PRIVATE SECTOR COOPERATION WITH MORTGAGE MODIFICATIONS—ENSURING THAT INVESTORS, SERVICERS, AND LENDERS PROVIDE REAL HELP FOR TROUBLED HOMEOWNERS

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PRIVATE SECTOR COOPERATION WITH MORTGAGE MODIFICATIONS—ENSURING THAT INVESTORS, SERVICERS, AND LENDERS PROVIDE REAL HELP FOR TROUBLED HOMEOWNERS

Wednesday, November 12, 2008

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:11 a.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Members present: Representatives Frank, Kanjorski, Maloney, Watt, Sherman, Meeks, Capuano, Lynch, Green, Cleaver, Donnelly, Foster, Speier; Bachus, LaTourette, Biggert, Neugebauer, and Price.

Also present: Representative Marshall.

The CHAIRMAN. I apologize for the lateness of this hearing. The period of repose that I had looked forward to for this committee has been one of the less important victims of the current economic turmoil, and I therefore had to cram more things into a shorter period of time than I had hoped. I apologize for keeping people waiting.

This hearing has evolved in some extent in its orientation. It was originally concerned about what was reported in the newspaper as two hedge funds saying that they were going to instruct their servicers not to take advantage of legislation that could reduce mortgages. We have since gotten letters and statements from the funds that—and I would ask unanimous consent to put into the record the statement from Harvey Allon, president of Braddock Corporation, and then also a letter from William Frey, who is the principal and CEO of Greenwich Financial Services. Mr. Frey notes he is not a hedge fund. Mr. Allon mentions that he is. But the letter from Mr. Allon—let me just read some excerpts in fairness—"Braddock urges all services to fully acquaint themselves with the text and guiding principles of the act, the HOPE for Homeowners bill that we passed, and are actively undertaking efforts to ensure that qualifying homeowners participate in this program and that the homeowner loans are modified in a timely fashion pursuant to the letter and intent of the act."

We believe this letter is constructive and sets forward what we believe to be the appropriate policy. That is not an issue that is before us. We had never intended the legislation for modifications to be imprudently granted to entities—to individuals who couldn't sustain it. And whatever there was in terms of a misunderstanding in the communication, that has now been resolved, and we acknowledge that the Braddock Corporation is urging servicers to take full advantage in an appropriate way of the legislation on the books.

Mr. Frey notes for the record: "I would like to clarify that I do not manage a hedge fund as erroneously assumed in a letter. I add there is nothing wrong with hedge funds." We agree obviously with both cases. He was inappropriately included in the article, and because he was inappropriately included in the article, he was inappropriately the recipient of the letter. So in one case, there was mistaken information on which we acted, and in the second case—or the first case that I mentioned, the situation has been resolved and the Braddock Fund is instructing its servicers to go forward.

Now I will begin with the opening statements.

The problem of servicers has become clearer and clearer. We have had some encouraging steps taken recently with regard to reducing foreclosures. And again we stress that reducing foreclosures is one of three things that I believe has to happen if we are to get out of the economic mire in which we find ourselves: One, the reduction of foreclosures; two, having the rescue plan that this Congress voted used efficiently, specifically to get the maximum amount of funds out into the economy that can be lent; and, three, an economic recovery program that would include funding to the States and others to do job creation. This committee has jurisdiction over the first two, but not over the third.

As to foreclosures, the argument needs to reemphasized that foreclosures damage the whole economy. Diminishing foreclosures is not entirely—maybe not for many people even a matter of examination for those who may be foreclosed. As long as you have the foreclosure cascade, as long as you have mortgage-based securities decreasing in value so rapidly, you do not get out of the problem we are in. So diminishing foreclosures—and clearly some people who took loans are beyond any assistance that could reasonably be extended, but diminishing foreclosures is an important part of helping us get out of this problem.

Now there have been assertions that the way to do that is—and there have been some plans floated to have taxpayer money go in, buy up the loans, and then reduce the amount paid. I think it should be very clear. No matter what people have argued, there is in my judgment zero likelihood that Federal taxpayer dollars will go to those who hold loans that never should have been made in the first place. People who have advocated this as a solution which involves Federal assumption of the risks of 100 percent of loans that should not have been made do not understand the mood of this country, and do not understand what rules will apply. Similarly, I do not think you are going to see taxpayer funds, nor should you, go to people to help them pay their mortgages. We have had some proposals; the FDIC has been very constructive in this regard, particularly Chairwoman Sheila Bair. The role of the Federal Government is appropriate, it seems to us, to do this in various forms. To induce those who hold the loans to recognize that they are holding loans that are not going to be repaid in full, to calculate that in many cases this would be a worse economic problem if they foreclosed, and to write down the terms of the loan, either by interest or principal or some combination, to a point where that borrower could repay, doing so because it would be in their economic interest to get something rather than to go through foreclosure.

The role of the Federal Government in the bill we passed and, as I understand it, what Sheila Bair is talking about, although it is muffled by intra-administration concerns, is similar to saying to the lender, if you recognize that you are holding loans that cannot be realized and take a loss, we will then, through Federal instruments, the FHA and our bill in appropriate cases, guarantee the new level of loan. There will be a refinancing to a lower level. What it says to the lender is you take your loss, the Federal Government is not going to make you whole for loans that shouldn't have been made in the first place. The inducement is once you have recognized the loss, that will be the extent of your loss. You will then have some stability and some ability to tell people what you owe and don't owe. There will be some risk for the Federal Government in that because we will be guaranteeing these loans for people who had some problems before. And in the bill we passed, that is accompanied by a requirement that any profit that is made on those loans be returned to the Federal Government in varying percentages for the first 5 years and even more by the fact that the Federal Government takes the house. This is not a free ride for that new borrower. There will be some losses, we were told by OMB, in a fairly small amount. I am hoping that Sheila Bair will be able to come up with a further approach.

We have also seen some encouraging efforts by the Bank of America and by JPMorgan Chase. I would say I feel vindicated. I am going to take a little extra time and, if there is no objection, we will allocate it equally. I will say I feel vindicated. When the Bank of America announced it was buying Countrywide, a number of my friends were concerned this would be a problem, that Bank of America was too big, and I was asked with some consternation by one person with whom I have worked on some issues how I could justify supporting the Bank of America buying Countrywide. My answer is at that point I would have supported Syria buying Countrywide. The disaster that was inflicted on the country by Countrywide was deep-seated. I think Bank of America did a useful thing. Obviously, they are trying to make money, but I think society will benefit. And so Bank of America, JPMorgan Chase, and now I am told Citicorp, as well, are taking constructive steps. We got an announcement yesterday that Fannie Mae and Freddie Mac will be doing more to improve the situation by reducing foreclosures, again from the standpoint of helping us deal with the economic problem.

But here is the problem that remains and will be on our agenda when we reconvene. So far all of the advances in losses being recognized by those who imprudently either made or bought loans that shouldn't have been made, they have all been by the owners. That is of course how we got into this. We have not seen servicers participating in any significant way. And I believe we now have a situation that requires legislation. We have been told by a number of people that the servicers do not have the legal authority and we have asked this question in general. We said to the servicers and to the owners, is there enough legal authority to act on modifications—again, if it is in the economic interest of the holder of the loan? I don't want to see us throwing more money to the side. If you would be better off reducing the loan than foreclosing, you have the authority to do that. We were told yes in general, but we are now being told no in particular. We have a serious obstacle apparently and it is true with Fannie Mae and Freddie Mac and others. We are getting some progress where the loans are owned in a definable way. All the more reason why it is a good thing to some extent that Fannie and Freddie had a portfolio and went ahead and securitized everything. But where we have servicers administering these securities, we apparently cannot get much done and it is a problem.

There should not be a public policy which allows important decisions that should be made in the economic interest of society to be unmakeable. You should not have a legal form in which the authority to make important decisions is so spread out and split up that no one can make them. I think what we have is the equivalent of what all of us have seen from time to time, a very nice home in a neighborhood which is left by a deceased to several siblings who hate each other. And you get a situation where the quarrel among the siblings means that the house cannot be disposed of and you come by what used to be a very nice home in the neighborhood that is now crumbling and in disrepair and you say, what is that all about, and the answer is, well, there are four sisters and brothers, and they can't agree, so the whole neighborhood suffers, I think.

The gentlewoman from California, Ms. Waters, has been very active in arguing this. I think this committee has to now act and hopefully the whole Congress on restructuring that servicing mechanism. Someone has to have the authority to make a decision and we face a situation now as we said in the case. So it is bifurcated. We are getting some progress where the legal authority to modify is clear. It took a while, but it is coming. We have not had that with our servicers.

The last point is this: When this Congress passed the Economic Stabilization Act and created the troubled assets program, we explicitly put in that big authority to the Secretary of the Treasury to buy whole loans or mortgage-backed securities to make us the owner so we could do these kind of reductions. Again, the distinction seems to be obviously owners and servicers. To date, the Secretary hasn't used that authority. A large amount of the first $350 billion that was available is being used up for other purposes; $290 billion is now accounted for by the grants to banks and advances to AIG, the loan to AIG. That is a question now that we will have to address, and it will involve using the second $350 billion. But I believe that we still have a need for that funding to be used to put the Federal Government in the position of being the owner so we can do the kind of sensible writedown of mortgage payments to avoid foreclosure. That is in the interest of the economy as a whole, and we will be talking further about that as well because we will have a hearing next week on the 18th on the administration of that program.

And with that, I will now recognize the gentleman from Alabama.

Mr. BACHUS. I thank the chairman. Mr. Chairman, how much time are we going to have on both sides? Are we going to extend that time?

The CHAIRMAN. Yes. What is the maximum we can get—20 and 20 because we have a fairly small panel? Is that acceptable?

Mr. BACHUS. That is fine.

The CHAIRMAN. Yes, we will do 20 minutes on each side. We only have the one panel and hopefully we won't have that much to do later.

Mr. BACHUS. Thank you, Mr. Chairman. I yield myself 7 minutes.

Mr. Chairman, first let me respond to the subject matter of this hearing. I have prepared a written statement which I have released and that goes into some detail. I would like to respond to some of the things that the chairman has said. It is in everyone's best interest as a general rule to prevent foreclosures. Foreclosures are a negative impact on not only the family in that home, but also their neighbors, their property values, the community, and the local government. A number of foreclosures as well as homeownership are relatively good predictors of criminal activity and economic development. Having said that, I think we should be very careful in saying that we need to prevent all foreclosures.

Number one, if the homeowner is underwater, if the house is worth less than the mortgage, I don't believe it is in the best interest of the homeowner in most cases to continue to pay the note. In fact, what we are seeing all over the country and most—I don't know whether it is most or a good number or a good percentage of foreclosures—are homeowners who are underwater and they are walking away, and that is why they are walking away, not so much that they can't pay it or they couldn't come up with the money. It is that they simply are not going to do that. And I don't see any practical way of preventing that.

Second, when you have a bank and a borrower, the traditional arrangement, it is easy to work out deals and it is normally in people's interest. Where we are running into a problem is with securitizations, and that is really the great majority of the mortgages that are in foreclosure or threatening foreclosure, is where you have multiple parties. Now that is, I think, what we are dealing with as much as anything in this hearing. Obviously we are talking about hedge funds, so you are talking about securitized mortgages. In those cases, I am all for encouraging the parties to work together, if they are willing. Often, they are not willing, and in those cases I am very hesitant to do two things. One, I am very hesitant to try to force the parties to an agreement. One reason—and let us say a willing buyer but an unwilling lender or hedge fund or whomever is holding the securitized mortgage, it affects future funding of future mortgages. I mean, if you are going to start interfering with contracts, you may get away with it with these, but how about mortgages in the future? Are people going to be willing to buy securitized mortgages? And the answer is, no, they are not, because if they think that the Congress or the government can come in there and change that contract, they are just not going to be willing to put their money at risk. So we have to be very careful in that case.

The only other thing I would say is that I am also skeptical of any proposal which requires the borrower to be 90 or 120 days late on their payment. That to me is going to almost encourage people who may be current and struggling, since they don't qualify unless they are 90 days later—I actually had a constituent who called us and said we are not going to qualify for this program because we are current, what should we do, should we miss three payments?

Having said that, let me say that I commend the chairman for holding this hearing.

Now, let me change the subject to what we are dealing with overall and that is government intervention into the private sector through either we call it intervention, a bailout, a rescue plan, etc., etc. We have all as members had 3 weeks to go home. And if you are like me, I basically will boil down the questions my constituents ask me to two question. The first question is basically—I can boil it down to how do you justify giving my money to somebody else as a taxpayer? How do you justify that? How—in a case of mortgages, hey, I went out, I negotiated a good price for a house, I bought it, I put 20 percent down, I put 10 percent down. I was very careful on the terms, I got a good interest rate. I am paying my mortgage, I am paying it on time. I don't think it is fair that you are going to take my tax dollars and subsidize or change a loan for someone else who wasn't as careful as I was or wasn't as responsible. Not that I—my constituents don't think they are necessarily bad people. They just don't want their money going to them.

Now, we are now talking about a bailout to the automobile companies. I know the questions we are going to have because of the questions we had with financial services. I have automobile plants in my district. Those automobile plants pay $25 to $35 per employee per hour. I am sure that I am going to be asked, Congressman, I work at Honda or I work at Mercedes, I get $40 an hour, why are you going to take my tax dollars and pay it to a company that is paying their employees $75 an hour? And these are questions we need to anticipate and need to be prepared to answer.

Even, I think, people who are going to be more hostile are that sawmill worker in my district who is making $15 an hour and he is working hard every day and he gets very dirty every day and it is a risky, hot job. Or it is very cold. It is usually very cold or very hot. He is making $15 an hour, and we are taking his money and we are paying it to a company that is paying $75 an hour. We are going to get those questions, and we need to be prepared to answer them.

How do I know we are going to get those questions? Because with the financial services companies, the Wall Street companies, we have already gotten those questions. If you didn't get those questions, you are not listening to your constituents. They are already beginning to ask—my constituents usually get about a $250 bonus at Christmas. They are already asking me, Congressman, did you take my money and give it to a company that is paying some of their employees $250,000 at Christmas, or year-end bonus or incentive or whatever you want to call it, and I get $250? It is a fairness issue and it is something that we are going to have to answer.

The second question is very simple, where does this stop, how do we get out of this mess, when are we going to quit, when are we going to end it? Well, we started with financial services. We went from banks to insurance companies and I will tell you this, I for one realize—and I think we all did—we could not let our financial structure of this country, our financial infrastructure, our banking system, we could not let it collapse. That was something that we could not allow. But now we are talking about manufacturing companies, automobiles. You start there. Does it end there? It didn't with financial services. We kept expanding that. And does it end with manufacturing? What about retail? What about Circuit City? I have read now that a lot of Circuit City employees are even more angry this week than they were last week that they are losing their jobs and they are seeing what is going on, on Capitol Hill, where we have intervened or bailed out on behalf of a lot of financial services companies and manufacturing companies. And I am afraid if we don't answer the question very soon, when does this stop, that it is going to stop when we run out of money, when we are unable to print more money, when foreign countries are unable to lend to us at a reasonable interest rate and quite frankly we need to stop before then. If we don't, I think the American people will simply rise up and stop us. And I, for one, hope that we are rational and reasonable enough to in going forward, being very, very careful.

I want to conclude on a positive note. We did something that I think was very good. In the last intervention, it was originally proposed that we buy $750 billion of the very worst assets in the financial system, and the proposal was that we actually buy those assets and that we manage them. Now, we would have had to have hired thousands of people to do that. Thank goodness, I believe we have almost dodged that bullet. Instead, what we did was a much more reasonable and rational approach, something that protects the taxpayers to a greater extent, not to a total extent, and that was we took preferred shares. We did the same thing Warren Buffett did; we made a deal. And we don't have to manage those assets, we don't have to set a price, we don't have to buy them, we don't have to sell them. We simply took preferred shares and that was a much better approach. We are still talking about buying some of these—call them worthless assets, call them impaired assets—and that is not going to be as good a deal. But so far we have made a terrible situation better.

But let us not—let us have an exit strategy, let us now agree that it has to stop and it has to stop soon.

Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman from Pennsylvania is recognized for 4 minutes.

Mr. KANJORSKI. Good morning, Mr. Chairman.

While the mortgage loan modifications theory remains sound, the practice has fallen short of expectations that many of us have. Keeping Americans in their homes should be a priority. Unfortunately, this view does not appear to be shared by all.

Today we will hear from several parties in the private sector to better understand the ever-widening gap between what ought to happen and what is happening. We will also discuss some of the proactive steps taken to date to address this important issue. This issue is not a partisan one. Back in March, Mr. Castle and I introduced the Emergency Loan Modification Act of 2008, H.R. 5579. The bill aimed to clarify the responsibilities of and provide a safe harbor from legal liability for mortgage servicers who helped troubled borrowers remain in their homes by engaging in loan modifications and workouts according to specific criteria. While pieces of that legislation did become law through the enactment of the larger housing package, the safe harbor provision fell by the wayside.

At the hearing, Mr. Castle stated, "I believe Congress can take specific steps to ensure loan servicers work with homeowners to keep mortgages solvent wherever practical." I shared that sentiment then and I believe it today. Congress last spoke to the issue when passing the Emergency Economic Stabilization Act which provided guidance and authority for the Treasury Department to increase the number of loan modifications. Despite our actions, certain industry players and, in fairness, the current Administration and government housing agencies simply have not pursued modifications with the urgency our Nation's financial crisis demands.

This reality must change quickly. As homeowners continue to find themselves underwater, we must all work to keep them afloat. More and more foreclosures have led to ever-declining home values and spiking foreclosure rates have also decimated some communities. Pointing fingers about which borrowers irresponsibly took out loans they could not afford or which lenders recklessly doled out money to unqualified borrowers does absolutely nothing to solve the problem. Instead of placing blame, we must work together toward a solution.

In this regard, I am pleased that entities like the Bank of America and JPMorgan Chase have stepped forward with their own initiatives for expediting mortgage modifications. Our lenders and servicers can learn from these actions and model their mortgage modification programs on these efforts.

In sum, our witnesses will help us all understand why loan modifications have not already increased and what can be done to ensure that a greater number of loan modifications occur in the days ahead. I look forward to their testimony and thank them for being here.

The CHAIRMAN. The gentleman from Texas is recognized for 4 minutes.

Mr. NEUGEBAUER. Thank you, Mr. Chairman. First of all, I want to associate myself with the ranking member's remarks on a number of fronts, but certainly on the direction that we are headed in this country as far as this major intervention into our markets by the Federal Government.

Interesting, before the first vote over the weekend before that, I was sitting in my office and I decided to take some calls from people in my district, but we have never had as many calls on one specific issue as we did on that one. And interestingly enough, at 5:00 on a Sunday afternoon, a young man who attends Texas Tech University called me from his dorm room, and he and three or four of his buddies were sitting around the dorm watching the news and they said, "Congressman, we are not quite sure we understand all the things that are going on in these markets, but we do understand that you are about to mortgage our future even more than it has already been mortgaged.'' And, in fact, we did do that. We had to increase the debt ceiling to $11.3 trillion.

I think what Ranking Member Bachus was saying is that Members of Congress all have these voting cards. Right now we are using them as credit cards and what we are doing is we are subsidizing the living and the lifestyle that we have today and we are asking the next generation to pay that back. I am not sure that is good for them. I am not sure that is good for us.

In relation to this hearing today, I have had a number of conversations with people who are involved in mortgage workouts and mortgage servicing over the last few months, and one of the first things that they tell me is foreclosure is the last resort for both the borrower and the lender because what happens at that particular point in time is somebody loses their house and the lender loses a lot of money. And what I have also heard from them is that many mortgage servicers and banks and institutions are working aggressively with borrowers who will work with them. Interestingly, the statistic that I am hearing is that if you take, say, 10 people who are behind on their mortgage, that you send a letter and the first 4 get current. The next four get current after a couple of letters have been sent, and of the last two, one of those people will most likely not return a phone call, answer a letter, or work with the lender in any way, leaving the lender with very little opportunities. But one of the things that most of those folks told me, and I am sure we are going to hear from the witnesses today, is that if somebody will enter into a dialogue with the lender, there will be some effort to try to keep those people in the home because, again, the lender does not want that property back, particularly in this real estate environment.

I think the second point is—and I think the ranking member was alluding to that—overall our mortgage finance structure in this country has worked relatively well for a number of years. Yes, we had some people who abused it and for that the market has been punished. But one of the things I think we have to be very careful of moving forward is that in looking at the short term, what are we doing to the long term? The best thing we can do for America and people who own homes today is to get the housing market back functioning again. And the way you get the housing market back functioning again is you get the housing finance market back functioning again. We have to be very careful that we do not do things here that impact the ability of the mortgage finance market to get back up and running again. For example, creating some doubt in the minds of people who are insuring mortgages, the PMI companies, that somehow the contractual relationship causes them to lose more money than the risk that they realized they are taking; also, making sure that we get securitization back up and going again. Securitization has become a nasty word, but quite honestly has provided an opportunity for us to provide a lot of housing finance in the future. And also we don't want to encourage borrower behavior that is not appropriate and, like the ranking member, constituents calling in saying the plan is we get 90 days behind and then we get a piece of the pie. That is an entitlement mentality that is permeating our country today, and I think we have to be very careful as we move in that direction.

So while I think these discussions will be productive, we should be very careful in moving in a direction where we are going to mandate that mortgage companies have certain behavior. I think we want to encourage good behavior. Quite honestly, I believe that behavior is probably already taking place in the market today.

Thank you.

The CHAIRMAN. The gentlewoman from New York is recognized for 2 minutes.

Mrs. MALONEY. Thank you, Mr. Chairman, for holding this important hearing. In my view, this Congress has been pushing and dragging a reluctant Administration to help homeowners in the same way and on the same scale that the Treasury rushed to help Wall Street. Yesterday, the Administration announced that Fannie and Freddie would help several hundred thousand homeowners restructure their loans using a systemic loan modification that was developed by the FDIC at IndyMac. Systemic loan modification is a good step in the right direction, but this program is only a tiny one. We need to be thinking in an order of magnitude that is much bigger, not hundreds of thousands, but millions. Some economists estimate that 2 to 5 million Americans may lose their homes. It is said that new protocol will be a standard for the industry to quickly move homeowners into long-term sustainable mortgages, and I hope to hear of their efforts today.

I do want to say that I am encouraged by the steps that were reported recently from JPMorgan Chase, Bank of America and Citibank on efforts that they are doing to help people stay in their homes. All economists say that we will not solve this problem until we stabilize home prices and housing in America. It is very vital for stabilizing our economy.

I look forward to hearing your testimony today on ways we can expand the program, not to hundreds of thousands, but to literally millions of Americans. Thank you.

The CHAIRMAN. The gentlewoman from Illinois is recognized for 4 minutes.

Mrs. BIGGERT. Thank you, Mr. Chairman. I thank you for holding today's hearing, and I will offer a few quick thoughts so that we can proceed.

First, I am pleased that the private sector continues to work independently and with government entities to keep qualified homeowners in their homes, and I am particularly pleased that these initiatives don't involve taxpayer dollars. However, I do remain concerned about the issue of fairness when it comes to homeowners who may have lived beyond their means or not saved for a rainy day who are getting a deal versus prudent homeowners, and that is most homeowners, who are making their mortgage payments and not getting a deal on a mortgage modification.

That aside, I think it has become increasingly clear that with a little lender and servicer flexibility as well as one-on-one counseling, many American homeowners in trouble can make their mortgage payment, can live within their means, and can stay in their homes. To many of my constituents, they see mortgages and other financial counselors as a critical lifeline and I would like today's witnesses to comment and offer ideas on how we can increase troubled borrowers' access to HUD certified counselors and increase financial literacy.

