Testimony of Michael Calhoun, Center for Responsible Lending
Before the U.S. House of Representatives Committee on Financial Services

"Promoting Bank Liquidity and Lending Through Deposit Insurance, The HOPE for Homeowners Program, And Other Enhancements"

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Good morning Chairman Frank, Ranking Member Bachus, and members of the Committee. Thank you for inviting me to testify on H.R. 703, a bill to promote bank liquidity and lending through deposit insurance, the HOPE for Homeowners program, and other enhancements.

I serve as President of the Center for Responsible Lending (CRL), a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, a nonprofit community development financial institution that consists of a credit union and a non-profit loan fund. For close to thirty years, Self-Help has focused on creating ownership opportunities for low-wealth families, primarily through financing home loans to low-income and minority families who otherwise might not have been able to get affordable home loans. In total, Self-Help has provided over $5 billion of financing to 55,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across America. Self-Help's lending record includes an extensive secondary market program, which encourages other lenders to make sustainable loans to borrowers with blemished credit.

With the constant barrage of statistics and staggering dollar figures that have become commonplace during this financial crisis, it is easy to become numb to the depth and scope of the financial pain American families are experiencing today. However, the numbers paint a picture we cannot ignore. Our most recent report on subprime mortgages shows that over 1.5 million homes have already been lost to foreclosure, and another two million families with subprime loans are currently delinquent and in danger of losing their homes in the near future.[1] New projections of foreclosures on all types of mortgages during the next five years estimate 13 million defaults from 2008Q4 until 2014.[2] On subprime mortgages alone, the spillover costs are massive. At least 40 million homes—households where, for the most part, people have paid their mortgages on time every month—are suffering a decrease in their property values that amounts to hundreds of billions of dollars in losses.[3] These losses, in turn, are impacting nearly every aspect of American communities, from police and fire protection to community resources for education.

While the causes of this crisis are many,[4] so far solutions are few. Voluntary efforts by servicers and lenders have not been able to get ahead of the curve, and many of the modifications made so far have not resulted in sustainable loans for a variety of reasons discussed below. To date, the federal government has not created a systematic, large-scale way to stop those foreclosures that can reasonably be prevented.

Helping families will stop the decline in neighborhood property values and will have a stimulative effect on the economy. In short, we need consumer spending power to pull us out of this downward economic cycle. Families who lose their homes are more likely to drag the economy down further. What's more, foreclosure prevention will strengthen the financial system as a whole. Financial institutions will not survive if their loan-related portfolios continue to fail, given that many banks have leveraged bets on the performance of these loans beyond investments in the securities backed by the loans themselves through credit default swap commitments or collateralized debt obligation investments.

So far, voluntary, loan-by-loan modification efforts are not effectively stemming the tide of foreclosures. Modifications being made are too often unsustainable, and many structural, legal, and financial obstacles exist to making modifications at all. Streamlined and sustainable modifications are necessary to get ahead of the foreclosure curve, and servicers and creditors need substantial incentives to get them to participate in such programs. Changes to the law such as those contained in the Servicer Safe Harbor provisions of H.R. 703 can help remove some obstacles to using streamlined loan modification programs for securitized loans, particularly if paired with changes to REMIC laws. Strengthened incentives for mortgage holders and homeowners to participate in the FHA Hope for Homeowners program will help more people into sustainable mortgages, and that program will be even more useful if combined with a TARP-backed streamlined loan modification program along with a change to the bankruptcy code that permits judicial modification of mortgages on primary residences.

I. Current voluntary modification efforts have failed to stem the tide of foreclosures.

Despite the loss mitigation encouragement by HOPE NOW, the federal banking agencies, and state agencies, voluntary efforts undertaken thus far by lenders, servicers and investors have not yet been sufficient to stem the tide of foreclosures. Moreover, servicers still face significant obstacles in making modifications.

Seriously delinquent loans are at a record high for both subprime and prime loans.[5] All available data consistently indicate that continuing foreclosures far outpace total loss mitigation efforts and that only a small share of loss mitigation efforts result in true loan modifications that are likely to result in sustainable loans.

