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TESTIMONY OF

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COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

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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.

INTRODUCTION

Chairman Frank, Ranking Member Bachus, and members of the Committee, on behalf of the Comptroller of the Currency, I appreciate the opportunity to discuss the state of national banks' residential mortgage modification efforts.

As has been widely described, current economic conditions continue to have a significant adverse affect on the mortgage market, on homeowners' abilities to meet their mortgage obligations, and on banks' abilities to effectively meet that challenge. High unemployment levels and depreciated home values have constrained many of the options available to financially pressed borrowers and their lenders. While banking regulators cannot solve these underlying structural issues confronting our economy, we do supervise banks with respect to their obligations to prudently meet the credit needs of their local communities and deal with their customers in a fair manner. In this regard, we can and are taking actions to ensure that national banks are working constructively with borrowers who are facing difficulties with their mortgages. The Office of the Comptroller of the Currency (OCC) has directed national banks to make their homeowner assistance programs more sustainable and to improve the quality of available information about the performance of national bank mortgage portfolios, programs to assist troubled homeowners, and trends in foreclosures. Given the problems servicers face with having sufficient operational and staffing capacity to handle the volume of modification requests, we also have directed national banks to implement action plans to address deficiencies in these areas.

As I discuss in my testimony, the pace and effectiveness of home retention efforts undertaken by national banks has improved in recent quarters. While much of the national focus has been on actions made under the "Home Affordable Modification Program" (HAMP), mortgage servicers also assist borrowers through other loan modification and payment plan programs.[1] National banks and federally regulated thrifts act as servicers with respect to approximately two-thirds of all residential mortgages in the United States, some of which they hold on their balance sheets, but most of which are held by third party investors in securitized mortgage pools. The largest national bank and thrift servicers are covered by the quarterly "Mortgage Metrics" reports issued jointly by the OCC and Office of Thrift Supervision (OTS). As reported in that report, these large national banks and thrifts implemented more than 1.8 million loan modifications and payment plans between January 1, 2008 and June 30, 2009, including 114,538 actions taken under HAMP.[2] None of the modifications or payment plans made outside of HAMP receive taxpayer-supported payments or incentives.

Despite the progress that has been made in national banks' loan modification efforts, the economic environment continues to pose considerable challenges to homeowners' and banks' home retention efforts. In many cases, these conditions result in borrowers who are unable or, less frequently, unwilling to comply with program documentation requirements or meet modified loan terms. The reality is that the various homeowner assistance programs underway will help many but not all homeowners.

My testimony today focuses on five areas: 1) the evolution of homeowner assistance programs; 2) the volume and type of loan modifications among large national bank and thrift servicers as reported in our quarterly Mortgage Metric Reports; 3) the performance of loan modifications to date; 4) our supervisory assessments of residential mortgage modifications; and 5) the call for additional regulatory initiatives.

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[1] Loan modifications are permanent changes to one or more terms of a mortgage contract. Payment plans are typically short-term agreements to return a mortgage to current and performing status or a period of trial payments prior to a permanent loan modification.

[2] See the *OCC and OTS Mortgage Metrics Report for the Third Quarter 2008* (http://www.occ.gov/ftp/release/2008-150a.pdf).

THE EVOLUTION OF HOMEOWNER ASSISTANCE PROGRAMS

Previous to this economic cycle, borrowers with financial difficulties typically worked through their problems by refinancing or selling their homes, and the demand for loss mitigation through loan modifications or payment plans was fairly low. When offered, loss mitigation was generally limited to borrowers who experienced a temporary disruption in income due to significant life events—divorce, serious illness, or temporary job loss. These traditional loan modifications were designed to give responsible borrowers an opportunity to weather a temporary disruption in income until they could resume regular monthly mortgage payments. The vast majority of these programs capitalized missed payments, interest and fees, and re-amortized the balance across the remaining term of the loan.