Second, FDIC Chairwoman Sheila Bair offered an idea to use the $50 billion of TARP money to guarantee mortgages, and I would like today's witnesses to comment on that.

In addition, I would be interested in any reaction to Chairwoman Bair's statement "that there are questions that remain about implementation" of the new GSA mortgage modification plan which was announced yesterday.

And finally, I think it is no secret that industry participants represented today by ASF and in part by MFA are purportedly stuck between a rock and a hard place. We will hear testimony that clearly indicates the willingness of the members of ASF and MFA to do whatever is possible to keep homeowners in their homes, and the problem that has been mentioned is that some industry participants with this willingness also hold contractual obligations to investors, which include our seniors with retirement funds and workers with pensions, so they will be able to maximize the value of troubled mortgage loans.

Well, as the saying goes, where there is a will, there is a way, and I would like to hear from today's witnesses exactly and specifically about how, and how quickly, the industry can collaborate, put together new guidelines to establish a floor for a net present value, and ultimately improve the process of mortgage modifications. It is important that sooner rather than later, the right balance is struck so that: One, qualified homeowners can stay in their homes; two, investors clearly understand and accept a mortgage modification process; three, servicers can obligate sufficient resources to modify the mortgages; four, fraudulent actors are exposed and prosecuted; and five, underwriting standards are strengthened so that a similar boom and bust cycle is not repeated.

I look forward to hearing from today's witnesses and I thank you, Chairman Frank. I yield back.

The CHAIRMAN. The gentleman from New York, Mr. Meeks, for 2 minutes.

Mr. MEEKS. Thank you, Mr. Chairman. I just want to thank you for the great job that you are doing in conducting this hearing this morning and just dealing with this whole crisis that we have. We are very proud of you and what you have been doing. I will be very brief. We all know about the economic crisis that we are going through. And the one way that when we talked about TARP and the $700 billion that we will often talk about is this is where Wall Street meets Main Street. And the way that we can show our constituents that Wall Street is meeting Main Street, and how we are not only just trying to fix the situation in regards to our financial institution, is to show that we are also trying to keep Americans in their homes. Reworking these mortgages, etc., becomes extremely important in doing that because absent that, then, of course, we have this problem and I could go on with a litany of statistics in my district for example, in Queens, which is leading the City of New York in foreclosure rates, in the price of homes that are going down, in how long it takes to sell a house now and on and on and on. But the key is trying to make sure that we keep people in their homes.

I have assembled in my office now on a weekly basis counselors, financial advisors, and attorneys every week on a Wednesday from 1:00 to 5:00. I have these counselors in my office and we set up appointments and they have been jampacked, and we are packed up now for the next, I think it is 6 weeks, with people. I will ask some questions when we get to the question period. But I just want to say that the key to this—in getting out of this crisis that we are in is keeping people in their homes and I want to compliment those individuals in the programs that I recently heard in regards to Citi, and I think Chase and a few others and I want to get into that. You know, as we ask questions. But—and that is why hearing from you and what your testimony and how we can make sure this is working is extremely important. So I thank you for being here today and I await your testimony.

The CHAIRMAN. The gentleman from Ohio, Mr. LaTourette, for 3 minutes.

Mr. LATOURETTE. Thank you, Mr. Chairman. And thank you for having this hearing, and I especially look forward to the next hearing that you are going to have on the 18th and thanks also for chatting with me over the break about National City Bank in Cleveland. All I can say is what a mess this is. And, Mr. Chairman, I have the highest respect for you and I think my plea is, after this morning and these hearings are over, you use all of the wisdom that you have to help us think outside of the box. And the reason I say that, if you go to the bill that we passed in July which Chairman Frank really did Yeoman-like work on, and I fully supported that piece of legislation, I have been told that only 42 mortgages have been submitted to date for modification and none have been granted because it takes 60 days, and that the regulators are saying that by next fall, it will only be 20,000, far short of the 400,000 that we envisioned when we passed that legislation.

I would ask unanimous consent to include into the record an article written by—and I never read this fellow before—Joe Nocera from the New York Times of November the 11th.

The CHAIRMAN. Without objection, it is so ordered.

Mr. LATOURETTE. Mr. Nocera makes the argument that is the subject of the hearing and that is everybody sees the wisdom of mortgage modifications, except nobody talked to Wall Street. And he makes the point that I think is good, that Fannie and Freddie have jumped up and they are going to come up to 38 percent of the gross income modification, Citigroup is good, JPMorgan is good. But if we don't do something on the liability that the fiduciaries have, we are not going to be able to refinance or modify anything. And so I would hope that the witnesses today, the title of Mr. Nocera's article yesterday is, "Can anyone solve the securitization problem?"

So I would hope that maybe the witnesses can chat about that with us and we can solve the securitization problem to actually have modification of mortgages.

And then lastly, the hearing next week is going to talk about TARP and I have to tell you, Mr. Chairman, that we have to get to the bottom of this and think outside the box because this TARP business, again, Mr. Nocera and others have pointed to the fact that rather than buying troubled assets, rather than buying preferred stock, now banks are hoarding the money, maybe they don't want to lend it.

In the case of PNC and National City Bank, they have used TARP money from one bank to buy another bank. And being from Cleveland, a PIS bank buying a Cleveland bank is a bad, bad, bad thing. And that is not what I thought the bill was supposed to be about. But that is where we are headed. So again, I appreciate your leadership, Chairman Frank and Ranking Member Bachus, but I really urge us to get this right and get this done so that we can move this forward and keep people in their homes.

The CHAIRMAN. The gentleman from Texas, Mr. Green, is recognized for 2 minutes.

Mr. GREEN. Thank you, Mr. Chairman, and Ranking Member Bachus. I find myself in accord with the previous speaker. The situation seems to be such that the home buyers are indicating that they would like to avoid foreclosure. The lenders and servicers are indicating that foreclosure avoidance is a good thing. In fact, information that I have indicates that it costs about $40- to $50,000 in attorneys fees and fees for property management when a foreclosure takes place. And that is per unit. It seems that we all are in agreement that foreclosure is not a good thing and that it should be avoided. But it is not happening.

And the question becomes, how do we connect the disconnect between the servicer and the borrower such that the foreclosure avoidance can actually take place? I have not, to date, heard of any legislation that would be mandatory, requiring write-downs of principle, requiring interest rates to be reduced. I have just not heard of such legislation; it may exist, but it has not been presented in a forum such that it can be debated and discussed, especially here at this committee level. And my fear is that if we continue to fight that which does not exist, it would make it difficult to deal with that which does exist, which is the necessity to connect this disconnect and try to avoid foreclosure without a mandatory requirement of a write-down or a reduction of interest rates. I am absolutely convinced that this is a solvable problem. It is one that requires careful thought, but it is something that can be resolved. I thank you for the time, Mr. Chairman, and I yield back.

The CHAIRMAN. The gentleman from Georgia is granted 3 minutes.

Mr. PRICE. I want to thank the chairman for holding this hearing as well and I had to step out for a moment. I don't know that anybody has mentioned what happened last Tuesday, but it seems like it would be inappropriate not to at least congratulate the chairman and his party on the election last Tuesday and just say that I think that the American people are now ready for us to move on on this issue and others and work together and solve these challenges and I for one look forward to that as well. We are all very concerned with the critical situation of homeownership and foreclosures. I think it is imperative, though, that we also recognize that over 90 percent of Americans either own their home or are current on their current payment schedule. There is a major problem without a doubt and it needs to be addressed. Of those that are challenged, it is my understanding as has been mentioned that over 50 percent of them—the borrower hasn't contacted the lender to determine how they might be able to work on voluntarily changing the parameters of the agreement and see if they could remain in their home.

So I am hopeful that we concentrate on those voluntary activities as some on the other side have mentioned. I want to commend—there is so much that has been done and can be done. I want to commend Mr. Meeks for what he is doing in his community. Obviously, there are a lot of folks who are working trying to get borrowers and lenders together to talk when there are concerns that are occurring. Some have said that we should not have, however, a public policy where decisions that are in the best interest of society are not makeable and I would suggest that the concern about that statement is that the best interest of society is movable or is changeable or is maybe different depending on where one sits. The squabbling siblings who were mentioned before and not able to find out what the disposition of the home ought to be unless it is a condemnation situation and there are laws that are in place to, especially in that area, but unless it is a condemnation situation, there are other laws in the courts of law to determine what ought to occur, to have the notion or the sense that it is the Federal Government's responsibility to step in in that situation and be the owner of the home, I think, is a step that frankly the American people are not interested in taking.

I would ask the witnesses specifically to talk about the moral hazard argument or the moral hazard situation that we find ourselves in. I want to thank the chairman for correcting the record regarding Greenwich Financial and I look forward to the testimony.

The CHAIRMAN. The gentleman from Massachusetts is recognized for 2 minutes.

Mr. CAPUANO. Thank you, Mr. Chairman. Mr. Chairman, I want to make it clear as to what my understanding of why this hearing is today because it I believe it is the best way for us to get our message out and to hear from some people in the industry that some of us think the industry hasn't gotten the message yet, that we want individual homeowners helped. Now, I don't think the people here today didn't get that message, but I think some people in the financial services industry didn't get it. I don't think anybody believes that every single homeowner can or should be helped. That is not the point. But something more than 42, maybe a few hundred thousand, pick a number, but something. And there are many of us who feel that the industry hasn't gotten the message and this is one way to do it, and also for us to find out if there are technical ways for us to assist the industry in implementing the message. But I also want to make it very clear that I hope, and I am looking forward and I am sure there will be other hearings.

I am actually, frankly, getting a little tired of having the chairman have to get on TV and tell the industry we don't want them to use money for mergers, we don't want them to use taxpayer monies for vacation, we don't want them to use taxpayer moneies for outrageous bonuses. I am not saying they can't do those things, but use their own money. And if they don't get it, I think we are going to have to have some further discussions with both the Treasury Department and I actually take last Tuesday's result as a comment by the American people that they want a more activist government to be involved in these things. Actually, we don't want to tell anyone what they have to do. That not the desire that may be necessary.

Now, my hope is that between now and then, the industry gets the message that we want more individual help, that we don't want taxpayer money being used for these ludicrous purposes, we want it used for one purpose and one purpose only, which is to get the American economy back on its feet and moving in the right direction. Again, I don't mean to address my remarks to this particular panel. I think from what I know you are all on the right page in trying to get in the same direction at the same time and it is one of the few opportunities that we get to allow the American people and more importantly the financial services industry to hear us and hear us as clearly as can and with that, thank you, Mr. Chairman, for the opportunity.

The CHAIRMAN. The last allocation of time, 2 minutes for the gentleman from Illinois, Mr. Foster.

Mr. FOSTER. I am most concerned in this thing that we somehow don't get into this mess again. One of the things I would be very interested in hearing about is whether or not there is well-understood language that would be incorporated into future securitization contracts and so on that would make them easier to unwind in times of financial stress, so that we really have an understanding that if—you know, as the securitization industry re-emerges from the current crisis, that when this happens again, that everyone understands the rules on how we get out of this quickly and simply. I would be very interested in hearing your comments on that. That is it.

The CHAIRMAN. We will now proceed with the panel.

We will begin with Mr. Benjamin Allensworth, who is the senior legal counsel with the Managed Funds Association.

STATEMENT OF BENJAMIN ALLENSWORTH, SENIOR LEGAL COUNSEL, MANAGED FUNDS ASSOCIATION (MFA)

Mr. ALLENSWORTH. Chairman Frank, Ranking Member Bachus, and members of the committee, my name is Benjamin Allensworth, and I am senior legal counsel for the Managed Funds Association (MFA). MFA represents the management of the world's largest hedge funds and is a primary advocate for sound business practices and industry growth. MFA appreciates the opportunity to testify today about efforts by private sector participants to work with Federal, State, and local officials in seeking to mitigate the current wave of foreclosures and defaults.

Our fundamental belief is that effective mortgage modifications are preferable to foreclosures whenever possible. As we have all learned over the past 12 to 18 months, our Nation's housing market is critical to the social and financial wellbeing of families and communities throughout our country and essential to the health and vitality of our capital markets and our economy. The wave of foreclosures has placed downward pressure on home prices, eroded home equity, and shattered confidence which, in turn, has led to a freezing-up of the mortgage backed securities market, a major source of liquidity and credit to our capital markets. That cascading effect has led to the tightening of the broader credit markets as financial institutions and market participants have been forced to satisfy redemption requests of investors and hold more capital.

To stem the effects of this crisis, bold proactive steps need to be taken. MFA and our members are committed to working with policymakers on effective remedies to address these serious economic challenges. Over the past few months, Congress has enacted a number of measures in response to the ongoing crisis in our mortgage and credit markets, specifically the Emergency Economic Stabilization Act and Housing and Economic Recovery Act. The central element of HERA is HOPE for Homeowners, a program that seeks to help those at risk of default and foreclosure move into more affordable loans insured by the FHA. MFA believes that with additional time and continued collaboration, HOPE for Homeowners can serve as a valuable tool to mitigate foreclosure and help inject much needed liquidity back into the mortgage and credit markets.

While MFA does not have a formal association policy regarding the terms and conditions for modifying MBS contracts, our association and our members strongly support effective mortgage modifications over foreclosure whenever possible. Loss mitigation is a challenge for all MBS market participants and investors. That includes hedge funds, which do invest in mortgage backed securities, though comprise a relatively small part of the MBS market as compared to other investors. There are a number of legal, fiduciary, and practical issues that must be taken into account when considering mortgage modifications. Mortgage servicers and institutional investors have fiduciary duties to their investors and clients respectively. Fiduciaries must weigh the effect of mortgage modifications on the earnings of their investors, which include pension funds and retail mutual funds, among others. Other factors, including the likelihood of a subsequent default, are also considered when making these important determinations.

As market participants consider these obligations in the context of loan modifications, one of the primary determinations is whether the net present value of a modified loan is greater than the NPV of a foreclosure. In preparation for this hearing, MFA sought out the views of our members and other stakeholders to help us better understand the impediments to more robust loan modification efforts. Among the concerns most commonly cited were: The process, technology, and accuracy in calculating NPV for modifications to groups of mortgages as opposed to the calculation of NPV when done on a mortgage-by-mortgage basis; the higher rates of subsequent default and the impact of that likelihood in the NPV calculation for non-HERA modified loans; the capacity of servicers, some of whom may be overwhelmed by having to make NPV determinations for so many troubled mortgages; and also constraints on the parts of some servicers who may be willing but unable to do loan modifications under HERA because they lack the ability to originate FHA-insured mortgages. While each of these challenges has the potential to undermine loan modification efforts, none are so daunting that they should deter us from our shared interest in keeping more families in their homes and restoring stability and confidence to our mortgage and credit markets.

In this regard, we believe there are some important measures that can be considered to help accomplish this important objective. These include: Developing a set of standardized protocols that would enable servicers to more efficiently calculate NPV. Yesterday's announcement by the Administration that, as part of the HOPE NOW Initiative, it will implement protocols to help streamline the loan modification process is a hopeful sign, though more is needed. Encouraging more owner servicers to do loan modifications and finding ways to have mortgage backed securities held and administered by a single entity, rather than a variety of entities with competing interests, which should provide for a more efficient loan modification process. And finally, examining the implications of higher subsequent default rates for non-HERA modified loans. We believe it is in the best social and economic interest to find ways to reduce the risk of future defaults on mortgage modifications of all types.

Mr. Chairman, as I stated at the outset, MFA and our members appreciate the social and economic importance of preventing mortgage foreclosures, and we are committed to working collaboratively with policymakers and other market participants on preserving the American dream of homeownership for millions of at-risk families.

Thank you for the opportunity to testify before this committee. I would be happy to answer any questions you may have.

[The prepared statement of Mr. Allensworth can be found on page 59 of the appendix.]

Mr. KANJORSKI. [presiding] Thank you very much. And now we will hear from Ms. Molly Sheehan, senior vice president of the home lending division, JPMorgan Chase.

STATEMENT OF MOLLY SHEEHAN, SENIOR VICE PRESIDENT, HOME LENDING DIVISION, JPMORGAN CHASE

Ms. SHEEHAN. Chairman Frank, Ranking Member Bachus, and members of the Financial Services Committee, we appreciate the opportunity to appear before you today on this most important topic of helping homeowners. We recognize that no one benefits in a foreclosure.

My name is Molly Sheehan, and I work for the home lending division of JPMorgan Chase as a senior housing policy advisor. Chase is one of the largest residential mortgage servicers in the United States, serving over 10.5 million customers on the platforms of Chase, and more recently WaMu and the EMC unit, formerly affiliated with Bear Stearns, with mortgage and home equity loans of approximately $1.5 trillion in every State of the country.

We are proud to be part of one of this country's preeminent financial institutions with a heritage of over 200 years. Chase services about $332 billion in mortgages and home equity loans it originated and owns. It also services or subservices an additional $1.1 trillion of first lien mortgage loans for investors.

As you know, we announced 2 weeks ago several significant enhancements to our foreclosure prevention and loan modification efforts. We would like to share those with you today.

While we have helped many families already, we feel it is our responsibility to provide additional help to homeowners during these challenging times. We will work with families who want to save their homes but are struggling to make their payments. That is why we announced on October 31st that we are undertaking multiple new initiatives designed to keep more families in their homes.

We will open regional counseling centers, hire additional loan counselors, introduce new financing alternatives, proactively reach out to borrowers to offer prequalified modifications, and commence a new process to independently review each loan before it moves into the foreclosure process. We expect to implement these changes within the next 90 days.

While implementing these enhancements, we will stop additional portfolio loans from entering the foreclosure process. This will give potentially eligible homeowners in owner-occupied properties an opportunity to take advantage of the new enhancements. Chase has worked diligently and will continue to work diligently with investors to get their approval to bring these enhancements to loans that we service on behalf of others so our efforts can have the broadest possible impact.

The enhanced program is expected to help an additional 400,000 families, with $70 billion in loans in the next 2 years. Since early 2007, Chase, WaMu and EMC have helped about a quarter of a million families avoid foreclosure, primarily by modifying their loans and payments.

So more specifically what we will do is systematically review our entire portfolio to determine proactively which homeowners are most likely to require help and try to provide it before they are unable to make payments; proactively reach out to homeowners to offer prequalified modifications, such as interest rate reductions, term extensions and principal forbearance where needed. The prequalified offers will streamline the modification process and help homeowners understand that Chase is offering a specific option to make their monthly payments more affordable.

We will establish 24 new regional counseling centers across the country to help provide face-to-face help in areas with high delinquency and foreclosure rates, building on the success of the 1- and 2-day HOPE NOW reach-out days, and we will partner with community counselors to reach more borrowers.

We intend to add 300 more loan counselors, bringing the total to more than 2,500, so that delinquent homeowners can work with the same counselor throughout the process, improving follow-through and success rates.

We will expand the range of financing alternatives offered to modified pay-option ARMs, which we inherited when we acquired the mortgage portfolios of WaMu and the EMC unit, to an affordable monthly payment including 30-year fixed rate loans, interest rate reductions, principal deferral, and interest-only payments. All of these alternatives will eliminate negative amortization.

We will also offer a substantial discount on or donate 500 homes to community groups, or through nonprofit or governmental programs designed to stabilize communities to deal with the growing inventory of REO. These enhancements reflect Chase's commitment to continue to seek additional ways to help homeowners.

Thank you for your attention, and I will be happy to answer any questions you may have.

[The prepared statement of Ms. Sheehan can be found on page 85 of the appendix.]

Mr. KANJORSKI. Thank you. Now we will hear from Mr. Gross, managing director of loan administration loss mitigation, Bank of America.

STATEMENT OF MICHAEL GROSS, MANAGING DIRECTOR, LOAN ADMINISTRATION LOSS MITIGATION, BANK OF AMERICA

Mr. GROSS. Good morning, Mr. Chairman and committee members. Thank you for the opportunity to appear again to update you on our efforts to help families stay in their homes.

Bank of America fully appreciates its role in helping borrowers through these difficult economic times. We are committed to being a responsible lender and servicer and facilitating homeownership and retention.

First I want to provide you a brief update on our mortgage business. We are open for business across America. From July through September, we funded more than $50 billion in home mortgage loans, financing over 250,000 homes. We are also working hard to help customers who may be in trouble.

We have developed important programs that are projected to provide relief for over $100 billion in loans, enough over 3 years to help keep up to 630,000 borrowers in their homes. Included in the $100 billion is Bank of America's ambitious new Homeownership Retention program announced on October 6th, potentially impacting and assisting up to 400,000 homeowners. It is designed to achieve affordable and sustainable mortgage payments for customers who finance their homes with subprime or pay-option adjustable rate mortgages serviced by Countrywide and originated by Countrywide prior to December 31, 2007.

Our 5,600 home retention professionals will be equipped to serve eligible borrowers with these new programs by December 1st of this year. Please know that the foreclosure process will not be initiated or advanced for a customer likely to qualify until we have made a decision on the customer's eligibility.

The centerpiece of the program is a proactive loan modification process to provide relief to eligible customers who are seriously delinquent or are likely to become seriously delinquent as a result of loan features such as rate resets or payment recasts. Various options will be considered for eligible customers to ensure modifications are affordable and sustainable. First-year payments of principal, interest, taxes, and insurance will be targeted to equate to 34 percent of the borrower's gross monthly income.

Modified loans feature limited step rate interest-rate adjustments to ensure annual principal and interest payment increases at levels with minimal risk of payment shock. The program's foreclosure alternatives provide a win for homeowners and investors and are intended to assist in the effort to stabilize the country's deteriorating housing market. Loan modifications will be made in accordance with servicing contracts, and where servicing contracts limit or prohibit modification, Countrywide will seek consent from investors and the other associated third parties.

Finally, I would like to highlight a couple of continuing impediments to loan modifications for the committee's consideration.

Bank of America today services approximately 15 million mortgage loans. Some of these loans are held for investment in our own portfolio, but others are serviced on behalf of investors, including GSEs, government entities, and private investors. Our servicing is governed by the underlying pool and servicing of contracts and related rules of these investors. For loans that are held for investment, we have broad flexibility to modify the loans. For other categories, however, investor rules and underlying servicing contracts with respect to modifications are not uniform and may prevent us from doing modifications that would benefit both borrowers and investors.

Under some arrangements, for example, servicers have express or implied authority to make loan modifications, while under other arrangements loan modifications are expressly disallowed. Even within categories of investors such as the GSEs, there is a significant variation in the rules that apply. Servicers are frequently unable to effect loan modifications because of contractual prohibitions.

Another challenge is the lack of uniformity in approaches to loan modifications. Servicers increasingly are accelerating their and our loan modification practices. Examples include voluntary loan modification programs like ours, as well as government programs like the FDIC IndyMac program.

Servicers are employing usual and customary loan modification techniques such as interest rate and principal reductions and term extensions, and they are developing underwriting and other guidelines to determine when and what type of loan modification is appropriate that benefits both homeowners and investors. Bank of America supports government and industry efforts to develop greater consensus regarding these elements of loan modification programs.

Yesterday's announcement by the Treasury Department, the Federal Housing Finance Agency, and GSEs to adopt systematic loan modification programs will help drive uniformity amongst these entities in the approach to loan modifications. We believe industry organizations, including those appearing before you today, also should play a role by issuing additional standards for loan modifications that will encourage servicers to do more.

There are certainly other challenges, and we would be glad to discuss those with the committee subsequent to the hearing.