In October, Credit Suisse reported that only 3.5 percent of delinquent subprime loans received modifications in August 2008.[6] Similarly, the most recent report from the State Foreclosure Prevention Working Group of Attorneys General and Banking Commissioners, which covers 13 servicers, 57% of the subprime market, and 4.6 million subprime loans, confirms that progress in stopping foreclosures is "profoundly disappointing."[7] Their data indicate that nearly eight out of ten seriously delinquent homeowners are not on track for any loss mitigation outcome, up from seven out of ten from their last report.[8] Even the homeowners who receive some kind of loss mitigation are increasingly losing their house through a short sale or deed-in-lieu rather than keeping the home through a loan modification or workout.[9]

What's more, when modifications and other workouts are made, they are frequently temporary or unsustainable, leading to re-default and placing homeowners and financial institutions in an even worse economic position than when they started. According to an analysis by Valparaiso Professor of Law Alan White, a national expert on foreclosure policy, of more than 3.5 million subprime and alt-A mortgages (all securitized), only 35% of modifications in the November 2008 report reduced monthly payments below the initial payment, while 20% left the payment the same and 45% increased the monthly payment.[10] Similarly, data through September 2008 indicate that the large majority of HOPE NOW efforts rely on repayment plans,[11] which typically require financially burdened households to add previously unpaid debt to their current mortgage payments.

In view of the foregoing, the recent report by the Office of the Comptroller of the Currency (OCC) regarding high loan modification redefault rates is unsurprising.[12] What is surprising is that the OCC seems to suggest that these redefault rates prove that loan modifications are useless in preventing foreclosures. To the contrary, what this report demonstrates is what we already suspected, which is that the modifications being made are not sustainable, affordable modifications. It does not take an economist to predict that if a homeowner in default is given a higher rather than a lower monthly payment, there is a high probability of redefault.

In fact, other studies tracking the results obtained by different types of modifications show that certain types of modifications are much more successful than other types. According to a recent Lehman Brothers analysis, rate reduction modifications result in a more significant improvement in performance than principal and interest capitalizations that add past-due amounts onto the balance of the loan.[13] Credit Suisse reports that when interest rates or principal are reduced, the re-default rate is less than half of those for these other modifications.[14] In a January 13 paper, Goldman Sachs concluded, “Principal writedowns are always more effective in reducing default rates than note rate reductions.”[15] And the OCC report suggests that modifications of mortgages held by a lender, rather than ones pooled into a mortgage-backed security, have been defaulting at lower rates, which further supports the notion that sustainable modifications can be made if obstacles to doing so can be overcome.[16]

II. Numerous legal and structural obstacles stand in the way of modifications.

A recent Federal Reserve Staff Working Paper identifies a number of obstacles that limit the scale of modifications.[17] These obstacles help explain why voluntary loss mitigation cannot keep up with demand.

- *Investor and PSA Concerns:* Servicers may shy away from modifications for fear of investor lawsuits.[18] While some Pooling and Servicing Agreements (PSAs) provide adequate authority to modify loans, these modifications may cause disproportionate harm to certain tranches of securities over other classes. Other PSAs include serious impediments to modifying securitized loans. For example, some limit the number or percentage of loans in a pool that can be modified.[19] Some impose modification costs on the servicers. And the FAS 140 accounting standards limit the selling of whole loans out of pools.

- *Second Liens:* Additional liens on a property pose a structural obstacle that is often impossible for servicers of the first lien to overcome. Between one-third and one-half of the homes purchased in 2006 with subprime mortgages have second mortgages,[20] and many more homeowners have open home equity lines of credit secured by their home. The holder of the first mortgage will not generally want to provide modifications that would simply free up homeowner resources to make payments on a formerly worthless junior lien, nor to modify a loan where there is a second mortgage in default. But as Credit Suisse reports, "it is often difficult, if not impossible, to force a second-lien holder to take the pain prior to a first-lien holder when it comes to modifications," thereby dooming the effort.[21]