As the economy deteriorated in 2007 and home prices fell, borrowers could no longer turn to refinance or sale options in most markets as ways to repay their mortgages. These conditions led to a sharp increase in delinquencies and foreclosures as well as the recognition by federal regulators and others that loan modification programs on a much larger scale would be needed. The full extent of the problem only became apparent over time, and banks efforts to meet those challenges faced difficulties. Those difficulties included the following:

- First, traditional loss mitigation programs were labor intensive, conducted loan by loan. Servicers did not have in place sufficient resources to address a high volume of troubled borrowers seeking loan modifications.
- Second, servicers initially had difficulty contacting customers who were at risk and could be assisted through loss mitigation efforts. Servicers reported that the response rate to offers or queries was extremely low.

- Third, servicers faced contractual and potential legal limitations to modifying loans on the scale needed to adequately respond to increasing delinquencies and foreclosures. Pooling and servicing agreements constrained the volume and type of modifications that servicers could offer to borrowers.

As the foreclosure crisis expanded, national banks, at our direction, ramped up the scale of their loan modification programs. The volume of loan modifications increased, but many borrowers were still unable to make sustained payments on their loans, even with the modifications. Loan modifications and payment plans made in late 2007 and early 2008 often followed the traditional approaches of capitalizing and re-amortizing past due interest and fees, resulting in increased monthly payments. While this strategy was effective when more favorable economic conditions existed and home values were rising, it was not effective in more adverse economic conditions in addressing the record number of borrowers who were falling behind on their mortgage payments. Reflecting these shortcomings, our quarterly Mortgage Metrics Report documented a high number of re-defaults in the loan modifications made in the first and second quarters of 2008. After six months, nearly 54 percent of the loan modifications made by national banks and federally regulated thrifts in the first quarter of 2008 were 30 or more days past due and nearly 37 percent were more than 60 days past due.

On March 4, 2009, the Department of the Treasury announced HAMP.[3] This program became the primary national focus of homeowner assistance with consumer, investor, and servicer incentives intended to provide sustainable loan modifications to prevent avoidable foreclosures. At about this same time, the OCC issued supervisory letters to all of the major servicers participating in the Mortgage Metrics reporting initiative, directing them to identify and

[3] See “Relief for Responsible Homeowners One Step Closer Under New Treasury Guidelines,” March 4, 2009. (http://www.makinghomeaffordable.com/pr_030409.html)

restructure modifications made during 2008 that did not result in sustainable performance, and assess loan modification policies and procedures to ensure sustainable modifications that would be more effective in keeping borrowers in their homes. The OCC was able to take this specific supervisory action because of the increased information regarding loan modification performance made possible through our Mortgage Metrics initiative. At the OCC, we also stepped up our monitoring and onsite examination of large bank mortgage default management functions. Since those actions, we have seen significantly more modifications that reduce monthly principal and interest payments and better performance from more recent modifications.

In advance of the Administration's program, in response to our directives, and the increased public visibility created by our quarterly Mortgage Metrics Report, servicers increased their focus on the combination of modified loan terms that improved the likelihood of payment sustainability. Mortgage Metrics data released in April 2009 showed loan modifications that reduced monthly payments by more than 10 percent experienced half the serious delinquencies after modification when compared with loan modifications that increased payments or left payments the same.[4] This early data supports a key objective of the Administration's program, which is designed to lower monthly payments as a means of making the modification more sustainable.

Under HAMP, borrowers are required to submit financial documentation to demonstrate repayment ability and to successfully complete a three-month trial period before their loan is permanently modified. While significant volumes of HAMP trial period plans began during the summer and fall of 2009, conversion to permanent modifications has been slow. Part of this has been due to servicers having insufficient staff and systems to process the increasing number of

[4] See *OCC and OTS Release Mortgage Metrics Report for Fourth Quarter 2008*, April 3, 2009. (http://www.occ.gov/ftp/release/2009-37a.pdf)

HAMP trial period plans. Because of these problems, OCC examinations at all of the large national bank mortgage servicers have focused on the adequacy of staffing and operating systems. Where we find shortcomings, we are requiring bank management to implement plans to remedy those shortcomings.