Thank you again for this opportunity to discuss Bank of America's efforts to keep our customers in their homes. Today's market conditions demand expedient, affordable loan modifications that help customers while protecting returns to investors. This is a critically important undertaking that must be done right if we as an industry are going to preserve the flow of capital of mortgage credit to support housing and at the same time protect communities and neighborhoods from avoidable foreclosures.

Thank you for this opportunity to appear.

[The prepared statement of Mr. Gross can be found on page 75 of the appendix.]

The CHAIRMAN. Next, Mr. Thomas Deutsch, who is deputy executive director of the American Securitization Forum.

STATEMENT OF THOMAS DEUTSCH, DEPUTY EXECUTIVE DIRECTOR, AMERICAN SECURITIZATION FORUM (ASF)

Mr. DEUTSCH. Chairman Frank, Ranking Member Bachus, and distinguished members of the House Financial Services Committee, my name is Tom Deutsch and I am the deputy executive director of the American Securitization Forum (ASF). I very much appreciate the opportunity to testify before this committee again on behalf of the more than 330 member institutions of the ASF, including mortgage lenders, servicers, and all institutional investors regarding loan modifications and how our industry and the Federal Government can work together to prevent avoidable foreclosures.

I testify here today with one simple overarching message: Industry participants have been and will continue to deploy aggressive and streamlined efforts to prevent as many avoidable foreclosures as possible. But macroeconomic forces bearing down on an already troubled housing market are simply too strong for private sector loan modifications alone to counteract the nationwide increase in mortgage defaults and foreclosures. In my testimony here today, I look to outline a number of ways the industry and the government can work together to target relief to troubled homeowners while simultaneously helping to restore credit to mortgage borrowers.

Economic and housing market conditions have clearly deteriorated over the last 18 months, with that deterioration intensifying as of late. Job losses, declining home values, and borrowers' consumer debt have all put extreme strain on homeowners' abilities to pay their mortgage debts.

Given these unprecedented challenges, servicers have responded with unprecedented efforts as no securitization market constituency—lenders, servicers, or institutional investors—benefits from loan defaults or foreclosures.

As a result, the number of loan modifications, for example, has increased by over 6 times the rate at which they were being provided to borrowers at this time last year. One driving force behind this exponential increase was the streamlined framework the ASF put together and developed last year that all major servicers have implemented to provide efficient loan modification decisions to subprime ARM borrowers facing interest rate resets.

Let me emphasize here, very clearly, servicers do have the legal authority, right, and responsibility to modify loans in appropriate circumstances, even if those loans are in mortgage-backed security pools. But in light of the deterioration in the broader economy and housing market, ASF has been working aggressively to develop an expanded framework that will give servicers even more latitude to modify loans in a streamlined manner.

Modifications generally in this framework must also be in line with the contractual rights and commercial expectations of institutional investors such as pension funds and mutual funds who depend on investments in mortgage-backed securities to help workers and families achieve their savings and retirement goals. As part of this effort, we are actively reviewing criteria and other loan modification approaches that have recently been announced, such as the plan implemented by the FDIC on the IndyMac portfolio and the Federal Housing Finance Agency protocol announced yesterday.

Ultimately though, we must recognize the seismic economic challenges in the United States, the epicenter of which is in the housing market, are too great for purely private sector loan modification solutions. As such, evolving servicer loan modification activities, though playing an important part of the solution, have limits to their effectiveness in addressing the extraordinary challenges in the housing market and should not be seen as a panacea for housing market ills.

As such, we believe expanded voluntary government programs will be very effective in helping bridge the gap to address the potential foreclosures that commercial and contractual arrangements cannot prevent.

We applaud you, Mr. Chairman, and the hardworking members of this committee for being a driving force in developing and enacting the voluntary HOPE for Homeowners program last summer. The program has a number of innovative elements to help homeowners refinance into a new FHA loan and it does provide incentives for servicers and loan holders to allow those homeowners to refinance. Unfortunately, the program has met with limited market reaction, as only 42 loans have been put through the program in its first month of operation.

We believe there are a number of impediments to HUD's implementation of this program, including the limitations on borrowers' total debt outstanding and the significant equity writedown that loan holders are asked to take. We believe a number of modifications to the program could allow many more borrowers access to the program and ultimately prevent their foreclosure.

In addition to refinancing opportunities, the newly enacted TARP, or Troubled Asset Relief program, allows the Federal Government to use guarantees to incentivize additional loan modifications for distressed borrowers. We believe there have been some positive proposals put forth, for example, by the Chairman of the FDIC and that which you outlined at the outset, Chairman Frank, that would allow the Federal Government, through TARP, to provide credit guarantees for redefaults on modified loans that we believe would substantially increase the number of loan modifications granted and ultimately foreclosures avoided.

Finally, we believe there are significant opportunities also for TARP to purchase individual distressed loans out of mortgage-backed security trusts, which could give the Treasury Department unlimited discretion to modify loans in whatever way the government feels fit.

The ASF has recently undertaken a review of the various opportunities and obstacles for servicers to sell individual distressed loans out at a discount to the Treasury Department. We expect to report out some initial progress on this initiative at the end of this week.

Let me just note one of the things that was mentioned in the opening statement by the ranking member is that securitization to some has become a dirty word; but let me emphasize and provide a quote from the finance ministers of the largest economies in the world that articulated last month that one of their top five global priorities is to, "take action, where appropriate, to restart the secondary markets for mortgages and other securitized assets." Simply, without securitization, the credit markets in America have dried up, and people don't have an ability to purchase new homes, to purchase autos, or to use their credit cards.

I thank you for the opportunity to testify on this important and timely issue today. ASF looks forward to continuing to work with this committee and the new Administration in our collective pursuit of avoiding preventable foreclosures.

[The prepared statement of Mr. Deutsch can be found on page 63 of the appendix.]

The CHAIRMAN. Thank you.

I am going to have to, when this hearing is over, ask the maintenance people to come up with some large rooms, because we are awash in straw up here from the number of strawmen that have been constructed and then demolished by my Republican colleagues.

Let me start with securitization. I don't know anybody who is trying to abolish securitization. I don't know anybody who is trying to substantially limit it. What I have said in every speech I have given on the subject is that securitization reminds me of the formation of large enterprises called trusts in the late 19th Century, and then of the broadening of the stock market, an innovation that produces a great deal of good for society but, because it is an innovation, is not always accompanied at the outset by appropriate regulation. And regulation helps enhance the innovation.

In fact, one of the problems we have now is that some people who bought things they shouldn't have bought now won't buy things they should buy. That is an obstacle to the securitization market. And just as the establishment of the Securities and Exchange Commission, over the objection of the conservatives of the day, helped the stock market flourish, the right rules here will encourage people to get in it.

The next one is retroactivity. No one has proposed—I take that back—a couple of people have proposed it. We haven't come close to enacting anything retroactive. We are talking, as Mr. Deutsch correctly said, about voluntary inducements. So this retroactivity scarecrow—I guess I just switched metaphors—is just a shimmer.

Nor are we talking—when the gentleman from Georgia, in talking about decisions being made, said well, but you don't want the government to own the house. No, we don't. Nobody has proposed it. That is why we didn't propose it, because no one wants it.

We are saying this: We have heard from a number of people, and he said correctly it isn't always clear what is the best answer. There does appear to be a consensus that in many, many cases—and, again, somebody said well, you can't protect everybody against foreclosure. True. And again, I don't know of a single human being who has said anything other than we are trying to diminish the number of foreclosures. There are people who are not going to be able to make their payments, and nobody is trying to stop it.

What we are talking about is in those situations where we are told there is agreement that foreclosure would be a worse case than some modification, we have been told that there are problems in getting there. So what we talk about is not the government making the decision; but, yes, I do think it is important and it has been an important matter of public policy to have somebody make the decision.

The gentleman from Georgia said, well, they can go to court. My conservative friend's preference for litigation ebbs and flows. I think leaving something to the courts, without adequate statutory guidance, is not an appropriate thing for us to do.

Let me just ask, Mr. Deutsch, please submit to us specifically those modifications on HOPE for Homeowners. But here is the nub of it to me. On page 5 of your written statement you say, "Although there is variation among individual transactions, most securitizations provide servicers with significant flexibility to engage in loan modification and other loss mitigation techniques subject to contractual obligations if the particular loss mitigation alternative selected maximizes the net present value or recovery." That is clearly the case.

We are told that in principal, but we are also told by many people that they can't get this worked out, that the servicer in fact is deterred from doing it. We tried to pass legislation to deal with that. We passed legislation—bipartisan—the gentleman from Delaware and the gentleman from Pennsylvania.

Certainly it is the case statistically, I am told, and we saw this again with Fannie and Freddie, that entities as holders have been able to do more modifications than mortgages where there is a servicer.

So if this is the case, I guess to some extent—and I want to believe what you say and I acknowledge that may be what is in the contract—but there still may be this fear.

You tell me that the securitizers, the servicers, have the power to do this, but we get every indication anecdotally and statistically that it is not being done as much. So I guess I am in the position of posing the question that Groucho opposed to Chico: "Who am I going to believe, you or my own eyes?"

I want this to be the case, but are you aware that there is this disparity in the actual number of modifications, that we get more when there are owners, the holders servicers? And if that is the case, are there further things we can do? What would account for what seems to me the gap between what I believe is an accurate statement by you of the legal situation and the actual experience?

Mr. DEUTSCH. Well, hopefully my name won't be referred to as Chico hereafter, but I think—

The CHAIRMAN. A side point, by the way. It was Chico, because it was based on his predilection for female companionship.

Mr. DEUTSCH. You are going to make me blush, Mr. Chairman.

Servicers have indicated that they believe and are very concerned that if they do overmodifications of mortgage loans, that they would be subject to lawsuits. Those same servicers should also be scared if they are subject to lawsuits for undermodification as well.

The CHAIRMAN. Is there anything we could do to alleviate the first fear, other than what we have already done? I do know this. The question of indemnification, you get taxpayer dollars there. Is there anything we can do, short of 100 percent indemnification, to alleviate the first fear?

Mr. DEUTSCH. I think the best thing we can do is what the ASF is actively working on right now, and that is bringing together all of the institutional investors, the pension funds, the mutual funds, the hedge funds, the banks, the financial guarantors, the insurance companies, all those that own mortgage-backed securities, and creating a more streamlined solution that ultimately gives a standard market practice for servicers to be able to modify in accordance with that. There is significant precedence for that. The ASF created last December a streamlined framework that allows servicers even before a borrower—

The CHAIRMAN. My time is up. I am glad to hear that. If it helps you, tell them that to the extent they are worried that we will intrude too much legislatively on this method that they believe is now working well, they can make us go away, but they can only make us go away if this effort you are talking about is successful and leads to significant modifications.

The gentleman from Texas is next on the list I was given.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

Mr. Deutsch, what would you say is the status of the secondary or the securitization market for mortgages today? You said nonexistent. Is it totally nonexistent, or is there some activity going on?

Mr. DEUTSCH. I can provide you stats that were in my written testimony, that in October of 2008, there was approximately $500 million of securitized product that was put out into the market. It sounds like a big number for those of us. But last year at the same time, it was approximately $50 billion in October of 2007. In previous cycles, it was much, much higher than that.

There is absolutely zero activity right now in the securitization credit markets, which ultimately leads banks not to have the available credit to lend to consumers.

Mr. NEUGEBAUER. Mr. Gross, you indicated, though, that you all had made a substantial number of mortgage loans in the last quarter.

Mr. GROSS. That is correct, sir.

Mr. NEUGEBAUER. What did you do with those mortgages?

Mr. GROSS. They are either portfolio product, or these would have been product delivered through the GSEs. I believe that the market Mr. Deutsch was referencing was the private securitization market.

Mr. NEUGEBAUER. So, Mr. Deutsch, the $500 million would be delivery outside of Fannie or Freddie. This would have been in the private markets.

Mr. DEUTSCH. Correct. And that encompasses consumer asset securitization as well—credit cards, auto loans, consumer loans, etc.

Mr. NEUGEBAUER. The chairman talks about the servicers and the portfolio managers and the trustees and all of the people who are involved in the securitization family there. Moving forward, in other words, we have some of these old contracts that are in place. What is the industry doing as we are moving forward to look at where some things in those documents could have been made better and bring some uniformity? Has anything taken place, or is the meeting that you are proposing where that should take place?

Mr. DEUTSCH. We have had a separate effort from beyond the existing—how to address existing contractual arrangements, an existing modification policy, a separate effort throughout all of 2008 called ASF Project RESTART, where we are examining all areas of securitization and ways to enhance the process of securitization.

I would point you to a request for comment that we put out this summer, that we will shortly be updating, where we note a number of different ways where we are trying to create a much more strengthened securitization process which ultimately will create market discipline.

One of the gentleman's comments over here was can we create servicing provisions that will ultimately allow more discretion, more flexibility into the future for servicers who are experts at servicing to be able to do that on behalf of investors who are experts in investing. Absolutely, we believe we will get to new standards that will even further create better securitization into the future.

But we all know it is going to be some months before securitization returns, and obviously none of us want securitization to return in the exact same form that it occurred in previous years.

Mr. NEUGEBAUER. One of the issues that I have about moving down to some kind of modification road here, of Congress stepping in the room again, is what that does to the private mortgage insurance industry, because I think they are going to have a much stronger role, probably already have been, as people are looking to go back in to make sure that if you are making above a 75 or 80 percent loan you are using, in many cases, some private mortgage insurance to do that.

What are the implications to those entities if we start going down a road where the potential loss could be made larger if that modification in fact doesn't really turn out to be appropriate? How do we address that?

Mr. DEUTSCH. Well, I think there are two ways we can address it. I think it is an important comment to note it is critical for people to have certainty of contracts moving forward.

You don't want to put capital to work if you are afraid somebody will change the rules after the fact. I do think there is a very positive way that the Federal Government through TARP can provide guarantees. And this will be a benefit to mortgage insurers, to the institutional investors, to financial guarantors, where this guarantee policy could apply if servicers were today even more proactive steps on loan modifications; that if those modifications would fail, ultimately that credit risk would flow to the troubled asset relief program rather than back to the ultimate holder or those borrowers.

Mr. NEUGEBAUER. Mr. Gross, over the last quarter, you originated a number of loans. Are you seeing that in any particular part of the country, or is the activity that you are reporting pretty much nationwide?

Mr. GROSS. That is a nationwide number, sir.

Mr. NEUGEBAUER. I would say what the chairman said. I think it would be in the best interests of the industry if you could sit down and work this out among yourselves, without asking or receiving any encouragement from this committee to do that. I think a better solution comes from the industry working it out.

One, you know more about the transaction than anybody in this room; and, two, I think it would be more of a market-based, market-driven solution that would accomplish the ultimate goal, and that is get these markets functioning again.

The CHAIRMAN. I am going to ask unanimous consent at this point to put into the record a very good report by Credit Suisse dated October 1st, "Subprime Loan Modifications Update." With your indulgence, I want to read just a couple of their conclusions, because it is relevant to what we are talking about.

First, it says that loan modification is a growing but perhaps underutilized tool to reduce lawsuits and prevent foreclosures; that redefault rates for some types of modifications are better than expected. Not surprisingly, principal reductions or interest rate reductions work better than simply sort of putting off the day of reckoning.

But here is a very important point that is relevant maybe to what Mr. Deutsch says. It probably gives some support to what you are talking about: "We show that there is a dramatic difference between how intensively servicers are using mods. Some servicers have already modified more than 10 percent of all outstanding 2005-and-later vintage loans. Others have modified less than 5 percent." Then it says servicers are finding the sweet spot between too many and too few that will improve bond values.

So the fact that there is this variation does argue for the point there is this authority. And, again, I think the success of that operation that you are talking about will have a major impact on this committee's legislative agenda.

Without objection, I will put in this report, and I recommend it to people. It does say they are increasing, "Actually subprime loan modifications have increased significantly since we published our first report on this topic. No one program has done what we would like." There are a whole bunch of them, including some individual things. So I do recommend this report to people.

The gentleman from Pennsylvania is recognized for 5 minutes.

Mr. KANJORSKI. Thank you, Mr. Chairman.

Mr. Deutsch, maybe you can straighten us out. Do you see over the horizon any certainty that deflation in the real estate market is going to stop and come to an end?

Mr. DEUTSCH. The deflation in the real estate market?

Mr. KANJORSKI. The devaluation of real estate.

Mr. DEUTSCH. My personal view is that we will continue to see price declines throughout 2009, particularly in the most troubled markets: California; Nevada; Arizona; Michigan; Ohio; and Florida.

Mr. KANJORSKI. Well, if that is the case, how will rewriting mortgages and making modifications really change that reality? At some point, every week or every month, more mortgages will be going underwater, not because they are speculative, not because they were improperly made, but just with the real estate evaluation.

Does that look like it will be a perpetual problem now for the next year, year-and-a-half? And then I wonder of what value mortgage modification is.

Mr. DEUTSCH. Well, as I indicated in my testimony, I do think loan modifications for the targeted and appropriate borrowers will be very helpful in helping stem the tide of delinquencies and defaults. But as I also indicated, given that dramatic decline and a lot of that being nationwide in home prices, is that you will also need to see additional efforts by the Federal Government to be able to help stabilize that housing market, because ultimately declining home values are an indication and cause of increasing foreclosures, delinquencies, and defaults. Part of that is because credit is simply not available today for either new mortgage borrowers to be able to get into homes for the first time, and also for existing borrowers to be able to refinance into different loans.

Mr. KANJORSKI. I notice there is a tremendous difference in the laws that apply to real estate and mortgages, say between California and Pennsylvania. In California, you just hand in the keys and you are out from under the obligation; in Pennsylvania, there is actually no way that you can escape the obligation that you made on the mortgage. So it would seem to me less likely for Pennsylvanians to be able to escape relative to Californians.

Now, the problem with that is whatever we do at the Federal level at the present disjointure of the real estate laws across the country, we advantage or disadvantage one State over another. Would you think it may be wise at this point to adopt, at least for temporary purposes, a uniform national standard of handling mortgage foreclosures and mortgage rights?

Mr. DEUTSCH. A national standard for—

Mr. KANJORSKI. A national standard so Pennsylvania and California are the same.

Mr. DEUTSCH. If we are talking about the ability for borrowers to walk away from their financial obligations, whether you view that as an investment in a home or a mortgage of sorts, I do think it would be very important to be able to provide incentives for those borrowers to stay in their homes or to reduce their ability to leave those homes and walk away from those obligations.

Mr. KANJORSKI. Wouldn't applying the laws of Pennsylvania to the State of California decrease the likelihood that Californians would walk when they are underwater?

Mr. DEUTSCH. Absolutely. From the way you have characterized it, I think that would further disincent people from walking away from their homes.

Mr. KANJORSKI. Should we think of doing that?

Mr. DEUTSCH. I think it would be very helpful to prevent those walk-away borrowers. If you have additional walk-away borrowers, more foreclosures on the market, that would certainly increase the number of homes available on market, which ultimately drives home prices down.

Mr. KANJORSKI. Very good.

Thank you, Mr. Chairman.

The CHAIRMAN. The gentlewoman from Illinois, in the absence of the gentleman from Ohio, is recognized for 5 minutes.

Mrs. BIGGERT. Thank you, Mr. Chairman.

There seems to be a sense of urgency and seriousness of the mortgage crisis to have creative thinking to address the anticipated foreclosures. Is there a danger that by responding to this crisis, regulators in Congress may damage investor confidence, leading to longer-term problems?

Mr. DEUTSCH. I would say that investor confidence is already damaged. There are significant concerns in the investment community about different proposals that are more mandatory in nature rather than voluntary, that has created significant volatility in the market and has ultimately depressed mortgage-backed security prices. By depressing those prices, you continue to prolong the inability for issuers to put new mortgage-backed securities out into the market, which ultimately takes their ability from being able to originate the same volumes in the past.

Mrs. BIGGERT. Do you think that there is also a lack of investor scrutiny when it came to the mortgage-backed securities?

Mr. DEUTSCH. Absolutely. There were investors who did not do the full amount of due diligence they should have done before purchasing a mortgage-backed security. I think there are a lot of investors who have learned their lesson. Some of those are no longer investing; they are selling shoes or doing something else because of their poor performance.

I think what you are seeing now in the market is a lot of reevaluation, and a lot of this is occurring through the ASF Project RESTART, about how to create more market discipline for those investors and ultimately provide them the information and certainty of the products that they would be purchasing.

Mrs. BIGGERT. So we might need some financial literacy for the investors as well as the borrowers?

Mr. DEUTSCH. I think it is not just financial literacy. We also have to keep in mind that in 2005 and 2006, we had enormous liquidity available in the market. There was capital flowing in from all parts of the globe into purchasing different assets, and mortgage-backed securities had very strong performance up until 2006. So you had a lot of investors putting money into securities where they were very hopeful about very positive returns.

Mrs. BIGGERT. Could you talk a little bit about your Project RESTART? Will that build investor confidence?

Mr. DEUTSCH. Yes. There are multiple prongs to Project RESTART. The first and priority prong is providing additional information to investors so that they understand all the different characteristics of an underlying mortgage loan within a security.

So if you are buying a conforming set of loans, say from Fannie or Freddie, they are very fungible, if you will. If you are buying nonconforming loans, those from Alt-A, subprime or others, there are all kinds of differentiation or variation.

We are trying to be able to effectively put the institutional investors as close to that closing table for all of those mortgages as possible. Obviously, given thousands of mortgage loans in a particular pool, we have to do that through data-driven exercises, and that is extremely costly. But ultimately, it is going to be necessary to increase the investor confidence in securitization going forward.

Mrs. BIGGERT. Thank you. This is a general question. The centerpiece of the HOPE for Homeowners program is a writedown of mortgage principal. Are servicers and investors not able to do this without government intervention?

Mr. DEUTSCH. Absolutely not. Servicers have historically and continue to write down principal in appropriate circumstances. What I have indicated in my testimony is that the current requirement to write down to an 87 percent loan-to-value ratio, effectively providing 13 percent equity into the home, is in many cases simply too far of a writedown, where servicers or investors don't find that to be an appropriate use. If that loan-to-value ratio were increased, it would provide substantially more refinances into the HOPE for Homeowners program.

Mrs. BIGGERT. Thank you. Would anybody else like to comment on that? Mr. Gross?

Mr. GROSS. Yes. Just amplifying on what Mr. Deutsch just said, with regard to HOPE for Homeowners, servicers are contractually obligated to choose the home retention or loss mitigation option which provides the best return to the investors. That is a contractual obligation. To the extent that we can do an interest rate reduction or term extension which will provide the homeowner with that affordable and sustainable payment, without doing the principal reduction, we are obligated to choose that option.

In most cases when we are looking at the hierarchy of options here, the HOPE for Homeowners program, with the effectively 13 percent writedown, at least that amount, would provide for a much greater immediate loss to the investor than the interest rate reduction or term extension would allow.

Mrs. BIGGERT. Thank you. I yield back.

The CHAIRMAN. If the gentlewoman would yield, I would note the distinction in Credit Suisse was a different one, and that was between either principal modification or loan reduction and the extension. Because what they reported was that there was a significantly higher redefault rate with regard to simply an extension of the term as opposed to either an interest or principal writedown.

So, as I said, they drew the line in their argument about the extension was in their experience there is a higher redefault rate.

The gentlewoman from New York.

Mrs. MALONEY. Thank you. I would like to follow up on my colleague's questioning, Mrs. Biggert, on the mortgage-backed securities, where she pointed out that we need more due diligence on these products.