- *Servicer Incentives:* The way servicers are compensated by lenders creates a market-distorting bias for moving forward with foreclosure rather than engaging in foreclosure prevention. Servicers are often not paid for modifications, but are reimbursed for foreclosure costs.[22] The Federal Reserve concludes, "Loan loss mitigation is labor intensive and thus raises servicing costs, which in turn make it more likely that a servicer would forego loss mitigation and pursue foreclosure even if the investor would be better off if foreclosure were avoided."[23]

- *Limited Servicer Staff and Technology:* With few but welcome recent exceptions, servicers have continued to process loan modifications through a labor-intensive, case-by-case review. While they have added staff and enhanced systems, the lack of transparent, standardized formulas has limited the number of modifications that have been produced.[24] Even when a servicer has a uniform methodology, the lack of transparency in the inputs to its net present value analysis, such as its selection of an appropriate discount rate, prevents borrowers and the public from properly evaluating modification decisions.

III. The Hope for Homeowners program could help many troubled homeowners, but changes must be made to encourage both creditors and homeowners to participate.

The Hope for Homeowners program meets three crucial policy criteria, the importance of which has only increased since the time the initial legislation creating the program was passed:

- It does not disproportionately bail out the lenders and investors whose actions led to the current crisis;
- It creates sustainable, affordable mortgages to preserve homeownership and family wealth; and
- It does not place taxpayers at undue risk.

Unfortunately, for a variety of reasons, the program has not caught on as an option for mortgage holders. We suggest a number of changes that can be made to Hope for Homeowners to make it more attractive both to lenders and homeowners. Some of these changes are proposed in H.R. 703, and others would need to be added either by statute or regulation. Most important, the FHA needs to have more flexibility to make changes to the program design to respond to rapidly changing market conditions and government policies, especially in terms of eligibility requirements and pricing.

A. Improve incentives for servicers, mortgage holders, and homeowners to participate in the program.

At present, the Hope for Homeowners program is running into problems on both the lender and homeowner side with respect to core incentives to participate in the program. The various administrative simplification measures proposed by H.R. 703 are all useful,[25] but changing the incentives described below is necessary to significantly increase program usage.

1. Provide more flexibility regarding the amount of the write-down that mortgage holders must take.

The Hope for Homeowners Act is structured to avoid bailing out lenders or investors or rewarding the irresponsible lending that helped create the current crisis. The core principle of the Act is that mortgage holders must write down the value of the mortgaged property to reflect current market value. Requiring mortgage holders to take this "haircut" ensures that lenders and investors shoulder a significant portion of the loss resulting from the poor lending and investing practices in which they engaged.

However, the write-down requirement appears to be discouraging participation to the extent that the program will be of little use at all unless this provision is revised. H.R. 703 proposes reducing the so-called haircut from 90% to 93%. This change is a move in the right direction and will hopefully encourage more mortgage holders to participate. We suggest, however, rather than enshrining a particular percentage in legislation, it may be more useful for the legislation to provide the FHA with flexibility in this area, capped at a maximum of 100%.

2. Eliminate the requirement that homeowners share appreciation with the government.

It is quite clear that the Hope for Homeowners requirement that homeowners share any appreciation above the market value of the home at the time of the FHA refinancing discourages homeowners from participating in this program. The possibility of appreciation is one of the key incentives that drives people to become homeowners, and the combination of appreciation and equity-building is a powerful tool for helping families build wealth over time. Several recent analyses identify the ability to build equity through mortgage payments and home appreciation as a bulwark against future defaults.[26] We agree that the shared appreciation provision should be eliminated. In our view, the equity-sharing provision provides adequate recapture for the government and is a fair way of splitting the opposing interests of repaying the government and leaving core homeownership incentives in place.

3. Provide financial incentives for servicers to participate in the program.

As noted above, the compensation model prevailing in the servicing industry today rewards servicers for holding delinquent accounts and for foreclosing on those accounts, but does not reward servicers for modifying loans or helping homeowners refinance into other loans. For this reason, it is crucial to provide monetary incentives to servicers to participate in Hope for Homeowners. We support H.R. 703 in this effort.