We must also recognize, however, that many servicers, in an effort to increase the number of HAMP actions, initiated trial period plans based on oral representations from the borrower. Servicers are now experiencing difficulty in obtaining and processing the necessary documentation required by the program to verify income and other financial information, and in validating the information when it is provided. Once the required documentation is received, servicers report that a significant number of these borrowers do not qualify under the current guidelines of HAMP. In some cases, the loan is already considered affordable to the borrower under the 31 percent debt-to-income guideline. In others, the borrower cannot demonstrate a valid financial hardship or is not at risk of imminent default. Increasingly, however, the inability to qualify under HAMP reflects borrowers whose financial conditions have deteriorated to the extent that it is not possible to structure an effective modification that meets the net present value requirement of the program.

To promote conversion to permanent modifications, the Department of the Treasury announced an initiative on November 30, 2009, to help convert trial period plans to permanent modifications.[5] The program provides additional information and assistance to homeowners to help them complete their obligations; it also intends to create greater accountability for servicers' performance in the program.

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[5] See "Obama Administration Kicks Off Mortgage Modification Conversion Drive," November 30, 2009. (http://www.makinghomeaffordable.com/pr_11302009.html)

In addition to HAMP, national banks continue to help troubled homeowners avoid foreclosure through their own loan modification programs. Servicers generally consider HAMP actions as only one, albeit an important, tool in their loss mitigation "toolbox" and often will offer proprietary modification to many borrowers who do not qualify under HAMP. We have emphasized to national banks that such programs should be designed to achieve both affordability and payment sustainability, and our data shows that more than three quarters of the modifications implemented during the second quarter of 2009 have reduced the borrowers' monthly principal and interest payments. Predictably, the performance of these modified loans improves as payments are reduced.

The various home retention alternatives used today, including HAMP and similar programs offered by servicers—especially those that appropriately reduce monthly payments—continue to hold the promise of producing sustainable modifications. They offer eligible borrowers an affordable payment and a chance to keep their homes, but success often requires borrowers to make significant debt and lifestyle changes. While many borrowers can and will be helped through these various programs, it is also important to acknowledge that there will be many who cannot.

THE VOLUME AND TYPE OF LOAN MODIFICATIONS AMONG NATIONAL BANKS AND FEDERALLY REGULATED THRIFTS

As previously noted, our most recent publicly released data on the volumes and types of loan modifications through the second quarter of 2009 showed a significant increase in volume and a continuing shift toward loan modifications that reduced monthly principal and interest payments. The *OCC and OTS Mortgage Metrics Report for the Second Quarter 2009*[6] continued to show the negative effects that high unemployment and depressed home values are having in the housing markets as the number of seriously delinquent mortgages and foreclosures in process continued to increase. Against this backdrop, however, home retention actions—including loan modifications and payment plans—rose 21.7 percent from first quarter 2009 to 439,574, nearly 75 percent more than were implemented a year earlier. We expect a further increase in the third quarter.

During the last two quarters, emphasis on HAMP contributed to a dramatic shift in the composition of home retention actions toward payment plans. Because actions taken under the program begin with a three-month trial period, they are reported as payment plans rather than loan modifications. As a result, servicers reported a 73.9 percent increase in payment plans, and a 25.2 percent drop in loan modifications. The 114,538 HAMP trial period payment plans reported in the second quarter more than offset a 47,995 decrease in loan modifications as servicers reallocated resources to HAMP.

Because HAMP did not become operational until May 2009, significant volumes of actions under this plan did not begin to occur until the third quarter of 2009. HAMP, however, represents only part of national banks' ongoing efforts to work with mortgage borrowers. The national bank and thrift servicers covered by our Mortgage Metrics Report implemented more than 1.8 million loan modifications and payment plans between January 1, 2008 and June 30, 2009, of which 114,538 were made under HAMP (see Table 1). Importantly, these institutions also have been originating and refinancing many new, lower-rate mortgages, including a

[6] See *OCC and OTS Mortgage Metrics Report for Second Quarter 2009* (http://www.occ.gov/ftp/release/2009-118a.pdf)

significant volume of FHA-guaranteed loans to low- and moderate-income borrowers who have had insufficient funds for a large down payment.