I would like to ask the panelists how much of the financial crisis is caused by the fact that the mortgage-backed securities were given to people who couldn't afford them under terms that were very unfavorable; teaser rates of 3 percent, that after 3 years jumped to 9 percent; that they were no-doc loans, no documents needed. Actually, the word in New York was that it was easier to buy a house than to rent an apartment, because they didn't ask about your income, they didn't ask anything. They just gave you a mortgage you couldn't afford.

How much of the problem we are confronting now was really mismanagement, abuse, and horrible behavior in an economy that has slowed down? How much of the problem that we are confronting in the housing crisis that Chairman Bernanke and others say are the prime goal, we have to stabilize the housing before we can move forward with our economy?

We have to understand how this happened. How much of it was caused because of mortgage-backed securities that people couldn't afford, and were sold to them knowingly that they couldn't afford them, and how much of it is an economic downturn in our economy? Anyone or everyone, I would like to hear your comments on it.

Mr. DEUTSCH. I guess I am being volunteered to go first.

I would say borrowers, lenders, and institutional investors all had irrational exuberance about the direction of home prices into 2004, 2005 and 2006 based on the significant uptick in home prices in that period. I believe everybody became very excited about the equity that was available through that.

Mrs. MALONEY. If I could add, then, because you were talking about the prices going up so they were very excited about it. So they didn't care if they sold a house to someone at a 3 percent interest rate, because they knew when they took the house back from them after having collected all that money, that they could then resell the house. Now, the problem is we can no longer resell the house because of a financial problem and the houses have fallen in price. So that, I think, is an important point. So continue.

Mr. DEUTSCH. I think as we have been discussing all this morning, no lender wants to take a home back in an appreciating or depreciating home price market because the costs of foreclosure are extremely high. The expectation of many borrowers and many lenders was that home prices, by continuing to increase, is that those borrowers would be able to either refinance or be able to use the equity that was growing in that appreciation.

Mrs. MALONEY. And it is clear they cannot. To my question, do you think this financial housing crisis is caused by the faulty, deceptive mortgage-backed securities, or a general downturn in our economy?

Mr. DEUTSCH. I believe there is a combination of both a downturn in the economy, job loss, etc., as well as the epicenter of which, of course, is being in the housing market where you did have a lot of irrational exuberance on the direction of home prices.

Mrs. MALONEY. How much of the problem do you think was caused because no one was held responsible? You could sell a house, get your fee, and immediately securitize it and move to Florida; unlike the old times, when the bank gave you a loan, they held that loan, and they were responsible.

I used to work for a bank. I had a loan line of $10,000, and let me make sure, I was absolutely positive I never gave a loan to anyone who couldn't pay that back, that $10,000, or I would have lost my job. But now you just securitize it, you sell it to the next one, the next one and the next one, and no one is responsible. So should we build some responsibility back into this, some accountability? If so, how would you suggest we do that?

I might ask, if I could add to that question, I want to sincerely applaud everyone who has moved forward with Fannie Mae and Freddie Mac. They say that is only 2 percent of the defaulted loans. Most, 20 percent are the adjustable rate subprime loans. So that is where the real problem is. We are relying on voluntary actions, and by all accounts the problem is millions, not hundreds of thousands.

So how can we encourage industry? Not that we are not very appreciative of the efforts you have taken so far, but how can we encourage you to adopt as a standard the systemic loan modification protocol that was used by the FDIC at the IndyMac takeover that was so successful?

The CHAIRMAN. We will get an answer. Does anyone want to answer?

Mr. GROSS. Well, I would like to say a couple of things. Number one, I think everyone is in agreement that there were loan programs available in prior years which in hindsight should not have been available. I am happy to say that Bank of America did not engage in those loan programs at that time.

With regard to the voluntary loan programs that are there today, Bank of America has closed approximately 225,000 home retention workouts thus far this year. So the voluntary aspects of this for the major servicers engaged in the HOPE NOW Alliance and other initiatives are working. Are they working fast enough? No. We need to do more.

The announcement yesterday with the GSEs, with Fannie Mae and Freddie Mac, will go a very long way in assisting in this, because this was, quite frankly, one of the areas where all servicers struggled.

The CHAIRMAN. The gentleman from Georgia.

Mr. PRICE. Thank you, Mr. Chairman. I want to thank all the members of the panel for their testimony. I am impressed with all that is being done. I know it is not fast enough for anybody, but I think it is imperative that we appreciate all that is being done.

It has been said that the goal that has been put on the table is that we diminish the number of foreclosures, and we all agree with that. I am heartened, Mr. Chairman, because I believe that we may be closer than folks might think. A commitment to a volunteer program and no retroactivity is a positive place to start. So I am hopeful that as we move forward, we will in fact be able to realize that significant decrease in the number of foreclosures.

The falling home values has been mentioned as being at the core of our current challenges, and I would agree, I think, that nobody would discount that at all. There have been some solutions offered by others out there that haven't been discussed this morning. I wonder if, Mr. Gross and Ms. Sheehan, if you might comment on solutions that are put on the table, like mortgage rate buydown and expanded home buyer tax credit.

Would you care to comment on whether or not you believe that those items can appropriately address the problem or would be part of the solution?

Ms. SHEEHAN. I think we all recognize that there needs to be a variety of different types of any initiatives in order to be able to sort of promote homeownership in the future. Some of it is looking at how we do our underwriting and lending. Some of it is incentives.

I know there was an incentive that was put into the stimulus package that was adopted over the course of the summer, and I think, frankly, part of the issue we have right now is sort of the balance in terms of credit underwriting.

We have been criticized for becoming too liberal. I think we now have the issue where everybody has come back in the other direction. So in order for our first-time home buyers to really take advantage of these programs, whether it is a tax credit or a State housing finance agency program, we need to think about how the tightened credit impacts that transaction.

So one of the things we see a lot of potential for, and a number of the major lenders have been working and talking to the State housing finance agencies, using their funds that they have gotten through the stimulus package to put together programs for first-time home buyers, that would be able to sort of bridge that gap between what is available realistically by way of downpayment, because that is one of the issues we see. So the market that exists today has moved toward a larger downpayment. First-time home buyers generally don't have that available.

Mr. PRICE. Would a tax credit help that?

Ms. SHEEHAN. A tax credit would help it to the extent it is refundable and it becomes sort of part of the underwriting of the package. But I do think that having the participation of the States, with their ability to put some guarantees around, if not all, a portion of the loan is really going to help. Because what we have seen happen certainly in the last 6 months at Chase is that there has been a lot more activity in the FHA programs, both basic FHA and FHASecure. We are building a pipeline for the FHA homeowner. So the market is still looking to get that sort of government backing, if you will, until we bring the private market back.

Mr. PRICE. Mr. Gross, a comment on the tax credit?

Mr. GROSS. No.

Mr. PRICE. No comment? Getting a little too liberal has become a disease around here, Ms. Sheehan, so I appreciate your comment regarding that.

Many of my constituents believe that the capital flowing into the market has stopped significantly, as has been mentioned by you, Mr. Deutsch, and that until there is some sense of certainty about the Federal Government stopping its actions, that the capital sitting on the sidelines is going to stay on the sidelines.

Is that an accurate assessment of what is going on?

Mr. DEUTSCH. I think it is very accurate that many investors, until they see how a situation plays out—and part of that is the home price market and the housing market, but also it is the new response of a new Administration, of a new Congress—if there are steps that would significantly disadvantage them. They are quite concerned about that and are effectively taking a wait-and-see approach.

So it is not just the act of doing something, it is the threat or concern of doing something; and it is preventing many investors to come back into the market.

Mr. PRICE. Do you have any thoughts about how we shorten that timeline for that point when there is certitude in the market, where money can get back in?

Mr. DEUTSCH. Part of it is the volatility in question as to how the home price depreciation market will go down. And as Representative Kanjorski was asking about, how many borrowers will effectively walk away from their homes, how many Jose Cansecos will we have who will just simply pick up and leave?

Mr. PRICE. Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman from North Carolina.

Mr. WATT. Thank you, Mr. Chairman.

One of the benefits of a hearing at this stage in the process is to try to make an assessment of what else, if anything, we need to be doing. It seems to me that there are four options: We can just wait on what we have already done to play itself out; we can aggressively push and jawbone for industry action based on industry's own interest and based on legislation that we have already passed; we can wait on regulators to take action based on legislation that we have already passed; or we can consider additional legislation. And obviously, one of the things we need to consider is additional legislation. That is within our prerogative.

And one of the things I guess is pointed to on page 9 of Mr. Gross' testimony where he talks about changed circumstances of borrowers being a real problem when people become unemployed, can't find jobs, and the economy doesn't work like it is supposed to. So I know our responsibility in the stimulus area is one, but both Mr. Allensworth and Mr. Gross pointed to some impediments that are still out there; and it wasn't clear to me whether you are looking for us, as legislators, to solve those impediments or whether you are looking to the regulators to solve those impediments or you are looking to the industry to solve those impediments.

Mr. Allensworth outlined three problems on page 4 of his testimony; Mr. Gross outlined a series of problems and kind of danced around the solutions to them on pages 8 and 9 of his testimony. I guess what I am trying to figure out is the same thing I was trying to figure out from the people who came to talk to us about setting up the new regulatory framework: What is it that you are proposing that we need to do, if anything, as legislators, as this committee, at this point?

Or is this a function of waiting on this to play itself out, waiting on the regulators to push you and give you a framework to operate in? Waiting on, as Mr. Deutsch has indicated, the industry to set some protocols and uniform standards for services?

Who should be doing that and what should our role as this committee be in it? I will start with Mr. Allensworth, since he has been sitting down there during the questioning without much participation. And then, I want to go over to Mr. Gross next, and if I don't run out of time, the other two witnesses also.

Mr. ALLENSWORTH. I think, as I outlined and as Mr. Gross outlined, there are a number of challenges that the market faces. I think one of the first solutions is the collaboration of market participants. I think you see with the panelists up here a willingness and a desire to work constructively to solve a lot of the issues that are outlined. And I think a lot of the issues we discussed can be addressed through collaborative efforts of the industry. That being said, there are a number of market participants who are not on the panel today, and I think the important thing is to bring everybody together, have everybody discuss it.

I think we have a shared interest in—

Mr. WATT. Maybe I should revise my question, since I am running out of time, and have you tell us what you think we ought to be doing, if anything, to move this process forward and stem the tide of foreclosures and get us out of this mess.

Mr. ALLENSWORTH. As the Hedge Fund Association, I don't think we—

Mr. WATT. No, "we" as members of this committee.

Mr. ALLENSWORTH. Right. On behalf of the Hedge Fund Association, we don't have any specific policy recommendations that this committee or that Congress needs to undertake at this point. Our primary recommendation is collaboration of industry participants to solve a lot of these issues.

Mr. WATT. Mr. Gross.

Mr. GROSS. I would suggest that there is a dramatic need for modernization of HUD. I know that the HUD staff is working feverishly to come up with new solutions, but because of their own regulations, they were unable to fully participate in the announcement that the GSEs came forward with yesterday. They cannot modify their loans to a 40-year term. They cannot modify loans that are less than 4 months delinquent.

Mr. WATT. Is that by statute or by their own ineptitude?

Mr. GROSS. My understanding is, it is by statute. And again, we, as an industry, would look forward to working with you on HUD modernization because it is dramatically needed.

Mr. WATT. I think I am out of time, unless anybody has some compelling answers to the question already asked.

I yield back, in that case.

Mr. KANJORSKI. We will hear from the gentleman from Alabama, Mr. Bachus.

Mr. BACHUS. This may be out of your field of expertise to the panel, but the vice chairman of the committee, Mr. Neugebauer, is from Lubbock, Texas, where Texas Tech is. I represent Tuscaloosa, Alabama, which is the University of Alabama.

They are number one and number two in all the football polls. And he has recommended that I wear this Texas Tech hat and jersey when I go home. What do you think? Do you think that would be advisable? Or do you think he is serious, this is a serious proposal on his part?

Mr. GROSS. I think that the ranking member is smarter than that.

Mr. DEUTSCH. We might have a new ranking member in the next Congress.

Mr. BACHUS. Mr. Vice Chairman, I'm smarter than that. That was very good advice. Let's try another one.

There has been a sharp rise in foreclosure. And President-Elect Obama and many of my Democratic colleagues have proposed giving bankruptcy judges the right to modify the terms of the primary mortgages. And also, they have proposed a forbearance or moratorium on mortgage foreclosures.

Mr. Deutsch, let me start with you and Mr. Allensworth, since, Mr. Gross, I think you gave a very good answer you couldn't improve on. So if you all would answer that question for me.

Mr. DEUTSCH. In short, as I indicated earlier, finance ministers from around the world have indicated the flow of credit to the

United States, to other countries, is one of the top five priorities to address. By enacting something like a foreclosure moratorium—which would effectively change the rules after mortgages have been made—or to create a situation where bankruptcy judges could cram down the principal values of mortgages, both of those would have an extraordinary chilling effect on institutional investors' bringing capital back into the markets and ultimately would prolong the credit crisis that we are in.

Mr. BACHUS. And I guess it would obviously, if that happened—and I agree with you—it would increase mortgage costs for all other borrowers.

Mr. DEUTSCH. It would either increase the cost or simply not make either refinancing or new credit available.

Mr. BACHUS. Thank you.

Mr. Allensworth.

Mr. ALLENSWORTH. I would agree. I think that the challenges that Mr. Deutsch outlined are some of the things that need to be considered.

Certainly, we have seen that the foreclosures in the housing market and the tying up of mortgage markets has had a huge spillover effect into credit markets and to the economy generally. So we are very supportive and want to be actively engaged in addressing the foreclosure problem.

But I do think we need to consider whatever solutions we undertake, what the effects will be not just on the current foreclosure issue, but going forward, and the availability of credit going forward.

Mr. BACHUS. But I think it is your answer that either a moratorium or allowing bankruptcy judges to change the terms of the primary mortgages would restrict credit and drive up cost?

Mr. ALLENSWORTH. For both of those issues we have not focused with our members on those issues up to this point. We would need to go back to our members to see what kind of effect they think that would have.

Mr. BACHUS. Would you do that and let us know?

Mr. ALLENSWORTH. Yes.

Mr. BACHUS. This question I will ask Mr. Gross and Ms. Sheehan. One thing we keep hearing, and in your testimony, is that you are trying to contact the borrowers and they are not responding to you; you have been unable to establish contact. We at least have heard that from institutions in some of the programs that have already been deployed. Is that a problem? Are you hearing from all of them?

Mr. GROSS. I think I would agree with the assessment that frequently contacting a borrower who is in default is often challenging. It requires very dedicated efforts, and it is done 7 days a week.

I would, I guess, argue a little bit with some of the statistics that have been used. In our own case, for loans that have gone through the foreclosure process, and we have looked back, we have had contact with over 90 percent of those borrowers during that specific default cycle. And we have had contact with, I believe, about 65 percent of those borrowers within the immediate 45 days prior to the foreclosure event.

And going back to a question that you raised a moment ago with regard to foreclosure moratoriums, one of the reasons why I don't believe that a foreclosure moratorium is either appropriate or needed is that any borrower who reaches out to their lender and says, I need help, if that loan is in the foreclosure process and we believe that they, number one, want to retain ownership of the property, number two, have a reasonable source of income or that it is reasonably foreseeable that they are going to be back to work soon, then we will work with those homeowners and we will stall the foreclosure action.

We have absolutely no incentive, we have no wish to have one more foreclosure than is absolutely required.

Mr. BACHUS. Thank you.

Can I get Ms. Sheehan to respond?

The CHAIRMAN. Quickly. Sure.

Ms. SHEEHAN. I think our experience has been that, depending on the method of contact, we get varying degrees of feedback from our borrowers, though I do agree with Mr. Gross that by the time you get through the foreclosure process, by and large, you have had at least one or two active contacts. But one thing we definitely have learned is that the more we can interface with counselors, the more we can have people on the ground to respond to borrowers, the much better outcomes we get much earlier in the game before they get too far underwater.

Mr. BACHUS. And let me just make a comment, and I will wrap it up.

I am concerned about in the delinquency stage before the foreclosures. And I have noticed that when third parties are hired, or counselors, sometimes it doesn't have Bank of America or JPMorgan Chase on it. That might be more effective, and I would just urge you to maybe look at that. There are studies that show if it has that bank name on there, they may not even open it, or certainly wouldn't respond.

The CHAIRMAN. The gentleman from California.

Mr. SHERMAN. I want to commend some of the lenders here for having congressional liaisons because very often the people in the most trouble who aren't opening your mail are calling our offices; and it is good for our staff to have somebody to call.

I am particularly drawn to solutions to this problem that don't involve risk or cost to the U.S. taxpayer or do not unduly imperil future investments in mortgage instruments. And so I hear Mr. Gross saying, well, we have loans in our portfolio, we will work reasonably with the borrower.

And then I hear horror story after horror story where people can't figure out who their servicer is. When they figure out who their servicer is, the servicer says, I would like to help you, but I might get sued. And so the question is whether Congress should act to make sure that servicers have all the legal rights to act on behalf of their various, in effect, trust beneficiaries taken as a whole.

Or are we going to have this perverse game where people say, well, we would like to help you, and it would be in the interest of the investors that we help you, but we can't help you because there is this risk of lawsuit? The way to deal with that, of course, is for

Congress to pass a law empowering trustees and protecting them from lawsuits.

Mr. Deutsch, do you support that clarification?

Mr. DEUTSCH. We would not support Congress taking legislative action that would—

Mr. SHERMAN. And so you want to continue to be in this circumstance where you can come here and say you want to help people, and then on the ground the servicer says, oh, I would like to, but—

Mr. DEUTSCH. No. I disagree with the characterization that servicers are saying, I would like to help you, but I am afraid I might get sued.

Mr. SHERMAN. Are you saying that never happens? Do you want to come to my district?

Mr. DEUTSCH. I am saying, under their contractual obligation, they have a responsibility to modify those loans in the appropriate circumstances. And if they don't modify those loans in those appropriate circumstances, they will equally find themselves at legal peril.

Mr. SHERMAN. Okay. So we have two legal perils and total fear of lawsuits.

Why would you oppose a statute that would clarify that the world is in fact as you describe it to be, that is to say that servicers are free to provide workouts, etc.?

Mr. DEUTSCH. Because in those circumstances, you will take the one effective way that investors have to control what servicers do on their behalf.

Mr. SHERMAN. So you would have a circumstance where a mortgage might be owned by 10 different investors, and you have 1 investor out of the 10 who wants to oppress the homeowner and disadvantage their fellow investors, and you want them empowered to be able to do so, and you don't want Congress to take away that power?

Mr. DEUTSCH. They don't have the power to influence the servicer by any contractual or legal means. If they would choose to sue the servicer—anybody in America is free to sue anybody—the question is, if the servicer takes a reasonable loss mitigation action, that servicer will not be held liable by—

Mr. SHERMAN. So why would you oppose a statute that said if the servicer takes reasonable loss mitigation action, that servicer will not be liable?

Mr. DEUTSCH. That has been approved already through EESA and through the HOPE for Homeowners program this summer.

Mr. SHERMAN. So when the servicers say they can't take reasonable action because they have a realistic risk of being sued by one of the investors, they are not telling you the truth?

Mr. DEUTSCH. I think the point is that that has already been passed by Congress.

Mr. SHERMAN. That is what I am saying. So you are saying the law is already as I describe it, and those servicers who describe it to me as being different are not telling me the truth?

Mr. DEUTSCH. I guess it was unclear as to whether you are suggesting something additional should be passed on top of what has already been passed.

Mr. SHERMAN. I am suggesting that Congress do whatever is necessary so the next time I am talking to a servicer they are not telling me they would like to and it would be in their interest, but they fear being sued.

You are convinced that the existing statutes give the servicers the power to do that, and the servicers who are telling me they are not empowered are just hiding.

Mr. DEUTSCH. I can't speak for what servicers are telling you in those private conversations.

The CHAIRMAN. Would the gentleman yield?

Mr. SHERMAN. I will yield.

The CHAIRMAN. The gentleman from California was very diligent in this. If he got such a comment from a servicer, would it be helpful if he gave you those specifics you talk about, trying to bring people together? I mean, could we report, frankly, to you and see if you can resolve this conflict?

Mr. DEUTSCH. Absolutely.

The CHAIRMAN. Because it is one that he reports that almost everybody has encountered, this gap, as I said, between your statement and what happens.

I thank the gentleman.

Mr. DEUTSCH. I think we would very much appreciate that.

In particular, we would be happy to have those institutional investors who own that security that that servicer is choosing not to maximize the net present value by not modifying in those appropriate circumstances. Those institutional investors will certainly—

Mr. SHERMAN. Where you have 10 investors, and any one of them can allege by a mere negligence standard that the value of the portfolio has not been maximized, you provide the servicer with safety through inaction. And I look forward to working with the committee to try to provide servicers with as much insulation as possible from lawsuits when they act in good faith to try to maximize the situation for both homeowners and for investors. And you can always make the allegation that a servicer has not maximized the portfolio value, and perhaps we need a higher legal standard, a gross negligence legal standard in order to make them feel secure.

I yield back.

The CHAIRMAN. I am going to ask for unanimous consent just for 1 minute to just say I am intrigued that they are also liable to be sued if they are too tough.

Who has standing? I mean, if I had a mortgage, could I sue them for not reducing it, or is it some other investor? I understand the theoretical possibility. I know who the plaintiffs are in the case of the people who think they are not getting enough money; but seriously, who would be the plaintiff in a case that said, you haven't been doing enough reduction?

Mr. DEUTSCH. The institutional investors who own the mortgage-backed securities would—

The CHAIRMAN. We have heard threats on the one. Frankly, I tell you this: It could be very helpful if you could talk to a few of them and have them threaten to bring such lawsuits. That might help with the problem we have all encountered.

Mr. DEUTSCH. I am not aware of any institutional investor suing any servicer either for overmodifying or undermodifying mortgage loans right now.

The CHAIRMAN. And I guess I just asked you to engage in barratry, so I can't do that. I retract it.

The gentleman from New York.

Mr. MEEKS. Thank you, Mr. Chairman. And let me thank those of you who are here.

I think that some of the atmosphere—and maybe you are leading it, or part of it—is going to change around here, the elections that were just concluded. Change is on the way. And I think that what President-Elect Obama is talking about is that we are going to have some civility, but we are going to talk and try to figure out how we can really make a difference for the American people. And I still, for one, believe in the statement that the American dream is alive, and I think that homeownership is an integral part of that. I still believe that we will get back to the point where, as I have always said, it is better to own a house than rent a car because a house is an appreciating asset—it is not today, but it has been and I think we will get back to that—and a car is a depreciating asset. And I think that will continue.

So I still think that one has pride when they own their home, and the objective here is to keep those individuals who have lived with the dream of owning a home, as my parents did. And the key is, when you are in this situation that we are currently in, and we talk about helping Wall Street, now it is critical to show that we can help Main Street and these homeowners.

And so, to that end, as I indicated in my opening statement, I have gotten together with individuals in my district—counselors, lawyers, etc., with people coming in—and one of the problems that I observed is, when they are talking, the homeowners and the advocates to individuals that call up banks, some of the time what they receive are individuals where the servicing has been outsourced. And the people that they are talking to, their call centers, are in foreign countries; and that seems to hamper responsiveness and ultimately the ability to help the distressed homeowner. We have had one situation where the person's home was ready to go on the auction block, and as a result of trying to get somebody to do something timely, there was just—you know, they couldn't navigate the system.

So I was wondering whether or not you have seen the impact of outsourcing call centers to foreign countries on the responsiveness of lenders to the distressed homeowners, and is there a system where you can provide immediate foreclosure prevention and loan modification solutions on the ground with the local banks that are there—you know, maybe the branch managers that are in the districts?

