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MARYLAND COMMISSIONER OF FINANCIAL REGULATION

On

THE FORECLOSURE CRISIS AND EFFORTS TO RESPOND

Before the

Committee on Oversight and Government Reform

United States House of Representatives

March 8, 2011, 9:00 a.m.

University of Maryland, Nathan Patz Law Center

Chairman Issa, Ranking Member Cummings and members of the Committee, thank you for the opportunity to appear before you today to address this important topic. As a lifelong Marylander, I appreciate not only your attention to critical foreclosure issues nationally, but your traveling to Baltimore to conduct this hearing in the field and to gain a window into the challenges we face here at the state and local level

I. Background

For state financial regulators, as well as Attorneys General and other officials, issues of foreclosure, loan servicing and loss mitigation have been at the forefront of our efforts for several years. While the macro problems gain nationwide attention in numbers that boggle the mind, we face them every day in our communities - in the voices of those calling our office for help, in the letters that document months of frustration and desperation, and in the literally thousands of foreclosure rescue scams that continue to evolve and morph within the crevices of the law. The costs are staggering – not only in economic terms, but in the lost homes and hopes of homeowners in neighborhoods all around our city and our state. And, as you know, Maryland is not the hardest hit.

Under Governor O'Malley's leadership, we have taken significant steps in Maryland to confront this crisis. As the Governor described, the entire foreclosure process was revamped in 2008 to provide a clear process for borrowers to follow in pursuing loss mitigation and additional resources in terms of early notice, outreach and support. In my office, we have captured address information from Notices of Intent to Foreclose that are furnished pursuant to those reforms and have used that information to deliver some 250,000 outreach packages to severely delinquent homeowners. Each package contains both mortgage assistance and scam prevention information.   At the same time, our state Department of Housing and Community Development has worked in concert with a network of housing counselors throughout the state to assist borrowers in distress. Last year, the Governor spearheaded enactment of a mediation program to ensure that homeowners have a forum for a conversation with the lender or servicer and a final opportunity to avoid foreclosure.

The Office of Financial Regulation has also been focused on servicing and related foreclosure issues from a regulatory perspective. Maryland is one of the few states that requires licensure to service loans. As such, my Office had jurisdiction over non-bank mortgage servicers, many of whom were focused on sub-prime loan servicing, as problems began to emerge. We developed and implemented an examination program for servicers beginning in 2008 and, looking back, the findings from our first exam are eerily familiar to those we confront today. The key areas of focus noted for management and board attention included (i) modifications that appeared unsustainable on their face and inconsistent with the licensee's stated policy to avoid foreclosure, (ii) technology that lacked robust loan resolution and loss mitigation capabilities and (iii) internal customer service reviews that showed average satisfaction levels were "below satisfactory" and falling.

In addition, at the Governor's behest, we undertook a series interagency meetings in 2009 and 2009 with larger servicers many of whom were beyond our legal jurisdiction. At these meetings, we raised similar issues of capacity and capabilities, and were assured by many of the largest servicers that they were adequately staffed and were prepared to meet the challenges that they faced. The reality obviously fell well short.

Leveraging our regulatory reach, the Office of Financial Regulation also implemented a reporting requirement for our licensed mortgage servicers, the first of its kind for any state. We did this to ground our policy conclusions in empirical data, not anecdotal stories. Further, good reporting also helps steer good performance. This reporting provided an important tool to look more substantively into the handling of troubled mortgages. Then, in response to the results of our initial examinations and other reports from the field, we modified our reporting in mid 2009 to measure the impact of modifications on the borrower's monthly payment. Shockingly, the results documented month after month that most of those who had successfully run the gauntlet of modification were paying more after completing the process than before. With the economic downturn deepening, it seemed very likely that these modifications were doomed from the start.

The Federal regulators began to collect data shortly thereafter, and we noted the failure to include a similar measure of the impact of the modification on monthly payments. The Office of the Comptroller of the Currency measured and publicized only redefault rates on modifications, which were predictably high, while doing nothing to capture the increased payments that our data suggested often lay beneath. It took almost a full year and requests from Congressional representatives including Congressman Cummings before the Comptroller would examine the impact of modifications on the borrower's underlying payment obligation. Once measured, modification terms began to improve materially and redefaults began to fall.

