgage note's status as a negotiable instrument. That is because UCC § 3-112(b) provides that "[i]nterest may be stated in an instrument[7] as a fixed or variable amount of money or it may be expressed as a fixed or variable rate or rates. The amount or rate of interest may be stated or described in the instrument in any manner and may require reference to information not contained in the instrument." UCC § 3-112(b).

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[6] Article 3 and Article 9 are not mutually exclusive. Article 9 applies to the transfer of all "promissory notes," which includes negotiable and non-negotiable instruments. Both Article 3 and Article 9 apply to "negotiable instruments." With respect to non-negotiable instruments, only Article 9 applies to the transfer.

[7] UCC § 3-104(b) defines "instrument" simply as a "negotiable instrument" for purposes of Article 3. As discussed in more detail below, the definition of "instrument" in Article 9 (governing secured transactions) is somewhat more expansive.

How is a Negotiable Mortgage Note Transferred?[8]

A negotiable mortgage note is transferred when it is "delivered" by a person other than the mortgagor for the purpose of giving the transferee the right to enforce the note. See UCC § 3-203(a). "Delivery" of a mortgage note occurs when there has been a voluntary transfer of possession of the mortgage note. See UCC § 1-201(b)(15). As a general matter, the "[t]ransfer of an instrument, whether or not the transfer is a negotiation, vests in the transferee any right of the transferor to enforce the instrument . . . ." UCC § 3-203(b). Accordingly, a person in possession of the note becomes a "person entitled to enforce" if it can prove that it is the transferee.[9] See UCC § 3-301.

The easiest and most common way to transfer a negotiable mortgage note is through "negotiation." Article 3 defines "negotiation" as "a transfer of possession, whether voluntary or involuntary, of an instrument by a person other than the issuer to a person who thereby becomes its holder." UCC § 3-201(a). The "negotiation" of a negotiable mortgage note that is payable to an identified person or entity (such as the entity that originated a mortgage loan and whose name appears as the payee in the mortgage note) – "requires **transfer** of **possession** of the instrument and its **indorsement** by the **holder**." UCC § 3-201(b) (emphasis added). As explained below, "indorsement" and "holder" are both defined terms in the UCC.

The "holder" of a negotiable mortgage note is "the person in possession of [the mortgage note] that is payable either to bearer or to an identified person that is the person in possession." UCC § 1-201(b)(21)(A). In other words, upon the closing of a mortgage loan, the "holder" of the mortgage note is the entity that is the payee on the mortgage note and that possesses the note (either actually or constructively). After a negotiable mortgage note has been negotiated, such as in connection with a loan securitization, the "holder" of the mortgage note is the entity that possesses the mortgage note if the mortgage note was indorsed to that entity or if the mortgage note was indorsed in blank or to bearer.

The term "indorsement" is defined to include "a signature . . . that alone or accompanied by other words is made on an instrument [in our case, a negotiable mortgage note] for the purpose of . . . negotiating the instrument." UCC § 3-204(a). Such an indorsement may be either a "special indorsement" or a "blank indorsement." See UCC § 3-205. A "special indorsement" is a written indorsement that specifically "identifies a person to whom it makes the instrument payable." UCC § 3-205(a). A "blank indorsement" is an indorsement that does not identify a person to whom the instrument is payable. See UCC § 3-205(b). Mortgage notes that are transferred in connection with loan securitizations are typically indorsed in blank with language such as "Pay to the order of ______________," where no name is filled in the blank. The effect of an indorsement in

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[8] It is important to note that Article 3 does not concern "ownership" of a mortgage note, but instead provides for the transfer of a mortgage note and the right to enforce such notes. See UCC § 3-301; UCC § 3-203 cmt. 1. A party need not be the "owner" of the mortgage note to enforce it. See UCC § 3-301 ("A person may be a person entitled to enforce the instrument even though the person is not the owner of the instrument or is in wrongful possession of the instrument."). Thus, a party may have the right to enforce the instrument, but not have "ownership" of that instrument. UCC § 3-203 cmt 1. For an example of situations where a party with the right to enforce an instrument is not also the "owner" of the instrument, see UCC 3-203 cmt. 1 and Note 12 infra.

[9] Note also that UCC § 3-203(c) provides for the scenario in which an instrument is transferred for value without the indorsement that, as described in the text below, would be needed for the mortgage note to have been "negotiated." Under that section, if a negotiable mortgage note is transferred for value as part of a loan securitization, but the transferor fails to indorse the note, the transferee of the note has the "specifically enforceable right to the unqualified indorsement of the transferor." UCC § 3-203(c); see Note 12, infra (discussing distinction between the right to enforce a mortgage note and ownership of the mortgage note).

blank is significant: "When indorsed in blank, an instrument becomes payable to bearer and may be negotiated by transfer of *possession* alone until specially indorsed." UCC § 3-205(b) (emphasis added).[10] See also UCC § 3-201(b) (The negotiation of a negotiable mortgage note that is payable to bearer (such as a negotiable mortgage note that has been indorsed in blank) is effected by "transfer of possession alone.").

The term "possession" is not defined in the UCC. Thus, courts rely on common law definitions of possession to interpret that concept in the context of the negotiation of an instrument such as a mortgage note. See, e.g., In re Kelton Motors, Inc., 97 F.3d 22, 26 (2d Cir. 1996) (because Article 3 does not define "possession," a court must look to the general law of the jurisdiction in determining whether a party is in possession of a negotiable instrument). Possession can be, and very often is, effected by an agent, nominee or designee, such as the designated custodian for the securitization trust. See, e.g., Midfirst Bank, SB v. C.W. Haynes and Co., Inc., 893 F. Supp. 1304, 1314-15 (D.S.C. 1994) (constructive possession exists when an authorized agent of the owner holds the note on behalf of the owner); Jenkins v. Evans, 31 A.D.2d 597, 598 (N.Y. App. Div. 3d Dept. 1968) (agent had authority to possess instruments for principal). In such cases, while the designated custodian has "physical" possession of the mortgage note, the trustee for which the custodian holds the mortgage note has "constructive" or "legal" possession. See Midfirst Bank, 893 F. Supp. at 1314-15; see also UCC § 9-313 cmt. 3 ("if the collateral is in [the] possession of an agent of the secured party for the purposes of possessing on behalf of the secured party, and if the agent is not also an agent of the debtor, the secured party has taken actual possession" (emphasis added)).

Who May Enforce A Negotiable Mortgage Note?

The maker of a mortgage note is obligated to pay the note to the "person entitled to enforce the instrument." UCC § 3-412. The "person entitled to enforce" a negotiable mortgage note includes "(i) the holder of the instrument, [and] (ii) a nonholder in possession of the instrument who has the rights of a holder." UCC § 3-301. Accordingly, to enforce a mortgage note against the borrower, a person must generally prove either that it is a "holder" or that it is a transferee with the rights of a holder. See UCC § 3-301.

The first category of persons that may enforce a mortgage note is a "holder." A "holder" of a negotiable mortgage note is "the person in possession of [the mortgage note] that is payable either to bearer or to an identified person that is the person in possession." UCC § 1-201(b)(21)(A). The manner in which one becomes a "holder" is described in the section above.

The second category contemplated by UCC § 3-301– a "nonholder in possession who has the rights of a holder" – is more difficult to define. Under this clause, a person would qualify as a "nonholder in possession" if possession of the mortgage note was transferred to him from the transferor, but the transferor did not indorse the mortgage note. See UCC § 3-203 cmt. 2. In this circumstance, the transferee is entitled to enforce the instrument, but to do so, the transferee must first prove both possession of the unindorsed mortgage note and prove the transfer of the mortgage note by the holder to the transferee. See id.[11] Under both clauses, the person

[10] An indorsement is considered to be made "on an instrument" for purposes of negotiation when it is made either on the mortgage note itself or on a separate paper, often referred to as an "allonge," that is affixed to the note. See UCC § 3-204(a). Once affixed, the allonge becomes "part of the instrument." Id.

[11] As noted above, the right to enforce an instrument and the ownership of that instrument are not necessarily the same. See UCC § 3-203 cmt. 1. Thus, a party may have the right to enforce the instrument, but not have "ownership" of that instrument. Id. A party

seeking to enforce the mortgage note must have possession of the note.

UCC § 3-301 also permits a person without possession to enforce a mortgage note where the mortgage note has been lost, stolen, or destroyed within the meaning of UCC § 3-309. See UCC § 3-301.[12] Courts have consistently affirmed the use of UCC § 3-309 to enforce lost, stolen or destroyed negotiable mortgage notes that a party, such as a securitization trustee, seeks to enforce when the party has proven the terms of the mortgage notes and its right to enforce the mortgage notes (i.e., it has proven the transfer of the mortgage note from the transferee). See, e.g., In re Montagne, 421 B.R. 65, 79 (D. Vt. 2009) (finding that plaintiff who satisfied requirements of UCC § 3-309 could enforce lost mortgage note); Waggoner v. Mortgage Elect. Registration Sys., Inc., No. 2003-CA-002666-MR, 2005 WL 2175439, at *1 n.1 (Ky. App. Ct. Sept. 9, 2005) ("The promissory note was proven ... by an affidavit concerning a lost or destroyed promissory note.").

What Rights Against Borrower Defenses are Available to the Holder of a Negotiable Mortgage Note?

A key concept relating to the negotiation of negotiable mortgage notes is the "holder in due course" doctrine. That is because where the "holder" of a negotiable mortgage note is deemed a "holder in due course," the holder takes the mortgage note subject only to specific limited defenses of the borrower. The following is a brief summary of an expansive area of law. Under UCC § 3-302(a):

> [A] "holder in due course" means the holder of an instrument if:
>
> (1) the instrument when issued or negotiated to the holder does not bear such apparent evidence of forgery or alteration or is not otherwise so irregular or incomplete as to call into question its authenticity; and
>
> (2) the holder took the instrument (i) for value, (ii) in good faith, (iii) without notice that the instrument is overdue or has been dishonored or that there is an uncured default with respect to payment of another instrument issued as part of the same series, (iv) without notice that the instrument contains an unauthorized signature or has been altered, (v) without notice of any claim to the instrument described in Section 3-306 [regarding claims of a property or possessory right in the instrument or its proceeds, including a claim to rescind a negotiation and to recover the instrument or its proceeds], and (vi) without notice that any party has a defense or claim in recoupment described in Section 3-305(a).

UCC § 3-302(a).

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need not be the "owner" of the note to enforce it. See UCC § 3-301 ("A person may be a person entitled to enforce the instrument even though the person is not the owner of the instrument or is in wrongful possession of the instrument."). For example, if X (holder of an instrument payable to X) sells the instrument to Y pursuant to a document conveying all of X's right, title and interest in the instrument to Y, but does not deliver immediate possession to Y, Y would have ownership of the instrument under the agreement, but Y generally would not be entitled to enforce the instrument until it obtained possession of the instrument. Id.

[12] UCC § 3-301 also permits a person without possession to enforce a mortgage note where, in certain circumstances, there has been mistaken payment as defined in UCC § 3-418(d).

Under Article 3, a holder in due course of a negotiable mortgage note takes the mortgage note free of (a) all prior claims to or regarding the mortgage note by any person and (b) most defenses to enforceability of the mortgage note that may be raised by parties with whom the holder in due course has not dealt. See UCC §§ 3-305 and 3-306; see also Provident Bank v. Community Home Mortgage Corp., 498 F. Supp. 2d 558, 565 (E.D.N.Y. 2007). The defenses to which a holder in due course may be subject are found in UCC § 3-305, and include:

> a defense of the obligor based on (i) infancy of the obligor to the extent it is a defense to a simple contract, (ii) duress, lack of legal capacity, or illegality of the transaction which, under other law, nullifies the obligation of the obligor, (iii) fraud that induced the obligor to sign the instrument with neither knowledge nor reasonable opportunity to learn of its character or its essential terms, or (iv) discharge of the obligor in insolvency proceedings.

UCC § 3-305(a)(1).

How Is a Mortgage Note Transferred Under Article 9 of the UCC?

The sale of mortgage notes is also governed, in significant part, by Article 9. Article 9 establishes (1) whether the interests of a transferee of a mortgage note have both "attached" and become "perfected" so that those interests will prevail over conflicting claims of third parties and (2) the rights of the transferee in and to the underlying mortgage that secures the mortgage note.

Article 9 addresses the sale of mortgage notes, regardless of whether they are negotiable or non-negotiable.[13] More specifically, Article 9 applies to "a sale of . . . promissory notes." UCC § 9-109(a)(3). A "promissory note" is defined as "an instrument that evidences a promise to pay a monetary obligation, does not evidence an order to pay, and does not contain an acknowledgment by a bank that the bank has received for deposit a sum of money or funds." UCC § 9-102(a)(65).[14] Given this broad definition, residential mortgage notes in common use today are typically "promissory notes" for purposes of Article 9.

Under Article 9, the sale of a mortgage note (whether or not the mortgage note is negotiable) is deemed a secured transaction and the transferee's "security interest" is automatically perfected when it attaches (more on "attachment" and "perfection" below). See UCC § 9-309(4). While security interests are most commonly thought of as the liens obtained by lenders, the UCC defines the term "security interest" to also include "any interest of a . . . buyer of . . . a promissory note in a transaction that is subject to Article 9." UCC § 1-201(b)(35) (emphasis

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[13] Article 9 also applies to the creation of a lien on, or a "less-than-ownership security interest" in, a mortgage note. Because most assignments and transfers of mortgage notes in loan securitizations are of the ownership of the mortgage notes, not a mere lien on or security interest in the notes, this paper addresses only outright sales of mortgage notes under Article 9. The principles discussed below regarding attachment of a buyer's interest in a sale of mortgage notes are identical to those that apply in the context of the creation of a lien on mortgage notes, and the principles regarding perfection of the interest in the mortgage notes are likewise very similar. "Although . . . Article [9] occasionally distinguishes between outright sales of receivables and sales that secure an obligation, neither . . . Article [9] nor the definition of "security interest" (Section 1-201(37)) delineates how a particular transaction is to be classified. That issue is left to the courts." UCC § 9-109 cmt 4.

[14] Under Article 9, the term "instrument" is defined broadly as "a negotiable instrument or any other writing that evidences a right to the payment of a monetary obligation, is not itself a security agreement or lease, and is of a type that in ordinary course of business is transferred by delivery with any necessary indorsement or assignment." UCC § 9-102(a)(47).

added). In addition, the definition of "secured party" includes "a person to which . . . promissory notes have been sold." UCC § 9-102(a)(72)(D).

Before a buyer's "security interest" in a mortgage note can be perfected under Article 9, the security interest must "attach." A security interest attaches when (1) value has been given for the sale, (2) the seller has rights in the mortgage note or the power to transfer rights in the mortgage note to the buyer and (3) either (a) the mortgage note is in the possession of the buyer pursuant to a security agreement of the seller or (b) the seller has signed a written or electronic security agreement that describes the mortgage note. See UCC § 9-203(b). Article 9 defines "security agreement" as "an agreement that creates or provides for a security interest," UCC § 9-102(a)(73), which, in the context of a mortgage loan securitization, would include an agreement pursuant to which mortgages and mortgage notes are sold and transferred from one entity to another. Such an agreement, normally a pooling and servicing agreement or trust agreement, typically will provide that the transfer of the mortgage note pursuant thereto effects a sale of the mortgage note, which would thus, under Article 9, constitute a "security agreement."

Significantly, the attachment of a security interest in a mortgage note that is itself "secured by a security interest or other lien on personal or real property is also attachment of a security interest in the security interest, mortgage or other lien." UCC § 9-203(g) (emphasis added).[15] Similarly, under UCC § 9-308(e), perfection of a security interest in a promissory note "also perfects a security interest in a security interest, mortgage, or other lien on personal or real property securing the right." UCC § 9-308(e) (emphasis added). In other words, perfection of a security interest (which includes a sale to a buyer) in a mortgage note pursuant to Article 9 also perfects a security interest in the mortgage that secures the note.

Perfection of the interest in the mortgage note is important because it provides the transferee of the mortgage note with a right in the mortgage note and mortgage superior to that of a subsequent lien creditor of the seller. And, perfection provides the transferee of the mortgage note with a right in the mortgage superior to that of a subsequent lien creditor of the mortgagee, which includes a bankruptcy trustee (see UCC § 9-102(a)(52)). See UCC § 9-308 cmt. 6.

Transfer of Mortgage Notes: Conclusion

In summary, under the UCC, the transfer of a mortgage note that is a negotiable instrument is most commonly effected by indorsing the note, which may be a blank or special indorsement, and delivering the mortgage note to the transferee (or the agent acting on behalf of the transferee). As the residential mortgage notes in common usage typically are "negotiable instruments," this is the most common method of transfer. In addition, even without indorsement, the assignment can be effected by transferring possession under UCC § 3-203(a). Moreover, the sale of any mortgage note also effects the assignment and transfer of the mortgage under Article 9. The attachment and perfection of the buyer's interest in the mortgage note attaches and perfects

[15] The comments to UCC § 9-203 expressly provide that "Subsection (g) codifies the common-law rule that a transfer of an obligation secured by a security interest or other lien on personal or real property also transfers the security interest or lien." UCC § 9-203 cmt. 9; see also Restatement (Third) of Property (Mortgages) § 5.4(a) (1997). The same holds true for UCC § 9-308(e), under which perfection of a security interest in a mortgage note also accomplishes perfection of a security interest in the mortgage. See UCC § 9-308 cmt. 6.

the buyer's interest in the underlying mortgage that secures the mortgage note. Securitization agreements often provide both for (a) the indorsement and transfer of possession to the trustee or the custodian for the trustee, which would constitute a negotiation of the mortgage note under Article 3 of the UCC and (b) an outright sale and assignment of the mortgage note. Thus, regardless of whether the mortgage notes in a securitization trust are deemed "negotiable" or "non-negotiable," the securitization process generally includes a valid transfer of the mortgage notes to the trustee in accordance with the explicit requirements of the UCC.

3. Assignment and Transfer of Ownership of Mortgages

As described above, when a mortgage loan is assigned and transferred as part of the securitization of the loan in the secondary market, both the mortgage note and the mortgage itself are typically sold, assigned, and physically transferred to the trustee that is acting on behalf of the MBS investors or to a trustee-designated document custodian pursuant to a custody agreement. The assignment and transfer are usually documented and performed in accordance with a pooling and servicing agreement.

What is the Relationship Between the Transfer of a Mortgage Note and the Transfer of Ownership of the Mortgage?

When a mortgage note is transferred in accordance with common mortgage loan securitization processes, the mortgage is also automatically transferred to the mortgage note transferee under the UCC and the general common law rule that "the mortgage follows the note." See, e.g., Carpenter v. Longan, 83 U.S. 271, 275 (1873) ("The transfer of the note carries with it the security, without any formal assignment or delivery, or even mention of the latter."); Mortgage Elect. Registration Sys., Inc. v. Coakley, 41 A.D.3d 674, 674 (N.Y. App. Div. 2d Dept. 2007) ("the mortgage . . . passed as an incident to the promissory note"); Restatement (Third) of Property, Mortgages § 5.4(a) (1997) ("A transfer of an obligation secured by a mortgage also transfers the mortgage . . . . ").

The rule that "the mortgage follows the note" has been codified in the UCC, but the rule's common law origins date back hundreds of years, long before the creation of the UCC. As stated in the official comments to UCC § 9-203(g), that section "codifies the common-law rule that a transfer of an obligation secured by a security interest or other lien on personal or real property also transfers the security interest or lien." UCC § 9-203 cmt. 9.

All states follow this rule.[16] In addition to the codification of the rule under UCC § 9-203(g), reported

[16] However, in some states, such as Massachusetts and Minnesota, courts have held that the transfer of a mortgage note without an express transfer of the mortgage vests in the note holder only an equitable interest in the mortgage. See, e.g., First Nat'l Bank of Cape Cod v. North Adams Hoosac Savs. Bank, 7 Mass. App. Ct. 790, 796 (1979); Jackson v. Mortgage Elect. Registration Sys., Inc., 770 N.W.2d 487, 497, 500-01 (Minn. 2009). This arrangement has been described as follows: the holder of the mortgage holds the legal title to the mortgage in constructive trust for the benefit of the mortgage note holder. See First Nat'l Bank of Cape Cod, 7 Mass. App. Ct. at 796. In both states, however, case law suggests that foreclosure proceedings must be initiated by, or at least in the name of, the holder of the legal title in the mortgage. See Jackson, 770 N.W.2d at 500; U.S. Bank Nat'l Ass'n v. Ibanez, Nos. 08 MISC 384283 (KCL), 08 MISC 386755 (KCL), 2009 WL 3297551, at *11 (Mass. Land Ct. Oct. 14, 2009) (rejecting argument that note holders had authority to foreclose on mortgages for which their status as full mortgagees was in dispute) (currently on appeal to the Massachusetts Supreme Judicial Court).

court cases in nearly every state and non-UCC statutory provisions in some states make clear that "the mortgage follows the note":

Alabama: Armour Fertilizer Works v. Zills, 177 So. 136, 138 (Ala. 1937) ("when the note is secured by a mortgage, such mortgage follows the note").

Arizona: Ariz. Rev. Stat § 33-817 ("The transfer of any contract or contracts secured by a trust deed shall operate as a transfer of the security for such contract or contracts.").

Arkansas: Leach v. First Cmty. Bank, No. CA 07-05, 2007 WL 2852599, at *1 (Ark. App. Ct. Oct. 3, 2007) ("Arkansas has long followed the rule that, in the absence of an agreement or a plain manifestation of a contrary intention, the security of the original mortgage follows the note or renewal thereof.").

California: Cal. Civ. Code § 2936 ("The assignment of a debt secured by mortgage carries with it the security"); In re Staff Mortgage & Invest. Corp., 625 F.2d 281, 284 (9th Cir. 1980) (in California, "[A] deed of trust is a mere incident of the debt it secures and . . . an assignment of the debt 'carries with it the security." (internal quotation omitted)).

Colorado: Carpenter v. Longan, 83 U.S. 271, 275 (1873) (in an appeal from the Supreme Court of Colorado Territory, the United States Supreme Court stated: "The transfer of the note carries with it the security, without any formal assignment or delivery, or even mention of the latter.").

Connecticut: Conn. Gen. Stat. § 49-17 ("When any mortgage is foreclosed by the person entitled to receive the money secured thereby but to whom the legal title to the mortgaged premises has never been conveyed, the title to such premises shall, upon the expiration of the time limited for redemption and on failure of redemption, vest in him in the same manner and to the same extent as such title would have vested in the mortgagee if he had foreclosed, provided the person so foreclosing shall forthwith cause the decree of foreclosure to be recorded in the land records in the town in which the land lies."); In re AMSCO, Inc., 26 B.R. 358, 361 (Bankr. D. Conn. 1982) ("An assignment of the note carries the mortgage with it . . . .").