I am calling a meeting with them tomorrow to see if we can call them directly and put something together to help these folks that are about to lose their homes.

I will start with Mr. Gross.

Mr. GROSS. Yes. Bank of America has not outsourced any call center activities to any third parties. We do have call centers in India and Costa Rica. These call centers are focused on very preliminary delinquency types of activity, but they are not handling any of the home retention, more seriously delinquent accounts. At no time are these accounts allowed to get through to the India call centers.

Mr. MEEKS. What about at Chase?

Ms. SHEEHAN. The answer is essentially the same. We do have a call center in the Philippines, and that handles only what we call "early stage delinquency" within the first 30 days. All the loss mitigation specialists are at Chase.

Mr. MEEKS. I am going to check, because I personally was sitting there when we got the runaround. And some of the homeowners that I know—I am not saying whether it was Chase or Bank of America, I will verify, but I know that the homeowners oftentimes had been frustrated themselves when they were trying to rework some of the modifications, and that is why I got these advocates in there that is making a difference.

Let me ask, was there any consideration, also further, because what we are trying to do is to help provide to these homeowners some financial literacy, some counseling with reference to how to budget, budget classes and debt management, so that if they do have the mortgages reset, then they can make sure that they keep them and understand them. I was wondering if there was any thought of the banks doing similar—and/or contracting, working collaboratively with community-based organizations to help provide further financial literacy and others to some of these people who are about to lose their homes?

Mr. GROSS. Bank of America has a very active and large neighborhood stabilization program that does go into homebuyer and consumer financial education, as well as working with local neighborhood groups on REO properties and dispositions. We are very actively involved in those activities you outlined.

Mr. MEEKS. And with Chase?

Ms. SHEEHAN. Yes. I would just say that we are in the same position in the sense that we have a lot of prepurchase counseling that is available, we have homebuyer seminars. We have a lot of work that we do with our neighborhood groups and community counselors.

I would agree with one statement that you made, and it is something we have been actually looking at, which is, what is the best way to sort of handle the total debt picture, postmodification, to ensure that, you know, once that modification is made sustainable, that we don't have additional new debt coming into the picture, to sort of have the situation recur. And that is a budgeting issue. I agree with that, and I think we should focus more on that.

The CHAIRMAN. The gentleman from Massachusetts.

Mr. LYNCH. Thank you, Mr. Chairman, and I want to thank the ranking member and also the panelists; I appreciate you coming here before the committee and trying to help us with our work.

I have somewhat of a confession to make. I also serve on the Government Oversight Committee, which is looking backward at this crisis, looking at AIG and Bear Stearns and some other firms, Lehman, that have had problems, as well as being on this important committee with Mr. Frank and looking forward.

But I have to confess to an irony. About 10 days ago, I was in a hearing room just down the corridor here criticizing roundly some lenders who were not careful enough in their lending practices and thereby contributing greatly, I think, to our current crisis. And here I am today about to press lenders for not being aggressive enough in this modification process and in their lending practices.

I know that someone once said that, "consistency is the last refuge of the unimaginative," and so I guess I cannot be accused of that.

We have talked about the HOPE for Homeowners program, and you are all familiar with that. And we had original hopes that there might be 400,000 folks who might be helped by this program. The most recent report—and I think the chairman has submitted the Credit Suisse Report, and also HUD has reported—that instead of 400,000, we have helped 20,000.

And what I would like to know from you, are there characteristics within that 20,000 that we have been able to help that would be instructive to us, going forward? Or are those just all whole mortgages, individually owned? Is that the profile of the person that we have been able to help?

Mr. Deutsch.

Mr. DEUTSCH. I would have to see exactly which loans are going out. I haven't reviewed which loans have gone into the HOPE for Homeowners program. I think what we have outlined are three different ways that the HOPE for Homeowners program can be expanded and modified to be able to increase the number of loans that would be able to go into that. And it encompasses a number of the things discussed today about being able to acknowledge that consumers have a lot more consumer debt than I think has been previously acknowledged, that widening that debt-to-income ratio, widening that net would allow more borrowers to go in.

There is also some hesitancy of the servicers from getting sued by State and local governments based on consumer privacy laws that we can all use some clarification on.

Mr. LYNCH. Mr. Gross, I don't know if you can help us on this, but there have been 20,000 people whom we have been able to help. And perhaps it is the characteristics of those people that are different from the group that we haven't been able to help thus far that might be instructive for us to be more productive.

Are there other people in the same category as the 20,000 that we have helped that we are not reaching out to? Is that part of our problem?

Mr. Gross.

Mr. GROSS. I apologize, sir, I am not familiar with the characteristics of the 20,000 borrowers that you are referencing.

Mr. LYNCH. All right. Ms. Sheehan, take a shot.

Ms. SHEEHAN. I would say—and I think we talked about this a little bit earlier—and I am not familiar necessarily with the profile of the borrowers, but they will have certain characteristics in common, meaning that they will probably be more seriously delinquent. And the reason it is important to mention that is that it plays into the debt-to-income ratios which are a constraint on the program.

And so we have found that it is easier to put people into modifications, frankly, than to put them into HOPE for Homeowners, given some of the characteristics of the program that those borrowers don't fit.

Mr. LYNCH. Okay.

Mr. Allensworth.

Mr. ALLENSWORTH. I am not in a position to be able to talk about the characteristics of any of the underlying loans that are going into it or not going into it.

I think one of the things we have heard is consistent with what Ms. Sheehan just stated, which is that alternative methods of modification have seemed to be an easier path or more successful path at this point than HOPE for Homeowners.

Mr. LYNCH. Thank you. I yield back.

The CHAIRMAN. The gentleman from Texas.

Mr. GREEN. Thank you, Mr. Chairman.

Let me thank the witnesses for appearing today. And let me start with Ms. Sheehan. Ma'am, what percentage of your workouts wherein you have modifications are portfolio loans?

Ms. SHEEHAN. I don't have that exact data with me.

Mr. GREEN. Would you say the majority are?

Ms. SHEEHAN. I would not be prepared to say the majority. I would actually want to get you good data, because the reality is, we do modifications today both for our own portfolio as well as for loans that are in securities.

Mr. GREEN. So the answer is, you don't know at this moment? You can acquire the intelligence at a later time?

Ms. SHEEHAN. Yes.

Mr. GREEN. Mr. Gross and Ms. Sheehan, are servicers compensated for costs incurred by the servicer when a mortgage is foreclosed upon?

Mr. GROSS. Servicers are reimbursed for third-party expenses that are incurred in the foreclosure process, yes.

Mr. GREEN. And would you concur, Ms. Sheehan?

Ms. SHEEHAN. Yes, I do.

Mr. GREEN. Must servicers make payments from the servicer's coffer to a mortgage holder pending a foreclosure?

Mr. GROSS. As a general rule, yes. We must advance the scheduled principal and interest payment to the investor through the foreclosure process and generally through the disposition of the REO property.

Mr. GREEN. Do you concur, Ms. Sheehan?

Ms. SHEEHAN. Yes.

Mr. GREEN. Now, the question becomes, finally—given that I only have 5 minutes—what reward does a servicer receive for restructuring a loan?

Mr. GROSS. Well, number one, we now have a performing loan on our books that hopefully will be sustained over a period of months or years—

Mr. GREEN. Excuse me, Mr. Gross, I have to interrupt because time is of the essence.

What reward does the servicer receive?

Mr. GROSS. The servicing fee that we collect on performing loans.

Mr. GREEN. So you will receive the same reward that you would receive if the loan were not going into foreclosure, correct?

Mr. GROSS. That is correct.

Mr. GREEN. Okay.

Now, if this is true, if the servicer receives some benefit in the sense that if a loan is going to foreclosure, the servicer benefits by getting that done as quickly as possible because you are paying money out of your coffer, you are incurring expenses that have to be reimbursed, if that can be seen as a benefit to move this to foreclosure and you don't receive a reward for restructuring, it seems to me that we have a circumstance where servicers will say, yes, I really do want to restructure these loans for various and sundry reasons. But the actual fact and the truth is that servicers have somewhat of a burden in the process; they have their cost that they are incurring, and then they have these out-of-coffer fees that they have to pay pending foreclosure.

The question is this: Given that the yield spread premium—now, this is a stretch and you are going to have to really follow me here—given that the yield spread premium helped us to get into this program—which means that the originator got a fee for causing a person to take out a loan for a percentage higher than the person actually qualified for—and I am sorry if the people at home don't follow this, but you and I know what I am talking about—why not reward the servicers for restructuring the loans, a reward above and beyond what the servicer will ordinarily get if the loan continues to be paid?

Why not simply reward the servicer?

Mr. GROSS. In many cases, there is an incentive—

Mr. GREEN. I believe the "many cases" theory, but we are talking about now a wholesale problem that I keep hearing retail solutions to.

Let's talk about a wholesale solution. Why not, on a wholesale basis, reward servicers—make it known, publish it that they are rewarded, just as we do with yield spread premium—they are rewarded for a solution that involves a restructuring of the loan? This would cause them to have reason to move to the table aggressively and try to restructure the loan, meaning work with principal, work with interest. They would have reason to do this.

Why not reward them for doing it?

Mr. GROSS. The reward that you are referencing is not contained within the pooling and servicing agreement—

Mr. GREEN. I understand it is not in the contract, and I would not abrogate contracts. I think that there are some constitutional problems whenever we start to talk about the government imposing itself into contracts.

But if I may just say this, Mr. Chairman, it seems to me that the system, as constructed, provides no incentive other than the servicers making commentary, no incentive for the servicers to do what the servicers say they would like to do.

I yield back the balance of my time.

Mr. WATT. [presiding] I thank the gentleman.

Just to make a point to the gentleman, I believe in the thing that was adopted yesterday with Fannie and Freddie and the government there is a move in this direction, where they pay servicers to do the modification; isn't that right?

Mr. GROSS. Yes.

Mr. WATT. Okay. I thought that was the case.

Mr. Cleaver is recognized.

Mr. CLEAVER. I will yield 10 seconds to my colleague.

Mr. GREEN. I thank the chairman for the commentary.

My comment went more to the private institutions that are currently working with the servicers as opposed to what the government might do. That was why I tried to encourage something that might be more suitable along having private enterprise work out the problem.

Mr. CLEAVER. I am going to have to move quickly.

First of all, have we been in this mode of workouts long enough to have any kind of data on modified loan redefaults? Do any of you have any information on that, please?

Mr. DEUTSCH. If you look at the Credit Suisse report that I think was passed around, there is data on the redefault rates. They run anywhere from 20 to 40 to 50 percent, depending on the type of loan you are looking at, the type of modification, part of the country, declining home prices, a whole set of variations depending on those factors.

Mr. CLEAVER. So would the 50 percent redefault rate—is that a point of discouragement for servicers to spend time in trying to do a workout?

Mr. GROSS. No, it is not. We will continue to work with those homeowners, and if they redefault, then we will work with them again. We are dedicated to finding ways to keep them in their homes.

Mr. CLEAVER. Okay. That is where I want to move next anyway.

We have the cost of the modification, as I understand it, rolled into the loan, albeit at the end; am I correct?

Mr. GROSS. I am sorry, I don't understand.

Mr. CLEAVER. The cost of the modification, there is a cost.

Mr. GROSS. There are no modification fees generally charged to homeowners for these, with some small exceptions.

Mr. CLEAVER. Do all of you agree with that?

Ms. SHEEHAN. Yes, I agree with that statement.

Mr. CLEAVER. Now, if a person wants to have his or her home loan modified, they are going to probably need an attorney?

Mr. GROSS. No.

Ms. SHEEHAN. No.

Mr. CLEAVER. So they can walk straight to the servicer and get the workout?

Mr. GROSS. Yes.

Ms. SHEEHAN. Yes.

Mr. CLEAVER. Okay. But servicers don't always have the loan documents. And if a servicer possesses the loan documents, how do we know that the documents are not fraud ridden? Because that has been one of the problems that created the current turmoil in the financial markets.

Mr. GROSS. If you are referring to fraudulent loans, those are handled outside of our normal modification processes.

Mr. CLEAVER. Yes, but how would a servicer know whether he or she is involved in trying to do a workout on a loan that is fraudulent? And considering the fact that the servicer does not always have the loan documents—am I right?

Mr. GROSS. Well, generally, I believe that the servicer does have the loan documents. And I assure you that homeowners that find themselves the victims of fraudulent loans are usually pretty vocal about telling us what the fraudulent aspects are that they believe.

Mr. CLEAVER. Yes. Okay. I am sometimes inarticulate. I don't know how to ask it any other way.

How will the servicer know that the mortgage is fraudulent or not?

Ms. SHEEHAN. Is there a particular type of fraud that you are concerned with? I mean, there are different types of fraud in mortgage transactions.

Mr. CLEAVER. Well, I am asking real, live questions that I am running into whereby a person was able to get a mortgage and his—in this case, his income was ratcheted up so that he would qualify for a loan. So he goes in to get a workout, and 30 or 40 days later he gets a knock on the door from the FBI and now they want to talk about how he had a fraudulent loan. He had no knowledge that his income had been increased by $25,000 on the loan documents.

Are you with me?

Mr. DEUTSCH. I think the answer is, the servicer does have access to all of the loan documentation originally so that they can go back and look at the paperwork to say, here it was, and do the forensics on who signed it, whether it was the mortgage broker or others.

Mr. CLEAVER. Let me ask the question another way: How does the servicer know whether or not the loan is fraudulent?

Mr. GROSS. From direct communication from the homeowner.

Mr. CLEAVER. I need somebody smarter to ask the question because I know you are smart enough to answer it.

I have a real, live situation where somebody ended up trying to get a workout and they find out, without their knowledge, the loan documents—everything that has transpired in the mortgage is fraudulent. And he is working out an agreement with the servicer, trying to get—

Well, now he has a new problem that the FBI is involved in, and the loan servicer didn't recognize it. They ended up—I guess the subprime lender was under investigation—maybe in another lifetime, he can get his house back or something.

Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman from Indiana.

Mr. DONNELLY. When you are putting your foreclosure information together to Bank of America or to Chase, do you have a formula that you use when you look at these documents and you say, can't make it, we are not going to be able to help; can make it, let's put a program together on this one?

Mr. GROSS. Generally, yes, there are formulas and underwriting criteria that are used, as we have seen in recent months and weeks—days in the case of the GSEs. Many of those criterion standards are being greatly simplified from what they have been in the past, and this is usually predicated upon information that we receive from the homeowner as to their present financial circumstances so that we can create this affordable and sustainable payment for them.

Mr. DONNELLY. Ms. Sheehan.

Ms. SHEEHAN. Yes. The process that we go through in working with the homeowner is to get information from them on a stated basis in terms of their income.

We do have a housing ratio. We set up targets in terms of how much of their gross monthly income ought to be toward their housing expense payment. And so the ratio moves based on income, so it is lower for lower incomes.

Mr. DONNELLY. And is that information available? For instance, if we have a family sitting at home wondering, we don't know if we can make this or not, and if it is even worth trying, I wonder if Chase will work with me or Bank of America or Citi will work with me, and before they make the call, is there any way that they can know, here are the standards by which you judge?

Mr. GROSS. The standard that we have published in our recently announced programs says that the first year's principal, interest, taxes, and insurance should roughly equate to 34 percent of the obligated borrower's gross monthly income.

Mr. DONNELLY. And when that decision is made by your organization, where along the chain does that call get made? When they look at this family's particular situation, who makes that call for you as to whether you are going to try to work this out or whether it is beyond hope?

Mr. GROSS. Generally, we, the servicer, would make that call.

Ms. SHEEHAN. That would be the parties who are charged, the counselors who are charged with working with the borrowers on the loan workout.

So, in other words, they would gather the income information, they would verify the income information, they would test it against the housing ratio to see if it was sustainable, and then they would work with the homeowner.

Mr. DONNELLY. But I guess what I am saying is, when the homeowner makes that first call and says can we put this together, is it like the second or the third or the fourth person that they talk to?

Is there a particular division charged with that?

Mr. GROSS. I think we would all try to make that decision and communicate the answer to the homeowner as early in the process as possible—hopefully, with the first person that they talk to, but it may require follow-up conversations.

Mr. DONNELLY. And I know we are trying to make this as simple as possible. For the homeowner who looks at this, many of them will say, I don't know if I can handle putting this together and getting the best possible situation, and they will get legal counsel or other help.

Can one of the homeowners working with you receive the same kind of deal, the same kind of workout that they could with legal representation or other help?

Mr. GROSS. Yes.

Ms. SHEEHAN. Absolutely. In fact, we encourage them to work with our community credit counselors to make sure that they are comfortable in dealing with the servicer to get the best workout.

Mr. DONNELLY. Thank you very much.

And, Mr. Deutsch, when you mentioned that 87 percent, that range doesn't really get it done for the investors; and I was reading—in your documentation, you talk about 97 percent, and at that point, you know, it may not get it done for the other side.

Is there a happy medium in this where you look at combining a different number along with maybe changing the terms a little bit? What are the other variables at play that can make this work?

Mr. DEUTSCH. I think there are multiple variables. And by "other side," do you mean the government or the borrower?

Mr. DONNELLY. Probably both.

Mr. DEUTSCH. Because there is a happy medium there of having some equity in the home for the borrower, some desire to stay beyond its just being their home, which should be sufficient on its face. But having some equity there is quite helpful.

I think 87 percent—as we have indicated, I think there are 42 loans that have been put into the program so far; and we are not talking just securitized loans here, but securitized as well as portfolio-held loans, GSA loans, etc., that have been put into the program. I think servicers have been reticent to put anything in there because of that significant write-down, so that number—maybe it is not 97, there is a range of different numbers there, but clearly what we are seeing so far is, the 87 is simply too low.

Mr. DONNELLY. Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman from Illinois.

Mr. FOSTER. The first question, I guess—both Mr. Deutsch and Mr. Gross have mentioned the possible benefits of having standardization in the mortgage modification language in these things. Do you have at this point agreed-upon, well-understood language that could be included in all future securitization contracts that would make them easier to unwind in this and future situations like this?

Mr. DEUTSCH. I will take the first shot.

We are working on that right now. Given our expectations that securitization NBS volume won't really revive or restart in the next couple of months or few months, we are focusing our efforts more on the loan modifications, effectively getting through the night before we start working into the dawn.

Mr. GROSS. Bank of America is a very active participant in working with the ASF and other industry parties to construct that language.

Mr. FOSTER. And one of the issues in some of the written testimony had to do with the different risk tranches and the conflicts of interest between the riskier and the less riskier tranches, and they may have different points of view on mortgage modification and how early and aggressively you should pursue it.

And I was wondering if there were institutions, in general, that specialized in the highest or lowest tranches of these that might have very different points of view and might make it difficult to get an industry-wide consensus on this.

Mr. ALLENSWORTH. Well, I think that different market participants tend to go into different tranches of the pools. Hedge funds tend to be in the more junior classes of the tranches, as a general statement. Mutual funds, pension plans, and insurance companies tend to be in the more senior tranches.

There are differences in terms of the risk profiles there, but I think there is a lot of common ground where all investors working together with the servicers can come to a conclusion that mortgage modifications are in the best interests of all of the investors. Obviously, I can speak on behalf of hedge funds, not on behalf of the other investors, but we do believe that effective modifications are the preferable course of action and strongly encourage that.

Mr. FOSTER. So you don't see it as an insurmountable object to getting an industry-wide consensus?

Mr. ALLENSWORTH. Not an insurmountable object, no. It requires discussion.

Mr. FOSTER. And my last question is, there has been a lot of attention recently towards the concept of what is called "dynamic provisioning," which in the case of banks would automatically adjust the bank capitalization requirements according to market conditions. My question is, is there something analogous that could or should be applied to the mortgage and securitization industries to automatically adjust the origination and securitization standards according to market conditions, to not have simply static requirements, but make them have an eye towards whether we are in an asset bubble or so on?

Anyone who wants to field that can.

Mr. GROSS. I am sorry, that is outside my area of expertise.

Mr. FOSTER. Fair enough. I yield back.

The CHAIRMAN. The gentlewoman from California.

Ms. SPEIER. Thank you, Mr. Chairman, and thank you to our witnesses this afternoon.

I would like to say that, while the word "securitization" is not a dirty word, I don't think it is a clean word. And if you were the recipient of as many letters as I have received from constituents over the last 2 months, many of which I am signing here this afternoon, they are hopping mad about what has happened because they feel like they are holding the bag and a lot of people were able to walk.

When you don't have any skin in the game, it is really easy to conduct yourself in a risky and irresponsible manner; and I think the securitization that went on in its heyday was very much like that.

Now, one of the things that you said, Mr. Gross, that I thought was worthy of us reviewing: It appears that many of the servicers have a whole level of subjectivity in terms of making the decision as to whether or not they are pursuing their fiduciary duty in terms of making sure the investors are maximizing their return and the determination that they must modify because they can't be unreasonable in modifying, and that we would be best served by having something that was standardized for all servicers.

Did I understand you to say that?

Mr. GROSS. If I understand your question correctly, I believe that would be fair, yes.

Ms. SPEIER. Now, if what Mr. Lockhart proposed yesterday is embraced, where the program that is being implemented now would be initiated if there were three missed payments, where it was a home that was a primary residence and where there had not been bankruptcy filed yet, and this program is going to be implemented in which they will be reducing the interest rates, extending the life of the loan or deferring payments on the principal, then it makes sense, does it not, that we must mandate that for all servicers in this country?

Mr. GROSS. Well, number one, that program is specific to, at this point, Fannie Mae and Freddie Mac.

Ms. SPEIER. Correct.

Mr. GROSS. Who have different servicing guidelines than what is often contained in the mortgage securitization market.

And if I could give you an example, in a private security, generally speaking, I can modify a loan that is either in default or where I find that default is reasonably foreseeable or imminent; which means, in theory, I can modify a loan that is contractually current or that is delinquent only one payment.

Yet the GSEs have dramatically different guidelines than that and, as you just read, where it is owing three or more payments; so it is much later in the default cycle that we are allowed to give these modifications than what we could in the private securitizations.

Ms. SPEIER. Okay, but we could in fact—I guess what I am getting at, I want some servicer principles that are going to be used throughout the marketplace so the consumers and homeowners in this country can feel confident in talking to their servicer and saying wait a minute, there is a law now that says if I miss up to three payments and I live in my home and I haven't filed bankruptcy, that you need to talk to me and we need to try to work this out. And I think if we sent that kind of a message out, you are going to have, you know, defaulting homeowners more willing to come forward and to negotiate. Because I don't necessarily think that they are in a position to negotiate.

Mr. GROSS. Okay. I believe that the American populace, the homeowners, are aware of the fact that they have the right to call their servicer and that the servicers are ready, willing, and able. We are ready to talk to them and to try to reach solutions to this. I also believe that there is a legal obligation that is already there for the servicer to undertake the actions that you are already referencing.

Ms. SPEIER. All right. One last question to all of you. I read recently where homeowners who have been absolutely current, they have a prime mortgage, are now looking at their scenario and thinking, am I a fool to not walk away from this loan because the house is now worth less than the loan that I have? What do we say to those individuals who have been playing by the rules but now are looking around them and saying, wait a minute, am I a fool to be doing this?

Mr. GROSS. For owner occupants, I do not believe that the lack of equity or declining property values is the primary reason for default. These homeowners who are defaulting that are owner occupied are defaulting because of employment issues, unemployment issues, medical issues, divorce, life events that are occurring that made these homes unaffordable for the properties that are being walked away from. It is my belief that those are largely nonowner occupied properties where someone bought them as an investment and they have simply said I am not going to put any more good money into this deal.