We have also partnered with our colleagues in other states who share the same foreclosure-related challenges and frustrations. Together with banking commissioners in four other states, our Office of Financial Regulation joined twelve state Attorneys General in the State Foreclosure Prevention Working Group launched under the leadership of Iowa Attorney General Tom Miller in 2007. This group sought to work collaboratively with the mortgage servicing industry and other parties to identify solutions to the myriad of problems we were seeing in addressing the crisis. The group gathered data submitted voluntarily from the largest subprime servicers and published five reports during 2008 to 2010 providing analysis on foreclosure issues and the servicing response. Unfortunately, this data and the related dialogue fell short of its potential as the Office of the Comptroller of the Currency forbade national banks from providing loss mitigation data to the states.

II. Securitization and the Third-Party Servicing Model

The advent of securitization and third-party servicing has forever changed the mortgage landscape and the experience of borrowers in Maryland and beyond. Gone are the days when local banks and bankers made mortgage loans that they kept on their books. The community banks that I regulate hold only a small minority of loans in our state and candidly, account for virtually none of the foreclosure complaints that flood our office. Instead, most mortgage loans are originated, securitized, sold and serviced by differing parties. The unbundling process may have facilitated the flow of cheap capital, but it has also fragmented roles, distorted market incentives and severely complicated the task of modifying loans to avoid preventable forclosures.

This evolution lies beneath many of the problems we face today. In theory, mortgage servicing is a scale business. This is certainly true when things are going well as automation and scale create a high volume operation that is profitable at low fees. It resembles any other transaction processing business model. Unfortunately, this structure is poorly suited to addressing problem loans. When mortgage defaults began to mount, third-party servicers were left without the expertise, financial incentives, and, most importantly, the resources they needed to engage in effective loss-mitigation programs.

To make matters worse, the same scale economies also drive consolidation. The market share of the top five mortgage servicers has nearly doubled since 2000, from 32 percent to almost 60 percent. Beyond the increased management challenge that comes from operating such a large operation in a crisis, I note that the largest servicers are owned by our major banks – the same banks that are systemically significant. This results in a market that is poorly suited to re-price the service in order to meet the new need. After all, the current provider, who is likely operating at a structural loss, is also too big to fail. The process of restoring a reasonable economic balance that supports a properly run business is distorted – and in large part at the homeowner's expense.

As a result, we continue to confront a major market failure, with all the accompanying inefficiencies. We see and hear from distressed borrowers who report all too frequently that they are forced to resubmit paperwork because it has been lost by the servicer. Loss mitigation requests are delayed for weeks and months as servicing staff seek to manage the volume. Ultimately, financial documents are stale and then must be resubmitted – triggering further delays and confusion. Servicers have remained largely unaccountable for these issues, while the borrower remains on a short leash. If lost documents are not resubmitted properly or strict deadlines are not met by the borrower, the modification is denied. The borrower has no leverage or remedy in the relationship. After all, it's not as if they have a choice selecting their servicer.

Through it all, the foreclosure process proceeds in parallel. This dual tracking is the most difficult element of all. Servicers have consistently told us that while they don't want to foreclose, they must keep the process moving and the pressure on. This creates enormous stress, particularly when the left hand doesn't know what the right hand is doing. Borrowers believe they are proceeding toward a modification only to find out they are headed for a foreclosure sale, while late fees and penalties continue to accrue, further compounding the problem.

<u>III. The Mortgage Foreclosure Multistate Group</u>

Shortfalls in the servicing process were thrust into the public eye late last year with the so-called “robo-signing” scandal. As Governor O’Malley described, the response to the scandal in Maryland was forceful. He joined the Attorney General and Congressman Cummings in contacting the major servicers and demanding a halt to foreclosures until these issues could be addressed. Likewise, our courts responded and adopted emergency rules providing that if the court has reason to suspect that any affidavit filed in a foreclosure may be invalid because of affiant’s lack of sufficient knowledge of the facts stated in the affidavit, the court may decline to accept or order the party to show cause why the action should not be dismissed.

Through our pre-existing relationship with the State Foreclosure Prevention Working Group, our office was invited along with Attorney General Gansler to participate in a joint effort of the 50 state Attorneys General and a committee of bank regulators representing all 50 states to address the problem. I am proud to serve on the Executive Committee of this task force.

The Working Group believes that the effort of the task force is critical for several reasons. First, we are closer to the problems than our federal counterparts and foreclosure remains an issue with local ramifications. Further, I hope I have demonstrated that we have been grappling with these issues for a long time on an organized, cooperative basis. Finally, speaking for the financial regulators involved, we bring critical expertise. To the extent servicing has been reviewed previously, we have been doing it. We have implemented coordinated multi-state examinations of the largest non-bank servicers under our jurisdiction. Currently, my staff is leading one of those examinations and supporting the others that are underway.