District of Columbia: Hill v. Hawes, 144 F.2d 511, 513 (D.C. Cir. 1944) (after mortgage note has been cancelled, cancellation of "any mortgage follows as a matter of course and does not require a separate action").

Florida: Capital Investors Co. v. Ex'rs of Estate of Morrison, 484 F.2d 1157, 1163 n.12 (4th Cir. 1973) ("That the mortgage follows the note it secures and derives negotiability, if any, from the note is the rule in Florida where the land under mortgage in this case was located." (citing Daniels v. Katz, 237 So.2d 58, 60 (Fla. App. 1970); Meyerson v. Boyce, 97 So.2d 488, 489 (Fla. App. 1957))); Margiewicz v. Terco Properties, 441 So.2d 1124, 1125 (Fla. Dist. Ct. App. 1983) (when a note secured by a mortgage is assigned, the mortgage follows the note into the hands of the mortgagee).

Illinois: Federal Nat'l Mort. Ass'n v. Kuipers, 314 Ill. App.3d 631, 635, 732 N.E.2d 723, 727 (Ill. Ct. App. 2000) ("The assignment of a mortgage note carries with it an equitable assignment of the mortgage by which it was secured. The assignee stands in the shoes of the assignor-mortgagee with regard to the rights and interests under the note and mortgage. . . . [I]n Illinois, the assignment of the mortgage note is sufficient to transfer the underlying mortgage.") (citations omitted).

Indiana: Lagow v. Badollet, 1 Blackf. 416, 1826 WL 1087, at *3 (Ind. 1826) ("a mortgage . . . follows the debt into whose hands soever it may pass").

Iowa: Bremer County Bank v. Eastman, 34 Iowa 392, 1872 WL 254, at *1 (Iowa 1872) ("The transfer of the note, secured by the mortgage, carried the mortgage with it as an incident to the debt, and the indorsee of the note could maintain an action in his own name, to foreclose the mortgage without any assignment thereon whatever.").

Kansas: Kan. Stat. Ann § 58-2323 ("The assignment of any mortgage as herein provided shall carry with it the debt thereby secured."); Bank Western v. Henderson, 255 Kan. 343, 354, 874 P.2d 632, 640 (1994) ("[T]he mortgage follows the note. A perfected claim to the note is equally perfected as to the mortgage.").

Maryland: In re Bird, No. 03-52010-JS, 2007 WL 2684265, at *2-4 (Bankr. D.Md. Sept. 7, 2007) ("The note and mortgage are inseparable; the former as essential, the latter as an incident. An assignment of the note carries the mortgage with it . . . .").

Massachusetts: The transfer of a mortgage note, without the express transfer of the mortgage, vests in the note holder an equitable interest in the mortgage (an interest that can be enforced by the note holder) and the mortgage holder is deemed to hold the mortgage in constructive trust for the benefit of the note holder. See Weinberg v. Brother, 263 Mass. 61, 62 (1928); Barnes v. Boardman, 149 Mass. 106, 114 (1889); Morris v. Bacon, 123 Mass. 58, 59 (1877); First Nat'l Bank of Cape Cod v. North Adams Hoosac Savs. Bank, 7 Mass. App. Ct. 790, 796 (1979); see also In re Ivy Properties, Inc., 109 B.R. 10, 14 (Bankr. D. Mass. 1989) ("[U]nder Massachusetts common law the assignment of a debt carries with it the underlying mortgage, without necessity for the granting or recording of a separate mortgage assignment.").

Despite the above cited authorities, the Massachusetts Land Court in a recent opinion cast doubt on the "mortgage follows the note" rule:

> [E]ven a valid transfer of the note does not automatically transfer the mortgage. . . . The holder of the note may have an equitable right to obtain an assignment of the mortgage by filing an action in equity, but that is all it has. . . . The mortgage itself remains with the mortgagee (or, if properly assigned, its assignee) who is deemed to hold the legal title in trust for the purchaser of the debt until the formal assignment of the mortgage to the note holder or, absent such assignment, by order of the court in an action for conveyance of the mortgage. . . . But . . . the right to get something and actually having it are two different things.

U.S. Bank Nat'l Ass'n v. Ibanez, Nos. 08 MISC 384283 (KCL), 08 MISC 386755 (KCL), 2009 WL 3297551, at *11 (Mass. Land Ct. Oct. 14, 2009) (citations omitted).

The Ibanez case appears to stand in stark contrast to the principles embodied in the UCC. The Ibanez case is currently pending on appeal before the Massachusetts Supreme Judicial Court, that state's highest court.

Michigan: Prime Fin. Serv. v. Vinton, 279 Mich. App. 245, 257, 761 N.W.2d 694, 704 (Mich. Ct. App. 2008) ("the transfer of a note necessarily includes a transfer of the mortgage with it") (citing Ginsberg v. Capitol City Wrecking Co., 300 Mich. 712, 717, 2 N.W.2d 892 (1942)); Jones v. Titus, 208 Mich. 392, 397, 175 N.W. 257, 259 (Mich. 1919) (when a note given with a mortgage was indorsed over to a third party it carried with it the equitable title to the mortgage).

Minnesota: Jackson v. Mortgage Elect. Registration Sys., Inc., 770 N.W.2d 487, 497 (Minn. 2009) ("Absent an agreement to the contrary, an assignment of the promissory note operates as an equitable assignment of the underlying security interest.") (emphasis in original).

Mississippi: Holmes v. McGinty, 44 Miss. 94, 1870 WL 4406, at *4 ("[T]he mortgage . . . follows the debt as an incident, and is a security for whomsoever may be the beneficial owner of it.").

Missouri: George v. Surkamp, 76 S.W.2d 368, 371 (Mo. 1934) (when the holder of the promissory note assigns or transfers the note, the deed of trust is also transferred).

Montana: First Nat'l Bank v. Vagg, 65 Mont. 34, 212 P. 509, 511 (Mont. 1922) ("The note and mortgage are inseparable; the former as essential, the latter as an incident. An assignment of the note carries the mortgage with it, while the assignment of the latter alone is a nullity. The mortgage can have no separate existence.") (citations omitted).

Nebraska: In re Union Packing Co., 62 B.R. 96, 100 (Bankr. D. Neb. 1986) (with or without the assignment of the mortgage, the assignee of the promissory note has the right to enforce the mortgage securing the note).

New Hampshire: Southerin v. Mendum, 5 N.H. 420, 1831 WL 1104, at *7 (N.H. 1831) ("When a mortgagee transfers to another person , the debt which is secured by the mortgage, he ceases to have any control over the mortgage. . . . And we are of the opinion, that the interest of the mortgagee passes in all cases with the debt, and that it is not within the statute of frauds, because it is a mere incident to the debt, has no value independent of the debt, and cannot be separated from the debt.").

New Jersey: In re Kennedy Mort. Co., 17 B.R. 957, 966 (Bankr. D. N.J. 1982) ("Anyone interested in acquiring an interest in the mortgage would be obliged to obtain an interest in the debt.").

New York: Mortgage Elec. Registration Sys., Inc. v. Coakley, 41 A.D.3d 674, 838 N.Y.S.2d 622 (App. Div. 2007) ("at the time of the commencement of this action, MERS was the lawful holder of the promissory note (see UCC 3-204[1]; Franzese v. Fidelity N.Y. FSB, 214 A.D.2d 646, 625 N.Y.S.2d 275), and of the mortgage, which passed as an incident to the promissory note (see Payne v. Wilson, 74 N.Y. 348, 354-355; see also Weaver Hardware Co. v. Solomovitz, 235 N.Y. 321, 139 N.E. 353; Matter of Falls, 31 Misc. 658, 660, 66 N.Y.S. 47, aff'd. 66 A. D. 616, 73 N.Y.S. 1134") (emphasis added); Provident Bank v. Community Home Mortgage Corp., 498 F. Supp. 2d 558, 564-65 (E.D.N.Y. 2007) (applying principle that the mortgage follows the note).

North Carolina: Dixie Grocery Co. v. Hoyle, 204 N.C. 109, 167 S.E. 469 (1933) ("The mortgage follows the debt.").

Ohio: U.S. Nat'l Bank Ass'n v. Marcino, 181 Ohio App.3d 328, 337 (2009) ("[T]he negotiation of a note operates as an equitable assignment of the mortgage, even when the mortgage is not assigned or delivered. Kuck v. Sommers (1950), 100 N.E.2d 68, 75, 59 Ohio Abs. 400. Various sections of the Uniform Commercial Code, as adopted in Ohio, support the conclusion that the owner of a promissory note should be recognized as the owner of the related mortgage. . . . Thus, although the recorded assignment is not before us, there is sufficient evidence on the record to establish that appellee is the current owner of the note and mortgage at issue in this case, and, therefore, the real party in interest.") (citations to Ohio's versions of UCC §§ 9-109(a)(3), 9-102(a)(72)(D) and 9-203(g) omitted).

Oklahoma: Zorn v. Van Buskirk, 111 Okla. 211, 239 P. 151 (1925) ("the mortgage follows the note").

Pennsylvania: In re Miller, No. 99-25616JAD, 2007 WL 81052, at *6 & n.7 (Bankr. W.D. Pa. Jan. 9, 2007) (citing and quoting with approval Gray, Mortgages in Pennsylvania at § 1-3 (1985) ("the mortgage follows the note")).

South Carolina: MidFirst Bank, SSB v. C.W. Haynes & Co., Inc., 893 F. Supp. 1304, 1318 (D. S.C. 1994) ("South Carolina recognizes the 'familiar and uncontroverted proposition' that 'the assignment of a note secured by a mortgage carries with it an assignment of the mortgage.' Hahn v. Smith, 157 S.C. 157, 154 S.E. 112 (1930); Ballou v. Young, 42 S.C. 170, 20 S.E. 84 (1894).").

Texas: Kirby Lumber Corp. v. Williams, 230 F.2d 330, 333 (5th Cir. 1956) (applying Texas law) ("The rule is fully recognized . . . that a mortgage to secure a negotiable promissory note is merely an incident to the debt, and passes by assignment or transfer of the note.").

Utah: Smith v. Jarman, 211 P. 962, 966 (Utah 1922) ("The modern doctrine that the mortgage follows the note as an incident was thus long ago recognized by this court . . . .").

Virginia: Yerby v. Lynch, 3 Gratt. 460, 1847 WL 2384, at *8-10 (Va. 1847) ("the mortgage follows the debt").

Virgin Islands: UMLIC VP LLC v. Matthias, 234 F. Supp. 2d 520, 523 (D. V.I. 2002) (citing and quoting with approval the "RESTATEMENT (THIRD) OF PROPERTY, MORTGAGES § 5.4(a) (1997). The comment to this section further explains that '[t]he principle of this subsection, that the mortgage follows the note, ... applies even if the transferee does not know that the obligation is secured by a mortgage.... Recordation of a mortgage assignment is not necessary to the effective transfer of the obligation or the mortgage securing it.' Id. § 5.4 cmt. b (1997). Accordingly, in the Virgin Islands, no separate document specifically assigning and transferring the mortgage which secures a note is required to accompany the assignment of the obligation, because the mortgage automatically follows the note.").

Washington: Nance v. Woods, 79 Wash. 188, 189, 140 P. 323, 323 (Wash. 1914) ("the mortgage follows the note").

As mentioned above, the general common law rule that "the mortgage follows the note" is codified in Article 9 of the UCC. Section 9-203(g) of the UCC states: "The attachment of a security interest in a right to payment or performance secured by a security interest or other lien on personal or real property is also attachment of a security interest in the security interest, mortgage, or other lien."[17] UCC § 9-203(g) (emphasis added). The phrase "security interest" in this provision includes a buyer's ownership interest because UCC § 1-201(b)(35) defines "security interest" to include "any interest of a . . . buyer of . . . a promissory note in a transaction that is subject to Article 9." Thus, under Article 9, a sale of a mortgage note means that the buyer's rights attach not only to the mortgage note itself but also to the mortgage that secures the mortgage note. Moreover, under UCC § 9-308(e), those rights are perfected and can be enforced against third parties.[18] Regarding the impact of these UCC provisions, one treatise states: "Article 9 makes it as plain as possible that the secured party need not record an assignment of mortgage, or anything else, in the real property records in order to perfect its rights in the mortgage." J. McDonnell and J. Smith, Secured Transactions Under the Uniform Commercial Code, § 16.09[3][b].

Courts in several states have affirmed and applied the "mortgage follows the note" rule in cases where the mortgage assignment was not recorded by the transferee.[19] See, e.g., Nat'l Livestock Bank v. First Nat. Bank, 203 U.S. 296, 307-08 (1906) (citing with approval a decision of the Supreme Court of Kansas for the proposition that "where a mortgage upon real estate is given to secure payment of a negotiable note, and before its maturity the note and mortgage are transferred by indorsement of the note to a bona fide holder, the assignment, if there be a written one, need not be recorded"); Jackson v. Mortgage Elec. Registration Sys., Inc., 770 N.W.2d 487, 497-98, 500 (Minn. 2009) (applying the "mortgage follows the note" rule where there was no assignment of the mortgage); UMLIC VP LLC v. Matthias, 234 F. Supp. 2d 520, 523 (D. V.I. 2002) ("Recordation of a mortgage assignment is not necessary to the effective transfer of the obligation or the mortgage securing it."); Federal Nat'l Mort. Ass'n v. Kuipers, 314 Ill. App. 3d 631, 635, 732 N.E.2d 723, 727 (Ill. Ct. App. 2000) ("Because the assignment of the debt, with nothing more, is sufficient to preserve the mortgage lien, it cannot follow that the lien is somehow extinguished for the failure to record the assignment. Therefore, we are persuaded that the

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[17] Courts have observed that UCC § 9-203(g) codifies the "mortgage follows the note" rule. See, e.g., U.S. Nat'l Bank Ass'n v. Marcino, 181 Ohio App.3d 328, 337 (2009) (quoting with approval Official Comment 9 to UCC § 9-203: "subsection (g) [of UCC § 9-203] codifies the common-law rule that a transfer of an obligation secured by a security interest or other lien on personal or real property also transfers the security interest or lien").

[18] As discussed above, UCC § 9-308(e) provides that "perfection of a security interest in a right to payment or performance also perfects a security interest in a security interest, mortgage, or other lien on personal or real property securing the right." UCC § 9-308(e) (emphasis added).

[19] In most states, recording of an assignment of mortgage is generally not required to ensure the enforceability of the assignment of mortgage as between the assignor and assignee, and anyone with knowledge thereof. It is beyond the scope of this paper to discuss in detail the potential risks to the mortgage transferee of not recording a mortgage assignment. Those risks might include, among others, delaying the transferee's ability to foreclose on the mortgage, failing to receive notices that may go to the mortgagee of record, and otherwise leaving the assignee open to negligent or fraudulent actions or inactions by the mortgagee of record that could bind the mortgage transferee and impair the value or enforceability of the mortgage. Similarly, when an assignment of mortgage is not recorded, the assignor may be liable for certain obligations imposed upon a mortgagee of record, such as the obligation to provide a pay-off statement or mortgage release within a designated time period.

mortgage lien and priority position inure to the benefit of the assignee and that recording the assignment is unnecessary to preserve the security for the debt."); In re Kennedy Mortgage Co., 17 B.R. 957, 964 (Bankr. D.N.J. 1982) ("The fact that assignments of mortgages may be recorded does not affect the validity of an assignment of a mortgage which has not been recorded.").

Courts have also affirmed and applied the "mortgage follows the note" rule even when there was no actual separate written assignment of the mortgage. See, e.g., Carpenter v. Longan, 83 U.S. 271, 275 (1873) ("The transfer of the note carries with it the security, without any formal assignment or delivery, or even mention of the latter."); Chase Home Fin., LLC v. Fequiere, 119 Conn. App. 570, 989 A.2d 606, 610-11 (Conn. Ct. App. 2010) ("General Statutes § 49-17 [which codifies the "mortgage follows the note" rule] permits the holder of a negotiable instrument that is secured by a mortgage to foreclose on the mortgage even when the mortgage has not yet been assigned to him." (emphasis added)); U.S. Nat'l Bank Ass'n v. Marcino, 181 Ohio App.3d 328, 337 (2009) (holding that bank was the "current owner" of a mortgage note and the related mortgage despite the fact that "there is no evidence on the record that appellee is the current assignee of the note and mortgage," and finding that "the negotiation of a note operates as an equitable assignment of the mortgage, even when the mortgage is not assigned or delivered" (citing Kuck v. Sommers, 100 N.E.2d 68, 75, 59 Ohio Abs. 400 (1950)); UMLIC VP LLC v. Matthias, 234 F. Supp. 2d 520, 523 (D. V.I. 2002) (the principle "that the mortgage follows the note, . . . applies even if the transferee does not know that the obligation is secured by a mortgage"); In re Union Packing Co., 62 B.R. 96, 100 (Bankr. D. Neb. 1986) (with or without the assignment of the mortgage, the assignee of the promissory note has the right to enforce the mortgage securing the note); Morris v. Bacon, 123 Mass. 58, 59 (1877) (note holder that endorsed and delivered mortgage note to bank as security for a loan, but without an assignment of the mortgage, was required by the court to transfer the mortgage to the bank); Bremer County Bank v. Eastman, 34 Iowa 392, 1872 WL 254, at *1 (Iowa 1872) ("The transfer of the note, secured by the mortgage, carried the mortgage with it as an incident to the debt, and the indorsee of the note could maintain an action in his own name, to foreclose the mortgage without any assignment thereon whatever."); Southerin v. Mendum, 5 N.H. 420, 1831 WL 1104, at *8 (N.H. 1831) ("the right of the mortgagee before foreclosure is . . . assignable by a mere assignment of the debt, without deed or writing").

Common MBS practices, as described above, are consistent with the general rule that "the mortgage follows the note": pursuant to the pooling and servicing agreement that governs a mortgage-loan securitization, and the language of assignment typically contained in such an agreement, the mortgage note and the mortgage itself are sold, assigned, transferred and delivered to the trustee, and the transferor also typically delivers a written assignment of the mortgage that is in blank in recordable form. Courts have held that the language of assignment contained in a pooling and servicing agreement, along with the corresponding transfer, sale and delivery of the mortgage note and mortgage, are sufficient to transfer the mortgage to the transferee/trustee or its designee or nominee. See, e.g., Wells Fargo Bank, N.A. v. Konover, No. 3:05 CV 1924 (CFD), 2009 WL 2710229, at *3 (D. Conn. Aug. 21, 2009) (MBS pooling agreement vested authority in pool trustee to bring legal action in the event of default); U.S. Bank N.A. v. Cook, No. 07 C 1544, 2009 WL 35286, at *2-3 (N.D. Ill. Jan. 6, 2009) (MBS pooling trust agreement effected an assignment of the mortgage at issue to the pool trustee); In re Samuels, 415 B.R. 8, 18 (Bankr. D. Mass. 2009) ("The [Pooling and Servicing Agreement] itself [by which the MBS loan trust was created], in conjunction with the schedule of mortgages deposited through it into the pool trust, served as a written assignment of the designated mortgage loans, including the mortgages themselves."); EMC Mortgage Corp. v. Chaudhri FSB, 400 N.J. Super. 126, 141, 946 A.2d 578, 588 (N.J. Super. Ct. 2008) ("any [mortgage] assignment shall pass and convey the estate of the assignor in the mortgaged premises, and the assignee may sue thereon in his own name.'" (citing New Jersey Stat. Ann. § 46:9-9 and Byram Holding Co. v. Bogren, 2 N.J. Super. 331, 336, 63 A.2d 822 (N.J. Ch. Div. 1949)); LaSalle Bank N.A. v. Lehman Bros. Holdings, Inc., 237 F. Supp. 2d 618, 632-33 (D. Md. 2002) (MBS pooling agreement granted trustee authority to bring suit on behalf of trust); LaSalle Bank N.A. v. Nomura Asset Capital Corp., 180 F. Supp. 2d 465, 470-71 (S.D.N.Y. 2001) (language in the pooling and servicing agreement for MBS trust effectually assigned mortgage to the pool trustee).[20]

What is the Relationship Between the UCC and State Real Property Laws?

Article 9 does not apply to "the creation or transfer of an interest in or lien on real property, . . . except to the extent that provision is made for . . . liens on real property in Sections 9-203 and 9-308." UCC § 9-109(d)(11) (emphasis added). As discussed above, UCC § 9-203(g) provides that, when a security interest in a mortgage note attaches, a security interest in the underlying mortgage also attaches, and UCC § 9-308(e) provides the same regarding the perfection of the security interest. See UCC § 9-203 cmt. 9 (the "mortgage follows the note" rule codified into UCC §§ 9-203(g) and 9-308(e)). In addition, UCC § 9-109(b) makes clear that Article 9 does apply to mortgage notes even though Article 9 does not govern the creation of the mortgage itself:

> The application of this article [9] to a security interest [remember that this term is defined to include any interest of a buyer of a promissory note in a transaction subject to Article 9] in a secured obligation [e.g., mortgage note] is not affected by the fact that the obligation [e.g., mortgage note] is itself secured by a transaction or interest [e.g., creation of the mortgage or deed of trust itself] to which this article does not apply.

UCC § 9-109(b).[21]

The creation of an interest in or lien on real property, including a mortgage, is governed by the non-UCC law of the state in which the property is located. See, e.g., Oregon v. Corvallis Sand and Gravel Co., 429 U.S. 363, 378-79 (1977). Likewise, the enforceability of mortgages (including the right and

[20] Although the rule is "the mortgage follows the note" when a mortgage note is assigned, some case law indicates that the converse is not true and that the mortgage note does not necessarily follow the mortgage if there is an attempted assignment of the mortgage alone or separate from the mortgage note. See, e.g., Bellistri v. Ocwen Loan Servicing, LLC, 284 S.W.3d 619, 623 (Mo. Ct. App. 2009) ("An assignment of the deed of trust separate from the note has no 'force.'"); Saxon Mort. Serv., Inc. v. Hillery, No. C-08-4357 EMC, 2008 WL 5170180, at *4-5 (N.D. Cal. Dec. 9, 2008) ("For there to be a valid assignment, there must be more than just assignment of the deed [of trust] alone; the note must also be assigned."); In re Wilhelm, 407 B.R. 392, 400-05 (Bankr. D. Idaho 2009); Kelley v. Upshaw, 39 Cal.2d 179, 192 (1952) ("In any event, Kelley's purported assignment of the mortgage without an assignment of the debt which is secured was a legal nullity."). This is consistent with the longstanding aspect of the "mortgage follows the note" rule that "the note and mortgage are inseparable; the former as essential, the latter as an incident." In re Bird, No. 03-52010-JS, 2007 WL 2684265, at *2-4 (Bankr. D.Md. Sept. 7, 2007).