4. Reduce premiums to keep costs down for all participants.

One of the reported reasons for the lack of applications for Hope for Homeowners is the very high cost of premiums – both upfront and annual – that participants must pay under the current program. It is true that the Hope for Homeowners program was initially designed to be self-sustaining. However, as recent economic events have played out, it is clear that even if the program requires some infusion of government funding, it will still be a low-cost alternative to the more direct government subsidies that may otherwise be required to ameliorate the foreclosure crisis. Therefore, we agree that the upfront premium should be removed and the annual premiums reduced. However, we believe that Congress should delegate to FHA the ability to set the premiums at a level that maximizes participation yet covers some portion of the costs.

B. Hope for Homeowners must find a way to deal with second liens before it will become a key tool for homeowners.

The Hope for Homeowners program currently requires that all junior liens be extinguished for a mortgage to be eligible for refinancing. The existence of second liens on so many mortgages (see II above) means that this requirement creates a significant barrier to participation. Congress should consider creating a way to purchase these second liens– current estimates are that they can be purchased at 5 cents on the dollar or less[27] – and eliminate this barrier. Such a purchase program could be run through the TARP program[28] (loans otherwise eligible for H4H would be referred to TARP to buy out the second liens) or could be run through a fund located at FHA itself.

C. Congress can make two key legislative changes to other laws that will significantly promote participation in the Hope for Homeowners Program.

Hope for Homeowners will be most effective as part of a multi-faceted, comprehensive approach to foreclosure prevention. Other components to this approach include the servicer safe harbor discussed below, and the use of the TARP program's powers to prevent foreclosure. Below, we briefly lay out two other important changes to the law that we believe will strengthen the Hope for Homeowners program specifically as well as help achieve the overarching goals of foreclosure prevention and market stabilization.

1. Eliminate the onerous tax burden on homeowners who receive principal writedown either through Hope for Homeowners or through other foreclosure-prevention programs.

When lenders forgive any mortgage principal, such as the lenders would do in taking the write-down required under the Hope for Homeowners program, that amount of forgiven debt is considered to be income to the homeowner. There are some circumstances under which the homeowner can exclude the income from tax, such as if the debt is "qualified principal residence indebtedness (QPRI)" under the Mortgage Forgiveness Debt Relief Act of 2007 or if the homeowner is insolvent. However, for many potential program participants, the debt forgiven through the Hope for Homeowners program will not count as QPRI. This problem will occur if homeowners refinanced their mortgages to make home repairs that did not increase the basis of the house, such as fixing a roof, or where homeowners refinanced their home and consolidated other debt.

Even for homeowners whose forgiven debt will qualify as QPRI, it is extremely burdensome to take advantage of the exception. To do so, the taxpayer must fill out a long form 1040 (which makes them ineligible for any assistance from the various tax clinics offered by the IRS and others for lower-income taxpayers) and must also fill out a Form 982, a form so complicated that the IRS estimates it can take over 10 hours to complete and the IRS National Taxpayer Advocate has identified it as one of the obstacles that prevent taxpayers from claiming exclusions to which they are entitled.[29] If a taxpayer fails to include the reported amount on their tax return or to claim an authorized exemption using Form 982, the IRS's automated documented matching system will flag the return and the IRS may attempt to collect the tax.

To increase participation in the Hope for Homeowners program and to support other solutions that involve the write-down of principal, Congress should expand the definition of QPRI to include all mortgage debt and should streamline the tax filing process to ensure that all taxpayers have the ability to claim the exemption.

2. Permit judicial modifications of principal residences as a backstop to Hope for Homeowners and other foreclosure-prevention programs.

Right now, judicial modification of loans in bankruptcy court is available for owners of commercial real estate and yachts, as well as subprime lenders like New Century and investment banks like Lehman Bros., yet current law makes a mortgage on a primary residence *the only debt* that bankruptcy courts are *not* permitted to modify in Chapter 13 payment plans. Eliminating this exception will provide a backstop for homeowners in trouble and will provide an incentive for mortgage holders to participate in the voluntary Hope for Homeowners program.