At the same time, we appreciate the focus that this issue has received from the federal level and remain committed to working cooperatively with the various agencies involved. We are well aware that the largest servicers handling the majority of loans in our states are federally supervised. A long term solution cannot be implemented without the support of the federal regulators responsible for that supervision.

As our investigation is ongoing, I am limited in the specifics that I can provide. However, I can make some observations based on the efforts of our team.

First, let me be clear that we do not view this as simply a technical issue. At one level, a home is a principal asset and given the stakes, compliance is and should be demanded. Moreover, as my Attorney General colleagues have noted, legal process matters. Due process rights and the rule of law are to be respected, not trivialized.

More broadly, we are concerned that the issues that drove the investigation are symptomatic of problems that have undermined the loss mitigation process for years. In that regard, the efforts reveal shortfalls in many areas. On an operating basis, we have found that files are incomplete, recordkeeping is inadequate and, in certain instances, loan data is inaccurate. At the same time, third-party oversight is lacking. In Maryland, we have seen this issue in our process with improper affidavits filed by foreclosure counsel. On the modification front, we find borrowers who continue to be given mixed signals throughout the process, believing they had qualified for a modification only to see foreclosure proceedings initiated. In Maryland, for example, my office received a copy of an affidavit attesting to the court that the borrower had failed a trial modification and therefore that the foreclosure should proceed. In point of fact, no plan had yet been offered. We have also identified instances where payoff amounts were overstated and foreclosures proceeded. While the resulting deficiency may not be enforced, such overstatements create a further impediment to foreclosure alternatives.

These problems are serious and the findings are not limited to our group. Acting Comptroller Walsh recently testified that his agency's review is also uncovering similar issues. He indicated deficiencies that "have resulted in violations of state and local foreclosure laws, regulations, or rules and have had an adverse affect on the functioning of the mortgage markets."[1] Federal Reserve Governor Tarullo indicated that their reviews revealed, among other things, "significant weakness in risk management, quality control, audit and compliance practices" as well as "staff training, coordination among modification and foreclosure staff, and management and oversight of third parties."[2]

The efforts of the multi-state task force are ongoing, as are the efforts to design and implement a remedy. Our federal counterparts are working toward the same end and I urge this Committee to support their efforts.

In the end, the critical issue is fixing the loss mitigation system. As the Governor has noted, we do not believe that every foreclosure is avoidable. To the contrary, we expect modification where the returns will exceed those of a foreclosure sale. At the same time, the costs of foreclosure are large, not just to the lender, but to our families, communities and economies. Recent events underscore our concerns that borrowers are being foreclosed upon even when it is not the economically best outcome. This is why the term "robo-signing" captured public focus so quickly. The term embodies the public's general sense that while

[1] Testimony of Acting Comptroller John Walsh before the United States Senate Committee on Banking, Housing and Urban Affairs, February 17, 2011.
[2] Testimony of Governor Daniel Tarullo before the United States Senate Committee on Banking, Housing, and Urban Affairs, December 1, 2010.

servicers and borrowers are stumbling through the broken process of loss mitigation, the foreclosure machine is robotically grinding forward in the next room, its methodical processes unencumbered by human involvement or oversight.

As we look to the future, I urge this Committee to press forward and to demand improvement. The federal banking regulators have begun development of national servicing standards. I support this effort and believe that it is essential given that the largest players are under federal supervision. Such standards would apply to all loans, delinquent or not, and would serve to professionalize the process over the long term.

In the short run, however, we must maintain focus on ensuring that those borrowers who have the desire to stay in their homes and qualify for a modification, receive that modification. This begins with a single point of contact for borrowers. This single human interface is key to providing consistency and clarity. That person must also be backed by adequate support staff and technology. As I have indicated, I question the profitability of the current servicing model, so I suggest such investment will need be demanded, not simply requested. Perhaps most importantly, I believe we need to increase accountability. This extends from the transaction level, where denials of loan modifications should be reviewed by an outside party before a sale proceeds, to the enterprise level with board and ultimately regulatory oversight.

None of this will be easy and none of it will be free. But the invisible hand of the market will not fix this – at least not in any near term time frame and not without significant economic and human cost along the way. Mitigating those costs, like mitigating the losses on the underlying loans, requires focus, resources and will.

IV. Conclusion

I want to thank Chairman Issa, Ranking Member Cummings and the members of this Committee once again for coming to Baltimore to conduct this field hearing. The foreclosure issues that you are considering are impacting communities like ours all over the country and cannot be ignored. As state officials, we are doing everything we can to battle this issue and to ensure that deserving homeowners retain their homes. But the forces and players involved are bigger than any one community or state. We need your support and we stand ready to provide ours.