Ms. SHEEHAN. I would agree with Mr. Gross. I think that has been our experience also at Chase. I mean, people who live in their homes are in the community, their children are in school, they don't just walk. It is usually because there is some other economic event that has happened to them.

Ms. SPEIER. My time has expired.

The CHAIRMAN. Thank you. I am glad you elicited that answer. I ask unanimous consent that one of our most distinguished, and I hope temporary alumni, the gentleman from Georgia, be allowed to participate. Without objection, I recognize the gentleman for 5 minutes.

Mr. MARSHALL. Thank you, Mr. Chairman. How many people do you run into whom you simply can't work things out with because they have other debt problems that can't get resolved?

Mr. GROSS. That is a very real issue. And I think—as you have noticed in most of the recent announcements, whether it be from FDIC and IndyMac program that we have announced, they generally deal with the payment for the first mortgage principal, interest, taxes, and insurance. And we are now hearing some people say, well, that doesn't take into consideration the homeowners' other obligations, auto loan payment, credit cards. And our belief is that it is unfair and not contractually viable for us to say that we are going to reduce interest rates or principal on first mortgage debt in order to subsidize other homeowner obligations.

Mr. MARSHALL. Do you ever encourage individuals to consider filing a Chapter 13 or a Chapter 7 bankruptcy to resolve the other debt issues as part of the process of getting them to a point where they are able to service a modified loan?

Mr. GROSS. No, that would not be part of our discussions with them.

Mr. MARSHALL. Do you work with people who have already filed?

Mr. GROSS. Yes, we do.

Mr. MARSHALL. So an individual could choose to file a 7 or a 13, clean up their debt, and then come to you and say, hey look, I want to keep my house, I can't keep it under the current circumstances, will you modify?

Mr. GROSS. We work with those homeowners every day.

Mr. MARSHALL. What percentage would you say?

Mr. GROSS. Percentage of—

Mr. MARSHALL. Do you have an idea of what percentage of individuals you are working with now to modify debt are individuals who have filed a 7 or 13 and dealt with their other debt that way?

Mr. GROSS. Probably—and this is a guess on my part, but I would say less than 2 percent.

Mr. MARSHALL. Less—

Mr. GROSS. Yes, less than 2 percent. And I would also note of homeowners who have filed bankruptcy, the last number I saw somewhere, 60 to 70 percent of those homeowners are contractually current on their mortgage obligations.

Mr. MARSHALL. At the time they filed bankruptcy?

Mr. GROSS. That is correct.

Mr. MARSHALL. What is the overall percentage of folks that you think you are going to be able to reach? The estimate that we have had is there are literally millions. I don't know what the current estimate is, and precisely, but millions of individuals who are going to default if they haven't already defaulted and who are going to go through a foreclosure process unless some other remedy is available to them? They are simply not going to be in a position to pay these loans. What percentage do you think you are going to be able to address using the programs that you currently have in place?

Mr. GROSS. I believe the programs that we currently have in place will handle the vast majority of homeowners. And I would stress again that we have contact with over 90 percent of the homeowners who do go through a foreclosure action. We will work with every homeowner who wants to—

Mr. MARSHALL. Do you have any statistics, the percentage of individuals that you just can't work with because they are just not able to meet—

Mr. GROSS. I don't have the statistics with me. We could work with the committee afterwards.

Mr. MARSHALL. It would be helpful to have those statistics. The impression I am left with is that there are an awful lot of individuals who, because of other debt issues, are simply not going to be able to take advantage of the programs that are currently offered without some other form of help. And you already identified a fairness issue yourself, saying why should we be modifying first mortgage obligations and yet all these other obligations are not being modified? There is no practical mechanism, outside of a bankruptcy setting, to deal with the multiple creditors that the typical consumer has. And simply the fact that we see an awful lot of recidivism, you know, follow-on defaults as a result of the report that I guess Deutsch Bank has provided us, evidence is the fact that a lot of people are struggling; they really want to keep their house, they will do the deal with you, but practically speaking, that deal is one they won't be able to live up to because of their other problems. It would be very helpful to have some statistical studies on this to see to what extent this program can actually be expected to be effective or do we have to take some other action.

The action I would suggest is not to have us step in and try to prop up borrowers, prop up lenders, etc., the folks who have gotten them into this mess. It is to force them to deal with it perhaps by permitting a modification of a certain type of mortgage for a certain period of time in a Chapter 13 setting. If you have evidence that is not necessary because you are going to be able to deal with all of this, then I think that would help all of here in Congress to get past this question of whether or not we should be modifying bankruptcy law in order to address this issue.

I have nothing further, Mr. Chairman.

The CHAIRMAN. With that, the hearing is adjourned with our thanks. And there will be follow-up.

Mr. Deutsch, in particular we would like to be able to stay in touch with you on this effort you have mentioned, because that could have a great impact on what we do moving forward. Members may have the appropriate time to extend their remarks on the record.

[Whereupon, at 1:08 p.m., the hearing was adjourned.]

A P P E N D I X

November 12, 2008

U.S. Congresswoman
Ginny Brown-Waite
Representing Citrus, Hernando, Lake, Levy, Marion, Pasco, Polk, and Sumter Counties

Committee on Financial Services

"Private Sector Cooperation with Mortgage Modifications"

November 12, 2008

Statement for the Record

Thank you Mr. Chairman for holding this hearing today. I think we can all agree that this hearing could not be more timely.

Experts estimate that 1 in 6 homeowners have been foreclosed upon, are in the foreclosure process, or owe more on their mortgage than their home is worth. It is important that we in Congress do not underestimate this problem. However, it is equally important that we do not rush in haste to enact well-intentioned legislation that has unintended consequences far into the future.

Today the committee is holding a hearing whose impetus arises from a New York Times article published on October 24, 2008. The article detailed in part the reluctance of private entities, who invested in mortgage back securities, are resisting efforts by mortgage servicers to modify the terms of a mortgage.

A little more than a month ago, Congress passed a well-intentioned $700 billion financial rescue package coupled with $150 billion of tax incentives and credits. I voted against this legislation as I did not believe Wall Street would use the appropriated funds to help troubled homeowners.

Rather than using the appropriated funds to mitigate the foreclosure crisis, or to assist homeowners in refinancing their mortgages, several banks have already announced that they will hoard the cash for the purpose of mergers and acquisitions.

However, we should also view government intervention into this process with a skeptical eye. For instance, during the great depression the federal government aggressively pressured private companies to restructure loans. The effect of this was to raise interest rates for everyone which dramatically reduced new loans.

Thus, moving forward, I encourage the private sector to pursue efforts to mitigate the foreclosure crisis, and I urge my colleagues to consider the unintended consequences of well-intentioned action.

Mister Chairman, thank you again for holding this hearing and I look forward to hearing from the witnesses before the committee today.

OPENING STATEMENT OF CONGRESSMAN PAUL E. KANJORSKI

COMMITTEE ON FINANCIAL SERVICES

HEARING ON PRIVATE SECTOR COOPERATION WITH MORTGAGE MODIFICATIONS: ENSURING THAT INVESTORS, SERVICERS, AND LENDERS PROVIDE REAL HELP FOR TROUBLED HOMEOWNERS

NOVEMBER 12, 2008

Good morning. Mr. Chairman, while the theory behind mortgage loan modifications remains sound, the practice has fallen short of the expectations that many of us have. Keeping Americans in their homes should be a priority. Unfortunately, this view does not appear to be shared by all. Today, we will hear from several parties in the private sector to better understand the ever-widening gap between what ought to happen and what is happening. We will also discuss some of the proactive steps taken to date to address this important issue.

This issue is not a partisan one. Back in March, Mr. Castle and I introduced the Emergency Mortgage Loan Modification Act of 2008, H.R. 5579. The bill aimed to clarify the responsibilities of and provide a safe harbor from legal liability for mortgage servicers who help troubled borrowers remain in their homes by engaging in loan modifications and workouts according to specific criteria. While pieces of that legislation did become law through the enactment of the larger housing package, the safe harbor provision fell by the wayside.

At the hearing we held on H.R. 5579, Mr. Castle stated, "I believe Congress can take specific steps to ensure loan servicers work with home owners to keep mortgages solvent where ever practical." I shared that sentiment then, and I believe it today.

Congress last spoke to this issue when passing the Emergency Economic Stabilization Act, which provided guidance and authority for the Treasury Department to increase the number of loan modifications. Despite our actions, certain industry players – and, in fairness, the current Administration and government housing agencies – simply have not pursued modifications with the urgency our nation's financial crisis demands. This reality must change quickly.

As homeowners continue to find themselves under water, we must all work to keep them afloat. More and more foreclosures have led to ever declining home values, and spiking foreclosure rates have also decimated some communities. Pointing fingers about which borrowers irresponsibly took out loans they could not afford and which lenders recklessly doled out money to unqualified borrowers do absolutely nothing to solve the problem.

Instead of placing blame, we must work together toward a solution. In this regard, I am pleased that entities like Bank of America and JPMorgan Chase have stepped forward with their own initiatives for expediting mortgage modifications. Other lenders and servicers can learn from these actions and model their own mortgage modification programs on these efforts.

In sum, our witnesses will help us all understand why loan modifications have not already increased and what can be done to ensure that a greater number of loan modifications occur in the days ahead. I look forward to their testimony and thank them for being here.

TESTIMONY OF

MANAGED FUNDS ASSOCIATION

UNITED STATES HOUSE OF REPRESENTATIVES

COMMITTEE ON FINANCIAL SERVICES

HEARING ON

"PRIVATE SECTOR COOPERATION WITH MORTGAGE MODIFICATIONS – ENSURING THAT INVESTORS, SERVICERS AND LENDERS PROVIDE REAL HELP FOR TROUBLED HOMEOWNERS"

NOVEMBER 12, 2008

Chairman Frank, Ranking Member Bachus, members of the Committee, my name is Benjamin Allensworth and I am Senior Legal Counsel for Managed Funds Association ("MFA"). MFA represents the majority of the world's largest hedge funds and is the primary advocate for sound business practices and industry growth for professionals in hedge funds, funds of funds and managed futures, as well as industry service providers. MFA's members manage a substantial portion of the approximately $2 trillion invested in absolute return strategies around the world.

MFA appreciates the opportunity to testify today about efforts by private sector participants to work with federal, state and local officials in seeking to mitigate the current wave of foreclosures and defaults that are turning the dream of homeownership into a nightmare for millions of American families. Our fundamental belief is that effective mortgage modifications are preferable to foreclosure whenever possible. As we have learned over the past 12-18 months, our nation's housing market is critical to the social and financial well-being of families and communities throughout our country, and central to the health and vitality of our capital markets and our economy.

The wave of foreclosures has placed downward pressure on home prices, which in turn has eroded home equity and consumer confidence in the mortgage market. This diminished confidence has in turn led to a freezing-up of the mortgage backed securities ("MBS") market, which has been a major source of liquidity and credit to our capital markets. A final cascading effect has been the tightening of the broader credit markets as financial institutions and market participants have been forced to satisfy redemption requests of investors and to hold more capital due to write-downs.

To stem the effects of this crisis and revitalize our nation's mortgage and credit markets, bold, proactive steps need to be taken. MFA and it members are committed to working with Congress and other relevant stakeholders on both short-and long-term efforts to address these serious economic challenges.

Congress has recently enacted several measures in response to the mortgage and credit crisis, specifically the Emergency Economic Stabilization Act ("EESA") and the Housing and Economic Recovery Act ("HERA"). The central element of HERA is Hope for Homeowners ("H4H"), a program that seeks to help those at risk of default and foreclosure refinance into more affordable and sustainable loans insured by the Federal Housing Administration ("FHA"). With additional time and continued collaboration between the public and private sectors, we believe that H4H can serve as a valuable tool to mitigate foreclosures and help inject much-needed liquidity back into the mortgage and credit markets.

MFA and its members recognize the important social and economic value of effective loan modifications as a critical tool to help prevent foreclosures, to keep families in their homes, and to stabilize our markets. The success of such efforts will in large part be correlated to stakeholder collaboration on this common objective. Foreclosure mitigation is a challenge affecting all MBS market participants including banks, insurers, investment advisers, MBS pool trustees, mortgage servicers, mutual funds, pension plans, securities firms and other institutional investors. Hedge funds that invest in MBS are also part of this group, although a relatively small part as compared to other investors, with investments making up an estimated 5-20% of the MBS market.

MFA does not have a formal association policy regarding the terms and conditions for modifying MBS contracts. We and our members support effective mortgage modifications over foreclosure whenever permissible.

There are a number of legal, fiduciary and practical issues that the aforementioned market participants take into account when considering mortgage modifications. Mortgage servicers report to trustees, which have fiduciary duties to the investors in MBS pools. Similarly, institutional investors holding MBS also have fiduciary obligations to their clients. As market participants consider these fiduciary obligations, one of the primary determinations, consistent with the intent of H4H, are whether the net present value ("NPV") of a modified loan is greater than the NPV of a foreclosure. Fiduciaries must weigh the effects of loan modification on earnings of institutional investors, such as pension funds and retail mutual funds, among others. A variety of factors, including the likelihood of a subsequent default on a modified mortgage, is considered when making these important determinations. That said, for most investors these considerations occur against the backdrop that effective mortgage modifications are more preferable to foreclosures.

In seeking the views of our members and other stakeholders in preparation for this hearing, we became aware of several impediments that can hinder the ability of a mortgage servicer to modify a loan.

Accuracy of NPV for Aggregate Loan Modifications: Some have suggested calculating NPV and doing loan modifications on groups of mortgages with similar characteristics rather than on a case by case basis. While this may be a more efficient and effective process, there are questions as to whether or not servicers can meet the obligation to maximize NPV for each specific mortgage when making collective determinations. Questions have also been raised regarding the reliability of automated valuation models and other desktop valuations, which have also been suggested as a more efficient system for determining NPV on an aggregate basis.

Higher Default Rates/Lower NPV for non-HERA Loan Modifications: The potential of a subsequent default on a modified loan is a factor for servicers not only in determining the NPV calculation, but also for determining which loans should be modified, consistent with the objective of ensuring that a distressed homeowner can afford a modified loan. HERA acknowledges this particular problem and provides government protection, through FHA insurance, against future defaults for mortgages modified through the program. However despite this backing, most modifications made to date have been done through interest rate reductions, extensions of terms and back-loading principal payments, i.e., not through the HERA program.

Because most modifications fall outside of HERA there is no government guarantee against subsequent defaults. The likelihood of a higher default on non-HERA modified loan modifications negatively affects the NPV calculation factored into the determination of whether to modify a mortgage or foreclose.

Resource/Capacity Issues: Consistent with H4H, the starting point for servicers seeking to make a determination as to whether or not to modify a loan is the obligation to first determine, but also maximize, the NPV of each mortgage in the pool. As defaults and foreclosures have risen sharply, some servicers may be overwhelmed by the process of having to make NPV determinations on a case-by-case basis for so many troubled mortgages.

Operational Constraints: We have also heard that, in some instances, servicers may be unable to do loan modifications under HERA because they lack the operational capacity to originate FHA mortgages.

While each of these challenges have the potential to undermine foreclosure prevention efforts, in our view none are so daunting that they should deter us from our shared interest in keeping more American families in their homes and restoring stability and confidence to our mortgage and credit markets.

In this regard, we believe that there are a number of measures that can be considered to increase the number of loan modifications. One measure would be to develop a set of standardized protocols that servicers could use to calculate NPV. Such standardization would be particularly beneficial to the extent that those calculations are done on a mortgage by mortgage basis. Yesterday's announcement by the Administration that it, as part of the HOPE Now initiative, is implementing protocols to streamline the loan modification process is a hopeful sign.

The modification of loans owned by IndyMac Federal, and other banks who service their wholly-owned loans through an affiliate, suggests that consideration be given to a "single-owner/servicer" approach to loan modifications. A framework in which MBS are purchased, held and administered by a single entity, rather than a variety of investors with competing interests, may similarly allow more efficient loan modifications to occur.

Finally, we recognize that policy makers are likely to address the issue of the high subsequent default rates for non-HERA modified loans. We believe that it is important to develop a solution that reduces the risk of subsequent defaults on mortgage modifications of all types.

As we stated at the outset, MFA and its members appreciate the importance of preventing foreclosures and we encourage our members and all stakeholders to support loan modifications efforts, to the fullest extent they are able to. MFA remains committed to working with its members, policy makers and other market participants on these important issues and playing a constructive role in helping advance more robust loan modification efforts.

Thank you for this opportunity to testify before the Committee. I would be happy to answer any questions that you may have.

American Securitization Forum

Statement of

Tom Deutsch
Deputy Executive Director
American Securitization Forum

Testimony before the

Committee on Financial Services
United States House of Representatives

Hearing on

"Private Sector Cooperation with Mortgage Modifications- Ensuring That Investors, Servicers and Lenders Provide Real Help for Troubled Homeowners"

November 12, 2008

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Chairman Frank, Ranking Member Baucus and distinguished Members of the Committee,

My name is Tom Deutsch and I am the Deputy Executive Director of the American Securitization Forum (ASF).[1] I very much appreciate the opportunity to testify before this Committee again on behalf of the 330 member institutions of the ASF, including mortgage lenders, servicers and investors, regarding loan modifications and how the mortgage-backed securities (MBS) industry and government can work together to prevent avoidable foreclosures.

I testify here today with one simple overarching message—industry participants have been and will continue to deploy aggressive and streamlined efforts to prevent as many avoidable foreclosures as possible. But macro economic forces bearing down on an already troubled housing market are simply too strong for private sector loan modification initiatives alone to counteract the nationwide increase in mortgage defaults and foreclosures. In my testimony today, I will outline a number of ways that the industry and the government can work together to target relief to troubled homeowners, while simultaneously helping to restore capital flows into the U.S. housing markets.

<u>Overview of Testimony</u>

The testimony that follows addresses four principal topics:

1) Current economic and housing market conditions, and the challenges those conditions impose on efforts to prevent foreclosures via loan modifications;
2) The goals, progress and limitations of industry loan modification initiatives targeting securitized residential mortgage loans to date;
3) Additional efforts underway within the securitization industry to further facilitate and streamline the loan modification process; and
4) Perspectives on additional steps that we believe the federal government should consider to expand opportunities to modify and refinance troubled mortgage loans, to avoid foreclosures and to help stabilize the broader housing market.

<u>Current Economic and Housing Market Conditions; Challenges for Loan Modification Initiatives</u>

Economic and housing market conditions have significantly deteriorated over the last eighteen months, and that deterioration has intensified recently. The primary factors our members have identified that have combined to put severe strain on homeowners and drive rising delinquencies, defaults and foreclosures include:

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[1]ASF is a broad-based professional forum of over 330 member organizations that are active participants in the U.S. securitization market. Among other roles, ASF members include institutional investors, servicers, issuers, financial intermediaries, and professional advisers working on securitization transactions backed by all types of mortgage and consumer credit assets. ASF's mission includes building consensus, pursuing advocacy and delivering education on behalf of the securitization markets and its participants. Additional information about the ASF, its members and activities may be found at ASF's internet website: www.americansecuritization.com. ASF is an independent affiliate of the Securities Industry and Financial Markets Association (SIFMA).

1) unavailability of mortgage credit for refinancing opportunities;
2) declining home values;
3) high levels of non-mortgage credit outstanding (e.g., credit card, auto loan, other debt)
4) prevalence of 2nd liens; and
5) rising unemployment levels and reductions in income, making mortgage payments unaffordable.

While critically important and increasingly employed, industry-led loss mitigation initiatives, including loan modifications, are not a panacea for declining home prices, mortgage defaults and foreclosures. Loan modifications are a viable foreclosure avoidance option for only a subset of mortgage borrowers now at risk of default. In general, loan modifications are appropriate and can be effective only for borrowers who: a) cannot afford their current or future mortgage payment; b) wish to remain in the home and are capable of managing the broader responsibilities of home ownership; and c) can afford a reasonable mortgage payment as modified. Loan modifications cannot overcome situations in which a borrower does not evidence a desire to stay in the home, or cannot afford payments on the loan as modified, even with significant reductions in interest or principal payments. Unfortunately, an increasing number of borrowers share one or both of these characteristics. A brief examination of recent mortgage market dynamics helps to explain why this is the case.

As prices have declined over the last two years, approximately 1 out of every 4 mortgage borrowers now owes more on their homes than what those homes are worth (underwater mortgages). Although these value declines are clearly unwelcome, they ultimately do not increase the monthly payment obligations for borrowers and therefore do not affect the affordability of their mortgage obligations. As such, most of these borrowers continue to pay on time. Unfortunately, some borrowers choose to ignore their obligations and 'walk away' from their homes, resulting in a foreclosure. Similarly, as financial obligation ratios have reached an all-time high,[3] servicers are finding an increasing number of borrowers whose mortgage and consumer debts (such as credit cards and auto loans), even after significant mortgage modifications, simply are too high, given their incomes, to sustain their mortgage payments. These borrowers face challenges in meeting debt obligations that extend well beyond their mortgage. This may help to explain why some 30-50% of mortgage payment defaults proceed to foreclosure with no borrower response to servicer outreach via phone calls and mailings—even where some of those borrowers might otherwise qualify for a modification.

Many borrowers having difficulties meeting their payments on their primary mortgage also have a 'silent' second lien (in the form of a home equity loan or line of credit). Second liens are serviced separately and often times by a different servicer than that of the first lien. A recent study estimates that approximately half of 2006 borrowers with a securitized subprime first lien mortgage have a second lien exposed or hidden behind that first lien.[4] In addition to contributing to an increased debt load and low or negative home equity for borrowers, the existence of these second liens creates significant difficulties for servicers who might be considering modifying the

[3] Loan Performance Data
[4] Loan Performance Data

first lien, especially in situations like a Hope for Homeowners (H4H) refinancing where the owner of the second lien is required to extinguish to allow the first lien to refinance. Also, servicers of first liens seeking to apply loss mitigation techniques, including interest and/or principal reductions, have to take into account the second lien. They cannot compel the second lien controlled by a different servicer to employ equal or greater loss mitigation strategies on the second lien as the first lien. Proper and efficient coordination of second liens has and is expected to continue to be a significant obstacle in expediting help for troubled borrowers.

We support changes such as one made in the Emergency Economic Stabilization Act (EESA) to the H4H program that allows the Department of Housing and Urban Development (HUD) to make payments "to any holder of an existing subordinate mortgage, in lieu of any future appreciation payments…"[5] Given the existing operational, legal and economic difficulties of extinguishing these second liens, the ability to provide direct payments rather than equity upside incentives will help expedite the process of appropriately clearing away second liens.

Even in situations where servicers successfully identify, grant and communicate a loan modification that meets a distressed homeowner ability to pay, up to 44% of borrowers have redefaulted after the lender has granted a modification concession.[6] As such, a redefault by a modified loan can expose the holder of that loan to even greater losses in a declining home price market.

Potentially the most troubling macro economic factor impacting the housing market today is the rapidly increasing levels of unemployment in America, which will continue to increase the rate of mortgage defaults and foreclosures. For example, Freddie Mac found that in June of 2008 45.5% of all delinquencies were due to unemployment or loss of income. Given recent announcements of additional job reductions across a wide range of industries and geographic regions, servicers are preparing for an even larger uptick in delinquencies due to rapidly rising unemployment levels. Especially in protracted economic downturns like our current one, a borrower who is laid off is not likely to find new employment that ultimately supports the same lifestyle and mortgage payment as his or her previous employment. In these situations, retention of the borrower's current home may not be sustainable even with an aggressive loan modification.