While this change to the bankruptcy code has been the subject of much debate in Congress, in light of the failure of voluntary modifications described above, an increasing number of market participants are coming to the conclusion that the change must be made. For example, last week, Credit Suisse released a report on judicial loan modications, concluding, "We expect the new bankruptcy reform will increase loan mods, particularly principal reduction mods, as it is likely to both pressure and also give justification to servicers to more actively pursue principal reduction mods."[30] Most tellingly, a few weeks ago, Citigroup reached an agreement with Congressional leaders to support court-supervised loan modifications in bankruptcy with some additional limitations in the bill.

D. Congress must ensure that FHA not become the new locus of predatory lending and broker abuses.

Finally, the administrators of the program will need to issue rules to protect against mortgage broker abuses in originating loans under the program. As the subprime and Alt-A credit markets have dried up, lenders and brokers are increasingly looking to the FHA as a source of loan funds for those who can't receive a conventional mortgage. Between January and July of 2008, government-guaranteed loan originations increased from 9.4% to 29.1% of the market,[31] most of which are FHA loans. We are already seeing evidence that bad actors are moving into the FHA space as the subprime market dries up.[32] It's critical that FHA loans are governed by appropriate standards to ensure that they are sustainable, contribute to helping low- and moderate-income families to build wealth, and help curb, rather than perpetuate, the current financial crisis.

1. Prohibit abuses in originating loans by brokers and lenders.

Most important, the FHA must avoid becoming the next victim of the origination abuses that plagued the subprime market. To keep its mortgages safe, the FHA should ban the use of yield-spread premiums (payments to brokers or retail lenders in exchange for selling the borrower a loan with a higher interest rate than the borrower qualifies for), which were one of the key drivers of the foreclosure crisis.

The FHA also must police loan terms to ensure that brokers and lenders are not charging excessive fees or interest rates, particularly since these loans are fully government-guaranteed. One approach would be to limit broker fees in coordination with current FHA limits on origination fees. Currently, some brokers are arguing that adding their compensation to lender fees and to the significant upfront mortgage insurance premiums for FHA loans[33] causes fees on FHA loans to exceed 5% of the loan amount, which can trigger many states' anti-predatory lending laws.[34] These groups are asking state lawmakers to exclude FHA upfront MI premiums from the points and fees threshold, thereby allowing room for significant YSPs. Instead, FHA should cap the total points and fees that can be charged on an FHA loan.

In addition, FHA should hold its originators accountable for any loans they originate that do not meet a long-term affordability standard or that otherwise violate FHA lending standards. Now that FHA is the main game in town, it has more leverage to require lenders to repurchase loans that don't comply with its standards. This is vital not only to protect consumers from abusive practices but also to preserve the sustainability of the program by protecting it from potentially debilitating losses.

2. Increase FHA's personnel capacity and information system technology to deal with increased volume and program participants.

HUD officials recently told Congress that they lack "sufficient staff, adequate technology and legal authority to screen questionable lenders who seek to participate in the issuance of federally backed loans," and that they are having the same problems with respect to appraisers.[35] It is crucial that FHA receive adequate funding to be able to ramp up its resources quickly and keep processes flowing, while also protecting the public purse.

It's not clear that FHA can clearly "pierce the corporate veil" to assess the personalities behind new applicants, but there should be some procedures in place that require FHA to consider qualifications of senior management in new applicants. One possibility is a "watch list" of any originators who have filed for bankruptcy or been involved in fraudulent activity against which FHA staff could compare new applicants; additional measures should be explored and implemented immediately for upfront screening, rather than trying to fix or sanction bad actors at the back end.

Additionally, since Fannie Mae and Freddie Mac are in government conservatorship and therefore are no longer real FHA competitors, FHA should take advantage of the GSEs' risk analytics to evaluate the credit risk of its portfolio and recent originations. Further, FHA should evaluate its underwriting criteria, particularly the areas in which large lenders have imposed voluntary screens to reject loans that would meet FHA standards, but which the lenders believe are too risky.

IV. A servicer safe harbor combined with changes to the REMIC law could help overcome some current obstacles to sustainable modifications.