[21] UCC Article 3, which applies to negotiable mortgage notes, does not apply to mortgages themselves because mortgages do not fit the definition of "negotiable instrument" in UCC § 3-104(a).

method to foreclose) is subject to all of the conditions precedent and requirements that are set forth in the particular mortgage itself and in all applicable state and local laws. Those conditions precedent and procedural requirements vary from mortgage to mortgage and from state to state. Thus, ownership of a mortgage (i.e., without notice to the mortgagor or the public, without judicial proceedings (where required), without satisfaction of other conditions precedent or procedural requirements in the mortgage itself or in applicable state law), does not always give the holder of the mortgage the legal ability to foreclose on the mortgage. Though a discussion of the other necessary prerequisites to foreclosure is beyond the scope of this paper, the fact that other steps may need to be taken by the owner of a mortgage note, or the owner of a mortgage, is neither unique nor surprising in our legal and regulatory system and does not diminish an otherwise legally effective transfer of the mortgage note and mortgage.

How Does the Use of MERS Affect These Issues?

The use of MERS as the nominee for the benefit of the trustee and other transferees in the mortgage loan securitization process has been a subject of litigation in recent years. See, e.g., Bellistri v. Ocwen Loan Servicing, LLC, 284 S.W.3d 619, 623 (Mo. Ct. App. 2009). Some cases address the authority or ability of MERS or transferees of MERS to foreclose on a mortgage for which MERS is or was the mortgagee of record. See, e.g., Saxon Mort. Serv., Inc. v. Hillery, No. C-08-4357 EMC, 2008 WL 5170180, at *4-5 (N.D. Cal. Dec. 9, 2008). As a general matter, the assignment and transfer of a mortgage to MERS as nominee of and for the benefit of the beneficial owner of the mortgage does not adversely impact the right to foreclose on the mortgage.

Decisions in many jurisdictions support this conclusion. See, e.g., In re Mortgage Elect. Registration Sys., Inc. (MERS) Litig., No. 2:09-md-2119, 2010 WL 4038788, at *8 (D. Ariz. Sept. 30, 2010) ("Plaintiffs have not cited any legal authority where the naming of MERS . . . was cause to enjoin a non-judicial foreclosure as wrongful."); Commonwealth Property Advocates, LLC v. Mortgage Elect. Registration Sys., Inc., No. 2:10-CV-340 TS, 2010 WL 3743643, at *3 (D. Utah Sept. 20, 2010) (MERS as nominee has authority to foreclose); Taylor v. Deutsche Bank Nat'l Trust Co., No. 5D09-4035, 2010 WL 3056612, at *3 (Fla. App. Aug. 6, 2010) ("[T]he written assignment of the note and mortgage from MERS to Deutsche Bank properly transferred the note and mortgage. . . . The transfer, moreover, was not defective by reason of the fact that MERS lacked a beneficial ownership interest in the note at the time of the assignment, because MERS was lawfully acting in the place of the holder and was given explicit and agreed upon authority to make just such an assignment."); Mortgage Elect. Registration Sys., Inc. v. Bellistri, No. 4:09-CV-731 CAS, 2010 WL 2720802, at *15 (E.D. Mo. July 1, 2010) ("[a]s the nominee of the original lender ... or the lender's assigns, MERS has bare legal title to the note and deed of trust securing it, and this is sufficient to create standing" to initiate foreclosure proceedings); Silvas v. GMAC Mortgage, LLC, No. CV-09-265-PHX-GMS, 2009 WL 4573234, at *8 (D. Ariz. Jan. 5, 2010) (MERS empowered to foreclose where MERS is designated on deed of trust as beneficiary); Diessner v. Mortgage Elec. Registration Sys., 618 F. Supp. 2d 1184, 1187-91 (D. Ariz. 2009) (MERS and trustee under deed of trust are authorized to institute non-judicial foreclosure proceeding); Jackson v. Mortgage Elec. Registration Sys., Inc., 770 N.W.2d 487, 501 (Minn. 2009) (rejecting argument that transfer of mortgage note to MERS is a transfer that must be recorded before foreclosure); Reynoso v. Paul Financial, LLC, No. 09-3225 SC, 2009 WL 3833298, at *2 (N.D. Cal. Nov. 16, 2009) (naming of MERS as initial beneficiary under deed of trust, as nominee for the lender, and the subsequent transfer of the deed of trust from MERS to a transferee was effective and did not hinder transferee's right to foreclose); Blau v. America's Servicing Co., No. CV-08-773, 2009 WL 3174823, at *8 (D. Ariz. Sept. 29, 2009) (MERS authorized under deed of trust to act on behalf of lender and transfer its interests); Farahani v. Cal-Western Recon. Corp., No. 09-194, 2009 WL 1309732, at *2-3 (N.D. Cal. May 8, 2009) (MERS authorized to pursue non-judicial foreclosure action); Vazquez v. Aurora Loan Servs., No 2:08-cv-01800-RCJ-RJJ, 2009 WL 1076807, at *1 (D. Nev. Apr. 20, 2009) (loan documents sufficiently demonstrate MERS' standing "with respect to the loan and the foreclosure"); Pfannenstiel v. Mortgage Elect. Registration Sys., Inc., No. CIV S-08-2609, 2009 WL 347716, at *4 (E.D. Cal. Feb. 11, 2009) (dismissing plaintiff's claim that MERS lacked authority to foreclose); Trent v. Mortgage Elect. Registration Sys., Inc., 288 Fed. App'x 571, 572 (11th Cir. 2008) (MERS "has the legal right to foreclose on the debtors' property" and "is the mortgagee"); Peyton v. Recontrust Co., No. TC021868, Notice of Ruling, at 2 (Cal. Super. Ct. County of Los Angeles S. Cent. Dist. Oct. 15, 2008) (MERS may foreclose under California law); Johnson v. Mortgage Elect. Registration Sys., Inc., 252 Fed. App'x 293, 294 (11th Cir. 2007) (summary judgment for MERS on its action for foreclosure of plaintiff's property); In re Smith, 366 B.R. 149, 151 (Bankr. D. Colo. 2007) (MERS has standing to conduct foreclosure on behalf of the beneficiary); Mortgage Elect. Registration Sys., Inc. v. Revoredo, 955 So.2d 33, 34 (Fla. Dist. Ct. App. 2007) ("Because, however, it is apparent – and we so hold – that no substantive rights, obligations or defenses are affected by use of the MERS device, there is no reason why mere form should overcome the salutary substance of permitting the use of this commercially effective means of business."); Mortgage Elect. Registration Sys., Inc. v. Ventura, CV054003168S, 2006 WL 1230265, at *1 (Conn. Super. Apr. 20, 2006) (MERS is proper party in foreclosure).

There are several minority decisions that, in some form, have taken issue with MERS. But none of these decisions, to our knowledge, has invalidated a mortgage for which MERS is the nominee, and none of these decisions has challenged MERS' ability to act as a central system to track changes in the ownership and servicing of loans:[22] See Rinegard-Guirma v. Bank of Am., Nat'l Ass'n, No. 10-1065-PK, 2010 WL 3945476, at *4 (D. Or. Oct. 6, 2010) (suggesting that MERS may not qualify as a legitimate beneficiary of a deed of trust under Oregon law, and preliminarily enjoining foreclosure action by MERS); In re Allman, No. 08-31282-elp7, 2010 WL 3366405, at *10 (Bankr. D. Or. Aug. 24, 2010) (same); Mortgage Elec. Registration Sys., Inc. v. Saunders, 2 A.3d 289, 297 (Me. 2010); In re Box, No. 10-20086, 2010 WL 2228289, at *5 (Bankr W.D. Mo. June 3, 2010) (finding that MERS, as beneficiary and nominee under the deed of trust lacked authority to assign the mortgage note because it never "held" the note itself);[23] In re Hawkins, No. BK-s-07-13593-LBR, 2009 WL

[22] Some investors and loan servicers have sought to lessen the risk of challenges to foreclosure pertaining to MERS by assigning loans out of MERS and to the note holder prior to the initiation of foreclosure.

[23] The Court in In re Box expressly noted, but did not decide, the question of whether MERS had authority to assign the note as an agent of the lender or even as "a nominee beneficiary." In re Box, 2010 WL 2228289 at *4. The same court, in a later case, answered the question directly and found that MERS, as the designated "nominee for the lender and its assigns," "was the agent for [the lender] under the Deed of Trust from the inception, and MERS became agent for each subsequent note-holder under the Deed of Trust when each such note holder negotiated the Note to its successors and assigns." In re Tucker, No. 10-61004, 2010 WL 3733916, at *6 (Bankr. W.D. Mo. Sept. 20, 2010) ("[w]hen [note-holder] acquired the right to enforce the Note as the note-holder, MERS held the beneficial interest in the Deed of Trust on behalf of [note-holder] and [note-holder] had the right to enforce all the rights granted to [the original lender] and its successors and assigns in the Deed of Trust"). Thus, the Court found that the Note and the Deed of Trust were not split because of MERS' status as agent for the note holders. Id.

901766, at *3 (Bankr. D. Nev. Mar. 31, 2009) (finding that MERS was not a true "beneficiary" under a deed of trust, that, under the UCC, MERS was not entitled to enforce the note, and that "[i]n order to foreclose, MERS must establish there has been a sufficient transfer of both the note and deed of trust, or that it has authority under state law to act for the note's holder").[24]

Finally, it is important to recognize that the UCC does not displace traditional rules of agency law. See UCC § 1-103(b) ("Unless displaced by the particular provisions of [the Uniform Commercial Code], the principles of law and equity, including the law [of] . . . principal and agent . . . supplement its provisions."); see also UCC § 9-313 cmt. 3 (principles of agency apply for purposes of determining "possession" under Article 9). Under general agency law, an agent has authority to act on behalf of its principal where the principal "manifests assent" to the agent "that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests assent or otherwise consents so to act." Restatement (Third) of Agency § 1.01 (2006). Accordingly, the UCC does not prevent MERS or others, including loan servicers, from acting as the agent for the note holder in connection with transfers of ownership in mortgage notes and mortgages. See, e.g., In re Tucker, No. 10-61004, 2010 WL 3733916, at *6 (Bankr. W.D. Mo. Sept. 20, 2010) (finding MERS was the "agent for [the lender] under the Deed of Trust from the inception, and MERS became the agent for each subsequent note-holder under the Deed of Trust when each such note holder negotiated the Note to its successor and assign"); King v. Am. Mortgage Network, Inc., No. 1:09CV162 DAK, 2010 WL 3516475, at *3 (D. Utah Sept. 2, 2010) (rejecting argument that note and deed of trust were split because Fannie Mae held the note and MERS was listed as the nominal beneficiary under the deed of trust and finding that both MERS and the authorized loan servicer had authority as agents of the note holder to act on behalf of the note holder, including the initiation of foreclosure proceedings on the underlying property); Mich. Comp. Laws § 600.3204(1)(d) ("The party foreclosing the mortgage is either the owner of the indebtedness or of an interest in the indebtedness secured by the mortgage or the servicing agent of the mortgage."); Hilmon v. Mortgage Elect. Registration Sys., Inc., No. 06-13055, 2007 WL 1218718, at *3 (E.D. Mich. Apr. 23, 2007); Caravantes v. California Reconveyance Co., No. 10-cv-1407-IEG (AJB), 2010 WL 4055560, at *9 (S.D. Cal. Oct. 14, 2010) ("as servicer of the subject loan in this case, JP Morgan had the authority to record the Notice of Default and to enforce the power of sale under the Deed of Trust"); Birkland v. Silver State Fin. Servs., Inc., No. 2:10-CV-00035-KJD-LRL, 2010 WL 3419372, at *3 (D. Nev. Aug. 25, 2010) ("MERS, as nominee on a deed of trust, is granted authority as an agent on behalf of the nominator (holder of the promissory note) as to the administration of the deed of trust, which would include substitution of trustees"). In short, principles of agency law provide MERS and loan servicers another legal basis for their respective roles in the transfer of mortgage notes and mortgages.

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[24] Some parties to litigation, and commentators, have relied upon the Kansas Supreme Court's decision in Landmark National Bank v. Kesler, 216 P.3d 158 (Kan. 2009), to support the proposition that the identification of MERS as a nominee on a mortgage is improper. However, reliance on the decision in Kesler for that proposition is misplaced and stretches the decision well-beyond its actual holding. In Kesler, the Court merely held that MERS, in its capacity as the nominee for the lender under a second-position mortgage, was not entitled to notice of a foreclosure sale by the holder of the senior mortgage. See id. at 169-70. As the Kansas Appeals Court that considered the case noted, "[w]hether MERS may act as a nominee for the lender, either to bring a foreclosure suit or for some other purpose, is not at issue...." Landmark Nat'l Bank v. Kesler, 192 P.3d 177, 180 (Kan. Ct. App. 2008).

4. Conclusion

In summary, the longstanding and consistently applied rule in the United States is that, when a mortgage note is transferred, "the mortgage follows the note." When a mortgage note is transferred and delivered to a transferee in connection with the securitization of the mortgage loan pursuant to an MBS pooling and servicing agreement or similar agreement, the mortgage automatically follows and is transferred to the mortgage note transferee, notwithstanding that a third party, including an agent/nominee entity such as MERS, may remain as the mortgagee of record. Both common law and the UCC confirm and apply this rule, including in the context of mortgage loan securitizations. The legal principles and processes discussed above provide for – and, if followed, result in – a valid and enforceable transfer of mortgage notes and the underlying mortgages. The transfer and legal effectiveness of mortgage notes and mortgages are not diminished by the fact that the enforceability of mortgages, including the right to foreclose, is subject to the conditions precedent and requirements that are set forth in the particular mortgage itself and in the laws of the state in which the mortgaged property is located.

Testimony of Kurt Eggert
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Before the U.S. Senate
Committee on Banking, Housing, and Urban Affairs

At a Hearing Entitled:
"Problems in Mortgage Servicing From Modification to Foreclosure Part II."

Dirksen Senate Office Building, Washington, DC
December 1, 2010

Good morning Chairman Dodd, Ranking Member Shelby, and members of the committee. Thank you for the invitation to discuss the problems that borrowers are facing with mortgage servicers, the conflicts of interests that servicers have with investors in mortgage-backed securities, and the emerging issues of robosigners and documentation problems bedeviling the mortgage industry.

As our country slowly digs its way out of what has been termed the "Great Recession," it is notable that the housing market is one aspect of the economy that has been a dead weight. Housing prices continue to drop in many parts of the country. Foreclosures are proceeding at a fearsome pace and the large number of bank-owned houses, along with those heading toward foreclosure, may continue to drive down housing prices in many markets for some time to come.

To stop this drag on the economy, we need to focus on two tasks. The first is finding a way to resolve the problem loans that were made during the last decade before the subprime meltdown in such a way as to prevent unnecessary foreclosures and to minimize losses to investors who purchased securities backed by those loans. Investors and borrowers sometimes have conflicting goals, and we need to find a way to balance their interests when they compete. However, borrowers and investors often have merging interests, when, for example, an appropriate loan modification would prevent foreclosure and maximize investor return.

The second task we should take on is restoring the mortgage market on an on-going basis. Currently, the mortgage system depends to an enormous degree on government-sponsored or government entities, because investors have lost so much faith in private origination and securitization of loans. If the private mortgage market is to be restored, investors must be certain that buyers do not regularly fall victim to predatory loans destined for default. But investors must also be assured that servicers will not take advantage of borrowers with junk fees and inappropriate foreclosures that harm borrowers and investors alike. Currently, servicers are able to unduly enrich themselves to the detriment of both borrowers and investors.

In this testimony, I will first discuss how we find ourselves in this foreclosure crisis, with too many robosigning servicer employers and too few effective loan modifications. Then, I will briefly describe securitization and how it creates the need for mortgage servicing and then describe in more detail the ways servicers financially abuse borrowers, with junk fees, unnecessary foreclosures, and the failure to provide or agree to appropriate loan modifications. After a discussion of the Robosigner scandal and mortgage transfer problems, this testimony will address the conflicts of interests that are rampant in the servicing industry and how those interact with the representations and warranties included in a securitization deal, and then conclude with some ideas about how to reform mortgage servicing to avoid many of the problems we see today.

How We Got Here

To understand the current servicer problems, it is important to understand how we reached such dire straits. The bubble and then meltdown of the subprime and non-prime mortgage was caused in large part by the securitization of those loans, and the fact that securitization allowed market participants to drive down underwriting standards, while hiding much of the reduction of those underwriting standards from investors in the securities that were backed by those loans. During the boom years, from 2005 until the subprime market collapsed in 2007, it was as if the American mortgage market were living in an almost lawless state.[1]

Many subprime lenders were regulated only by state agencies, which did almost nothing to control the types of loans they made or the underwriting standards that they applied. Federally regulated subprime lenders migrated to whatever federal agency regulated and reined them in as little as possible. The Federal Reserve Board, which held the authority to issue regulations under the Truth in Lending Act and might have curbed the no documentation and exotic loans with multiple layers of risk, instead chose until too late to trust banks largely to self-regulate. The Federal Reserve Board's then chair seemed to disdain consumer protection, and withheld needed regulation in the belief that lenders' own self-interest would cause them to act responsibly.

With the mortgage collapse and resulting economic turmoil, it became painfully obvious that more regulation of financial institutions would be necessary. The Federal Reserve Board finally acted to curb some of the worst mortgage practices. The recent Dodd–Frank Wall Street Reform and Consumer Protection Act was designed to prevent much of the misbehavior by financial institutions that helped cause the mortgage boom and bust. An important aspect of that bill is the creation of the Bureau of Consumer Financial Protection, designed to protect consumers in the use of financial products and services. While Dodd-Frank has much to recommend it, it also leaves much of the detail work to regulatory agencies, with instructions on what to accomplish but some discretion on how to accomplish it.

One task that regulators have in implementing Dodd-Frank is to design new rules for the securitization of residential mortgages, recognizing that the system that we had until the mortgage meltdown was riddled with holes that the financial institutions running the system understood and exploited. When discussing mortgage servicing's problems, it is important to put this issue in the larger context, to see that our current system of mortgage servicing is part of a mortgage system so flawed that it came crashing to a stop because of those flaws, leaving myriad foreclosures, bankrupt companies, ravaged investors, and trashed economies in its wake.

Regulators who would fix securitization must be bold in their repairs, recognizing that the system needs far more than the pinch of transparency and dash of requiring "skin in the game" that some have proposed. But fixing securitization means more than just fixing how loans are originated and securitized. It also means fixing how residential mortgages are serviced. For many borrowers, how a loan is serviced means as much or more to them as how it was originated. Servicing is a crucial piece of the securitization industry, and so far it is being run on the cheap, half in the dark, with

[1] For an explanation of how and why the mortgage meltdown happened, see Kurt Eggert, *The Great Collapse: How Securitization Caused the Subprime Meltdown*. 41 CONNECTICUT LAW REVIEW 4 (2009), available at SSRN: http://ssrn.com/abstract=1434691

little effective regulation or oversight. Borrowers are at the mercy of their servicers, with some providing modifications, others not. Some servicers promise modifications and then at the last minute yank the rug out from under borrowers by starting foreclosures even while negotiating a modification that might have prevented that foreclosure. Some servicers push borrowers into foreclosures by the late fees, the suspense accounts, and other means to squeeze their maximum gain from borrowers, even if it hurts borrower and investor alike.

The financial industry and the federal agencies that regulate it have often viewed consumer protection for borrowers as a zero sum game, in that the more protection consumers are given in the mortgage industry, the less profit banks can make. Since banking regulators have long focused fixedly on the safety and soundness of their regulated institutions, too often protections for consumers were viewed as a threat to the financial soundness of regulated banks, and so federal regulators protected banks, rather than consumers.

With securitization, however, it is important to recognize that there are three major players at the table, banks, consumers, and investors. As banks discovered when investors pulled out of the market for non-GSE mortgage-backed securities, investors are just as important as lenders and borrowers for any mortgage industry that is dependent on securitization. However, the banks who survived the Great Collapse seem either to be missing this lesson or choosing to ignore it in the short term in order to reap short term profits. Over and over, banks have been taking steps to push losses for bad loans onto investors, despite representations and warranties of the fitness of those loans by banks. Ironically, banks are engaging in much better examination of loan files in order to avoid repurchasing bad loans than they ever conducted before making the loans.

This battle against investors shows itself in mortgage servicing as well. Investors in mortgage-backed securities are the true owners of the loans backing those securities. However, investors have few of the rights that owners of property should possess. It is difficult for investors to examine even basic documents regarding their property to see if they were defrauded when they purchased the securities. Their agent, the mortgage servicer, often is a subsidiary of the lender that may have sold them bad loans, yet has the power to deny them such basic rights of ownership. The agreement that binds their relationship with the servicer, the Pooling and Servicing Agreement (PSA), was normally drafted before investors purchased their securities, and so was offered to the investors on a "take it or leave it basis."

Investors have a great stake in how servicers work with borrowers, what loan modifications they grant, and whether they foreclose unnecessarily. A foreclosure that could and should have been prevented costs investors dearly. And so, anyone discussing problems with mortgage servicing should not fall into the trap set by those who claim that mortgage servicing problems are mere technical defects being seized upon by deadbeat borrowers who should be losing their houses anyway. Mortgage servicer abuses have two sets of victims, the homeowners/borrowers and the investors in mortgage-backed securities.

Securitization and the Need for Mortgage Servicing

Securitization has transformed the American system of originating, funding and holding mortgage loans. While some in the financial industry portray securitization as a crucial component of the mortgage market, residential lending is conducted without securitization, or at least securitization that would be recognizable to Americans, in many parts of the world. Furthermore, many of those countries did not experience the great mortgage crash seen in the U.S., at least not first-hand.

Securitization is the process of pooling assets, such as home loans, that produces an income stream, and then selling securities that are backed by those assets, allowing investors in the securities to divide the income-stream that the assets produce. Securitizing loans is supposed to convert the fairly illiquid individual loans into much more liquid, tradable securities. In theory, securitization was supposed to benefit investors by allowing them to reduce their information-gathering costs by being able to rely on rating agencies and to reduce their risk of default by having an entire pool of loans to rely for payment on, and to benefit from other means of enhancing the stability of loan pool, such as buying insurance against the risk of default and requiring more loans in the pool than would be necessary to provide a sufficient income stream.