Table 1. Number of Home Retention Actions—New Loan Modifications and Payment Plans							
	6/30/08	9/30/08	12/31/08	3/31/09	6/30/09	1Q %Change	1Y %Change
Loan Modifications	**125,348**	**114,070**	**116,354**	**190,357**	**142,362**	**-25.2%**	**13.6%**
"Making Home Affordable Trial Period Plans	--	--	--	--	114,538	--	--
Other Trial Period Plans	--	--	--	51,189	59,571	16.4%	--
Other Payment Plans	126,114	154,649	177,314	119,756	123,103	2.8%	-2.4%
Total Payment Plans	**126,114**	**154,649**	**177,314**	**170,945**	**297,212**	**73.9%**	**135.7%**
Total	**251,462**	**268,719**	**293,668**	**361,302**	**439,574**	**21.7%**	**74.8%**

As shown in Table 1, the number of home retention actions, which combines both loan modifications and payment plans, has steadily increased over the past year. We anticipate seeing additional increases in the third quarter when we release our next Mortgage Metrics Report later this month.

To achieve modifications with more affordable payments, servicers are increasingly changing more than one term in a borrower's mortgage contract. Indeed, three quarters of all modifications implemented during the second quarter of 2009 changed more than one loan term. The most common modification actions to date have been the capitalization of missed fees and payments accompanied with reduction of the interest rate and term extensions. While still a small fraction of all loan modifications, the percentage of modifications that reduced principal more than tripled to 10 percent of modifications made in the second quarter compared with 3.1 percent in the first quarter.

As shown in Table 2, more than 78 percent of all modifications implemented during the second quarter of 2009 reduced monthly payments, up from fewer than 54 percent in the previous quarter. This trend, which we expect to continue in the third quarter, represents a significant shift from earlier practices, in which the vast majority of loan modifications either did not change or increased monthly payments.

***Table 2.* Change in Monthly Principal and Interest Payments Owing to Modification** (Percentage of Modifications)							
	6/30/08	9/30/08	12/31/08	3/31/09	6/30/09	1Q %Change	1Y %Change
Decreased by 20% or More	18.1%	18.0%	26.1%	28.8%	38.6%	34.4%	113.2%
Decreased by 10% to Less than 20%	10.6%	12.3%	13.1%	12.2%	19.7%	62.2%	85.9%
Decreased Less than 10%	12.2%	12.4%	13.6%	12.6%	19.9%	57.8%	62.9%
Subtotal for Decreased	**40.9%**	**42.7%**	**52.8%**	**53.5%**	**78.2%**	**46.2%**	**91.1%**
Unchanged	26.4%	24.8%	22.4%	28.4%	4.3%	-84.8%	-83.6%
Increased	32.7%	32.6%	24.8%	18.1%	17.4%	-3.5%	-46.6%
Subtotal for Unchanged and Increased	**59.1%**	**57.3%**	**47.2%**	**46.5%**	**21.8%**	**-53.2%**	**-63.2%**
Total	100.0%	100.0%	100.0%	100.0%	100.0%	--	--

One important measure of the effort to assist responsible homeowners is the number of new home retention actions compared with the number of new foreclosures. In the second quarter of 2009, home retention actions—loan modifications and payment plans—continued to increase more quickly than new foreclosures. Subprime mortgages had almost twice as many new home retention actions as new foreclosures during the quarter. Early analysis of third quarter data suggests that this trend will also continue.