Providing servicers with protection from investor lawsuits is an important way to encourage more sustainable modifications. H.R. 703 aptly recognizes that current restrictions in the contracts between servicers and investors are standing in the way of economically rational modifications that would both keep families in their homes and also provide a greater net present value return to investors as a whole. Specifically, roughly half of subprime PSAs have restrictions that limit servicers' and trustees' discretion to modify mortgages even when such modifications are in the best interests of investors as a whole.[36]

Yet in most cases, the net present value of a modification is greater than foreclosing, even factoring in the possibility that the modified loan will redefault in a declining market, which means that the PSA restrictions are affirmatively harming the financial interests of investors. What's more, the requirement that servicers must repurchase a mortgage before modifying it is, as H.R. 703 recognizes, a substantial disincentive for liquidity- and capital-starved servicers to make these modifications.

There is substantial empirical evidence that servicers are unable to effectively modify loans in securities compared with whole loans sitting on banks' balance sheets.[37] One of the main reasons for this poor performance is that servicers fear being sued by investors if they modify too aggressively, both because of restrictions in the PSAs and because many modifications may advantage one tranche of investors over another, even when benefiting investors as a group. H.R. 703 addresses these obstacles by providing that servicers can modify mortgages regardless of any limitations contained in a PSA and that servicers are not required to repurchase loans out of pools to make such modifications. In addition, it creates a safe harbor from lawsuits for servicers attempting to do the right thing.

We support these changes, but would suggest an alternative method to achieve the first goal: a change to REMIC laws to make favorable REMIC pass-through tax status contingent on changing the PSAs to remove artificial obstacles to modifications. Right now, the loans in the vast majority of private label securities are held in real estate mortgage investment conduits (REMICs). REMICs are tax-favored instruments (income is not taxed at the entity level), and are therefore a creature of social policy. Given that there is no investment-based expectation that tax law will forever remain unchanged, the government could, entirely safe from any takings challenge, condition future REMIC status on trustees amending the agreements to remove any artificial restrictions hamstringing modifications. Since the vast majority of PSAs require the trustee to conform the agreements to maintain REMIC status on an on-going basis without the need to seek permission from investors, trustees will need to permit the modifications.

This approach could be paired with a servicer safe harbor similar to Section 6 of H.R. 703; however, with the restrictions on modifications taken out of the PSAs, the language could be softened to say something to the effect of "unless otherwise established in the PSA" there shall be a safe harbor, and pulling in the criteria from Section 6(a)(2)(B).

Finally, with respect to the language of Section 6, it is crucial that we not harm anyone who has a legitimate claim against a servicer. Any safe harbor for servicers needs to be carefully drawn to prevent the scammers from using it to protect themselves. Therefore, we suggest either removing or clarifying Sec. 6(a)(1)(B), which we believe could be misused to prevent homeowners from making claims related to the improper origination of these loans. In our view, Sec. 6(a)(1)(A) covers all the necessary parties by referring to any person with "any interest" in either a pool of loans or in securities, as that definition should cover even investors in derivative products. However, if it is important to keep 6(a) (1) (B) intact, the words "other than the consumer" should be added after "any person."

Conclusion

Today's financial crisis is a monument to destructive lending practices—bad lending that never before had been practiced on such a large scale and with so little oversight. These practices have now undermined not only just the entire US economy, but the world economy as well. There is no single solution to the challenges facing us today, but we support the provisions of H.R. 703 that would add additional tools to the toolkit of those attempting to increase the number of families who can stay in their homes.

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1 Center for Responsible Lending, *Continued Decay and Shaky Repairs: The State of Subprime Loans Today* (Jan. 8, 2009) p. 2 [hereinafter "*Continued Decay*"], *available at* http://www.responsiblelending.org/issues/mortgage/research/continued-decay-and-shaky-repairs-the-state-of-subprime-loans-today.html.

2 Goldman Sachs Global ECS Research, *Home Prices and Credit Losses: Projections and Policy Options* (Jan. 13, 2009), p. 16 [hereinafter *Home Prices and Credit Losses*]; *see also* Credit Suisse Fixed Income Research, *Foreclosure Update: Over 8 Million Foreclosures Expected* (Dec. 4, 2008), p.1.