In practice, however, securitization of non-prime loans turned out to be a quagmire for investors, as it was difficult for them to detect the high risk of loans backing the pools, and the complexity of the resulting securities rendered their risk opaque. Such securitization was opaque in two ways, the first being that investors were not given timely and adequate information about the risks of the loans backing the securities they were purchasing. Secondly, by hiding default risk in securities with complex structures, the risks of which were again sliced and diced among CDOs, credit default swaps, insurance, repurchase agreements and other hedge attempts, securitization made it difficult to determine the amount and danger of mortgage default risk held by different financial institutions.

Securitization transformed the mortgage industry because it "atomized" it, as termed by Michael Jacobides, allowing a different entity taking over each stage of the process.[2] Rather than a single entity, such as a neighborhood bank, making and holding and collecting on a loan throughout the life of a loan, each task can be assigned to a different company. While a mortgage broker may sell the loan, a

[2] Michael G. Jacobides, *Mortgage Banking Unbundling: Structure, Automation and Profit. Mortgage Banking*, Jan. 1, 2001.

separate company may make the loan, another may fund the loan, and another may acquire it and bundle it with other loans for securitization. A Wall Street investment bank may acquire the loan pool and transfer the loans to a special purpose vehicle (SPV) such as a trust run, a rating agency normally is hired to rate the securities created that are backed by the trust assets, and then the investment bank will sell the resulting securities to investors, hold them itself, or rebundle them into a CDO for the creation of new securities. In the meantime, a trustee theoretically oversees the trust holding the loans, but actually a loan servicer, either directly or through a special servicer, collects on the loan, conducts any loss mitigation necessary if the borrower has trouble paying the loan, and determines when foreclosure is necessary.

The rights of the investors and their legal relationship between the investors, the trustee of the trust and the servicer is primarily contractual, in that the relationship and the legal rights and obligations of the parties are spelled out and determined by the Pooling and Servicing Agreement (PSA) governing that particular securitization transaction. The PSA comprises both the trust agreement between the trustee and the investors and also the agency agreement between the trustee and the primary servicer. However, the PSA is drafted and negotiated before the securities are issued, and so investors are not directly involved in the PSA's negotiation and drafting. At most, investors can participate only indirectly, by refusing to purchase securities with a PSA that is too unworkable or too unfair to investors.

Servicer Abuse of Borrowers

One of the purposes of this hearing is to determine how, why, and to what extent servicers engage in behavior that takes advantage of borrowers and increases borrowers' likelihood of foreclosure. While the mortgage industry might like to think that servicers currently have short term difficulties due to the increased number of defaulting and foreclosing loans they currently must address, in fact servicer abuse was afflicting borrowers long before the current financial and foreclosure crisis. In 2004, I documented the widespread misbehavior of mortgage servicers, and defined "servicer abuse" as follows:

> Abusive servicing occurs when a servicer, either through action or inaction, obtains or attempts to obtain unwarranted fees or other costs from borrowers, engages in unfair collection practices, or through its own improper behavior or inaction causes borrowers to be more likely to go into default or have their homes foreclosed. . . .Servicing can be abusive either intentionally, when there is intent to obtain unwarranted fees, or negligently, when, for example, a servicer's records are so

> disorganized that borrowers are regularly charged late fees even when mortgage payments were made on time.[3]

The types of servicer abuse that my 2004 article discussed are still quite present today and are the subject of many of the complaints about servicers. While we may have gained greater understanding about how and why servicers engage in this unfair and inappropriate behavior, sadly it appears that we have done little to prevent or even greatly discourage it.

Improper foreclosure or attempted foreclosure

On a regular basis, servicers attempt to foreclose on property where either the borrower is current on the note or would be but for bad behavior by servicers, or where the investors would benefit from a loan modification that the borrower would be able to afford. While many have defended aggressive foreclosure efforts by arguing that by and large the homeowners were behind on their mortgages and so foreclosure was appropriate, it is important to keep in mind that the servicer is supposed to be working for the benefit of the investors, and if the servicer forecloses when a loan modification would be more valuable to investors, the servicer has committed a wrong against the investors.

Courts have long complained about servicers attempting to foreclose when it appears that no foreclosure is justified. In the 2002 case, *In re* Gorshtein, the court noted three examples of where servicers falsely claimed borrowers were in default and sanctioned the creditors, saying that its decision was "provoked by an apparently increasing number of motions in this Court to vacate the automatic stay filed by secured creditors often based upon attorney affidavits certifying material post petition defaults where, in fact, there were no material defaults by the debtors."[4]

Lest anyone thing that these are problems from the past, in the case from August, 2010, *In re* Cothern, the court noted how a servicer drove two borrowers into bankruptcy and attempted to foreclose, even though the borrowers had always paid their mortgage payments like clockwork. The servicer had wrongly concluded that the borrowers had failed to insure the house, and bought force-placed insurance on the property. Even when the servicer realized its mistake, however, it did not fix it, but rather began putting the borrowers' payments into a suspense account rather than applying them to principal, and in the end tried to collect foreclosure fees, attorneys fees, and other charges totaling $15,000, even though the borrowers had made timely mortgage payments and insurance payments. The court concluded, "There is no doubt that the unrelenting actions of [the servicer] drove the Cotherns into

[3] Kurt Eggert, *Limiting Abuse and Opportunism by Mortgage Servicers*, 15 HOUSING POL'Y DEBATE 753, 756 (2004), available at Available at SSRN: http://ssrn.com/abstract=992095.
[4] *In re* Gorshtein , 285 B.R. 118 (2002),

bankruptcy. [The servicer's] conduct throughout this factual scenario represents the most callous and egregious effort to collect an indebtedness that was never owed that this court has been called upon to review. Succinctly stated, [the servicer's] incompetent servicing tactics converted a loan transaction that was being paid like 'clockwork' to a loan that was virtually impossible to pay, particularly for modest income borrowers."[5]

Even when borrowers are able to stop the foreclosures eventually and with great effort, they are still damaged by the servicers' behavior. Borrowers who are the victims of unwarranted claims of default find their credit scores suffer and may find it more difficult later to buy a house or refinance their loans. They may even lose out on a new job or a promotion as a result.[6]

Servicers often have a great financial incentive pushing them toward foreclosure. For example, servicers may be attempting to recover advances or costs for a loan as they are paid first from the proceeds of the foreclosure. Also, servicers may have a conflict of interest with the investor that could encourage them to foreclose on a loan quickly, in that the servicers' parent organization may benefit from a foreclosure. These issues will be addressed in later sections.

Improper fees

At the heart of abusive servicing is the charging of inappropriate fees, late fees or other charges to which the servicer is not entitled. The temptation for servicers to charge fees is enormous, given that fees are a great percentage of their income, and that the payment system structure was designed before servicers realized how high foreclosure rates would climb and that their job would be transformed from by and large mere payment collection to active loan restructuring for a large percentage of the loans they serviced. Servicer costs were increased not only by the high default rate, but also by the exotic loans that were generated during the last decade, with

Servicer income comes from four primary sources, (1) late fees and other fees on borrowers, (2) the "float" of interest that accrues between the time that borrowers pay on their loans and when servicers pass those funds on to investors, and (3) a flat servicing fee that they charge to investors, the size of which depends on the type of loan, with prime loans carrying half the fee of subprime loans, and investment income from the servicers interests in the pool being serviced.[7] Even this greater charge for

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[5] *In re* Cothern, --- B.R. ----, 2010 WL 4235864 (Bkrtcy.N.D.Miss.)

[6] For a discussion of the effect on borrowers of default, see Roberto G. Quercia and Michael A. Stegman, *Residential Mortgage Default: A Review of the Literature*. JOURNAL OF HOUSING RESEARCH 3(2):341–79 (1992).

[7] Diane E. Thompson, Nat'l Consumer Law Center, *Why Servicers Foreclose When They Should Modify and Other Puzzles of Servicer Behavior, Servicers Compensation & Its Consequences* (2009), vi, available at http://www.consumerlaw.org/issues/mortgage_servicing/content/Servicer-Report1009.pdf

subprime loans, though, does not make up for how much more expensive subprime loans are to service, and so with subprime and non-prime loans, servicers look to fees to borrowers, rather than investors, for a sizable portion of their payment. In 2006, subprime servicers were able to collect about three times the amount of late fees per loan as prime servicers.[8]

It is difficult for borrowers to fend off improper fees. They may not be certain, for example, whether a servicer received a payment late or just sat on the check for a day or two before processing it. Borrowers may not be familiar with what fees their loan agreement authorizes, and may not recognize it when a servicer charges a fee not allowed by the loan documents. Pooling and servicing agreements typically provide that the servicer, not the trustee or the investors, are entitled to these fees from borrowers, which encourages servicers to discover as many fees as possible, even if it might mean stepping over the legal or ethical line.

Just how willing servicers are to push fees on borrowers can be seen in a study of fees claimed by servicers in borrower bankruptcy proceedings, when one might think that servicers would be most cautious in trying to extract unwarranted fees. Not only do mortgage servicers consistently claim that they are owed more than borrowers have scheduled, but also a review of their claims shows, according to its author, Katherine M. Porter, "Many creditors do not comply with applicable law governing claims. Routinely, fees are not identified with specificity, making it impossible to determine if these charges are legal. In most instances, mortgagees believe the debt is greater than debtors do; these differences typically represent thousands of dollars. Yet, creditors are rarely called to task for these behaviors."[9]

The Federal Trade Commission has had some luck in suing mortgage servicers for inappropriate fees and other abusive behavior. However, the history of FTC litigation indicates that they are likely only able to target the worst offenders, while other servicers skate by without sanction. In 2003, the most notorious servicer, Fairbanks Capital, agreed to create a $40 million fund to help borrowers who had been damaged by its improper actions. Fairbanks also agreed to abide by a set of best practices for good behavior by mortgage servicers. At the time, it was hoped that the FTC could, by sanctioning Fairbanks and establishing a set of best practices, encourage good servicing practices among other servicers.[10] That hope seems to have been in vain, though, and the FTC has had to regularly seek sanctions against other servicers.

In 2008, Bear Stearns and its servicer subsidiary settled claims that they had "misrepresented the amounts borrowers owed, charged unauthorized fees, such as late fees, property inspection fees, and loan modification fees, and engaged in unlawful

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[8]Ted Cornwell, *Profit Run Might Stall.* MORTGAGE SERVICING NEWS 11(3):1 (2007).

[9] Katherine M. Porter, *Mortgage Misbehavior*, 87 TEX. L. REV. 121, 162 (2008).

[10] For a discussion of Fairbanks's actions and the FTC litigation against Fairbanks, see Kurt Eggert, *Limiting Abuse and Opportunism by Mortgage Servicers*, 15 HOUSING POL'Y DEBATE 753, 761 - 67 (2004), available at Available at SSRN: http://ssrn.com/abstract=992095.

and abusive collection practices." To settle the claims, Bear Stearns and its servicers agreed to establish a data integrity system and to pay $28 million.[11] Again, in 2010, the FTC announced yet another landmark fine and settlement against a mortgage servicer, this time Countrywide's loan servicing operation, which the FTC had accused of deceiving borrowers by using an intermediary to mark up the cost of services provided when homeowners are in default, such as property inspection, lawn care, and other services designed to protect the property value securing the loan at issue. This time, the settlement amount jumped to $108 million.[12]

While this series of settlements with servicers with an escalating pattern of payments is no doubt well-intentioned by the FTC, it is worrisomely similar to the pattern of payouts by subprime lenders before the great mortgage collapse. Rather than put an end to abusive lending, settlements of $484 million by Household Finance settlement in 2002 and for $325 million by Ameriquest in 2006 were primarily examples of how lucrative such lending could be.[13]

Failing to Engage in Appropriate Loan Modification

It has long been recognized that an important tool to deal with problem loans is for servicers to work with borrowers to agree to appropriate loan modifications instead of proceeding to foreclosures. Foreclosures clearly are damaging to borrowers, even those who are underwater and have no equity to lose in their homes. Their credit is damaged and they may have great purchasing another home. The wave of foreclosures hurts communities as well, as it lowers property values and leaves strings of empty houses in its wake. Foreclosures can also be harmful to investors, especially when the borrower owes more than the house is worth and a foreclosure sale will return only a fraction of the loan amount.

Servicers are supposed to maximize the value of the return of the loan to investors, to foreclose when that would give most value and to engage in other loss mitigation when that would give investors the greatest return. Making that calculation more difficult is the possibility that borrowers will redefault when provided a second chance through a loan modification, might refinance if faced with foreclosure, or

[11] See the Federal Trade Commission's press release regarding this settlement, Bear Stearns and EMC Mortgage to Pay $28 Million to Settle FTC Charges of Unlawful Mortgage Servicing and Debt Collection Practices, September 9, 2008, available at http://www.ftc.gov/opa/2008/09/emc.shtm

[12] See the Federal Trade Commission's press release regarding the Countrywide settlement, *Countrywide Will Pay $108 Million for Overcharging Struggling Homeowners; Loan Servicer Inflated Fees, Mishandled Loans of Borrowers in Bankruptcy,* June 7, 2010, available at http://www.ftc.gov/opa/2010/06/countrywide.shtm

[13] For a discussion of these settlements, see Kurt Eggert, *The Great Collapse, How Securitization Caused the Subprime Meltdown,* 41 CONN. L. REV. 1257, 1297 (2009).

might find some other way to bring the property current.[14]

Much of the response to the mortgage crisis has been a series of initiatives by both industry and government to encourage and even fund such modifications. While these programs have by and large been well-intentioned and have helped some borrowers, the overall result so far has been disappointing. New HAMP Trial starts have been leveling off, with fewer and fewer new such trial modifications, while fewer than 500,000 permanent modifications have begun since the start of this program.[15]

It is becoming increasingly clear that the process of securitization itself creates impediments to loan modifications, even those that would benefit both borrower and investor alike, though not all economists agree on this. Adelino, Gerardi, and Willen (2009) had discounted the idea that securitization reduced effective loan modification, but instead argued that servicers were failing to engage in loan modifications for economically rational motives. According to their analysis, servicers are faced with several dilemmas. Borrowers that request loan modifications may sometimes cure their loans even without that potentially costly help. Conversely, borrowers who receive loan modifications regularly redefault anyway, despite the labors and expenses by the servicers for the modification. And so waiting and hoping might be a more economically sound decision than modifying the loan.[16]

To challenge this analysis, other economists have compared how third party servicers, those servicing loans on behalf of investors, handle problem loans compared to banks servicing their own loans held in portfolio. For example, Piskorski, Seru and Vig (2010) found that securitization causes a "foreclosure bias," noting, "Controlling for contract terms and regional conditions, we find that seriously delinquent loans that are held by the bank (henceforth called 'portfolio' loans) have lower foreclosure rates than comparable securitized loans (between 3% (13%) to 7% (32%) in absolute (relative) terms)." Piskorski, et. al. also note that governmental agency reports on loan modifications also validate the idea that securitized loans exhibit a "foreclosure bias," and state, "OCC and OTS Mortgage Metrics Reports (2009b) point out that the re-default rate for renegotiated loans serviced by third parties was significantly higher than the re-default rate for loans held in the servicers' own portfolios (for example, 70% higher after six months).[17]

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[14] Manuel Adelino, Kristopher S. Gerardi, and Paul Willen. 2009. *"Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitization."* Federal Reserve Bank of Boston Working Paper No. 09-4, available at SSRN: http://ssrn.com/abstract=1433777

[15] See Making Home Affordable Program, Servicer Performance Report Through September 2010, available at: http://www.financialstability.gov/docs/Sept%20MHA%20Public%202010.pdf

[16] Manuel Adelino, Kristopher S. Gerardi, and Paul Willen. 2009. *"Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitization."* Federal Reserve Bank of Boston Working Paper No. 09-4, available at SSRN: http://ssrn.com/abstract=1433777

[17] Tomasz Piskorski, Seru, Amit and Vig, Vikrant. 2010. "Securitization and Distressed Loan Renegotiation: Evidence from the Subprime Mortgage Crisis" Chicago Booth School of Business Research Paper No. 09-02; AFA 2010 Atlanta Meetings Paper. SSRN: http://ssrn.com/abstract=1321646

After reviewing the economic evidence, noted economist Christopher Mayer stated in testimony this year, "I believe there is compelling empirical evidence showing that third party servicers have undertaken more foreclosures than would otherwise have taken place if all mortgages had been made by portfolio lenders."[18]

This "foreclosure bias" by third party servicers has several causes, but the primary ones are the direct financial incentives to servicers that encourage foreclosure over loan modification, the conflict of interest that some servicers have, given that they are often subsidiaries of the bank that originated the loan or currently holds a second loan secured by the same property, and the fear of "tranche warfare" whereby the servicer may face litigation by other investors should the servicer modify the loan in ways that help some tranches of the investors while harming others.[19]

Robosigners and False Affidavits

Three years after the non-prime mortgage market essentially shut down after investors finally recognized how shoddy subprime underwriting had become and how much risk came with their non-prime mortgage securities, a new example of the perfidy of the mortgage industry came to light. Robosigners had been signing the affidavits used in judicial foreclosure states to justify foreclosures. In states that require judicial foreclosures, servicers had long relied on affidavits to prove up their cases, to show the payment history of the borrowers, the amount owed and what payments were in default, in order to demonstrate that the entity foreclosing on the note was legally entitled to do so.[20]

Robosigners are employees of servicers or law firms employed by servicers who sign affidavits attesting to facts justifying a foreclosure even though the robosigner has no personal knowledge of those facts, has not reviewed the business files that contain those facts and/or often has not even read the affidavit that he or she is signing under penalty of perjury.[21] The existence of robosigners was discovered by borrowers' attorneys who deposed the servicer employees who signed affidavits for the

[18] Christopher Mayer, *Housing, Subprime Mortgages, and Securitization: How did we go wrong and what can we learn so this doesn't happen again?*, testimony before the Federal Crisis Inquiry Commission, February 27, 2010, available at: http://fcic.gov/hearings/pdfs/2010-0227-Mayer.pdf

[19] For a discussion of these causes and why loan modifications have not been forthcoming, see Kurt Eggert, Comment on Michael A. Stegman et al.'s "Preventive Servicing Is Good for Business and Affordable Homeownership Policy": What Prevents Loan Modifications?, 18 HOUSING POL'Y DEBATE 279 (2007), available at SSRN: http://ssrn.com/abstract=1081479

[20] See Katherine Porter, Testimony Before the Congressional Oversight Panel, Hearing on the TARP Foreclosure Mitigation Program, October 27, 2010.

[21] Paul Tharp, *Bank of America suspends foreclosure sales nationwide* 10/8/10 N.C. Law. Wkly. 2010 WLNR 21011587

borrowers' judicial foreclosure cases. When they began questioning the servicer employees charged with supplying testimony about the mortgages, they found that the servicer employees were woefully unprepared even to understand what they were signing, with some not knowing even what an "affidavit" or a "mortgage" was, some admitting they were lying in their affidavits, or that they signed the affidavits without reading or seeing their contents. One bank employee admitted that she signed up to 8,000 foreclosure documents a month, but rarely reads any of them[22] One servicer supervisor charged with signing affidavits admitted she could not define even a basic term like "promissory note" and that she did not know what conditions were required before a bank could foreclose or would was the holder of the mortgage note, explaining "I don't know the ins and outs of the loan, I just sign documents."[23]

This extensive use of robosigners allows banks and servicers to foreclose on borrowers without regard to whether such foreclosure is proper and to hide from courts flaws in the banks and servicers documentation for the loans, be it bad records regarding mortgage payments or loan modifications or missing documents that would show whether the foreclosing entity even owns the loan it is trying to foreclose. On a massive scale, servicers seemed to have been committing fraud on the court, submitting testimony from witnesses who had little idea of the contents of the affidavits they signed, let alone whether the affidavits were in fact true.

Servicers responded to the robosigning in various ways, including engaging in foreclosure moratoriums generally in the 23 judicial foreclosure states pending review of the problem. The use of robosigners was widely reported and caused a significant drop in the stock prices of banks caught up in this scandal. Investors too weighed in, pressuring banks and servicers to resolve the problem quickly so that investors would not be harmed either by legal claims against the trusts holding the loans or by long delays in foreclosures. However, at least some banks and servicers fairly quickly announced that they had completed their reviews and that foreclosures would recommence, though it appears that recommencing foreclosures may take longer and be more challenging than the banks and servicers have let on.[24]

Servicers and their defenders argue that the robosigning scandal was a set of mere technical defects, and ones that the bank can correct on move on with processing these same foreclosures. They claim that the borrowers deserve to be foreclosed and it should not matter greatly whether the affidavit was the product of a robosigner,

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[22] Jenifer B. McKim, *Lenders on autopilot: Using robo-signers to process thousands of foreclosures opens banks up to legal risks* 11/2/10 Boston Globe 7

[23] Michelle Conlin, *Robo-signers: Mortgage experience not necessary* 10/13/10 AP General Fin./Bus. News 01:21:31, October 13, 2010.

[24] Dan Fitzpatrick and Ruth Simon, *Foreclosure Restarts Limp Out Of The Gate*, Wall Street Journal, . November 27, 2010, available At: http://online.wsj.com/article/SB10001424052748704008704575638943432734062.html

since the servicer's staff had already determined that foreclosure is appropriate. Such an argument completely undermines the judicial process that some states have set up to oversee foreclosures. States that require judicial foreclosure do so in order to provide a venue for a borrower to contest the foreclosure, to challenge the servicer's claims about how much money is owed and whether the claimed holder of the note has the right to foreclose. Robosigning of affidavits short-circuits this process, as the foreclosure could proceed without valid evidence that the borrower was even in default or that the foreclosure even owned the note.

One important question, given the great cost to banks of the robosigning scandal and the accompanying foreclosure moratorium is why the banks and servicers employed robosigners to begin with. The potential cost savings to be gained by having servicer employees speed through affidavits without reading them seems small compared to the losses banks and investors have suffered as a consequence.

Borrower advocates have questioned whether the purpose of employing robosigners is more nefarious than mere cost-cutting. Perhaps, the advocates query, servicers use robosigners to hide defects in the loan records, either in the payment and mortgage fee history or in the documentation of the ownership of the loan to begin with. Currently, the servicing industry is haunted with the specter that the robosigning controversy may only be an early symptom of a much greater, industry-threatening problem. Just as the rise in early mortgage defaults in 2006 presaged the mortgage meltdown a year later, some argue that the robosigning scandal is an early warning of greater problems ahead.