Ultimately, it must be recognized that the seismic economic challenges in the United States, the epicenter of which is the housing market, are too great for purely private sector loan modification solutions. As such, evolving servicer loss mitigation activities, though playing an important part of the solution, will not be sufficient to address the steep challenges the American housing market faces today. In addition to expanded industry efforts, federal government initiatives, such as H4H and the Troubled Asset Relief Program (TARP), will have to be even more aggressive in their efforts to stabilize homeownership, neighborhoods and communities around the country.

[5] Emergency Economic Stabilization Act, Section 124 (2008).
[6] Credit Suisse Fixed Income Research, Subprime Loan Modifications Update, October 1, 2008.
[8] Hope Now Alliance October Data Release.

<u>Current and Future Industry Loan Modification Initiatives</u>

Notwithstanding the formidable challenges outlined above, securitization industry participants have worked to avoid foreclosures and mitigate losses on defaulted loans wherever possible. From July 2007 through September 2008, some 2.5 million troubled borrowers were assisted by industry loan modification and loss mitigation initiatives. Those efforts continue, for example, in September 2008 alone, servicers helped some 212,000 borrowers avoid foreclosure, 30,000 more than the previous record established in August 2008.[8] Through these efforts, the number of loan modifications and workouts has increased by over six times the rate at which they were being provided to borrowers at this time last year.

Securitization industry participants have strong incentives to pursue loan modifications because, as a general matter, no securitization market constituency—including lenders, servicers and investors—benefits from loan defaults and foreclosures. Because foreclosure is usually the most costly means of resolving a loan default, it is typically the least-preferred alternative for addressing a defaulted loan, whether or not the loan is held in a securitization trust. Although there is variation among individual transactions, most securitizations provide servicers with significant flexibility to engage in loan modifications and other loss mitigation techniques, subject to contractual obligations that the particular loss mitigation alternative selected maximizes the net present value, or ultimate recovery, on the related mortgage loan.

Given the multiple variables and detailed analysis involved, this can be a complex and difficult judgment for servicers to make. Where a loan modification is pursued, the servicer must be able to demonstrate a reasonable basis for concluding that the particular modification selected is likely to produce a greater recovery than other loss mitigation alternatives available, including but not limited to foreclosure. ASF therefore recognizes and strongly supports the benefit of providing additional, industry consensus guidance on ways that servicers can fulfill more efficiently their obligations to mitigate losses and maximize recoveries on distressed mortgage loans, in a manner that is also consistent with their duties to investors. As outlined below, we have taken steps to provide this guidance in the past, and are actively engaged in additional efforts to provide additional guidance to servicers in light of the increasing challenges they face.

Over the past two years, the ASF has worked to develop several market standards and practices initiatives aimed at promoting the utilization of loss mitigation and loan modification strategies to prevent avoidable foreclosures. For example, in December, 2007, ASF announced the release of the first systematic protocol, the ASF Streamlined Foreclosure and Loss Avoidance Framework for Securitized Adjustable Rate Mortgages ("ASF Framework"), which outlines systematic criteria that servicers can use to streamline the evaluation of their subprime hybrid ARM portfolios and offer appropriate solutions to borrowers facing significant interest rate resets.

As a result of servicers' efforts under the ASF Framework, approximately 111,000 subprime ARMs have been modified with over 73 percent of these modifications having a duration of 5 years or longer.[9] As outlined in two scenarios in Appendix A of this testimony, servicers

[9] Hope Now Alliance October Data Release.

generally seek to employ interest rate modifications to achieve affordability for the borrower prior to contemplating any principal reductions. A recent study on the use of loan modifications notes that, "Because of ASF's streamlined loan mods plan beginning in January 2008, this type of mod [rate reset] currently makes up the largest group of subprime loan mods."[10] The fact that very few borrowers are experiencing delinquencies caused by a resetting interest rate on a subprime ARM ultimately demonstrates the ASF Framework has been effective in achieving the targeted aim.

Notwithstanding the above initiatives, in light of the recent deterioration in the broader economy and housing market, ASF is working aggressively to develop an expanded framework that servicers can use to modify loans in a manner that is consistent with appropriate loan modification goals, and with the contractual rights and commercial expectations of institutional investors. A group of ASF members, including investors, is reviewing criteria from other loan modification approaches that have recently been announced, such as the plan implemented by the FDIC with respect to loans it acquired via the receivership of IndyMac Bank or the plan the Federal Housing Finance Agency (FHFA) announced yesterday. We believe that the development and application of an investor-developed framework with input from all stakeholders can help to establish broader consensus on ways that loan modifications can be effectuated in a manner that appropriately targets them efficiently and effectively. We are optimistic that this new approach will promote an even greater number of appropriate loan modifications delivered throughout the industry via more streamlined processes.

Some of the key challenges that we are actively working to address include:

1. Developing a mechanism to distinguish between troubled borrowers needing assistance and borrowers who otherwise have an ability to pay and don't need assistance;
2. Addressing the motivations that might exist for non-troubled borrowers to default or to attempt to disguise their true ability to pay;
3. Streamlining methods of verifying troubled borrowers true income and occupancy status to avoid 'no doc loan mods' that assist housing speculators;
4. Addressing the complex challenges presented by pay option ARMs in a depreciating housing market;
5. Developing operationally-efficient, market-accepted methods to compensate and extinguish second liens to allow a first lien to refinance into a more sustainable loan;
6. Creating appropriate loss mitigations on second liens that are proportionate and appropriate in relation to the loss mitigation being applied to first lien positions;
7. Designing better evaluative tools for all of a borrowers' debts, including both mortgage and consumer debts, to make more effective and sustainable loss mitigation solutions;
8. Accounting for a borrower's relative income bracket, size of loan and geographical location in any calculation that compares their mortgage debt with their income;
9. Addressing operational challenges of detecting borrower, broker or other fraud in origination that would trigger alternative approaches; and
10. Providing greater market practice clarity to servicers to apply appropriate streamlined loss mitigation techniques in compliance with their pooling and servicing agreements.

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[10] Credit Suisse Fixed Income Research, Subprime Loan Modifications Update, October 1, 2008.

[12] Emergency Economic Stabilization Act, Section 124 (2008).

<u>Governmental Initiatives to Expand Refinancing and Loan Modification Alternatives</u>

Although industry-driven loan modification and loss mitigation actions have been and will continue to be key components to preventing avoidable foreclosures, there are limits to their effectiveness in addressing the extraordinary challenges in the housing market. As such, we believe expanded government programs may be effective in bridging this gap, and helping to address the potential foreclosures that commercial and contractual arrangements cannot prevent. The nationwide home price correction and persistent uptick in foreclosures present systemic risks to the national economic infrastructure. Moreover, foreclosures are bad for everyone—borrowers, communities and investors. Vacant homes drive down home prices and invite crime. Given these extraordinary systemic risks and public policy concerns, we believe the federal government could helpfully supplement industry initiatives to modify and expand voluntary programs to aggressively seek to prevent additional foreclosures.

1. Expand Eligibility of Hope for Homeowners Program

We applaud you Mr. Chairman, and the hardworking members of this Committee for being a driving force in developing and enacting the Hope for Homeowners program last summer. The program has a number of innovative elements to help homeowners refinance into a new FHA loan and it provides incentives for servicers and loan holders to allow those homeowners to refinance. Unfortunately, the program has met with limited market reaction, as only a handful of loans have been put through the program in its first month of operation. We believe there are three significant impediments to greater participation, which include: 1) the current noteholder is required to write down the principal of the existing loan to a loan-to-value (LTV) ratio of effectively 87% of the current appraised value of the home; 2) significant uncertainties regarding the potential treatment of H4H loans under federal and state consumer credit laws exist, which affect the ability and willingness of lenders to participate in this program; and 3) the back-end DTI limit eliminates a substantial number of potential program participants due to the significant amount of debts (other than first-lien mortgages) being carried by the American population.

Our servicer and investor members have suggested that this LTV write-down requirement to 87% is too deep of a principal reduction to incentivize widespread participation in the H4H program. The recently enacted EESA recognized this challenge to the H4H program and allows "such higher percentage [LTV] as the Board determines, in the discretion of the Board."[12] The prevailing market view is that if the governing Board of the H4H program were to exercise its new authority to increase the LTV percentage to that of FHASecure (97%), the H4H program would incentivize servicers, based on investor approvals, to refinance a significantly higher volume of loans into the H4H program. This new LTV requirement would still require loan holders to make significant principal reductions and provide some limited equity in the new FHA mortgage for borrowers formerly owing more on their mortgage than their home's value.

The second impediment for servicer implementation of the program is the legal combination of an FHA-insured loan made by the lender to the borrower and two separate transactions between the borrower and HUD providing for a sharing of equity and appreciation on the sale or the property or refinancing of the loan. The federal and state consumer credit laws that apply to creditors would not at first glance seem to apply to these two separate transactions with HUD since HUD is not a creditor. Yet the fact that the two separate transactions are required to be consummated by the borrower to be eligible for the FHA-insured loan creates material uncertainty that a court would treat all three as a single integrated transaction.

These legal arrangements create two significant difficulties for lenders. First, it is not clear how the combined transactions are to be treated under federal and state consumer credit laws, leaving the lender at risk that it will be subject to consumer and government claims for incorrect characterizations. Second, HUD obligates the lender to represent and warrant that the loan documents drafted by HUD comply with all state laws—a representation and warranty that is impossible to give in good faith given the material uncertainty of how the three transactions are treated under state laws, including those that outright ban shared appreciation mortgages.

To further facilitate the use of H4H, we believe the federal government should definitively clarify that (a) the insured loan between the borrower and the lender should be treated separately and apart from the shared equity and shared appreciation transactions between the borrower and HUD, (b) federal and state consumer credit laws do not apply to the two separate transactions because the originating creditor is not the payee or beneficiary under the documents and HUD is not a creditor and (c) federal law would control the characterization of the transaction through express federal preemption.

Finally, the governing Board of H4H should consider liberalization of the DTI requirements under the H4H program to better reflect the reality of the financial obligation ratios currently owed by the average American family the H4H program was designed to assist.

2. **Troubled Assets Relief Program (TARP)**

- **Federal Guaranty of Loan Modification Redefault Risk**

In addition to refinancing opportunities, the EESA also allows the federal government to use guarantees to incentivize additional loan modifications for distressed borrowers. In particular, the Act specifically authorizes that "the Secretary may use loan guarantees and credit enhancements to facilitate loan modifications to prevent avoidable foreclosures."[13] We believe there have been some positive proposals put forth by, for example, the Chairman of the FDIC that would have the federal government, through TARP, provide credit guarantees for redefaults on modified loans. Although there are a number of details that would need to be worked out on both the modification protocols as well as the guarantee arrangements, ASF believes there is significant opportunity for such an approach to work. A well-tailored program could result in a significant increase in loan modification activity to help homeowners stay in their homes and provide significant support for a declining housing market. In sum, there appears to be a substantial opportunity to marry a much larger industry-wide loan modification protocol with a guarantee program under TARP.

One particular benefit of a guarantee program under TARP is that the same outlay of funds through a guarantee program could provide support for a significantly higher number of outstanding loans than can be assisted via other means. Direct purchase of loans, although a

[13] Emergency Economic Stabilization Act, Section 109 (2008).

desirable option to consider requires direct and immediate use of the limited capital available under TARP. A guarantee program may in some cases then be a more efficient use of limited TARP funds.

- **Direct Purchase of Loans Out Of Securitization Trusts**

Since the TARP program was announced, there has been a great deal of discussion regarding what assets the program would purchase and how that ownership would give the federal government control over the servicing of those assets. If whole loans are purchased by TARP, for example, the government would clearly be able to apply its own loss mitigation protocols to those loans. If the TARP program were to buy mortgage-backed securities (MBS) though, their ability to exercise control over the servicing policy of any particular trust would be limited unless a supermajority of each outstanding class of notes of that trust were to vote to amend the underlying pooling and servicing agreements.

One potential opportunity is that TARP could purchase individual distressed loans out of MBS trusts, which could give the Treasury Department unlimited discretion to modify those loans. Historically, whole loans have not been sold out of securitization trusts by servicers for a variety of legal, tax, and accounting constraints. The ASF supports, where feasible, facilitating such purchases as part of a broader range of loss mitigation alternatives, and has recently undertaken a review of the various opportunities and obstacles for servicers to sell below par individual distressed loans out of MBS to the TARP.

- **Provide Lending or Guarantee Facilities for Servicer Advances**

Another area where the federal government, potentially through TARP or through other mechanisms, could provide critical liquidity in the housing market is in the area of servicer advances on MBS. As part of their contracts with investors, servicers often advance their own funds to cover unpaid principal, interest, taxes and insurance as well as for other property protection and related advances. The servicer ultimately receives a first priority reimbursement for these advances when troubled loans payoff or are liquidated. Due to the recent significant increase in delinquencies, the amount of advances that servicers must make to remain in compliance with their servicing obligations under these servicing agreements has risen exponentially. Simultaneously, the number of commercial banks that help servicers finance these advances has shrunk dramatically, thereby radically increasing these funding costs. Servicers unaffiliated with depository banks may soon simply not have the funds to continue to make these advances into the securities, forcing the servicing to transfer to another servicer. These transfers would cause significant disruptions to borrowers making payments or working out loans and ultimately less liquid securities. Federal government provision of lending or guarantee facilities for liquidity constrained servicers at little or no risk to the taxpayer, given the first priority reimbursements, would provide significant assistance to homeowners serviced by nondepositary institutions.

Mortgage and Consumer Credit Availability in the U.S.

There is currently $7.55 trillion dollars of securitized mortgage debt outstanding, which is slightly more than half of the $14.8 trillion dollars of mortgage debt outstanding in the United States.[14] Yet, only $500 million of securitization bonds were issued in October of 2008, which is less than 1% of the $50.7 billion issued in credit-constrained October of 2007.[16] As these figures indicate, private investment capital flows into the U.S. securitization market have all but disappeared, threatening the availability of credit to all current and future mortgage borrowers.

Significant action is being taken by the industry, such as through ASF's Project RESTART, designed to rebuild investor confidence in both the assets and process of securitization. The finance ministers of the largest economies of the world went so far as to articulate as one of their top five global priorities to, "take action, where appropriate, to restart the secondary markets for mortgages and other securitized assets."[17] Voluntary programs that incentivize private actors in securitization, such as servicers and institutional investors, to reduce foreclosures are the only constructive options to help address housing dislocations in a credit- starved environment. To the extent that governmental initiatives can offer loan modification and refinancing opportunities beyond those that are commercially feasible in the private market, those programs may provide an effective bridge to a wider range of troubled borrowers and help to stabilize housing prices and markets.

Conclusion

Chairman Frank and distinguished Members of the Committee, I thank you for the opportunity to participate in this hearing on some of the most pressing issues facing our country today and look forward to answering any questions you may have regarding my testimony.

Thank you.

[14] Statistical Supplement to the Federal Reserve Bulletin, October 2008, Table 1.54 Mortgage Debt Outstanding
[16] Wall Street Journal, Bond Woes Choke Off Some Credit to Consumers, C1, November 6, 2008.
[17] G-7 Finance Ministers and Central Bank Governors Plan of Action, October 10, 2008

Appendix A

LOAN MODIFICATION EXAMPLES

Original Scenario

Borrower and co-borrower earn $35,000 and $32,000, respectively and pay as agreed based on an adjustable rate mortgage.

	Original Economics
Income	$67,000
Home Value	$400,000
Loan Size	$320,000
Mortgage Rate	7.0%
Monthly Payment	$2,129
DTI	38%

Scenario 1 - Job Loss

Co-borrower loses job with limited employment options locally. The monthly housing obligation for the family is now unaffordable.

Job Loss	**New Economics**	**Job Loss - Rate Reduction with Interest Only for 5 yrs**	**Job Loss - Principal Reduction**
Income	$35,000	$35,000	$35,000
Home Value	$400,000	$400,000	$400,000
Loan Size	$320,000	$320,000	**$165,000**
Mortgage Rate	7.0%	4.2%	7.0%
Monthly Payment	$2,129	$1,120	$1,098
DTI	**73%**	38%	38%
Impact		**No Immediate Loss**	**Results in immediate loss of $155,000 or 48%**

Scenario 2 - Rate Reset

The initial interest rate was fixed at 7% for 2 years, providing for an affordable monthly payment. Upon resetting to 95, the loan is now unaffordable based on a 46% housing ratio.

Rate Reset	**New Economics**	**Rate Reset - Rate Reduction w Interest Only Period**	**Rate Reset - Principal Reduction**
Income	$67,000	$67,000	$67,000
Home Value	$400,000	$400,000	$400,000
Loan Size	$320,000	$320,000	**$265,000**
Mortgage Rate	9.0%	8.0%	9%
Monthly Payment	$2,575	$2,133	$2,132
DTI	**46%**	38%	38%
Impact		**No Immediate Loss**	**Results in immediate loss of $55,000 or 17%**

TESTIMONY OF

MICHAEL GROSS

MANAGING DIRECTOR, LOAN ADMINSTRATION LOSS MITIGATION

BANK OF AMERICA

Before the

HOUSE FINANCIAL SERVICES COMMITTEE

UNITED STATES HOUSE OF REPRESENTATIVES

WASHINGTON, DC

NOVEMBER 12, 2008

Good morning, Mr. Chairman, Ranking Member Bachus and Committee Members. I am Michael Gross, Bank of America's Managing Director of Loan Administration Loss Mitigation. Thank you for the opportunity to appear again to update you on the efforts of servicers like Bank of America to help families prevent avoidable foreclosures and stay in their homes. As the leading lender and servicer of mortgage loans in the country, following the acquisition of Countrywide in July 2008, Bank of America understands and fully appreciates its role in helping borrowers through these difficult economic times. We are committed to being a responsible lender and servicer, and facilitating home ownership and retention.

First, I want to provide a brief update on our mortgage business. We are making great progress integrating Countrywide Financial Corporation into Bank of America. And we are actively making new mortgage loans available to eligible customers for buying homes and refinancing their current mortgage loans.

- We are open for business across America. In the three months following the merger, we funded more than $50 billion in home loans, financing over 250,000 homes.
- We are leading the industry in responsible lending practices. Our goal is to ensure that our customers are successful homeowners and we work to provide financing that helps them not only get into their homes, but stay there.
- We're also working hard to help customers who may be in trouble. We've developed important programs that are projected to modify over $100 billion in loans; enough, over three years, to help keep up to 630,000 borrowers in their homes.

In addition to being America's largest home lender, we are one of the nation's largest and most solid financial institutions. With over 6,100 banking centers, 59 million customers and over

$800 billion in deposits, Bank of America has the strength and stability to help people, as we always have, finance their homes in ways that are right for them.

Bank of America is leading the mortgage industry out of today's challenging environment. We know that consumers who are experiencing financial challenges, but who ultimately have the ability and willingness to repay their loans, often need our help to stay in their homes. We are ready to help them. We do so because *no one* benefits from a foreclosed home.

Since I was last here Bank of America has announced an ambitious new proactive National Homeownership Retention Program. The program was announced on October 6 and was developed together with several state Attorneys General. It is designed to achieve affordable and sustainable mortgage payments for borrowers who financed their homes with subprime loans or pay option adjustable rate mortgages serviced by Countrywide and originated by Countrywide prior to December 31, 2007. Our 5,600 home retention professionals will be equipped to serve eligible borrowers with these new program elements by December 1. The foreclosure process will not be initiated or advanced for a customer likely to qualify until Bank of America has made a decision on the customer's eligibility.

The centerpiece of the program is a proactive loan modification process to provide relief to eligible customers who are seriously delinquent or are likely to become seriously delinquent as a result of loan features, such as rate resets or payment recasts. Various options will be considered for eligible customers to ensure modifications are affordable and sustainable. First-year payments of principal, interest, taxes and insurance will be targeted to equate to 34 percent of the borrower's income. Modified loans feature limited step-rate interest rate adjustments to ensure annual principal and interest payments increase at levels with minimal risk of payment shock. The program's foreclosure alternatives provide a "win" for borrowers and investors and are intended to assist in the effort to stabilize the country's deteriorating housing market. Modification options include, among others:

- FHA refinancing under the HOPE for Homeowners Program;
- Interest rate reductions, which may be granted automatically for certain borrowers that become seriously delinquent as a result of interest rate adjustment; and
- Principal reductions on pay option adjustable rate mortgages that restore lost equity for certain borrowers.

The program applies to eligible mortgage loan customers serviced by Countrywide and who occupy the home as their primary residence. Under the national program, Countrywide will not charge eligible borrowers loan modification fees, it will waive late fees associated with the borrower's present default, and Countrywide will waive prepayment penalties for subprime and pay option ARM loans originated between 2004 and 2007 that it or its affiliates own. Loan modifications will be made in compliance with servicing contracts and, where servicing contracts limit modification, Countrywide will seek consents from investors and other third parties.

I also want to take this opportunity to reaffirm to the Committee Bank of America's support of the Hope for Homeowners program contained in the Housing and Economic Recovery Act of 2008 and assure you that we are engaged in efforts to utilize the new tools that it provides. We expect the Hope for Homeowners program will contribute to efforts to bring stability to the housing market, and we believe it will help both homeowners and investors alike. Subject to investor consent and state procedural considerations, we will avoid completing foreclosure sales for these customers while we determine eligibility.

We also want to thank this Committee for including more flexibility for the implementation of the Hope for Homeowners program in the recently enacted Emergency Economic Stimulus Act (EESA) legislation. We understand the Oversight Board is considering how best to use this new authority. Added underwriting flexibility means more customers will qualify, and so we encourage the Board to increase the minimum loan-to-value levels requirement. (For certain pay option ARM borrowers who have no equity in their homes, we may consider a write down of principal to 95% of current market value under our recently-announced loan modification program.) Additionally, we ask the Oversight Board to consider increasing the minimum debt to income ratio requirements. (Our program will use a starting front end ratio of 34%, but may go as high as 42%.) Lastly, we encourage the Board to examine pricing to ensure these new loans under the program are both viable for the eligible homeowners and competitive to other approaches to loan modifications. These adjustments will help servicers fully utilize this important new tool during these difficult economic times.

I also would like to update the Committee on additional progress we have made to date on our home retention efforts. As I testified last time, we have added more staff and improved the experience, quality and training of the professionals dedicated to loss mitigation. Since early last year, as the housing and credit markets have struggled, the combined home retention staff for Bank of America and Countrywide has more than doubled, to over 5,600. We will continue to maintain sufficient staffing levels to ensure that we are responsive to our customers.

At the core of our combined operations are the substantial commitments we made to engage in aggressive loss mitigation efforts to help customers avoid foreclosures and remain in their homes. In addition to the new loan modification program for subprime and pay option borrowers I described earlier, Bank of America is devoting significant resources to modifying and working out loans of *any* type for customers who are facing default and possible foreclosure. Specifically, we are tailoring our workout strategies to a customer's particular circumstance. Bank of America currently uses a range of home retention options to assist customers who are struggling to make their monthly loan payments. These options include:

- Formal and informal workout arrangements that allow customers additional time to bring their loans current;
- Loan modifications that may significantly reduce interest rates, extend maturities or otherwise modify loan terms; and
- Partial claims that involve unsecured, no-interest or low-interest loans to customers to cure payment defaults.

Bank of America begins evaluating and working on these options to assist at-risk borrowers from the time we become aware a customer is having difficulty making mortgage payments through the foreclosure process. We also continue to educate customers about the options available to them and the workout solutions they may be able to employ to stay in their homes.