3 *Continued Decay* p. 3.

4 On October 16, 2008, Eric Stein, senior vice president of the Center for Responsible Lending, testified before the Senate Banking Committee regarding the causes of the crisis [hereinafter Stein Testimony October 2008]. While more details can be found in his testimony, it is clear that dangerous lending greatly inflated the housing bubble, and the resulting foreclosures of patently unsustainable mortgages are magnifying the damage of the bubble's collapse. Testimony is available at http://www.responsiblelending.org/pdfs/senate-testimony-10-16-08-hearing-stein-final.pdf

5 *See* HOPE NOW Data for all periods, *available at* http://www.hopenow.com/upload/data/files/July%202008%20Industry%20Extrapolations.pdf.

6 Credit Suisse Fixed Income Research, *Subprime Loan Modifications Update*, October 1, 2008, p.2, *available at* http://www.credit-suisse.com/researchandanalytics [hereinafter "Credit Suisse Update"].

7 State Foreclosure Prevention Working Group, *Analysis of Subprime Servicing Performance*, Sept. 2008, at 2, *available at* http://www.mass.gov/Cago/docs/press/2008_09_29_foreclosure_report_attachment1.pdf.

8 Id. at 6.

[9] Id. at 7-9.

[10] Alan White, *Deleveraging American Homeowners: December 18, 2008 Update to August 2008 Report*, Valparaiso University School of Law (December 2008), p.2.

[11] *HOPE NOW Loss Mitigation National Data July 07 to September 08*, p.9 HOPE NOW Alliance (October 2008) *available at* http://www.hopenow.com/upload/data/files/HOPE%20NOW%20Loss%20Mitigation%20National%20Data%20July%2007%20to%20September%2008.pdf.

[12] *See* OCC and OTS Mortgage Metrics Report (Third Quarter 2008), *available at* http://occ.gov/ftp/release/2008-150a.pdf [hereinafter "OCC Report"]. One of the many concerns about this report is that meaningful, sustainable loan modification efforts did not become active until the third and fourth quarters of 2008, long after the OCC's data was collected, including the streamlined modification programs being used by the FDIC for IndyMac Federal Bank and by Fannie Mae and Freddie Mac.

[13] Lehman Bros. U.S. Securitized Products Fixed Income Research, *The Loan Modification Story So Far* (Sept. 11, 2008), p. 2.

[14] Credit Suisse Update, p.1.

[15] *Home Prices and Credit Losses*, p. 19.

[16] OCC Report, pp. 5-6. We hope that the OCC will release disaggregated data, which we anticipate would show that when modifications reduce monthly payments and are made in accordance with the homeowner's ability to pay, these modifications are much less likely to redefault than modifications that do not reduce or even raise monthly payments.

[17] Larry Cordell, Karen Dynan, Andreas Lehnert, Nellie Liang and Eileen Mauskopf, *The Incentives of Mortgage Servicers: Myths and Realities*, (Federal Reserve Staff Working Paper, Finance and Economics Discussion Series, 2008-46) [hereinafter *Myths and Realities*].

[18] *See* Bajaj, Vikas and Meier, Barry, *Some Hedge Funds Argue Against Proposals to Modify Mortgages*, New York Times, October 23, 2008.

[19] *See* Credit Suisse, *The Day After Tomorrow: Payment Shock and Loan Modifications*, Apr. 5, 2007 (noting specific examples of PSAs with various modification restrictions, including 5% by balance, 5% by loan count, limits on frequency, and limits on interest rate).

[20] Credit Suisse, *Mortgage Liquidity du Jour: Underestimated No More*, March 12, 2007 at 5.

[21] Credit Suisse Update, p. 8.

[22] *See* Testimony of Stein Testimony October 2008 at fn 30.

[23] *Myths and Realities*, p 15.

[24] Id. at 3, 9, 23.