Mortgage Transfer Problems

One of the largest of the potential problems facing the mortgage and servicing industry stems from the realization that, during the scramble of the boom mortgage years from 2004 until mid-2007, lenders and securitizers cut corners in many regards. Clearly, lenders cut underwriting standards and Wall Street houses reduced their diligence in trying to weed out bad loans from being securitized. The great worry some have is that this shoddy work extended to whether lenders and securitizers also cut corners in transferring notes to the trusts that hold them for investors. Wall Street may have fallen down, the theory goes, in transferring not only ownership of the notes but also the right to enforce them to the trusts holding the notes on behalf of investors in mortgage-backed insurance. The investors may be holding securities backed by far fewer loans than they anticipated, or may have a theoretical ownership right in the notes, but lack the power to enforce to enforce the notes through foreclosure.

Borrowers have seized on this issue and have regularly challenged servicers to "show the note" and prove the right to foreclose. Servicers have fought back against the "show the note" defense by various means. In some non-judicial foreclosure states, courts have ruled that state foreclosure law does not require that the beneficiary of a deed of trust even to possess the note in order to enforce it, as the state law governing non-judicial foreclosure does not require possession of the note.[25] Even in states where a party attempting to foreclose must prove up the right to foreclose, including possession of the note, as needed, servicers have widely used and even abused the lost note affidavit to finesse this requirement.[26] However, as Professor Whitman observes, "By its literal terms, the person who seeks to enforce the note must have been in possession of it when the loss occurred. Under this view, the 'lost note' provisions do nothing to assist a party who claims to own a note but who never had possession of it to begin with, either because it was lost by a predecessor holder or because the predecessor never delivered it to the present claimant."[27] While a revision of the UCC and some courts would allow a party who lost a note in essence to transfer the benefits of a lost note affidavit to transferees, this rule is not universal.[28] Worse yet, as Professor Levitin notes, many signing lost note affidavits have no personal knowledge that the note is in fact lost, as it may well be held by a document custodian who only requires notice and payment to retrieve it.[29]

Lenders have disparaged the "Show the Note" defense. However, it is grounded in a central element of the negotiable instrument law that governs negotiable notes. According to that law, the debt of the borrower is not just evidenced by the note; it is reified in it, in that the note constitutes the law and is proof of title of the debt. As Professor James Steven Rogers noted, negotiability is a title recognition system, and possession of the note indicates who is entitled to enforce the note. Rogers stated, "The key element of the negotiability transfer system is that the liabilities of the parties to negotiable instruments are 'reified' in the pieces of paper, that is, the writings become the indispensable embodiments of the liabilities of the parties. Accordingly, the appropriate way of transferring the rights embodied in the writings is by transferring the writings themselves."[30]

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[25] See, for example, *Chilton v. Federal Nat. Mortg. Ass'n*, Slip Copy, 2009 WL 5197869, E.D.Cal.,2009. December 23, 2009, and the cases cited therein for the proposition that under California law, "It is well-established that non-judicial foreclosures can be commenced without producing the original promissory note." This holding is based on the theory that foreclosure in California the Civil Code provisions specifically concerning foreclosure "cover every aspect" of the foreclosure process, citing *I.E. Assoc. v. Safeco Title Ins. Co.*, 39 Cal.3d 281, 285, 216 Cal.Rptr. 438, 702 P.2d 596 (1985), and also are "intended to be exhaustive," citing *Moeller v. Lien*, 25 Cal.App.4th 822, 834, 30 Cal.Rptr.2d 777 (1994). However, these decisions fail to note that the right to enforce notes in California is governed by the U.C.C. provisions regarding the transfer of notes, as adopted by California, and that specific foreclosure provisions should be read in tandem with the U.C.C. provisions' requirements for such enforcement.

[26] For a discussion of the use of lost note affidavits, see Dale Whitman, *How Negotiability Has Fouled Up The Secondary Mortgage Market, And What To Do About It* 37 Pepp. L. Rev. 737, 758 - 62 (2010).

[27] Id., at 759

[28] Id.

[29] See Adam Levitin's Testimony before the House Financial Services Committee Subcommittee on Housing and Community Opportunity "Robo-Singing, Chain of Title, Loss Mitigation, and Other Issues in Mortgage Servicing" November 18, 2010.

[30] James Steven Rogers, Negotiability as a System of Title Recognition, 48 Ohio St. L.J. 197, 200 (1987).

The rules regarding negotiability were created when bills and notes circulated widely in the economy, acting as currency in the days before government-issued notes took over that function. To make bills and notes circulate as currency, it was important that one receiving the bills and notes be able easily to determine whether they were acquiring both good title and the right to enforce the note. From this need came the system of negotiation, so that from the note itself, a purchaser could determine whether he was receiving good title by examining the indorsements on the note. If there was an unbroken chain of indorsements up to the purchaser, or if the note was indorsed in blank after an unbroken chain of indorsements, then the purchaser would take over title to the note by gaining possession of it.[31]

While this title recognition system benefited buyers of notes, it also includes an important protection for borrowers. Requiring possession of a note in order to enforce it ensures that a borrower who pays off a creditor, either directly, through a refinance, or through a foreclosure, will not face another creditor claiming ownership of a note and demanding payment even after the borrower has paid off the note once. Borrowers have the right to be certain that they are paying off the party with the actual right to enforce the note. Negotiability works as a title recognition system because a note has only one physical presence, and so only one party can hold the note at a time.

This protection for borrowers has been recognized by the courts. In a notable recent case, *Kemp v. Countrywide*, which will be discussed at greater length later in this testimony, the court noted how a previous court had "explained that the maker of the note must have certainty regarding the party who is entitled to enforce the note" and quoted at length:

> From the maker's standpoint, therefore, it becomes essential to establish that the person who demands payment of a negotiable note, or to whom the payment is made, is the duly qualified holder. Otherwise, the obliger is exposed to the risk of double payment, or at least to the expense of litigation incurred to prevent duplicative satisfaction of the instrument. These risks provide makers with a recognizable interest in demanding proof of the chain of title. Consequently, plaintiffs here, as makers of the notes, may properly press defendant to establish its holder status.[32]

UCC Section 3-301, which governs what party can enforce a note, recognizes this central importance of possession, stating, ""Person entitled to enforce" an instrument

[31] There are some exceptions, of course, where the person gaining possession of a note would not obtain title, for example where he or she obtains possession as an agent or document custodian for the true owner.
[32] *In re* Kemp, Slip Copy, 2010 WL 4777625, Bkrtcy.D.N.J.,2010. (November 16, 2010), quoting *Adams v. Madison Realty & Dev. Inc.*, 853 F.2d 163, 166 (3d Cir.1988)

means (i) the holder of the instrument, (ii) a nonholder in possession of the instrument who has the rights of a holder, or (iii) a person not in possession of the instrument who is entitled to enforce the instrument pursuant to Section 3-309 or 3-418(d). A person may be a person entitled to enforce the instrument even though the person is not the owner of the instrument or is in wrongful possession of the instrument."

The importance of the transfer of possession of a note is underscored by UCC Section 3-203, regarding transfer of a note, and its comment which describes how even the owner of a note may not have the power to enforce it until the note is transferred to the owner, that ownership and the power to enforce can be separated:

> "The right to enforce an instrument and ownership of the instrument are two different concepts. . . Ownership rights in instruments may be determined by principles of the law of property, independent of Article 3, which do not depend upon whether the instrument was transferred under Section 3-203. Moreover, a person who has an ownership right in an instrument might not be a person entitled to enforce the instrument. For example, suppose X is the owner and holder of an instrument payable to X. X sells the instrument to Y but is unable to deliver immediate possession to Y. Instead, X signs a document conveying all of X's right, title, and interest in the instrument to Y. Although the document may be effective to give Y a claim to ownership of the instrument, Y is not a person entitled to enforce the instrument until Y obtains possession of the instrument. No transfer of the instrument occurs under Section 3-203(a) until it is delivered to Y."

Thus, under the UCC, if the loan originator does not transfer the physical instrument (the note) up the securitization and ultimately to the trustee on behalf of the securitization trust, that trust does not have the right to enforce the note even if it may contractually be the note's owner.

Have Originators Failed to Transfer the Notes They Originated?

Given the importance of the transfer of physical possession of notes to transfer the right to enforce them, it is easy to understand why many have wondered whether the originators of notes failed to transfer them during the securitization process, thus denying the trusts that supposedly hold them and the servicers who are agents of those trusts the power to enforce them. Anecdotal evidence indicates that, on a wide scale basis, these transfers were not made.[33] Even such a luminary as Dale A. Whitman, co-

[33] See Gretchen Mortgenstern, Guess What Got Lost in the Loan Pool, NY Times, February 28, 2009, available at: http://www.nytimes.com/2009/03/01/business/01gret.html

author of the standard hornbook on real estate finance law, considers this an enormous concern, stating:

> While delivery of the note might seem a simple matter of compliance, experience during the past several years has shown that, probably in countless thousands of cases, promissory notes were never delivered to secondary market investors or securitizers, and, in many cases, cannot presently be located at all. The issue is extremely widespread, and, in many cases, appears to have been the result of a conscious policy on the part of mortgage sellers to retain, rather than transfer, the notes representing the loans they were selling. (Footnotes omitted.)[34]

There has been considerable anecdotal evidence that originators have, on a regular basis, failed to deliver notes to the trusts that are intended to hold them. One noted foreclosure defense attorney, April Charney has noted the extreme frequency in which she has encountered lost note declarations in her cases, indicating that many notes were never delivered up the securitization chain. She estimated that eighty percent of the 300-some foreclosures she defended during 2008 in her Florida practice involved lost-note affidavits, and commented, "Lost-note affidavits are pattern and practice in the industry. They are not exceptions. They are the rule."[35]

More evidence of how broadly notes may never have been transferred to the trust may be found in a recent, widely reported bankruptcy case, *In re* Kemp.[36] Countrywide filed a proof of claim for a loan in arrears as a servicer for the Bank of New York for a loan that Countrywide had originated. However, the court found that the "note in question was never been indorsed in blank or delivered to the Bank of New York, as required by the Pooling and Servicing Agreement," even though the mortgage securing the note had been assigned to the Bank of New York. Though Countrywide had previously submitted an affidavit of lost note, it produced at trial an undated allonge purporting to transfer the note to the Bank of New York as trustee and its witness testified that the allonge had been created in anticipation of the instant litigation.

Countrywide's witness's additional testimony has created consternation across the country. She testified on behalf of Countrywide that the original note never left the possession of Countrywide and that it apparently was transferred directly to Countrywide's foreclosure unit, while the new allonge had not been attached to the note. Furthermore, she testified that Countrywide customarily maintained possession of original notes and related loan documents. As a result, the court ruled that the

[34] Dale Whitman, *How Negotiability Has Fouled Up The Secondary Mortgage Market, And What To Do About It*, 37 PEPP. L. REV. 737, 758 (2010).
[35] Bob Ivry, *Banks Lose to Deadbeat Homeowners as Loans Sold in Bonds Vanish,* Feb. 22, 2008, http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aejJZdqodTCM
[36] *In re* Kemp, Slip Copy, 2010 WL 4777625, Bkrtcy.D.N.J.,2010. (November 16, 2010).

Bank of New York could not, through its servicer Countrywide, enforce the note because the Bank of New York had never obtained possession of the note and so can not qualify as the holder of the note even though it might have a valid claim of ownership.

If this witness's testimony is true, Bank of America could have a monstrous problem on its hands.[37] If Countrywide never delivered the notes as required by the PSAs, it was in violation of those in a manner that would leave the servicers of the undelivered loans unable to foreclose on them pursuant to rulings such as that in *In re* Kemp. Worse yet, this may not be a problem that Bank of America can solve merely by finding all of the notes and delivering them to the appropriate trustee for each respective trust. PSAs have strict time requirements for when actions should be taken, and while the terms of PSAs may vary, no doubt such delivery should occur in most cases before years have passed, as they have here since the shut-down of the subprime market. Furthermore, it is not clear that the trustees for the loans could accept the notes at this point without endangering the status of the securities they are supervising. Securitized mortgage trusts are supposed to be static creatures, with the mortgages delivered at or near the creation of the securities and changes in those mortgages only pursuant to specific rules.

Moreover, if the trustee is adequately representing the interests of the securities investors, it may be that the trustees should not even accept the delivery of the late-arriving mortgage notes. Instead, it may be that the trustee and servicer should refuse such delivery and instead demand repayment for those undelivered notes, forcing Bank of America to take them back pursuant to the terms of the PSA and the representations and warranties contained therein. Whether the trustee and servicer could do so would depend on the terms of the PSA, but this is a legitimate concern.

Bank of America has attempted to walk back this witness's testimony, claiming that she was "not comfortable testifying about the circumstances under which original loan documents would move, or whether and to what extent they ever are moved." A spokesperson for Bank of America has since provided a less than complete denial, stating, "Countrywide's policy and practice has been and remains to fully comply with the pooling and servicing agreements, including forwarding any necessary documents to the trustee."[38] This denial does not fully answer the question, however, as it is not clear whether Countrywide delivered the notes or instead has some argument that the underlying notes are not "necessary documents" to deliver to the trustee.

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[37] For a different and perhaps more alarming analysis on Bank of America's potential problems, see Adam Levitin, The Big Fail, posted on Credit Slips, November 22, 2010, at http://www.creditslips.org/creditslips/2010/11/securitization-fail.html.

[38] Abigail Field, *Countrywide's Mortgage Document Errors May Doom Bank of America,* Daily Finance, 11/22/10, available at: http://www.dailyfinance.com/story/credit/bank-of-america-mortgage-document-errors-trouble-countrywide/19728402/

Servicers' Conflicts of Interest

Servicers of mortgage loans appear to be plagued by conflicts of interest, some they try to resolve, others they do not appear even to address. A primary conflict of interest they have is that should they try to modify loans, they run the risk of falling prey to "tranche warfare," whereby one tranche of investors could claim that the servicer's actions benefited another class to the first class's detriment. The industry may claim that servicers act for the good of the investors as a totality. However, servicers may have their own interest in which securities benefit or lose. In order to give loan originators "skin in the game," in some deals they service the resulting loan pools and also retain a portion of the resulting securities. The idea was that originators would do more careful underwriting if they held some of the resulting securities. Similarly, if originators held the servicing rights, they would be penalized for making loans likely to default, as those loans would be more expensive to service.[39] Instead of having that effect, however, where servicers in essence hold an investment piece in the securitization, they have a motive to conduct loan modifications or foreclosures that benefit them rather than investors has a whole.

Another conflict of interest, already discussed, is that servicer profits may be dependent on taking advantage of the passivity of investors. When servicers gauge excess fees from borrowers, especially borrowers in bankruptcy and facing foreclosure, they are often taking money not from the borrower, who will often lose the house anyway, but from the investors whose main hope of repayment is from the foreclosure and resale of the house. To the extent that servicers add junk fees to the amount they are owed by borrowers and recoup those fees during the foreclosure, they are taking that money directly from the investors in many cases. Another conflict stems from the fact that many of the servicers are subsidiaries of other entities in the mortgage chain, either originators or investment banks. For example, Countrywide was purchased by Bank of America and Litton by Goldman Sachs.

During the course of securitizing the loans, securitization entities made various representations and warranties that are included in the pooling and servicing agreements, including representations and warranties about the qualities of the loan and about the loan transfers. It is difficult for investors to act directly on those representations and warranties, and so often must depend on servicers to prosecute any actions to seek recompense from the sponsors for violations of those representations and warranties.[40] Servicers are loathe to seek putbacks of loans, however, when the putbacks would come from their parent companies.[41] Trustees are

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[39] Kathleen C. Engel & Patricia A. McCoy, *Turning a Blind Eye: Wall Street Finance of Predatory Lending*, 75 FORDHAM L. REV. 2039, 2064 (2007).
[40] See Adam Levitin's Testimony before the House Financial Services Committee Subcommittee on Housing and Community Opportunity "Robo-Singing, Chain of Title, Loss Mitigation, and Other Issues in Mortgage Servicing" November 18, 2010.
[41] Nora Colomer, *Conflicts Arise from Servicer's Dual Role*, 11/8/10 Nat'l Mortgage News 15, 35(8), 2010 WLNR 22307700.

not much help for investors either, because they would be unlikely to notice the violation of the representations and warranties unless it was pointed out to them by the Servicer,[42] and because a trustee may derive much of its income from a single lender. For example, according to Professors Tara Twomey and Adam Levitin, Deutsche Bank derives nearly two-thirds of its RMBS trustee business from Bank of America/Countrywide.[43]

Servicers that are subsidiaries of banks have an even greater conflict of interest if the bank also holds a second lien on property secured by a loan serviced by the subsidiary. In that case, the servicer's own parent organization may refuse to allow a loan modification unless the parent bank is paid more than the second loan is currently worth. This conflict is rampant in the servicing industry given that banks own servicers and second liens, while the loans in first position are owned by investors but managed by servicers. According to a recent trade article on servicer conflicts, "As of the second quarter, the four largest banks-JPMorgan Chase, Wells Fargo, Citigroup and Bank of America-own 56.2% of one-to-four family loan servicing industry, said Laurie Goodman, senior managing director at Amherst Securities Group. . . She said that these banks also own $433 billion of the roughly $1 trillion HELOC and second-lien markets, essentially owning about 43% of the outstanding."[44] Owning most of the servicing industry and almost half of the second-lien market puts these four largest banks in continual conflicts between the needs of the investors in the first liens and the banks' own interests in the second liens, with the borrower often stuck in the middle.

The pooling and servicing agreements are typically drafted to make it difficult for investors to act to protect their own interests. Ownership of the securities is often widely dispersed, with many investors who do not know each others' identities, and so collective action by investors has been difficult and scarce. For investors to challenge the actions of servicers, such as their failure to seek putbacks because of violations of representations and warranties or to give investors good information to prove such violations, investors need to accumulate a percentage of investors in a cohesive group, 25% of investors according to many PSAs, to make such a demand.[45] Getting this many investors together has long been thought virtually impossible, leaving servicers free to act without investor control.

[42] *See* Amherst Mortgage Insight, *"The Elephant in the Room—Conflicts of Interest in Residential Mortgage Securitizations"*, 15, May 20, 2010.

[43] See Adam Levitin's Testimony before the House Financial Services Committee Subcommittee on Housing and Community Opportunity "Robo-Singing, Chain of Title, Loss Mitigation, and Other Issues in Mortgage Servicing" November 18, 2010, citing Adam J. Levitin & Tara Twomey, *Mortgage* Servicing, 28 YALE J. ON REG. (forthcoming 2011).

[44] Nora Colomer, *Conflicts Arise from Servicer's Dual Role*, 11/8/10 Nat'l Mortgage News 15, 35(8), 2010 WLNR 22307700.

[45] Nora Colomer, *Beyond Foreclosures, Buybacks are the Real Issue*, 11/1/10 Asset Securitization Rep. 10(11), 2010 WLNR 21818979.

However, recently investors and attorneys aiding them have found a method for investor collective action. Attorneys have been gathering pools of investors to overcome this limitation and have recently announced a collection of investors large enough to make demands on servicers and trustees. One clearinghouse for collective action now apparently has gathered investors holding at least 25% in over than 3,000 securitization deals, as well as investors holding more than 50% of 1,325 deals, and its participants are said to include such heavy-hitting investors as "BlackRock, PIMCO, Fortress Investment Group, Fannie Mae and Federal Home Loan Banks, among others."[46]

A group of such investors with over 25% of the voting rights for more than $47 billion worth of RMBS issued by Countrywide (before it was acquired by Bank of America) wrote the Countrywide, the servicer, and Bank of New York, the trustee, complaining that Countrywide had not been servicing the loans backed by the securities properly, and asked that the Bank of New York demand that loans be repurchased pursuant to the representations and warranties in the PSA.[47] The purpose of this letter could be to attempt to switch the servicer to one that would be more amenable to representations and warranties claims or to providing documentation that would buttress such claims, or to pressure Bank of America to accept more putbacks directly.[48]

With such collective action, investors may be able to enforce the representations and warranties and force sponsors of securitizations to repurchase loans that do not meet the underwriting criteria for the loan pool. If this happens, this could be a huge blow to the banking system, with JPMorgan analysts estimating "that put-back risk will be approximately $23 billion to $35 billion for agency mortgages, $40 billion to $80 billion in non-agency and roughly $20 billion to $30 billion for second liens and HELOCs."[49]

While these putbacks could be extremely expensive for banks, they could actually help some borrowers. Instead of being trapped in a securitized loan pool, with the barriers to modifications and the foreclosure bias that entails, the borrower could be back with the originator of the loan. The originator could be more able and willing to provide borrowers with effective loan modifications, while eliminating the conflicts of interest that the servicers may have had with investors. So even while a massive set of putbacks could cause a great deal of harm to banks, it may help borrowers at the same time.

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[46] *RMBS Investor Group's Clout Grows*, 11/12/10 Total Securitization & Credit Inv., 2010 WLNR 23711881

[47] Ronald D. Orol, Second *round of bank stress tests advocated*, 11/5/10 Marketwatch 20:54:02

[48] Bill Berliner, *Behind the Mortgage Market Headlines*. 11/1/10 Asset Securitization Rep. 18, 10(11), 2010 WLNR 21818971

[49] Nora Colomer, *Beyond Foreclosures, Buybacks are the Real Issue*, 11/1/10 Asset Securitization Rep. 10(11), 2010 WLNR 21818979.

Where To Go From Here

Policy makers have tried several programs to encourage servicers to make reasonable loan modifications. They have tried begging them and bullying them and even paying them. The FTC has tried to saddle the worst servicers with large fines. None of this seems to have worked. What is needed now is a thorough investigation of servicer behavior by someone with the power to demand to see their books, to review their processes and their fee structure, to see why they are failing to modify loans that could help investors, and to demand specific changes. One part of such an investigatory effort is that of 50 attorneys general who have begun an investigation of mortgage servicers' practices, spurred on by the robosigning scandal.[50] While they are in talks with servicers, in an effort to spur servicers into making more loan modifications, it is important that they also release the results of their investigations so that Americans are still not in the dark as to why there are so few effective loan modifications.

