TESTIMONY OF MARLO YOUNG
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BEFORE THE
HOUSE SUBCOMMITTEE ON CAPITAL MARKETS,
INSURANCE, AND GOVERNMENTAL SPONSORED ENTERPRISES

UNITED STATES HOUSE OF REPRESENTATIVES

HEARING ON H.R. 5579, THE EMERGENCY MORTGAGE LOAN MODIFICATION ACT OF 2008

APRIL 15, 2008

Chairman Kanjorski, Ranking Member Pryce, Congressman Castle and distinguished Members of the Subcommittee:

Good afternoon and thank you for the opportunity to testify here today. My name is Marlo Young and I am honored to be here representing Thacher Proffitt & Wood to discuss the Emergency Mortgage Loan Modification Act of 2008 and ways to prevent foreclosures and mitigate losses. We commend you for calling this hearing, and look forward to offering our views on these important matters.

Background

I am a partner with Thacher Proffitt & Wood, a financial services law firm whose practice includes the representation of various banking and financial institutions in connection with the securitization of various asset types including residential mortgage loans. Thacher Proffitt also recently served as outside counsel to the American Securitization Forum (ASF) for its loan modifications task force. In that role we helped to prepare a number of ASF statements and publications, including the streamlined loan modification framework developed by the ASF and the HOPE NOW Alliance that was announced by President Bush in December 2007 (ASF Framework).

Impediments to Loan Modifications

Although a substantial number of loans have been modified to date, servicers have been unable to complete the desired amount of loan modifications due to operational challenges, including technological challenges presented in administering large volumes of loan modifications. The servicer must choose among a variety of loss mitigation alternatives to achieve a sustainable arrangement with the borrower that is also in the best interest of investors. This can be a very labor intensive and time consuming endeavor for the servicer, and unfortunately there is not one particular type of loan modification that is suitable in every circumstance.

Establishing early contact with borrowers is important to the success of loan modifications. In most cases, such contact is necessary for a servicer to determine the appropriate loan modification and the borrower's ability to pay under the modified loan terms. Although borrowers have expressed frustration in contacting lenders to modify the payment terms of their loan, many servicers have reported difficulties communicating with borrowers.

The loan modification process would benefit from more streamlined approaches and enhanced automation. The ASF Framework released last December was a worthy attempt at streamlining the loan modification process. However, one of the criteria developed to support the determination that a streamlined loan modification is in the best interest of investors was based on the magnitude of the payment shock experienced when the mortgage rate resets. Ironically, the recent reduction in short term rates lessened the anticipated payment shock and has resulted in a smaller number of adjustable rate loans that are eligible for modification under the streamlined framework.

Servicing agreements do not create disincentives for servicers to make loan modifications nor do they create incentives to choose to foreclose over making a loan modification. Servicers are only entitled to their servicing fee so long as the loan is outstanding and there are no additional fees or other entitlements for pursing a foreclosure. The servicer is entitled to out-of-pocket costs whether it forecloses or makes a loan modification.

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We do not believe there are major legal or contractual impediments to making loan modifications. Rather, our study of typical servicing agreement provisions for the ASF concluded that generally, servicers of loans in securitizations have the authority to implement loan modifications and other forms of loss mitigation alternatives, when the loan is in default or default is reasonably foreseeable, provided that the action taken is in accordance with accepted servicing practices and is in the best interest of investors.

The provisions of Section 2(a) of the Emergency Mortgage Loan Modification Act of 2008 employ concepts that are consistent with these servicing provisions. Although most servicing agreements generally permit loan modifications, some agreements may provide for some limitations on modifications, such as a limit on the number of loans that can be modified or a minimum modified mortgage rate. However, we do not think the standards set forth in Section 2(a) would conflict with the general standards of typical servicing agreements.

We support the inclusion of the provision in Section 2(a) of the bill that reads "Absent specific contractual provisions to the contrary." Removing any requirement that a loan modification or other loss mitigation not contradict the terms of the servicing agreement may interfere with the existing contractual terms of servicing agreements, and result in actions that are not necessarily in the best interest of investors.

We think Section 2(a) should clarify that the servicer should select from all available loss mitigation alternatives the one that maximizes recovery, and not compare the alternative selected solely to foreclosure. We believe that "accepted servicing practices" is an evolving standard and that the servicer should be able to rely on reasonable policies and procedures that it adopts over time. It should also be recognized that such policies and procedures may not be the same for each servicer. In addition, as long as the servicer's procedures for evaluating the net present value of a particular loss mitigation alternative are reasonable, the servicer's decision should not be challenged on the grounds that other evaluation procedures might have led to a different result.

We question, however, whether the safe harbor in Section 2(b) is necessary or desirable, if the standards in Section 2(a) are adopted. As Section 2(a) requires that any loss mitigation action not contradict any terms in the servicing agreement and sets forth standards that are generally consistent with existing servicing provisions, the safe harbor contained in Section 2(b) does not appear to be necessary. In fact, the safe harbor provision may interfere with existing contractual provisions and bring into question the rights of investors under servicing agreements. Finally, we question whether the concept of "qualified loan modification" contained in Section 2(d)(1) of the bill is too limiting. Imposing a five-year modification term, for example, may conflict with the applicable servicing standard and hinder the servicer's ability to maximize proceeds and do what is in the best interest of investors.

Policy Options For Facilitating Loan Modifications

We believe that portions of the bill, in particular Section 2(a), would be helpful in providing certainty regarding appropriate loss mitigation standards. In addition, Section 2(a) would clarify that the phrase "in the best interest of investors" refers to all investors in a given securitization trust in the aggregate, without regard to the effect on any specific class, which would make the servicer's task of determining the appropriate loss mitigation more manageable.

We believe that a major impediment to a servicer utilizing the full range of loss mitigation alternatives is the absence of an available loan product for funding a short refi, or a refinancing that pays off only a portion of the existing first lien, for borrowers who are in default or imminent default. There presently is not a suitable loan product in the mortgage industry for this purpose. Accordingly, we think that proposals to expand FHA Secure, or create a new FHA program for this purpose, could serve as a key role in reducing foreclosures.

However, we would suggest that an FHA product targeted to short refis for borrowers in default or imminent default, should be available to refinance any type of loan, not just adjustable rate subprime loans at the time of the first rate adjustment. Given that reduced short term rates have had a mitigating effect on ARM rate increases, property value decline may now be a more significant cause of default than rate shock.

In addition, any FHA product developed to support short refis of defaulted loans should be one that servicers may be able to select, in a significant number of cases, as the alternative that maximizes recoveries to investors. In this regard, the servicer should be able to compare the short refi against other alternatives such as a rate reduction modification, which might result in no reduction of principal, or a short sale that would result in a recovery much closer to 100% of current loan-to-value than would a foreclosure. Proposals for any FHA product that result in short refis in the range of 85% of current value may not provide the servicer with a short refi alternative that it can reasonably determine maximizes recoveries to investors.

Finally, we think any such proposals for FHA products for short refis of defaulted loans should not mandate that any upside which might result from improved future property values go to either the FHA or to the borrower. Rather, these proposals should leave open the possibility that any such excess go back to the investors in the existing loans, to the extent of the loan amounts originally funded by them.

Conclusion

I thank you for the opportunity to participate in today’s hearing. Finding solutions to the current mortgage and housing crises and preventing foreclosures should be a high priority for all market participants and our communities. Again, I commend your leadership on these important matters.