[25] H.R. 703 makes the following administrative changes: (1) eliminates borrower certification regarding not intentionally defaulting on any debt; (2) eliminates requirement to collect two years of tax returns; (3) eliminates originator liability for first payment default; (4) eliminates deadline of March 1, 2008, for DTI test; (5) eliminates prohibition against taking out future second loans; and (6) requires Board to make documents, forms, and procedures conform to those used for normal FHA loans to the maximum extent possible.

[26] *See* Kristopher Gerardi, Adam Hale Shapiro, and Paul S. Willen. "Subprime Outcomes: Risky Mortgages, Homeownership Experiences, and Foreclosures" (homeowners with negative equity are significantly more vulnerable to foreclosure since they often cannot sell or refinance the home or obtain a home equity loan to withstand a short-term financial difficulty), Federal Reserve Bank of Boston, Working Paper 07-15 (Rev. May 4, 2008); *see also Home Prices and Credit Losses,* ("principal writedowns are always more effective in reducing default rates than note rate reductions"), p. 19.
[27] *Myths and Realities,* p. 27.

[28] *See* Testimony of Michael Calhoun, Center for Responsible Lending, Before the U.S. House of Representatives Committee on Financial Services, January 13, 2009, at pp. 9-10, *available at* http://www.responsiblelending.org/pdfs/calhoun-testimony-1-13-09-final.pdf.

[29] National Taxpayer Advocate, *2008 Annual Report to Congress*, p. 341, 391-396.

[30] Credit Suisse, *Bankruptcy Law Reform – A New Tool for Foreclosure Avoidance* (Jan. 26, 2009), p. 1.

[31] Mortgage Bankers Association Press Release, MBA Study Shows Government-Insured Share of Mortgage Applications for JulyTripled in the Past Year, Aug. 18, 2008, http://www.mortgagebankers.org/NewsandMedia/PressCenter/64461.htm.

[32] See Chad Terhune and Robert Berner, "FHA-Backed Loans: The New Subprime--The same people whose reckless practices triggered the global financial crisis are onto a similar scheme that could cost taxpayers tons more," Business Week, Nov. 19, 2008 (noting that originators who engaged in aggressive sales tactics and outright fraud in the subprime or Alt A markets have reconstituted themselves as FHA originators). Since June 2007, the number of lenders and brokers approved to market federally insured mortgage loans has more than doubled from 16,000 to 36,000.

[33] 1.75% for purchase and refinances of conventional loans, 1.5% for refinancing an existing FHA borrower into another FHA loan, and 3% for delinquent borrowers refinancing into an FHA Secure loan.

[34] Currently, given other lender fees incurred on FHA loans, it is possible for many low-income families (and veterans using similar VA programs) to pay as much as $10,000 in fees or more on a $150,000 brokered FHA loan, which is excessive.

[35] Neil Roland, *Shady subprime lenders creeping into federal mortgage program: Short-staffed Federal Housing Authority unable to adequately police loan originators; 'bad actors'*, Financial Week, Jan. 12, 2009; *see generally* testimony of James A. Heist, Department Of Housing And Urban Development, before the U.S. House of Representatives Committee on Financial Services, Jan. 9, 2009.

[36] Such restrictions include limits on the type of modification that can be done (such as prohibiting principal reduction, interest rate reduction or term extensions) or require approval by a third party (NIMS insurer, ratings agency, master servicer or subordinate tranche holder) before doing any modification at all or exceeding a 5% cap on a pool's number of loan modifications. *See* Kevin Byers, CPA, *Summary of Analysis: Loss Mitigation Provisions in Selected Subprime Securitizations*, 12/20/08.

[37] See Note 16; see also Citi, *U.S. Mortgage Lending Data and Servicing Foreclosure Prevention Efforts*, Third Quarter 2008; Piskorski, Tomasz, Seru, Amit, and Vig, Vikrant, *Securitization and Distressed Loan Renegotiation: Evidence From the Subprime Mortgage Crisis*, Dec. 2008 ("This evidence supports the view that, relative to servicers of securitized loans, servicers of portfolio loans undertook actions that resulted in lower rates of foreclosure").