We also need to follow through on the promise of the Dodd Frank bill and the coming Bureau of Consumer Financial Protection. This bureau would be a natural for the regulation of servicers, something that has only been done piecemeal by other regulators, as it would focus on the protection of consumers in the servicing process and so work on fixes of many of the problems that bedevil the servicing industry. Sheila Bair, head of the FDIC, noted that the agencies currently regulating servicers (to the extent they even do so), were essentially asleep at the switch when it came to the rise in problem foreclosures and the robosigning scandal, saying in October of this year, "In retrospect, there were warning signs that servicing standards were eroding. Those signs should have caused market participants and regulators alike to question current practices. . . We should have been asking how servicers were able to achieve such efficiencies without sacrificing quality. Sadly, those types of questions were not asked."[51]

A consumer protection agency with the ability to write regulations would be tasked with asking those questions, demanding the answers, and finally reining in servicer abuse. Such an agency could finally obtain some real leverage over servicers, as servicers should be nationally licensed, regularly audited, and required to explain and document their fee system, their loan modifications and their foreclosure process. Such a consumer protection agency could threaten to strip servicers of their license to

[50] See Stephanie Armour, *Hearing: Foreclosures Hit Homeowners Not In Default*, USA TODAY, 11/17/2010, available at: http://www.usatoday.com/money/economy/housing/2010-11-17-foreclosures17_ST_N.htm

[51] Donna Borak, *Bair Says Regulators Share Blame*, 10/26/10 Am. Banker 1 2010 WLNR 21345594

service mortgages should they misbehave, and threaten them with lesser sanctions as needed. Having hands-on regulation by an agency dedicated to protecting consumers from unfair practices is the best plan to turn the servicing industry around.

By fixing these problems, we will not just be helping borrowers who might otherwise be loaded with junk fees or face unnecessary foreclosures. We will also be helping investors in their struggles against servicers. Doing so will not only help us deal with the problem loans of the past, but can also lay the groundwork for a more workable mortgage market in the future.

RESPONSE TO WRITTEN QUESTION OF CHAIRMAN DODD FROM JOHN WALSH

Oversight of the Protecting Tenants at Foreclosure Act

Q.1. The Protecting Tenants at Foreclosure Act (PTFA) requires mortgage holders to permit renters in foreclosed properties to remain in their homes for at least 90 days, and, in many cases, for the remaining terms of their leases. I was pleased to work with Senator Kerry on this legislation, which prevents disruptive evictions and homelessness among tenants who have done nothing wrong and helps protect neighborhoods against the blighting influence of additional vacancies. It has come to my attention that many renters are not receiving the protections of PTFA. Given the many problems banks and servicers are having as they implement basic aspects of the foreclosure process, I am not confident that they are protecting renters as provided in the PTFA.

What steps has your organization taken to implement the PTFA? Have you monitored compliance with the PTFA? If so, what have you found? If you have not yet examined compliance with PTFA, when do you plan to begin doing so?

A.1. The OCC has taken a number of specific steps to ensure that banks, bank examiners, and the public have been provided information about the provisions of the Protecting Tenants at Foreclosure Act of 2009. Shortly after the Helping Families Save their Homes Act of 2009 was signed into law, the OCC issued guidance to national banks and bank examiners to explain that new protections from eviction were now in effect for tenants, if the property they were renting was foreclosed upon. The guidance explained the protections of the law and was followed in January 2010, with updates to the OCC Compliance Handbook and new examination procedures that included a worksheet that banks and examiners could use to review audit work papers, evaluate bank policies, and ensure appropriate training was provided. Finally, the OCC developed three different public service announcements for the radio and print media to explain the provisions of the law.

The OCC expects national bank examiners to test compliance with the provisions of the PTFA when they review loan foreclosures. Beginning in the first quarter of 2010, OCC supervisory teams held focused discussions with the large national bank mortgage lenders which revealed:

- National banks have policies and procedures in place that address the Act and, in some instances, they continue to enhance processes;
- Most national banks use third party/outside counsel when providing information to renters regarding their rights and eviction processes; and
- Six national banks have relocation programs that provide funds to help tenants offset the cost of moving. Two banks also allow tenants to stay rent free if their lease expires in 90 days or less or for a minimum of 90 days if the tenant does not have a valid lease.

Our supervision will continue to include ensuring compliance with the provisions of the PTFA in 2011 and beyond.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR JOHNSON FROM JOHN WALSH

Q.1. What role do your Agencies play in ensuring that the documentation process, including the transfer of the note, is done properly?

A.1. The OCC expects national banks to have the necessary policies and operating procedures to ensure an appropriate and legally compliant chain of title to the note, as well as the security interest in the collateral. This entails proper endorsement of the note upon transfer of ownership and, where required and as dictated by State or local law, proper assignment of the mortgage/deed of trust. Where national banks serve as document custodians for themselves or other investors, we also require controls and tracking systems to properly safeguard the physical security and maintenance of these critical documents. The OCC typically relies on the bank's internal control functions, including line of business operating procedures, quality control and internal audit, and audits by third-party investors to ensure that correct and compliant endorsements and assignments are accomplished.

As part of the recently completed horizontal review of bank foreclosure management processes, we also tested individual files, and conducted onsite inspections at document custodian facilities to validate bank controls over note endorsements, mortgage/deed assignments, and physical control of critical documents. We found that banks had physical control of the documents and, with some exceptions, notes were properly endorsed and mortgages/deeds of trust were properly assigned. We have instructed banks to address all noted exceptions and strengthen control processes where warranted.

Q.2. In your written testimony, you state that "HAMP guidelines preclude servicers from initiating a foreclosure action until the borrower is determined to be ineligible for a HAMP modification." In your opinion, should this prevent the two track process where a homeowner could be in negotiations for a modification and also foreclosed upon?

A.2. The OCC is concerned that the two track process of loan modification and simultaneous foreclosure proceedings may be unnecessarily confusing for distressed or troubled homeowners, and may expose servicers to increased reputation risk. Immediately following my testimony, the OCC directed the eight largest national bank mortgage servicers to develop and implement policies and procedures to suspend foreclosure proceedings for borrowers in all successfully performing trial period modifications where the bank as servicer has the legal ability to do so, similar to current Home Affordable Modification Program (HAMP) guidelines. The OCC also believes that HAMP guidelines that preclude servicers from initiating a foreclosure action until the borrower is determined ineligible for a HAMP modification will prevent initiation of the two track process for eligible loans while active negotiations for a HAMP modification are proceeding. HAMP guidelines do, however, allow for initiation of foreclosure actions under various defined circumstances, including when the servicer has satisfied the reasonable effort solicitation standard and/or when the borrower has been offered a trial period plan but fails to make required payments. Additionally, it should be noted that HAMP guidelines apply only to loans eligible for the Treasury HAMP program, and only when the guidelines do not otherwise conflict with other investor contract requirements. Some servicers have procedures for suspending foreclosure referrals similar to HAMP guidelines for loans held in their own portfolios. However, other third-party investors, including Fannie Mae and Freddie Mac, may impose other requirements for initiating foreclosure actions prior to the loans having been considered for non-HAMP modifications. Servicers are contractually required to follow these requirements, which may result in the two track process. Nevertheless, we will continue to call on servicers to implement operating procedures and controls to better communicate with borrowers and minimize the confusion of the two track process.

Q.3. Can you discuss the occurrence of a performing second lien when the first lien is delinquent? Does the OCC consider whether a homeowner would be able to afford a modified first and second lien when issuing guidance?

A.3. The volume of current and performing second liens held by national banks behind delinquent or modified first liens remains relatively small. In the second quarter of 2010, the OCC analyzed second liens held by national banks and matched more than 60 percent of them ($293 billion) to first-lien mortgages. Of these 5 million matched second mortgages, about 6 percent, or 235 thousand were current and performing, but behind delinquent or modified first liens. The balance of those current and performing second liens behind delinquent or modified first mortgages totaled less than $18 billion.

The OCC does expect mortgage modifications to be structured in a manner that improves the likelihood that a borrower can repay the entire debt, including any restructured credit and existing loan obligations. As part of Supervisory Memorandum 2009–7: *Guidance for the Treatment of Residential Real Estate Loan Modifications,* examiners have been directed to review the reasonableness of banks' loan modification programs and ensure mortgage modifications are designed to improve the likelihood that a borrower can repay the restructured credit under the modified terms and in accordance with a reasonable repayment schedule. The guidance also instructs examiners to ensure impairment analyses incorporate the borrower's troubled condition and consider combined debt obligations and repayment capacity.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR BROWN FROM JOHN WALSH

Q.1. You have suggested that the OCC is "aggressively" taking steps to "hold banks accountable and fix the problem."

What is the OCC's process for reviewing the banks' files?

A.1. In October 2010, the OCC, together with the FRB, the FDIC and the OTS, commenced onsite examinations at the 14 largest federally regulated mortgage servicers, including the eight largest national bank mortgage servicers. The primary objective of the examinations was to evaluate the adequacy of controls and governance over bank foreclosure processes, including compliance with applicable Federal and State law. Examiners also evaluated bank self assessments and remedial actions as part of this process, assessed foreclosure operating procedures and controls, interviewed bank staff involved in the preparation of foreclosure documents, and reviewed approximately 2,800 borrower foreclosure cases [1] in various stages of foreclosure. Examiners focused on foreclosure policies and procedures, organizational structure and staffing, vendor management including use of third parties, including foreclosure attorneys, quality control and audits, accuracy and appropriateness of foreclosure filings, and loan document control, endorsement, and assignment. When reviewing individual foreclosure files, examiners checked for evidence that servicers were in contact with borrowers and had considered alternate loss mitigation efforts, including loan modifications, in addition to foreclosure.

To ensure consistency in the examinations, the agencies used standardized work programs to guide the assessment and document findings of each institution's corporate governance process and the individual case review. Specifically, work programs were categorized into the following areas:

- *Policies and Procedures*—Examiners determined if the policies and procedures in place ensured adequate controls over the foreclosure process and that affidavits, assignments, and other legal documents were properly executed and notarized in accordance with applicable laws, regulations, and contractual requirements.
- *Organizational Structure and Staffing*—Examiners reviewed the functional unit(s) responsible for foreclosure processes, including staffing levels, qualifications, and training programs.
- *Management of Third-Party Service Providers*—Examiners reviewed the financial institutions' governance of key third parties used throughout the foreclosure process.
- *Quality Control and Internal Audits*—Examiners assessed foreclosure quality control processes. Examiners also reviewed internal and external audit reports, including Government-sponsored enterprise (GSE) and investor audits and reviews of foreclosure activities, and institutions' self-assessments to determine the adequacy of these compliance and risk management functions.
- *Compliance with Applicable Laws*—Examiners checked compliance with applicable State and local requirements as well as internal controls intended to ensure compliance.
- *Loss Mitigation*—Examiners determined if servicers were in direct communication with borrowers and whether loss mitigation actions, including loan modifications, were considered as alternatives to foreclosure.

[1] The foreclosure file sample was selected independently by examination teams based on preestablished criteria. Foreclosure files at each bank were selected from the population of in-process and completed foreclosures during 2010. In addition, the foreclosure file sample at each bank included foreclosures from both judicial states and nonjudicial states.

- *Critical Documents*—Examiners determined whether servicers had control over the critical documents in the foreclosure process, including appropriately endorsed notes, assigned mortgages, and safeguarding of original loan documentation.
- *Risk Management*—Examiners determined whether institutions appropriately identified financial, reputation, and legal risks, and whether these risks were communicated to the board of directors and senior management.

In general, the examinations found critical deficiencies and shortcomings in foreclosure governance processes, foreclosure document preparation processes, and oversight and monitoring of third-party law firms and vendors. These deficiencies have resulted in violations of State and local foreclosure laws, regulations, or rules and have had an adverse effect on the functioning of the mortgage markets and the U.S. economy as a whole. By emphasizing timeliness and cost efficiency over quality and accuracy, examined institutions fostered an operational environment that is not consistent with conducting foreclosure processes in a safe and sound manner.

Despite these deficiencies, the examination of specific cases and a review of servicers' custodial activities found that loans in foreclosure were seriously delinquent, and that servicers maintained documentation of ownership and had a perfected interest in the mortgage to support their legal standing to foreclose. In addition, case reviews evidenced that servicers were in contact with troubled borrowers and had considered loss mitigation alternatives, including loan modifications. A small number of foreclosure sales should not have proceeded because of an intervening event or condition, such as the borrower: (a) being covered by the Service members Civil Relief Act; (b) filing bankruptcy shortly before the foreclosure action; or (c) being approved for a trial period modification.

While all servicers exhibited some deficiencies, the nature of the deficiencies and the severity of issues varied by servicer. The OCC and the other Federal banking agencies with relevant jurisdiction are in the process of finalizing actions that will incorporate appropriate remedial requirements and sanctions with respect to the servicers within their respective jurisdictions. We also continue to assess and monitor servicers' self-initiated corrective actions. We expect that our actions will comprehensively address servicers' identified deficiencies and will hold servicers to standards that require effective and proactive risk management of servicing operations, and appropriate remediation for customers who have been financially harmed by defects in servicers' standards and procedures.

Finally, to address concerns about the practice of continuing foreclosure proceedings, even when a trial modification has been negotiated and is in force, in December 2010, the OCC directed each of the eight largest national bank mortgage servicers to develop and implement policies and procedures to suspend foreclosure proceedings for borrowers in all successfully performing trial period modifications where legally possible. The intent of this directive was to reduce borrower confusion and potentially conflicting actions associated with two-track foreclosure/modification processing.

Q.2. Why is the OCC not complying with suggestions made by Members of Congress and the Congressional Oversight Panel to, for example, examine collateral files or consider the potential ramifications of re-valuations of second liens?

A.2. The OCC requires that national banks recognize known impairment and maintain appropriate loss reserves commensurate with the credit risk in their junior lien mortgages. Our retail credit classification policy requires banks to classify and hold increased reserves for most junior lien mortgages when they become 90 days past due. Delinquent mortgages must be written down to the fair value of the collateral, net of any senior lien mortgages, when they become 180 days past due. In addition, we have notified national banks that performing junior lien mortgages that stand behind delinquent or modified first liens have an elevated risk of default and loss, and that appropriate loan loss reserves must be maintained to reflect this elevated risk. In recent quarters, we have also made additional information available to holders of junior lien mortgages on the delinquency and modification status of first lien mortgages serviced by other institutions to ensure that appropriate loss reserves are maintained. We require that bank internal risk management functions follow these guidelines and directives, and our field examiners will periodically evaluate compliance.

Q.3. You have mentioned that "the OCC's primary focus [is] on efforts to prevent avoidable foreclosures by increasing the volume and sustainability of loan modifications." What actions is the OCC taking to increase the volume and sustainability of loan modifications?

A.3. The OCC has issued several formal communications to national banks encouraging them to work with troubled borrowers on any of their residential real estate loans whenever possible. The largest national bank mortgage servicers have all committed to comply with Treasury's HAMP as well as the Second Lien Modification Program (2MP). In recognition of the high re-default rate of modifications implemented through 2008, the OCC issued a Supervisory Letter in March 2009, to the largest mortgage servicers directing them to modify existing policies, procedures and programs to ensure affordable and sustainable mortgage modifications, and to look for opportunities to further restructure existing modifications where warranted to better ensure sustainability.

During 2009, we examined the default management/loss mitigation functions of all major servicers and, where necessary, directed banks to correct identified deficiencies and strengthen operating procedures, programs, and data information systems. In addition, the OCC, along with the OTS, publishes quarterly the OCC and OTS Mortgage Metrics Report through which we make a considerable amount of data and analysis on mortgage delinquencies, foreclosures, modifications, and modification performance available for public review. This same information is provided to each participating servicer and our examining staff to better measure the volume and sustainability of loan modifications and identify issues requiring further attention or corrective action.

RESPONSE TO WRITTEN QUESTION OF SENATOR MERKLEY FROM JOHN WALSH

Enforcement Actions

Q.1. As you know, the Federal Reserve and the OCC have significant supervisory and enforcement tools that can be used to address deficiencies in the foreclosure and mortgage transfer process. Such actions can include the imposition of Civil Money Penalties (CMP's) for more extreme violations of regulations.

Please list the enforcement actions that your organization has taken in the last 2 years with regard to improper foreclosure and mortgage transfer activities, and please indicate the specific penalties imposed for each action.

A.1. The OCC has a wide range of supervisory and enforcement tools that it can impose upon a national bank to address serious concerns or deficiencies. These tools range from informal supervisory actions, such as a communication to the bank management and Board documenting a deficiency, or the development of a Memorandum of Understanding to correct a problem, to formal enforcement action, which could include Cease and Desist Orders, Consent Orders, Formal Agreements, civil monetary penalties, removals from banking, or criminal referrals. During the past 2 years, the OCC has taken informal, or non-public, actions and has required that national bank mortgage servicers take specific actions to address outlined errors or concerns identified in our supervisory processes. We also have enforcement actions under consideration as a result of our foreclosure examinations of the eight largest national bank servicers. We hope to bring those matters to a conclusion in the near future.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR JOHNSON FROM EDWARD J. DEMARCO

Q.1. What role do your Agencies play in ensuring that the documentation process, including the transfer of the note, is done properly?

A.1. Fannie Mae and Freddie Mac (Enterprises) have contractual agreements with seller/servicers to service their loans, including processing foreclosures. These agreements require that seller/servicers meet the requirements outlined in each Enterprises' seller/servicer guide and all legal requirements. The Enterprises monitor seller/servicer requirements and have a range of remedies available under the terms of the contract if the seller/servicers do not meet the terms of the contract. The Federal Housing Finance Agency (FHFA), as conservator and regulator of the Enterprises, does not directly monitor compliance of the seller/servicers, but does review and monitor the Enterprises' oversight actions.

Generally, when a seller/servicer sells a mortgage loan to either Enterprise, it must deliver the original note for each mortgage loan, together with any power of attorney or modifying instrument (such as a modification agreement, conversion agreement, assumption of liability or release of liability agreement) to a document custodian, which holds the documents in trust for the Enterprises.

These custodians are under contract with the Enterprises and must meet specific requirements in their seller/servicer guides.

Due to the recent problems identified with processing foreclosures, FHFA has begun a targeted review of the Enterprises' oversight programs for seller/servicers and related attorney networks. The goal of the review is to ensure proper oversight and therefore proper processing of foreclosures and loan servicing.

Q.2. During our last hearing on this topic, it was pointed out that Fannie Mae and Freddie Mac require the foreclosure process to go forward once initiated even if the homeowner seeks a modification. Does this comply with the single-family seller servicer guides for Fannie Mae and Freddie Mac regarding HAMP and Home Affordable Foreclosure Alternatives Program?

A.2. The Enterprises comply with the Home Affordable Modification Program (HAMP) and the Home Affordable Foreclosure Alternatives (HAFA) guidelines and suspend foreclosure processing when certain milestones are reached. For example, the foreclosure process is suspended while a borrower is under a HAMP trial modification. The HAMP and HAFA guidelines do allow for continuing the foreclosure process, but not reaching the point of a foreclosure sale, while a modification is being negotiated. Due to the extended timeframe to complete foreclosure, anywhere from 6 months to more than a year depending on the State, the ability to continue the process is necessary to reduce the costs to the Enterprises. That said, the Enterprises' servicers are expected to exhaust all possible foreclosure alternatives before initiating a foreclosure.

Q.3. Would this include proceeding to a foreclosure sale while a modification is still being negotiated?

A.3. Foreclosure sales at both Enterprises are suspended when a modification is under negotiation or pending.

Q.4. As conservator, how does FHFA balance the benefits of mortgage modification with the benefits of a swift foreclosure process for homeowners and taxpayers, respectively?

A.4. While FHFA remains committed to ensuring borrowers are presented with foreclosure alternatives, it is important to remember that FHFA has a legal obligation as Conservator to preserve and conserve the Enterprises' assets. As I testified at the hearing, this means minimizing losses on delinquent mortgages. Clearly, foreclosure alternatives, including loan modifications, can reduce losses relative to foreclosure and benefit homeowners and neighborhoods, adding some measure of stability to local housing markets. But when these alternatives do not work, timely and accurate foreclosure processing is critical for minimizing taxpayer losses.

The direct effect on taxpayers is thus: when an Enterprise-guaranteed mortgage is delinquent 4 months, the Enterprise removes the mortgage from the mortgage-backed security in which it was funded, paying off the security investors at par. The delinquent mortgage then goes on the balance sheet of the Enterprise, funded with debt issued by the Enterprise, debt supported by the Treasury Department's Senior Preferred Stock Purchase Agreement. While awaiting foreclosure (or some foreclosure alternative), that loan is generating no revenue because the borrower has stopped paying, but the Enterprise must keep paying interest on the debt supporting the mortgage. The cost of the delay is why it is critical to FHFA's responsibilities as Conservator to ensure timely processing of foreclosure actions—the cost is ultimately borne by the taxpayer.

I want to thank you for the time and effort that you and your staff have dedicated to this important issue. As conservator and regulator of the Enterprises, I am committed to working to resolving any issues in the foreclosure process.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR JOHNSON FROM TERENCE EDWARDS

Q.1. There seems to be a good deal of confusion regarding what servicers are required to do when a borrower becomes delinquent. In your testimony, you state that servicers are required to offer HAMP eligible borrowers HAMP modifications before foreclosing on the property but you also defend the two track process. Can you clarify what the requirements are for modification and foreclosure?

A.1. When a borrower falls behind on mortgage payments, Fannie Mae requires its servicers to follow a series of steps to develop and secure a solution that is tailored to the particular circumstances of the borrower. In doing so, Fannie Mae expects that servicers should specifically set out to borrowers how the modification process will work and in a manner that does not create confusion. Servicers are responsible for communicating with borrowers. We believe our efforts to encourage servicers to create a single point of contact with each borrower will improve communication.

Set forth below are the foreclosure prevention alternatives that we require servicers to offer to borrowers and an explanation of when servicers are required to offer such alternatives.

Foreclosure Prevention Alternatives

When a borrower is delinquent, we require servicers to first determine whether the borrower qualifies for a HAMP modification. A HAMP modification will take a borrower's monthly payment to a level where his or her first-lien mortgage debt-to-income (DTI) ratio is 31 percent. Servicers are required to offer a HAMP modification to any borrower that meets the eligibility requirements of that program.

If the borrower does not qualify for HAMP, servicers are required to consider other home retention options. As discussed below, these other options include modification solutions developed by Fannie Mae specifically for borrowers who are not eligible for HAMP. Fannie Mae's current modification options include opportunities to lower interest rates, forbear principal, or extend terms, and are all designed to help borrowers achieve an affordable, sustainable payment.