As noted at the outset of my testimony, the OCC has directed bankers to focus on improving the sustainability of homeowner assistance programs. Improving sustainability and returning borrowers to a positive cash flow ultimately reduces the number of eventual foreclosures, provides homeowners a means of holding on to their homes for the long term, and minimizes losses to banks and investors.

THE PERFORMANCE OF LOAN MODIFICATIONS TO DATE

An increasing volume of home retention actions and an increasing proportion of those modifications that significantly reduce monthly principal and interest payments resulted in improvements in the sustainability of more recent loan modifications.

Overall, the percentage of modified loans that were 60 or more days delinquent or in the process of foreclosure rose steadily in the months subsequent to modification for all quarterly vintages within our report. However, early indications are that more recent vintages of modifications, in particular those implemented in fourth quarter 2008 and first quarter 2009, are performing better than previous vintages and may be more sustainable over time.[7] We will continue to monitor these modifications to determine whether they will perform significantly better in the long run.

***Table 3.* Modified Loans 60 or More Days Delinquent**
(60+ Re-Default Rate for 2008–2009 Modifications)

Modification Date	Three Months after Modification	Six Months after Modification	Nine Months after Modification	12 Months after Modification*
First Quarter 2008	22.8%	37.0%	46.6%	54.0%
Second Quarter	27.9%	44.1%	52.1%	56.2%
Third Quarter	30.8%	46.2%	53.5%	--
Fourth Quarter	28.1%	40.8%	--	--
First Quarter 2009	27.7%	--	--	--

When we look more specifically at the performance of loan modification by change in monthly principal and interest payments, we see significant differentiation in the performance of those loan modifications.

Modifications that decreased monthly payments had consistently lower re-default rates, and loans with greater percentage decreases in payments exhibit lower subsequent re-default rates. While lower payments reduce monthly cash flows to mortgage investors, they also appear

[7] Data include only modifications that have had time to age the indicated number of months.

to improve longer term sustainability of the mortgage payments. After 12 months, about 34 percent of modifications that decreased monthly payments by 20 percent or more were 60 or more days past due. In contrast, about 63 percent of modifications that left payments unchanged and nearly 65 percent of modifications that increased payments were 60 or more days past due after 12 months (see Table 4).

Table 4. **Re-Default Rates of Loans Modified in 2008-2009 by Changes in Payment**
(60 or More Days Delinquent)*

	Three Months after Modification	Six Months after Modification	Nine Months after Modification	12 Months after Modification
Decreased by 20% or More	15.0%	24.6%	30.4%	34.1%
Decreased by 10% to Less than 20%	16.7%	29.3%	36.9%	43.0%
Decreased by Less than 10%	18.8%	36.1%	45.4%	50.8%
Unchanged	47.2%	57.0%	62.8%	63.4%
Increased	30.3%	50.9%	60.6%	64.7%

*Data include only loans implemented since first quarter 2008 that had time to age the indicated number of months as of June 30, 2009. For example, only modifications implemented during first and second quarter 2008 have been in effect at least 12 months subsequent to the modification.

We will continue to track and report the performance of these modifications as we go forward.

SUPERVISORY ASSESSMENTS OF RESIDENTIAL MORTGAGE MODIFICATIONS

While there has been progress in expanding homeowner assistance programs, there are still very significant challenges ahead for homeowners, the housing market, banks, and investors who have significant exposure to residential mortgages. These challenges include continued fallout from weak economic and residential real estate market conditions, ongoing mortgage performance issues resulting from consumer over-leverage and unemployment, and restoration of investor confidence and a functioning secondary market.

The financial system and markets are more stable than in the fall of 2008, but weak asset quality continues to be a significant concern across most loan portfolio segments, including residential mortgage portfolios. At the end of the second quarter of 2009, of the 34 million loans evaluated in our quarterly Mortgage Metrics Report, the percentage of current and performing loans had fallen for the sixth consecutive quarter to less than 89 percent. The percentage of seriously delinquent loans—loans 60 or more days past due and mortgages to delinquent bankrupt borrowers—reached 5.3 percent of the total portfolio, or nearly 1.8 million loans. The number of foreclosures in process increased to 2.9 percent or just less than 1 million loans. We expect the trend of increasing delinquencies to continue as homeowners feel the effects of high unemployment and depressed home prices. While loan modifications will help a percentage of responsible homeowners struggling to make payments to stay in their homes, sustained high unemployment and home values that are underwater will limit the percentage of homeowners that loan modifications will be able to help. As a result, foreclosures will remain high even as the economy begins to recover.