- If the borrower is facing a short-term hardship (for example, temporary sick leave, seasonal furlough, or life transition), then a servicer is required to offer the borrower a forbearance or a repayment plan. These plans provide immediate relief to borrowers who need it. We also permit up to 6 months of payment relief for homeowners who are struggling to make their mortgage payments because of unemployment with an extension up to 12 months under extreme circumstances.

- If the borrower is facing a long-term hardship (for example, a reduction in income, long-term disability, or death of a co-borrower), and is not eligible for HAMP, servicers are required to offer a Fannie Mae proprietary modification that is designed to modify the borrower's mortgage payment to an affordable level. There are two programs. First, Fannie Mae has developed a modification option that assists borrowers who did not qualify for HAMP but could achieve a DTI ratio of 24 percent. Servicers are directed to evaluate borrowers for this modification after the HAMP evaluation. Second, we also require servicers to offer a modification that uses a formula-driven approach to develop modification terms rather than meeting a particular DTI ratio. The approach seeks to offer meaningful payment relief for most borrowers and helps reduce re-default rates. This modification program has defined steps that start with a permanent rate reduction, then a term extension and finally, a non-interest bearing and non-amortizing principal forbearance of a portion of the total amount due.

Our ultimate goal is to help borrowers avoid foreclosure. If none of our modification plans can help a borrower reach an affordable payment, servicers are required to offer other foreclosure avoidance options, including a short sale or a deed-in-lieu of foreclosure. With short sales, we permit the borrower to sell the property at a price that is less than the mortgage debt obligation and provides clear title at sale. The deed-in-lieu of foreclosure allows the borrower the ability to deed the home back to us and gives them time to transition out of the home. For deed-in-lieu, the borrower is also offered a financial incentive to help them relocate to alternative housing, and we also offer options for the borrower to rent the home back for a period of time if they wish to remain in the home and community.

Foreclosure Prevention Process

Our expectation is that servicers will explore HAMP and the alternative home retention options addressed above during the early stages of the borrower's delinquency (typically within the first 90 days or when three payments are missed). During this time, borrowers are on a single track and no foreclosure actions should be taken against the borrower. As addressed in the answer to the next question, our requirements set forth specific timelines for how and when a servicer is required to contact a delinquent borrower to determine their eligibility for a modification or other foreclosure prevention alternative. These guidelines require early intervention with a delinquent borrower so that foreclosure prevention alternatives are considered soon after the first missed payment and well before foreclosure referral.

Given the length of time that the foreclosure process requires in many states, servicers are generally required to refer loans to foreclosure shortly after the borrower has missed three payments. This timeframe may be extended if necessary in order to comply with our requirements relating to the HAMP and HAFA programs or if the borrower has implemented a workout arrangement, such as a forbearance or repayment plan.

In addition, we require servicers to continue to solicit borrowers for modifications after the loan has been referred to foreclosure and while the foreclosure process is continuing. Despite our requirements for early intervention, in some cases it is not until a borrower faces the reality of a foreclosure proceeding that they are ready to consider a workout solution. Accordingly, in order to help these borrowers, there are circumstances where the foreclosure process may happen simultaneously with a borrower being considered for a modification.

To avoid foreclosure sales where a modification may still be possible, Fannie Mae requires that 30 days prior to going to foreclosure sale, the servicer must review the borrower's account to confirm all required communications have been sent and no payment or workout arrangements are pending.

Again, servicers have the responsibility to communicate with borrowers. We expect servicers to discuss with borrowers the different steps that may occur during the modification process in a clear and concise manner to avoid confusion.

(References: Fannie Mae Servicing Guide: VII, Section 610.04.04: Temporary Suspension of Foreclosure Proceedings)

Q.2. If foreclosures are not initiated until after 90 days of delinquency, is there a requirement to contact the borrower with the option of a modification or remedy as soon as a borrower misses a payment?

A.2. Fannie Mae has imposed a number of requirements on servicers on how and when they should contact delinquent borrowers. In April 2010, Fannie Mae released new requirements on this topic. At that time, servicers were instructed to implement them as soon as possible, but no later than January 1, 2011.

Fannie Mae requires that servicers call delinquent borrowers 3 to 15 days after the first missed payment. Starting on day 16 after a missed payment the servicer is required to make a minimum of two calls per week until:

- The servicer has contacted the borrower and a promise to pay or payment is received;
- The borrower has worked out a way to resolve their delinquency in accordance with Fannie Mae's guidelines; or
- The case is removed from the calling queue due to justifiable reasons based on a discussion with the borrower.

If the initial calls have not resulted in a resolution of the delinquency or the initiation of a modification for the borrower, the servicer is instructed to send a letter soliciting the borrower for a modification or other foreclosure prevention alternative between day 35 and day 45 after the first missed payment. A reminder letter is sent 15 days after this solicitation letter. During the 30-day period after the servicer's first solicitation letter, the servicer is required to make a minimum of six calls to the borrower in an attempt to discuss the letter with the borrower and to work with the borrower to determine the appropriate foreclosure prevention solution.

Prior to day 80, the servicer must send a second foreclosure solicitation letter. This letter must be sent via overnight mail, via 2-day delivery or via hand delivery. If a workout is still not pending, the servicer must send a third letter to the borrower within 45 days after referral to foreclosure offering a preapproved workout solution, which could be a HAMP modification, another modification or an alternative foreclosure prevention option. Fannie Mae also requires that additional solicitation letters must be sent every 90 days until the delinquency is resolved or a foreclosure sale occurs.

Finally, to avoid foreclosure sales where modifications may still be possible, Fannie Mae requires that 30 days prior to going to foreclosure sale, the servicer must review the borrower's account to confirm all required communication have been sent and no payment or workout arrangements are pending.

(References: Announcement SVC–2010–06 and Fannie Mae Servicing Guide Part VII, Chapter 2)

Q.3. What kind of oversight does Fannie Mae have over its servicers and what kind of remedies are required if a servicer does not comply with the servicing agreement?

A.3. We expect servicers to comply with our requirements. Servicers are required to maintain adequate internal audit and management control systems to ensure that the mortgages are serviced in accordance with sound mortgage banking and accounting principles; guard against dishonest, fraudulent, or negligent acts; and guard against errors and omissions by officers, employees, or other authorized persons.

We oversee servicer operations in a number of ways:

- We monitor servicers through weekly field reports and monthly onsite reviews into servicers' operations, performance and compliance with guidelines;
- We have increased our onsite presence from 104 to 204 people this year at the various servicer offices to train, provide guidance, oversee and make decisions on Fannie Mae cases, where appropriate;
- We have officer-level employees assigned to servicers where our exposure is the greatest; and
- Our internal Lender Assessment of Risk and Controls (LARC) team performs an independent assessment of seller/servicer compliance with Fannie Mae guide requirements and the assessment of seller/servicer operational risk and controls.

If we determine that a servicer is failing to comply with our servicing guidelines, Fannie Mae can pursue a variety of options, including:

- imposing compensatory fees or formal sanctions;
- requiring the lender to repurchase a mortgage;
- requiring the lender to indemnify Fannie Mae for losses; and/or
- terminating the servicer's contract/servicing arrangement or the right to add new mortgage loans to its Fannie Mae portfolio.

However, our first priority is to work with servicers to improve their processes. When we see servicers are constrained, struggling, or not performing, we have implemented additional measures to address those issues. For example, we have transferred hundreds of thousands of loans in the last year to servicers that can do the job more efficiently and effectively. While we have taken this step, we are also limited in how much we can transfer or whether we can terminate servicer contracts because approximately 60 percent of mortgage loan servicing is controlled by five large financial institutions and there is not capacity in the remaining portion of the industry to handle the volume currently assigned to the largest servicers.

In addition to transferring servicing, we also:

- Provide more Fannie Mae review of loan files (rather than delegate such review to the servicers) in order to ensure that servicers are making the right decisions and assisting borrowers through potential roadblocks to a workout.
- Contract with component servicing providers to help fill in capacity where our servicers lack resources and expertise and to help with door knocking, documentation collecting, fulfillment, and related borrower outreach activity.
- Created several escalation desks within Fannie Mae for servicers to use to resolve issues related to mortgage insurers, subordinate liens/seconds and short sales that all help facilitate foreclosure prevention efforts.

While Fannie Mae owns or guarantees more than 35 percent of the single-family mortgages in America, only about 4.5 percent of our borrowers are 90 days or more behind on their payments, as compared to the serious delinquency rate of nearly 9 percent across the industry. Accordingly, servicers are handling many more delinquent loans from other investors than those owned or guaranteed by Fannie Mae. Nevertheless, we expect our servicers to comply with our requirements as it relates to our loans and we are continuing to review other measures that we can take to improve servicer performance.

(Reference: Fannie Mae Servicing Guide Part I, Section 301)

RESPONSE TO WRITTEN QUESTIONS OF SENATOR JOHNSON FROM KURT EGGERT

Q.1. You speak with great conviction about the need for regulators to take action. What actions do you believe they should be taking?

Q.2. One of the criticisms raised in this hearing is improper incentives. How would you structure incentives and disincentives to make the servicing, modification and if necessary foreclosure processes function better?

A.1.–A.2. My name is Kurt Eggert, and I am a professor of law at Chapman University School of Law. I testified at the hearing, "Problems in Mortgage Servicing From Modification to Foreclosure Part II" in front of the Senate U.S. Senate Committee on Banking, Housing, and Urban Affairs. After that hearing, I was asked to submit supplemental testimony to this Committee regarding what actions regulators should be taking to resolve the current problems in mortgage servicing and how to correct the incentive structure for mortgage servicing. I appreciate being asked to respond to additional questions on this subject, and my supplemental testimony should be read in conjunction with my initial testimony for the above hearing, which laid out the servicer abuses and other problems we are currently seeing, and also the causes of those problems and why servicers are acting, and so far have been free to act, in those ways.[1]

Establishment of National Standards:

The most important step that Federal regulators could take would be, as quickly as feasible, to: (a) establish national standards for mortgage servicers, and (b) give a Federal agency the power to enforce those standards, including the power to issue meaningful sanctions for the violation of those standards. Mortgage servicers should be licensed by a Federal regulator, and that regulator should have the authority to take action against servicers, including being able to suspend or revoke the servicers' license to service in appropriate circumstances. For too long, mortgage servicing has been relatively unregulated, with no one agency given the task of overseeing servicing and preventing abuses by servicers by designing national regulations intended to prevent servicer abuse and failure to modify loans where appropriate.

Instead of an organized system of regulation, what we have seen is haphazard and so far ineffectual regulation. The primary Federal protection for consumer debtors is the Fair Debt Collection Practices Act, which is designed to protect borrowers from overly aggressive debt collectors. However, the act does not apply to mortgage servicers, unless they are collecting on a mortgage that they received when it was already in default. Furthermore, the Fair Debt Collection Practices Act was not designed with mortgage servicing in mind, so even where it does apply, it is a poor fit to prevent many of the problems we see in the servicing industry.

Other laws regulating servicers also do little to quell abusive practices by servicers. While the Truth in Lending Act until recently little affected servicers, it was amended in 2009 to provide servicers some safe harbor from liability to investors should servicers enter into loan modifications with borrowers. The goal was to lessen the effect of "tranche warfare," whereby some investors could claim that their individual interests were harmed by a loan modification, even if the modification helped investors as a whole. While this amendment gives servicers protection against some claims as they modify loans, it does not give borrowers more leverage in obtaining such loan modifications.

Another law that affects servicing is the Real Estate Settlement Procedures Act (RESPA), which is designed to inform borrowers when the servicing rights to their mortgage have been transferred, give them some disclosure of how that transfer will affect them, and provide some protection from late fees during transfer. In addition, RESPA allows borrowers to seek some information regarding

[1] A copy of that written testimony and a video archive of the oral testimony can be found at: *http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing__ID=ea6d7672-f492-4b1f-be71-b0b658b48bef.*

their loans' payment history and current status and requires servicers to respond to those requests as well as requests that errors in the account be corrected. While RESPA can be useful for borrowers, its usefulness is relatively limited and does not reach many of the current issues embroiling the servicing industry. As noted by Adam Levitin and Tara Twomey:

> RESPA's significance for servicing is not the rights it grants, but those it does not. RESPA does not allow borrowers to choose their servicer or have any say in how the servicer handles their loan beyond complaining of errors. If a borrower is dissatisfied with a servicer, the borrower can sue the servicer for specific acts, but has no ability to switch servicers, and there is no cause of action for a homeowner not offered a loss mitigation option instead of foreclosure.[2]

While the existing statutory framework provides little protection for borrowers from the improper fees, shoddy paperwork, and unnecessary foreclosures that have marked the mortgage servicing industry, some Federal agencies have the power to take steps against such practices and have on occasion used that power. For example, the Federal Trade Commission has reached important settlements with mortgage servicers accused of abusive treatment of borrowers, including a 2003 settlement with Fairbanks Capital providing a $40 million fund for injured borrowers, which included a set of "best practices" guidelines for mortgage servicing,[3] a 2007 modification of that settlement with additional guidelines,[4] a 2008 settlement for $28 million with Bear Stearns and its servicers, that included the establishment of a data integrity system,[5] and a settlement for $108 million with Countrywide's loan servicing operation, which the FTC had accused of inflating loan fees.[6] While such actions are helpful, the FTC's actions have been too limited to have a significant effect on the servicing industry.

Other Federal agencies or quasi-Federal organizations have significant power to affect servicing organizations under their regulatory jurisdiction but so far have focused more on the safety and soundness of their regulated institutions or on their own pecuniary gain than on preventing servicer misbehavior that primarily damages borrowers. In this December 1, 2010 hearing of the Senate Committee on Banking, Housing, and Urban Affairs, officials from the Office of the Comptroller of the Currency, the Homeownership Preservation Office of the United States Department of the Treasury, and the Federal Housing Finance Agency, as well as a Governor of the Board of Governors of the Federal Reserve System, all testified about problems in the mortgage and servicing industry. By and large, according to their testimony, they acknowledged that

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[2] Adam J. Levitin & Tara Twomey, *Mortgage Servicing,* 28 Yale J. On Reg. (forthcoming 2011).

[3] For a discussion of Fairbanks's actions and the FTC litigation against Fairbanks, see Kurt Eggert, *Limiting Abuse and Opportunism by Mortgage Servicers,* 15 Housing Pol'y Debate 753, 761–67 (2004), available at SSRN: *http://ssrn.com/abstract=992095.*

[4] See the Federal Trade Commission's press release regarding this settlement modification, FTC, Subprime Mortgage Servicer Agree to Modified Settlement, August 2, 2007, available at *http://www.ftc.gov/opa/2007/08/sps.shtm.*

[5] See the Federal Trade Commission's press release regarding this settlement, Bear Stearns and EMC Mortgage to Pay $28 Million to Settle FTC Charges of Unlawful Mortgage Servicing and Debt Collection Practices, September 9, 2008, available at *http://www.ftc.gov/opa/2008/09/emc.shtm.*

[6] See the Federal Trade Commission's press release regarding the Countrywide settlement, *Countrywide Will Pay $108 Million for Overcharging Struggling Homeowners; Loan Servicer Inflated Fees, Mishandled Loans of Borrowers in Bankruptcy,* June 7, 2010, available at *http://www.ftc.gov/opa/2010/06/countrywide.shtm.*

they had some authority over mortgage servicing, that they recognized that there was a significant problem with mortgage servicing as it stands today, and that they were currently investigating the scope of the problem and hoped to have some idea soon how widespread the problem was and what they could and should do about it.

While such investigation is no doubt necessary and could be a crucial step in reining in servicer misbehavior, so long as it is followed by appropriate sanction and direction of servicers, it is telling that to a great extent, this widespread servicer abuse appears to have come as some surprise to these agencies, despite their power to investigate and regulate servicers. John Walsh, Acting Comptroller of the Currency noted, "The OCC supervises all national banks and their operating subsidiaries, including their mortgage servicing operations. The servicing portfolios of the eight largest national bank mortgage servicers account for approximately 63 percent of all mortgages outstanding in the United States—nearly 33.3 million loans totaling almost $5.8 trillion in principal balances as of June 30, 2010."[7] With such broad supervisory powers over such a significant segment of the servicing industry, the OCC should have been in position to monitor ongoing servicer behavior, to detect servicer misbehavior as it happened, and to administer corrective measures, including real sanctions for servicer misbehavior. However, it appears that only now is the OCC making an intensive investigation into foreclosure misconduct by servicers and into "whether foreclosed borrowers were appropriately considered for alternative loss mitigation actions such as a loan modification." According to this testimony, the OCC hopes to have analysis of its findings completed in January, 2011. Given the lackadaisical attitude that the OCC has demonstrated toward servicer misbehavior, it is reasonable to worry that the OCC will be using this investigation as a way to stall for time and in the end will not take meaningful action to deter and punish servicer misbehavior.

Similarly, Daniel K. Tarullo, a Governor in the Board of Governors of the Federal Reserve System, noted that "The Federal Reserve serves as the primary Federal regulator for two of the 10 largest servicers affiliated with banking organizations. . ." After noting that the Federal Reserve is participating with other Federal agencies in a review of servicer behavior, Tarullo notes the size of the problem they are discovering:

> While quite preliminary, the banking agencies' findings from the supervisory review suggest significant weaknesses in risk-management, quality control, audit, and compliance practices as underlying factors contributing to the problems associated with mortgage servicing and foreclosure documentation. We have also found shortcomings in staff training, coordination among loan modification and foreclosure staff, and management and oversight of third-party service providers, including legal services.[8]

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[7] See Testimony of John Walsh, Acting Comptroller of the Currency, at a hearing before the U.S. Senate Committee on Banking, Housing, and Urban Affairs at a Hearing Entitled: "Problems in Mortgage Servicing From Modification to Foreclosure Part II." Available at: *http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=ea6d7672-f492-4b1f-be71-b0b658b48bef.*

[8] See Testimony of Daniel K. Tarullo, Member in the Board of Governors of the Federal Reserve System, at a hearing before the U.S. Senate Committee on Banking, Housing, and Urban Affairs At a Hearing Entitled: "Problems in Mortgage Servicing From Modification to Foreclosure Part II." Available at: *http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=ea6d7672-f492-4b1f-be71-b0b658b48bef.*

Again, the Federal Reserve is investigating the problems in mortgage servicing and hopes to do something about the problems it is finding in the near future, but does not appear to have acted aggressively to curb servicer misbehavior in the past. One wonders what confidence can one have that the Federal Reserve will take aggressive action to rein in such misbehavior in the future.

When Phyllis Caldwell, Chief of Homeownership Preservation Office of the U.S. Department of the Treasury testified, she indicated that Treasury is taking at least some limited action, stating, "While Treasury does not have the authority to regulate the foreclosure practices of financial institutions, nor to ensure that those practices conform to the law, it is working closely with agencies that do have such authority."

In addition, according to Caldwell, "The Federal Housing Administration (FHA) has been reviewing servicers of loans it insures for compliance with loss mitigation requirements." However, it appears that even though the Making Home Affordable program, and its key component HAMP, are designed to encourage mortgage servicers to generate more loan modifications, in a key issue, which is ensuring that servicers hire sufficient staff to perform those hands-on loan modifications, Caldwell states, "To remedy servicer shortcomings, we have urged servicers to rapidly increase staffing and improve customer service."[9] We should be well beyond the stage of merely "urging" servicers to take the steps needed to ensure appropriate loan modifications are being made. Servicers in the HAMP program should be mandated to have staffing adequate to fulfill their HAMP obligations.

While some have been arguing for national mortgage standards for years, those calls have recently grown louder, and for good reason.[10] As noted in my testimony to this Committee, as well as the recent testimony of others to this and other Congressional committees, the mortgage servicing industry is regularly engaging in abusive practices, such as pushing borrowers into foreclosure with junk fees, failing to credit their payments in a timely fashion, and foreclosing rather than implementing loan modifications that would benefit both investor and borrower alike.[11] A recent survey of consumer attorneys indicates that a large percentage of the borrowers they represent have had foreclosure proceeding initiated either due to "improper fees or payment processing" or while the borrower is

[9] See Testimony of Phyllis Caldwell, Chief of Homeownership Preservation Office of the U.S. Department of the Treasury, at a hearing before the U.S. Senate Committee on Banking, Housing, and Urban Affairs At a Hearing Entitled: "Problems in Mortgage Servicing From Modification to Foreclosure Part II." Available at: *http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing__ID=ea6d7672-f492-4b1f-be71-b0b658b48bef.*

[10] See, for example, news of a letter signed by a group of academics, analysts, and investors urging the establishment of a set of national standards for mortgage servicing, described in Alan Zibel, Regulators Urged to Devise National Loan-Servicing Standards, Wall Street Journal, December 21, 2010, available at: *http://blogs.wsj.com/developments/2010/12/21/regulators-urged-to-devise-national-loan-servicing-standards.*

[11] See, among other testimony, Diane E. Thompson, Counsel, National Consumer Law Center, before the Senate Committee on Banking, Housing & Urban Affairs, in a Hearing entitled "Problems in Mortgage Servicing From Modification to Foreclosure" November 16, 2010, Adam Levitin's Testimony before the House Financial Services Committee Subcommittee on Housing and Community Opportunity in a hearing entitled "Robo-Singing, Chain of Title, Loss Mitigation, and Other Issues in Mortgage Servicing" November 18, 2010, and Julia Gordon, Center for Responsible Lending, Before the Congressional Oversight Panel, in a hearing entitled *"HAMP, Servicer Abuses, and Foreclosure Prevention Strategies,"* October 27, 2010.

"awaiting a loan modification."[12] One reason that servicers have been able to continue such behavior is that there currently is no effective Federal regulation or supervision over them, so that servicers are free to act in their own best interests rather than in such a way that maximizes value to investors while avoiding unnecessary foreclosures.