The OCC fully supports servicer participation in HAMP and the Administration's Second Lien Modification program. On Monday, we issued guidance to our examiners restating our support for these programs and further clarifying how examiners should review loan modification programs and the related accounting for Troubled Debt Restructurings (TDRs). The guidelines are applicable to both government and proprietary modification programs, and do not replace or supersede generally accepted accounting principles (GAAP) or other existing supervisory guidance. The guidance also stresses that participation in government or proprietary modification programs does not relieve banks of their fiduciary responsibilities to ensure that their regulatory reports and financial statements are accurate and fairly represent the financial condition of the bank and its assets. In this regard, we expect banks to follow GAAP and maintain adequate allowance for loan and lease losses (ALLL) regardless of whether a loan is modified. This includes recognition of loan modifications as TDRs with appropriate reserves and/or charge-off recognition when necessary. Key factors, such as demonstrating a borrower's ability and willingness to repay debt, should not be sacrificed for the expediency of making a loan modification or to increase the number of reported payment plans and modifications. In the long run, relaxing basic prudential standards with regard to documenting proof of income and key underwriting factors will only lower the success of programs designed to help homeowners and minimize loss.

As might be expected given the significant increase in troubled borrowers and the challenges in implementing effective loan modifications and other loss mitigation strategies, the number of complaints related to home lending and loan modifications made to our Customer Assistance Group has increased in the last two quarters. We take these complaints very seriously, and promptly obtain and forward the necessary information to the banks and, when appropriate, our onsite examiners to ensure appropriate resolution. As part of our ongoing supervision at national banks, our examiners assess management's complaint resolution process and require corrective action for identified deficiencies.

CALL FOR ADDITIONAL REGULATORY INITIATIVES

The need for prudent, well structured and sustainable loan modifications continues. However, we would be remiss if we did not examine the causes of the current crisis to make needed changes to avoid repeating these terrible problems in the future. In this regard, Comptroller Dugan recently urged financial regulators both here and abroad to establish minimum underwriting standards for all mortgages made in their respective countries. Chief among these standards in the United States are required financial documentation to evaluate and verify the borrower's payment ability; meaningful down payments to ensure the borrower has "skin in the game"; and qualification of borrowers for mortgages based on the fully indexed rate and payment that the loan structure will require, rather than on an introductory or temporary minimum payment that is typically much lower. We believe that such national standards would significantly improve the confidence in housing markets and help prevent a recurrence of the housing risks we saw over the past few years. In this regard, it will be critical to implement and enforce such standards uniformly across all lenders, ensuring that the far more lax standards of unregulated mortgage originators are raised to the same level as regulated banks and thrifts.

CONCLUSION

Although there are positive signs in many parts of the economy, the residential mortgage market continues to struggle with the effects of high unemployment, low home prices, and highly leveraged borrowers. We have directed national banks to improve operational efficiency to keep up with volume, improve the management of their internal processes, and answer their customers' concerns accurately and promptly.

There has been progress in the industry's loan modification efforts. But, I am realistic about the fact that we will see further deterioration in loans serviced by banks in the months ahead as unemployment remains high and home prices remain low. In these economic conditions, homeowner assistance will help many but not all homeowners.

Finally, I think it is useful to remember that the vast majority of national banks are strong and have the capacity to weather difficulties related to residential lending, and that the vast majority of borrowers are performing on their loan obligations. The OCC will continue to work through the difficult issues related to residential lending in cooperation with the Administration and other financial regulators.