Central to this problem is that Fannie Mae and Freddie Mac, quasi-governmental bodies with their own pecuniary interests at stake, have been given much of the task of regulating servicer conduct, both directly for the loans they have purchased or guaranteed, and through the HAMP program. Treasury granted Fannie and Freddie this power by entering into contracts with Fannie and Freddie to oversee HAMP. Under those contracts, Fannie Mae is designated as the point of contact for servicers that participate in HAMP, not only to pay them for their HAMP modifications, but also to instruct them how loans should be modified.[13] Fannie Mae is also supposed to be the HAMP program's primary collector and keeper of data and other records regarding HAMP and loan modifications, and is supposed to "help design and execute a program that implements standardized, streamlined mortgage modifications for all types of servicers, regardless of the risk holder (*e.g.,* bank, PLS, GSE MBS, *etc.*), and that lowers monthly payments for qualified borrowers."[14]

Freddie Mac, on the other hand, was hired by Treasury to be its program compliance agent, to examine and investigate mortgage servicers to ensure that servicers comply with the published rules of HAMP and to report to Treasury the results of its investigations.[15] Freddie Mac has the authority to conduct onsite audits of servicers and, in consultation with Treasury, require certain corrective measures by servicers, such as suspending foreclosures. Treasury, through the actions of its MHA Compliance Committee, can impose penalties on servicers that fail to comply with their HAMP obligations, such as withholding or requiring repayment of incentive payments. Apparently, Treasury has not used this power to any significant extent, however. According to the Congressional Oversight Panel's December report:

> . . . Treasury has seemed reluctant to do more than vaguely threaten the potential for clawbacks of HAMP payments. Despite rampant anecdotal stories of servicer errors, to date, no servicer has experienced a clawback or other financial repercussion. The steepest penalty Treasury has levied to date has been withholding payments to servicers due to data issues.[16]

At the time Treasury contracted with Fannie and Freddie to run HAMP, some thought that Fannie and Freddie would have greater expertise in servicer oversight than any in the Treasury Department, given Fannie and Freddie's work with servicers for their own

[12] National Association of Consumer Advocates and the National Consumer Law Center, Survey: Servicers Continue to Wrongfully Initiate Foreclosures, December 15, 2010, available at: *http://www.naca.net/__assets/shared/634280136429845000.pdf.*

[13] U.S. Department of the Treasury, *Financial Agency Agreement Between U.S. Department of the Treasury and Fannie Mae,* Feb. 18, 2009, available at *www.financialstability.gov/docs/ContractsAgreements/Fannie%20Mae%20FAA%20021809%20.pdf.*

[14] Id., at Exhibit A, p. 1.

[15] U.S. Department of the Treasury, Financial Agency Agreement Between the U.S. Department of the Treasury and Freddie Mac, Feb. 18, 2009, available at *www.financialstability.gov/docs/ContractsAgreements/Freddie%20Mac%20Financial%20Agency%20Agreement.pdf,* at Exhibit A, p. 1.

[16] Congressional Oversight Panel, December Oversight Report, December 14, 2010, at p.50.

loans. However, it has become apparent that Fannie and Freddie are failing to perform their oversight function, likely in large part because their own financial interests conflict with regulating servicer behavior to protect borrowers from abusive practices. The Congressional Oversight Panel has noted Fannie and Freddie's self interest in overseeing HAMP, and how that self-interest may limit Freddie's willingness to engage in aggressive oversight of mortgage servicers. Regarding Freddie Mac, the Panel's most recent report stated:

> In response to revelations that servicers have been using "robo-signers" to submit false affidavits in thousands of foreclosure cases, Freddie Mac noted that "we believe that our seller/servicers would be in violation of their servicing contracts with us to the extent that they improperly executed documents in foreclosure or bankruptcy proceedings." Trying to enforce Freddie Mac contractual rights, however, "may negatively impact our relationships with these seller/servicers, some of which are among our largest sources of mortgage loans."[17]

If Freddie Mac is allowing the impact on seller/servicers, and hence its relationship with seller/servicers, to affect its enforcement of HAMP guidelines and contracts, Freddie Mac seems to be in direct violation of its obligation, under its contract with the Treasury Department, to avoid conflicts of interest between its duties under that contract and its own business interests. The agreement between Freddie Mac as "Financial Agent" and the Treasury Department specifically states:

> The Financial Agent will adopt an internal policy, to be approved by the Treasury Department, establishing the principles that, in the performance of the Financial Agent's services under this FAA, (a) all decisions are to be made solely based on the objectives and applicable requirements of the program and that the program is to be administered uniformly, and (b) employees of the Financial Agent are not to consider (i) potential benefit to either mortgage sellers or mortgage servicers with whom the Financial Agent does business or (ii) potential benefit to the Financial Agent from modification of mortgages that it owns or that back Mortgage Participate Certifications that it has guaranteed.[18]

Also weakening the oversight of mortgage servicers is the voluntary nature of this HAMP oversight. While it is not clear what the servicers' rights are, some are concerned that if Treasury through Fannie and Freddie crack down on servicer behavior, then servicers will attempt to leave the HAMP program to avoid sanction.

Because of the great weakness of the current regulation of mortgage servicers, it seems clear that a new system of national mortgage servicer regulation is in order. A natural agency to draft such regulations would be the new Consumer Financial Protection Bureau, to be established as mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act. While this Bureau is ramping up, however, it is not clear how soon it will be in a position to draft national servicing regulations and to enforce them

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[17] Congressional Oversight Panel, December Oversight Report, December 14, 2010, at p.82, footnotes omitted. The Panel added, "The Panel condemns this sentiment. If Freddie Mac is hesitant to jeopardize their relationships with servicers to enforce their rights in their own book of business, it is reasonable to worry that they may be similarly unwilling to risk these relationships on Treasury's behalf by aggressively overseeing HAMP servicers." Id.

[18] U.S. Department of the Treasury, *Financial Agency Agreement Between the U.S. Department of the Treasury and Freddie Mac,* Feb. 18, 2009, available at *www.financialstability.gov/docs/ContractsAgreements/Freddie%20Mac%20Financial%20Agency%20Agreement.pdf,* at Exhibit F, at p. F–6.

once it officially opens for business next July, 2011. In the more immediate short term, the FDIC could and should build servicing regulations into its risk retention requirements for asset-backed securitizations, as mandated by Section 941 of Dodd-Frank. The purposes of such risk retention requirements include to promote the public interest and to protect investors, and national servicer requirements could be designed to accomplish both goals. When mortgage servicing breaks down and servicers foreclose rather than providing loan modifications that would benefit both investors and borrowers, that action increases the risk of loss to investors and so runs counter to the goals of risk retention.

Whatever agency drafts national regulations regarding mortgage servicing, they should follow several overarching principals. First of all, such Federal servicing regulations should constitute a floor rather than a ceiling of such regulation and should not preempt simultaneous State regulation of mortgage servicers. Some states have been much harder hit than others in the subprime mortgage meltdown, and so may require more strenuous regulation of mortgage servicers in order to protect the State from excessive foreclosures. One of the lessons we should have learned from the Federal preemption of State anti-predatory lending statutes in the last decade is the importance of allowing individual states to provide additional protections to their citizens when needed, especially where Federal agencies become captured by the industries that they are supposed to regulate.

Another organizing principal should be attempting to ensure the transparency of the servicing and especially mortgage modification process. One problem borrowers have had is being in the dark about whether and when their loan modification might be granted, at what stage their modification decision is, whether the servicer claims that documents needed for a mortgage modification are missing and if so which documents, whether they are likely to meet the criteria for mortgage modifications, and if not, why they do not. If lenders have underwriting software that can determine whether a potential borrower is likely to be approved for a loan, it should not be that difficult to design a Web portal that allows loan counselors and even borrowers to discover this information.

Apparently, such portals are on the drawing boards, with Treasury planning a borrower portal so that borrowers can conduct their own analysis to see if they should be eligible for a loan modification, applying the Net Present Value (NPV) analysis, seeing whether such a modification would make the most economic sense to their owners of their loan.[19] The Congressional Oversight Panel "has repeatedly recommended that Treasury and Fannie Mae develop a Web portal to allow borrowers to submit and track modification applications, to deliver application documents to servicers, and to centralize information."[20] There currently exists a too-little used Web portal to allow loan counselors to manage loan modifications on behalf of borrowers, operated by HOPENOW, and this

[19] See Congressional Oversight Panel, December Oversight Report, December 14, 2010, at p. 65.

[20] Id., at p. 75–76.

should be expanded to allow borrowers to input documentation directly and made mandatory for mortgage servicers.

Another overarching principal of servicer regulation should be to attempt to minimize servicer conflict of interest to the extent possible. Mortgage servicers currently act even in the face of a direct conflict of interest. For example, servicers will service first position mortgages even where the servicer or its parent organization owns a junior mortgage, so that the value of the junior mortgage is dependent on how the senior mortgage is serviced.[21] This conflict of interest may affect the servicer's willingness to engage in loan modifications, as it may be tempted to protect its parent company's interest in the second mortgage. Similarly, it should be considered a conflict of interest for a servicer either to "short" the mortgage-backed securities for which it is acting as a servicer or to be affiliated with another company that is shorting those securities.

Another conflict of interest that should be considered is when servicers service mortgages that they themselves originated, either directly or through an affiliated organization. Investors have learned, to their chagrin, the difficulty of convincing servicers to put back loans that do not meet underwriting standards when it is the servicer or the servicer's affiliated organization that would have to repurchase the loans.

Servicing mortgages is currently quite profitable, with a significant portion of the profits built into the servicers' basic fees for collecting mortgage payments. Resolving problem loans, especially through mortgage modification, can be a significant expense, as it often requires significant hands-on activity by the servicers. Servicers have responded to this allocation of profit and cost by reaping the profits of economies of scale in the collection of mortgage payments, while minimizing the costs of hands-on loan modifications.

Federal regulation should act to tie the profits of payment collection with the costs of appropriate mortgage modification, so servicers that fail to engage in the latter risk losing the former. Currently, this profit and cost are not effectively tied together, as investors have been unable to rein in servicer misbehavior, borrowers are unable to force servicers to make appropriate modifications, and Freddie, Fannie, and Federal regulators have done too little to force servicers to spend the money to engage in thenecessary widespread modifications.

Specific Regulations

The following are specific recommendations that are designed to realign servicer incentives to constrain abusive practices and encourage appropriate loan modifications. In course of drafting regulations governing servicers, whichever agency takes on that task should consider making rules such as the following:

- Require servicers servicing more than a set number of loans to be licensed by the Federal agency given the task of overseeing

[21] See Adam Levitin's Testimony before the House Financial Services Committee Subcommittee on Housing and Community Opportunity "Robo-Singing, Chain of Title, Loss Mitigation, and Other Issues in Mortgage Servicing" November 18, 2010, noting previous testimony from two bank officials that they own the second position mortgage on about 10 percent or more for the first position mortgages they services.

the servicing industry. Provide the Federal regulator with the power to suspend or revoke that license or otherwise sanction the servicers for abusive behavior or failure to perform its duties as servicer.

- Require prompt crediting of payments and prompt correction of miscounted or misapplied payments, combined with rules mandating that payments made be first applied to principal and interest and only then to late fees.
- Limit late fees and other fees to a sum commensurate with the actual additional cost to servicers and investors of the late payment or other action that engendered the fee, so that late fees are not a profit center, but rather are merely repayment for additional costs to servicers and investors.
- Require that once a loan is a certain number of days delinquent, perhaps 90 days, that servicing of the loan be transferred to a special servicer, so that the servicer is motivated to work with borrowers to prevent them from becoming 90 days or more late and no longer benefits from late fees or other fees from borrowers with very delinquent loans that it has failed to resolve.
- Ban the two-track system whereby servicers are processing both a loan modification and a foreclosure for borrowers simultaneously. Servicers should be required to evaluate homeowners for a loan modification before they can even initiate foreclosure proceedings. Without determining whether the investors' return would be maximized through a loan modification, servicers cannot know whether a foreclosure is appropriate, and there appear to have been too many foreclosures that occur as borrowers are finalizing loan modifications.
- Mandate a mediation and appeal system, whereby borrowers can request mediation with servicers before foreclosure and borrowers who meet a baseline test that indicates that they may be eligible for loan modifications that maximize the net present value to investors can appeal a denial by servicers of such loan modification. To be eligible for such appeal, borrowers should submit evidence of their current income and assets.
- Mandate random samples of servicers' fees, servicing and payment history, designed to detect abusive servicing fees. Make the results of servicer investigation public, after allowing response by servicer.
- Require servicers to seek modification and/or waiver of any pooling and servicing agreement that limits the number or kinds of loan modifications, beyond those seeking to maximize investor return.
- Where servicer claims that a loan modification was denied because of investor restrictions on loan modifications, require servicers to provide both the borrowers and the investors with documentation of such investor restrictions.

Actions Federal Agencies Should Take Now, Pending Further Servicer Regulation

While the creation of national servicing regulations is a crucial step toward limiting servicer abuse, and one that should be taken with all due speed, there are interim measures that existing Federal regulators can take in order to curb servicer abuses, minimize servicer conflicts of interest and correct misaligned servicer incentives. The primary entities that could immediately ramp up servicer regulation are Fannie Mae and Freddie Mac, under what should be beefed-up supervision by the Treasury Department. Fannie and Freddie have both the authority granted to them pursuant to their HAMP contracts with the Treasury Department, but also have direct powers over servicers through their own contracts with seller/servicers, both on the loan origination side and on the servicing side. Fannie and Freddie appear loathe to apply this authority sufficiently to force servicers to engage in sufficient loan modifications, no doubt at least in some part because they do not want to threaten their other business relationships with these seller/servicers.

The Treasury Department should demand changes from Fannie and Freddie to strengthen their oversight of servicers, using all of the powers at its disposal. Fannie and Freddie should rigorously enforce HAMP guidelines and penalize servicers that violate these guidelines, and Treasury should, as necessary, step in to mandate such enforcement. Treasury should consider additional instruction that would develop clear guidelines on the penalties that should be imposed for failure to comply with HAMP guidelines, and then monitor Freddie Mac to see if has begun to impose such sanctions for failure to comply with HAMP guidelines. Freddie Mac should be aggressively monitoring whether servicers have fully and correctly implemented the NPV model to determine which loan modifications are appropriate. At the same time, Fannie Mae and Freddie Mac should consider increasing their rewards for servicers that engage in successful loan modifications, including those that involve principal reductions.

One crucial area for strict enforcement of HAMP rules is in the Escalated Resolution Process, whereby borrowers can seek a redetermination or other resolution when they feel that they were wrongfully denied a loan modification. Borrower advocates have sought an independent review process for borrower appeals, and it appears that at least a partial such process has recently been created, though it is not yet in effect. According to a new supplemental directive, Supplemental Directive 10–15, under the HAMP Escalated Resolution Process, servicers "may not conduct a scheduled foreclosure sale unless and until the Escalated Case is resolved in accordance with the requirements of this Supplemental Directive, and all other MHA Program guidelines."[22] While the Supplemental Directive appears to give servicers great discretion in resolving escalated cases, it also contains the following prohibition: "If the case was referred by HSC or MHA Help, the servicer may

[22] See Supplemental Directive 10–15—Case Escalation Process/Dodd-Frank Act NPV Notices, issued November 3, 2010, available at: *https://www.hmpadmin.com/portal/programs/docs/hamp_servicer/sd1015.pdf.*

not consider the case resolved unless HSC or MHA Help concurs with the proposed resolution, with evidence of this concurrence retained in the servicing file." MHA Help is, according to the Supplemental Directive, "a team of housing counselors dedicated exclusively to working with borrowers and servicers to resolve MHA escalated cases," under the auspices of Fannie Mae, as Program Administrator for the MHA Program. HSC is a "similar resolution resource . . . to manage escalated cases received from housing counselors, government offices, and other third parties acting on behalf of a borrower." If MHA Help and HSC have the authority to stop case resolution by refusing to concur with the proposed resolution, and servicers may not conduct a foreclosure sale unless and until the Escalated Case is resolved, that would provide MHA Help and HSC significant power to demand appropriate case resolutions instead of foreclosures.

If MHA Help and HSC do not have the power to halt foreclosure sales by failing to concur with the servicer's proposed resolution, than that power should be given to some entity, so that borrowers can seek an independent determination on whether they should receive a loan modification pursuant to HAMP.

Actions by Other Governmental Housing Programs

In addition to the Treasury Department, Fannie Mae, and Freddie Mac, other Federal housing programs should strictly enforce their servicing rules, and take appropriate action against servicers who violate those rules. From recent testimony by officials from the Federal Reserve Board and the OCC, it appears that several Federal agencies are coordinating a broad-ranging investigation of mortgage servicing practices and abuses. It is important that such investigation be thorough yet completed in a timely fashion. The Federal agencies should be cooperating with and sharing information on servicer misdeeds with the Attorneys General who are also currently investigation servicer misbehavior.

When the OCC and the Federal Reserve complete their investigation, it is important that, after giving the servicers the right to respond, these agencies make their findings public, laying out in detail what they discovered, with reference to specific servicers. Also, the OCC and the Federal Reserve should state specifically what correctional instructions have been given to servicers and also what sanctions have been imposed. The danger is that the OCC and the Federal Reserve, which have regularly concerned themselves more fully with the safety and soundness of their regulated financial institutions than with borrowers or consumers, will fail to sanction servicers sufficiently for their misbehavior, and so encourage its continuation. Given the public nature of the servicer wrongdoing, the public has a right to know what the OCC and the Federal Reserve have discovered and what specifically they have done about it.

Similarly, the FHA should complete its investigation of servicers to determine whether servicers have been following its guidelines regarding foreclosures and loan modifications, and make public its results and any sanctions suffered by servicers who failed to follow those guidelines. Recent reports indicate that FHA is discovering non-compliance with its servicing guidelines.

Conclusion

What is needed most to limit abusive servicer practices is Federal regulation of mortgage servicers, along with a Federal regulatory agency tasked with monitoring servicer behavior and sanctioning servicer misbehavior, up to and, if necessary, including removing a business entity's license to service. Until such Federal regulation is drafted and enacted, it is crucial that Federal agencies with existing power to oversee servicer behavior complete their current examinations and take aggressive action to rein in servicer misconduct, while making public what misbehavior they discovered and what action they took. At the same time, the Treasury Department should take strong steps to force Fannie Mae and Freddie Mac engage in more active and effective oversight of servicers, both in their own loans or those they guarantee, but also those servicers participating in the HAMP program. The misbehavior of servicers requires strong medicine, and these are some suggestions for such a prescription.

Federal Housing Finance Agency

Foreclosure Prevention & Refinance Report
August 2010

Appendix: Data Tables

4 Enterprises Combined - Home Forfeiture Actions ***(# of loans)***

	Aug-09	Sep-09	Oct-09	Nov-09	Dec-09	Jan-10	Feb-10	Mar-10	Apr-10	May-10	Jun-10	Jul-10	Aug-10	YTD 2010
Short Sales	5,256	5,838	6,377	5,538	7,187	7,600	7,092	8,687	8,741	10,082	10,552	11,276	9,392	73,422
Deeds-in-lieu	238	363	232	236	247	284	290	360	434	515	557	499	594	3,533
Nonforeclosure - Home Forfeiture Actions*	5,494	6,201	6,609	5,774	7,434	7,884	7,382	9,047	9,175	10,597	11,109	11,775	9,986	76,955
Third-party Sales	1,312	1,596	1,844	1,582	1,482	1,753	1,677	1,741	2,278	2,304	3,274	3,384	4,302	20,713
Fannie + Freddie Foreclosure Sales	20,112	22,123	26,726	20,646	25,617	31,226	25,165	36,369	35,769	31,394	37,334	39,120	42,032	278,409
Third-party & Foreclosure Sales	21,424	23,719	28,570	22,228	27,099	32,979	26,842	38,110	38,047	33,698	40,608	42,504	46,334	299,122
Foreclosure Starts	94,754	74,072	77,865	67,915	97,705	97,436	71,045	77,792	88,551	91,968	94,576	121,696	118,547	761,611
Top Five Reasons for Delinquency														
Curtailment of Income	40%	41%	41%	39%	41%	44%	48%	49%	49%	48%	48%	48%	47%	
Excessive obligations	16%	15%	14%	13%	13%	13%	13%	13%	13%	14%	14%	14%	14%	
Unemployment	8%	8%	8%	8%	8%	8%	8%	8%	8%	8%	8%	8%	8%	
Illness of principal mortgagor or family member	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%	
Marital Difficulties	3%	3%	3%	3%	3%	3%	3%	3%	3%	3%	3%	3%	3%	

* Short sales and deeds in lieu of foreclosure completed.

Please see glossary on page 15

5 Fannie Mae and Freddie Mac - Refinance Volume (*# of loans*)

	Jul-09	Aug-09	Sep-09	Oct-09	Nov-09	Dec-09	Jan-10	Feb-10	Mar-10	Apr-10	May-10	Jun-10	Jul-10	Aug-10
Total Refinances														
Fannie Mae	264,802	193,814	167,958	121,997	124,644	170,612	141,199	146,909	128,921	121,994	118,632	115,956	123,959	156,737
Freddie Mac	158,182	164,875	98,048	86,796	92,498	126,134	107,589	107,436	106,861	89,650	82,229	98,170	86,925	105,079
Total	422,984	358,689	266,006	208,793	217,142	296,746	248,788	254,345	235,782	211,644	200,861	214,126	210,884	261,816
HARP LTV >80% -105%														
Fannie Mae	16,032	15,295	14,781	10,425	11,623	18,771	15,520	18,070	18,751	15,135	15,060	14,786	12,774	14,145
Freddie Mac	14,577	16,846	8,684	7,136	9,087	14,576	14,751	15,668	14,040	13,396	11,721	12,336	11,859	12,669
Total	30,609	32,141	23,465	17,561	20,710	33,347	30,271	33,738	32,791	28,531	26,781	27,122	24,633	26,814
HARP LTV >105% -125%														
Fannie Mae	1		36	129	283	521	626	685	794	809	892	779	799	891
Freddie Mac				106	257	590	716	868	924	1,117	989	1,122	1,143	1,222
Total	1		36	235	540	1,111	1,342	1,553	1,718	1,926	1,881	1,901	1,942	2,113
All Other Streamlined Refis														
Fannie Mae	38,627	27,857	23,420	16,539	19,342	30,900	26,660	32,090	29,128	26,160	27,006	24,929	25,459	31,370
Freddie Mac	9,543	11,927	7,563	7,965	12,214	19,616	21,254	22,331	17,055	18,989	16,277	14,726	19,715	22,806
Total	48,170	39,784	30,983	24,504	31,556	50,516	47,914	54,421	46,183	45,149	43,283	39,655	45,174	54,176

Notes:

HARP Refinance Loans are defined as Fannie Mae to Fannie Mae and Freddie Mac to Freddie Mac first lien refinance loans with limited and no cash out that are owner-occupied with LTVs between 80% and 125%.

All Other Streamlined Refis are streamlined refinances that do not qualify as HARP (LTVs between 80% and 125%) refinances. Fannie Mae implements streamlined refinances through the Refi Plus product for manual underwriting and DU Refi Plus product for loans underwritten through Desktop Underwriter. The product is available for refinances of existing Fannie Mae loans only. Freddie Mac implements streamlined refinances through the Relief Refinance Mortgage product. Loans may be originated by any Freddie Mac approved servicer.