A key component of successful loss mitigation initiatives undertaken by national servicers such as Bank of America includes partnerships with financial counseling advocates and community based organizations such as Hope Now, NeighborWorks, NACA and the Homeownership Preservation Foundation. We are also actively engaged in foreclosure prevention outreach programs with both governmental and community organizations around the country. We will continue to work with investors, the government-sponsored enterprises (GSEs), regulators and community partners to further identify ways to improve our ability to reach customers with affordable home retention solutions.

Early and open communication with customers is the most critical step in helping prevent foreclosures. So far in 2008, we have participated in more than 340 home retention outreach events across the country, including foreclosure prevention and "train the trainer" events. We are proactively reaching out to customers by:

- Making an average of 15 attempts per month to contact delinquent homeowners through phone, mail and other means.
- Seeking to contact customers through outbound calls, including nearly 13 million outbound calls in October. These outbound calls resulted in approximately 1 million conversations with at risk homeowners in October.
- Mailing, on average, 800,000 personalized letters and cards each month that offer customers the choice to contact Bank of America, a HUD-approved housing agency, or a nonprofit housing organization.
- Sending company workout counselors to branch offices and events all over the nation to meet directly with homeowners who need assistance.

In the first ten months of 2008, the Home Retention Division completed over 214,000 retention workouts, a 214% increase over the first 10 months of 2007. I would emphasize here that these are workouts in which the customer enters into a plan to *keep their homes*. It does *not* include deeds in lieu of foreclosures or short sales.

In addition to sharply increasing the pace of workouts, we have also become more aggressive in the types of workout plans completed. Since we announced a series of home retention initiatives last autumn, loan modifications have become the predominant form of workout assistance. Year to date, through October of 2008, loan modifications have accounted for approximately 75% of all home retention plans, while repayment plans accounted for 12% of home retention plans. Prior to the programs announced last year, loan modifications accounted for less than one-third of all home retentions. For example, interest rate relief modifications – where the servicer freezes or reduces the borrower's interest rate – were extremely rare until late last year. Today, interest rate modifications account for 67% of all the loan modifications completed in 2008. Importantly, the vast majority of these rate relief modifications have durations of at least 5 years.

Finally, I would like to highlight a few continuing impediments to loan modifications for the Committee's consideration. Bank of America today services approximately 15 million loans. Some of these loans are held for investment in our own portfolio, but others are serviced on behalf of investors, including GSEs (the largest category of investors), government entities (such as FHA and VA), and private investors. Our servicing is governed by the underlying pooling and servicing contracts and related rules of these investors. For loans that are held for investment, we have broad flexibility to modify the loans. For other categories, however, investor rules and underlying servicing contracts with respect to modifications are not uniform and may prevent us from doing modifications that would benefit borrowers and investors. Under some arrangements, for example, servicers have express or implied authority to make loan modifications; while under other arrangements, loan modifications are expressly disallowed. Even within categories of investors, such as the GSEs, there is significant variation in the rules that apply. Servicers are frequently unable to effect loan modifications because of contractual prohibitions.

Another challenge is lack of uniformity in approaches to loan modifications. Servicers increasingly are responding to current market conditions by accelerating their loan modification practices. Examples include voluntary loan modification programs like ours, as well as government programs, like the one the FDIC adopted in connection with its acquisition of IndyMac. Servicers are employing usual and customary loan modification techniques, such as interest rate and principal reductions or deferrals; and they are developing underwriting and other guidelines -- frequently imbedded in models -- to determine when and what type of a loan modification is appropriate and benefits borrowers and investors. Bank of America supports government and industry efforts to develop greater consensus regarding these elements of loan modification programs. Yesterday's announcement by the Treasury Department, Federal Housing Finance Agency, HUD and other government entities to adopt systematic loan modification programs will help drive uniformity among these entities in the approach to loan modifications. We believe industry organizations, including those appearing before you today, also should play a role by issuing additional standards for loan modifications that will encourage servicers to do more.

Finally, changed circumstances of the borrower, such as unemployment, divorce or dissatisfaction with the property may make a loan modification unattainable. As a baseline, we can only modify loans where the borrower has the ability and willingness to repay. Our studies show such 'unresolvable' borrower issues represent the largest impediments to modifications, and this could worsen without economic growth and housing market stability.

There are certainly other challenges, and we would be glad to discuss those with the committee subsequent to the hearing.

Bank of America thanks you for the opportunity to describe our new home retention initiative. We recognize there is still much more to be done. Today's market conditions demand expedient, affordable loan modifications that help borrowers, while protecting returns to investors. This is a critically important undertaking that must be done right if we as an industry are going to preserve the flow of mortgage credit to support housing, and at the same time protect communities and neighborhoods from avoidable foreclosures. I would be happy to answer any questions you might have.

Testimony of JPMorgan Chase & Co.

Committee on Financial Services
U.S. House of Representatives

November 12th, 2008

Chairman Frank, Ranking Member Bachus and Members of the Financial Services Committee, we appreciate the opportunity to appear before you today on this most important topic of helping homeowners. We recognize that no one benefits in a foreclosure.

My name is Molly Sheehan and I work as a senior housing policy advisor in the Home Lending Division of JPMorgan Chase & Co. Chase is one of the largest residential mortgage servicers in the United States, serving over 10.3 million customers on the platforms of Chase, WaMu and EMC, with mortgage and home equity loans of approximately $1.5 trillion in every state of the country. We are proud to be part of one of this country's pre-eminent financial institutions with a heritage of over 200 years.

Here is a snapshot of our servicing portfolio of $1.5 trillion:

- Chase owns $332 billion in mortgages and home-equity loans: $176 billion (12% of total serviced) is first-lien mortgage loans and $156 billion is home equity (10% of total serviced).
- Chase services or sub-services $1.17 trillion (78% of total serviced) in first-lien mortgage loans owned by investors.
- Non-prime loans total $123 billion (8%): $27 billion of it owned by Chase and $97 billion owned by investors.
- Pay-Option ARMs total $128 billion (8.5%): $51 billion owned by Chase and $77 billion owned by investors.

As you know, two weeks ago we announced several significant enhancements and we would like to share those with you.

Expanded Foreclosure Prevention Initiatives

While Chase has helped many families already, we feel it is our responsibility to provide additional help to homeowners during these challenging times. We will work with families who want to save their homes but are struggling to make their payments.

That's why we announced on October 31st that we are undertaking multiple new initiatives designed to keep more families in their homes.

We will open regional counseling centers, hire additional loan counselors, introduce new financing alternatives, proactively reach out to borrowers to offer pre-qualified modifications, and commence a new process to independently review each loan before moving it into the foreclosure process. We expect to implement these changes within the next 90 days.

While implementing these enhancements, we will stop any additional portfolio loans from entering the foreclosure process. This will give potentially eligible homeowners an opportunity to take advantage of the enhancements, and applies to owner-occupied properties with mortgages owned by Chase, WaMu or EMC, or with investor approval. Chase has worked diligently and will continue to work diligently with investors to get their approval to bring these enhancements to loans we service on behalf of others so our efforts can have the broadest possible impact. We also will advise homeowners in the foreclosure process to continue to work with their assigned counselors, who will have access to the expanded toolkit.

The enhanced program is expected to help an additional 400,000 families – with $70 billion in loans – in the next two years. Since early 2007, Chase, WaMu and EMC have helped about 250,000 families avoid foreclosure, primarily by modifying their loans or payments. The enhanced programs apply only to owner-occupied properties.

We inherited pay-option ARMs when we acquired WaMu's mortgage portfolio in September and EMC's portfolio earlier this year as part of the Bear Stearns acquisition. After reviewing the alternatives that were being offered to customers, we decided to add more modification choices. All the offers will eliminate negative amortization and are expected to be more affordable for borrowers in the long term.

As a result of these enhancements for Chase, WaMu and EMC customers, Chase will:

- Systematically review its entire mortgage portfolio to determine proactively which homeowners are most likely to require help – and try to provide it before they are unable to make payments.

- Proactively reach out to homeowners to offer pre-qualified modifications such as interest-rate reductions and/or principal forbearance. The pre-qualified offers will streamline the modification process and help homeowners understand that Chase is offering a specific option to make their monthly payment more affordable.

- Establish 24 new regional counseling centers to provide face-to-face help in areas with high delinquency rates, building on the success of one- and two-day Hope Now reach-out days. We will partner with our community counselors to reach more borrowers.

- Add 300 more loan counselors – bringing the total to more than 2,500 – so that delinquent homeowners can work with the same counselor throughout the process, improving follow-through and success rates. Chase will add more counselors as needed.

- Create a separate and independent review process within Chase to examine each mortgage before it is sent into the foreclosure process -- and to validate that the homeowner was offered appropriate modifications. Chase will staff the new function with approximately 150 people.

- Not add any more Chase-owned loans into the foreclosure process while enhancements are being implemented.

- Disclose and explain in plain and simple terms the refinancing or modification alternatives for each kind of loan. Chase also will use in-language communications, including local publications, to more effectively reach homeowners.

- Expand the range of financing alternatives offered to modify pay-option ARMs to an affordable monthly payment, including 30-year, fixed-rate loans, interest rate reductions, principal deferral, and interest-only payments for 10 years. All the alternatives eliminate negative amortization.

- Offer a substantial discount on or donate 500 homes to community groups or through non-profit or government programs designed to stabilize communities.

- Use more flexible eligibility criteria on origination dates, loan-to-value ratios, rate floors and step-up features.

The enhancements reflect Chase's commitment to continue to seek additional ways to help homeowners.

Expanded Offers For ARM Customers

Chase offers two programs for unsolicited rate modifications for short-term hybrid ARMs (with initial fixed terms of only two or three years). These programs are specifically designed to avoid delinquency and reward current borrowers who have demonstrated a willingness and ability to pay but may be subject to future payment shock.

- In late 2007, we began a blanket loan modification program for Chase-owned loans. It works very simply for homeowners: We unilaterally lock in the initial interest rate for the life of the loan on all short-term ARMs that are due to reset in the coming quarter. This saves each homeowner hundreds of dollars a month. We also have done similar blanket modification programs for investors at their request. Fewer than 10% of these modified loans end up in re-default. We are currently reviewing the EMC and WaMu portfolios to see if this program should be expanded.

- In early 2008, we kicked off the American Securitization Forum Fast Track loan modifications for non-prime, short-term hybrid ARMs that we service. The American Securitization Forum developed a systematic, highly streamlined process that quickly freezes the loan's current interest rate for five years, protecting the borrower from rate and payment increases. WaMu and EMC also use the American Securitization Forum Fast Track procedures.

Chase also provides loan modifications for customers who can not sustain their current payment due to affordability. As a general rule, an analysis is completed to determine an affordable payment level for the customer that will result in a reasonable housing ratio (principal, interest, taxes and insurance and condo or association fees as a percentage of income) while producing a more positive result for the investor than foreclosure. Income is subject to verification. WaMu and EMC presently use a net present value (NPV) and affordability model to determine the optimal modification for the borrower and investor. Chase is reviewing that model to determine which approach yields the most consistent and efficient process across all the portfolios.

Chase has had a proactive outreach program for resetting ARM customers since the first quarter of 2007, with no restriction based on origination date. The outreach is done for all ARM customers with contacts occurring 120 days and 60 days before reset. Under WaMu's Program for pay-option ARMs, starting in January 2008, customer contact begins for all pay-option ARM customers up to 180 days before reset to explore workout and refinance options. EMC has a similar program of outreach that it started in the fourth quarter of 2007, beginning outreach up to 270 days before reset.

Also, as we announced, we will proactively reach out to homeowners to offer pre-qualified modifications such as interest-rate reductions and/or principal forbearance. The pre-qualified offers will streamline the modification process and help homeowners understand that Chase is offering a specific option to make their monthly payment more affordable.

New Offers for Pay-Option ARM Customers

As mentioned, Chase did not originate, own or service pay-option ARMs, but has acquired portfolios of both owned and serviced pay-option ARMs through WaMu and EMC. Chase has reviewed the existing programs and expanded them.

In January of 2008, WaMu began a proactive program for its owned pay-option ARM portfolio. A month ago, WaMu kicked off a more aggressive campaign with more refined targeting and offers for borrowers due to recast in the next 180 days. The offers – and the frequency of follow-up mailings -- depend on whether the consumer is coming up on a scheduled recast or a forced recast. Under the WaMu and EMC programs, the first offer is a refinance into an Agency or FHA loan, including FHASecure. Borrowers can also be referred directly to loss mitigation counselors at their request.

Under the expanded initiatives we announced two weeks ago, our second offer for pay-option ARMs will be a modification to a 30-year fixed-rate fully amortizing loan that eliminates the possibility of negative amortization. It also allows the deferral of principal to bring the amortizing balance as low as 95% of the home's current value, with a loan at a market interest rate. The initial interest rate can be reduced as low as 2% to achieve affordability, and the rate would step up to a market rate over five years with adjustments no sooner than after years two and four to eliminate payment shock. This program is designed for owner occupants who want to stay in their home.

Under the WaMu and EMC programs, the third offer is a 10-year/interest-only ARM at a rate discounted to a floor of 3.5% and no modification fees. If a below-market rate is required, the rate will step up to a market rate over five years with adjustments no sooner than after years two and four to eliminate payment shock. Negative amortization is eliminated. Principal deferral also can be used to bring the amortizing balance as low as 95% of the home's current value. This program is also limited to owner occupants.

Once operational at Chase, the FHA Hope for Homeowners Program will provide an additional option for these borrowers.

For these loan modification programs, we will determine affordability based on a housing ratio (principal, interest, taxes, insurance and condo or association fees) that generally does not exceed a range of 31% to 40% of income. Borrowers, with housing ratios between 40% and a hard cap of 50% may be eligible if they demonstrate documented compensating factors, which can include the amount by which the monthly payment has been reduced and payment history during the trial modification period. Chase uses these ratios today in current modification programs and the relatively low level of recidivism validates their reasonableness. Where necessary, principal forbearance will be used to achieve an affordable housing ratio, as long as the result is still NPV positive. There is no interest charged on the principal forbearance, but a required payment upon sale or refinance allows the owner of the loan to share in any potential future appreciation.

Once borrowers provide preliminary income information, they begin making a reduced payment. But the final modification will be subject to 1) the borrower making up to three consecutive payments at the modified amount, 2) Chase receiving and validating income information and 3) Chase confirming the current collateral value. No modification fees will be charged and delinquency fees will be waived.

As announced, we anticipate being able to roll out the program over the next three months and, during the implementation, we will not commence foreclosure proceedings for potentially eligible borrowers for loans owned by Chase and seek investor consent, where required, for serviced loans. Chase has worked diligently and will continue to work diligently with investors to get their approval to bring these enhancements to loans we service on behalf of others so our efforts can have the broadest possible impact.

The Committee has asked what conditions servicers could impose that would make a universal approach to loan modifications acceptable to investors. It is not the servicer's role to impose conditions on investors; instead our role is to fulfill our contractual obligations by working to achieve the best possible results for our investors while creating affordable payments for the borrowers. That is what we intend to do with our new program.

The Committee has also asked what policy or operational changes the servicing industry could implement to make loan modifications more feasible under current pooling and servicing agreements. At Chase, we are designing our just-announced process to consistently achieve a result that is positive to the investors on a net present value basis. Once we tangibly demonstrate the methodology and the process, we believe we will receive the consents necessary to roll out the program more broadly. We also believe that the efforts of many servicers, the sharing of best practices and the leadership of the FDIC is helping the industry to converge on a new industry standard for loan modifications. To the extent the investor community joins in accepting this emerging standard, there will be greater certainty for the servicing industry.

We are pleased to provide this information to you and we will be happy to meet with you and respond to additional questions you may have or ideas you would like to share. In turn, as we continue to improve or programs and efficiency, we would be happy to keep you advised. We especially appreciate your leadership and that of Committee members in keeping a focus on this important issue of keeping families in their homes.

BRADDOCK
FINANCIAL

Statement for the Record
Harvey B. Allon
President
Braddock Financial Corporation
before the
United States House of Representatives
Committee on Financial Services

November 12, 2008

Braddock Financial Corporation | Tabor Center | 1200 17th Street, Suite 880 | Denver, CO 80202 | ph : 303-308-6400 | fx : 303-291-1312 | www.braddockfinancial.com

BRADDOCK

My name is Harvey Allon and I am the President of Braddock Financial Corporation ("Braddock").

I have participated in the mortgage securities markets since 1981, and founded Braddock in 1994. Based in Denver, Colorado, Braddock is an SEC-registered investment adviser that specializes in the structured finance sector of the fixed income market and invests primarily in mortgage and asset-backed securities. Our investors include pension funds, college and university endowments, charitable institutions and high net-worth individuals. On behalf of our firm, I am pleased to have the opportunity to provide our perspective on private and public efforts to address the housing and credit crisis.

Over the past 18 months, and especially in the last quarter, we have experienced a financial crisis that is far-reaching in both its scope and magnitude. The loss of confidence in U.S. capital markets has had a direct impact on Main Street America and the families who live and work there. Many have already lost jobs and their retirement savings and are now struggling to hold on to their homes during these exceedingly turbulent times.

The current cycle of home foreclosures followed by distressed sales followed by more foreclosures and more distressed sales has driven down prices on homes, impaired home equity, damaged consumer confidence, and led to a freeze in credit in the housing sector. Braddock strongly supports efforts designed to break this cycle.

In Braddock's view, loss mitigation has always been, and will always be, critical to the healthy functioning of the credit markets, and loan servicers should use their best judgment and best efforts to mitigate losses arising from a borrower's inability to meet his or her mortgage obligations. Such programs might include interest-rate reduction, term modification, and/or principal deferment or write-downs.

We believe it is critical to keep in mind the goals of loan modification and the factors that should be weighed when modifying loans, and to do so in the context of the current housing crisis.

- Important considerations include:
    - Whether a borrower has a strong desire and capacity to stay in his or her home.
    - Whether a loan can be modified to create a payment a borrower can afford so re-default risk is minimized (which may include an analysis of a borrower's debt-to-income ratio to prevent any overly burdensome modifications).
    - Whether a modification can be made without encouraging others to seek aid who don't qualify for assistance.

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- Loan modification programs that are interest rate and term-extension based are preferable in most cases, because:
    - The process of such loan modification is not overly difficult or burdensome.
    - The affordability of a payment can be determined and verified relatively easily.
    - Property revaluation is not necessary.
    - A balance can be reached between the lender's financial interest in its return of capital and the borrower's ability to pay.
    - The risk that many borrowers would be encouraged to default on their mortgage to capture additional equity would be reduced.

The chart below illustrates how interest rate reductions can provide a similar level of payment relief as significant principal write-downs.

Original Fully Amortizing Loan

		Payment
Balance	150,000.00	($1,100.65)
Interest Rate	8.00%	

Balance Reduction on Fully Amortizing Loan

		Payment
Balance	100,000.00	($733.76)
Interest Rate	8.00%	

Rate Reduction on Fully Amortizing Loan

		Payment
Balance	150,000.00	($716.12)
Interest Rate	4.00%	

Braddock believes the HOPE for Homeowners Act of 2008 ("Act") provides a valuable tool to servicers to help homeowners avoid foreclosure while it simultaneously provides much needed liquidity in the housing market. We encourage servicers to work with qualified borrowers, as described by the Act, to create an affordable monthly payment to keep homeowners in their houses.

With respect to the fiduciary duty we have to represent our investors, we have been and remain concerned about the potential for abuses of the Act that would run counter to its intent. Specifically, we believe that servicers should use their best efforts to insure that only qualified borrowers, as described in the Act, participate in the program. Not every home purchaser who finds that his property has declined in value is entitled to receive a reduction in his or her debt. The impact of such a policy would be detrimental to housing values and insure a longer and deeper recession in housing that would run counter to the intent of the Act.

In addition, we have urged servicers to be prudent in determining the value of each property for the purposes of determining loan amounts and assessing whether the Hope for Homeowners program is the best option for loss mitigation. For example, Automated Valuation Models ("AVMs") or other "desktop" valuations have been shown to be an imprecise method for determining value and as such are detrimental to the stabilization of housing prices.

Moreover, because the Act is designed to provide a floor under the housing market, we believe the housing crisis could be exacerbated if servicers used excessively low valuations based on distressed sales and foreclosure "comps." In fact, producing excessively low valuations on homes before placing them under the Act's provisions could make the Act less effective than other loss mitigation options that are available to servicers.

In conclusion, Braddock urges all servicers to fully acquaint themselves with the text and guiding principles of the Act and to actively undertake efforts to ensure that qualifying home owners participate in this program and that their home loans are modified in a timely fashion, pursuant to the letter and intent of the Act.

# # #

CREDIT SUISSE

01 October 2008
Fixed Income Research
http://www.credit-suisse.com/researchandanalytics

Subprime Loan Modifications Update

Structured Products Research • Americas

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Summary

- With the recently proposed TARP program nearing another Congressional vote, loan mods have taken center stage as a key tool in the arsenal to help reduce the damage inflicted from the housing crisis. This report reveals that loan modification is a growing, but perhaps underutilized, tool to reduce losses and prevent foreclosures and that redefault rates for certain types of modifications are better than expected.

- Our data below shows that there has been a dramatic increase in loan mods in 2008. Compared to last year, the number of new mods made per month has jumped more than six-fold.

- Performance data on loan mods show that the redefault rate of loan mods depends on the type of mod. Therefore, the historical redefault rate typically associated with traditional mods may not be applicable to recent mod types.

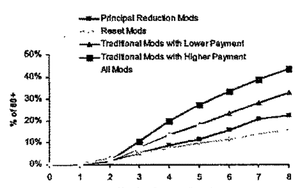
- Specifically, rate freeze (where the rate is frozen around the ARM reset date) and principal reduction mods (where principal is permanently forgiven) have redefault rates less than half of those for more traditional mods. As shown in Exhibit 1, only 15% of rate mods and 23% of principal mods made in Q42007 became 60+ days delinquent eight months after modification, compared to 44% of traditional mods that had higher payments after mods. Given that more than 80% of loans were delinquent prior to modification, the 23% redefault rate from principal mods is encouraging.

- Further, we show that there is a dramatic difference between how intensively servicers are using mods. Some servicers, such as Litton, Nationstar, Ocwen and EMC, have already modified more than 10% of all outstanding 2005 and later vintage loans. Others, such as First Franklin, Ameriquest and Saxon, have modified less than 5% of all loans outstanding.

- Finally, servicers who find the sweet spot between too many and too few modifications will likely improve bond values, as the mods are expected to reduce lifetime losses.

Exhibit 1: Post-mod performance varies greatly by type

Looking at loan mods made in 4Q2007



Source: Credit Suisse, LoanPerformance

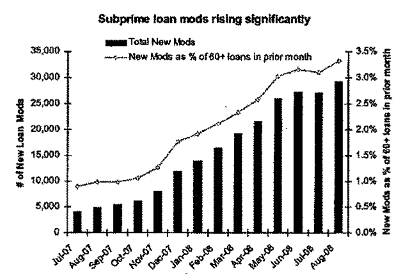
Subprime loan modifications have increased significantly since we published our first report on this topic *The Day After Tomorrow: Payment Shock and Loan Modifications* in April 2007 (click here to see report). In this update, we review recent trends in subprime loan modifications, discuss both traditional and new types of loan mods, and present an early review of post-modification redefault rates. We will continue to provide timely updates on subprime loan modification, particularly, as a main goal of the coming $700 billion government housing reinvestment program (i.e., the TARP program – we think a housing reinvestment program sounds nicer than "rescue" or "bailout") is to modify loans in order to make payments more affordable and to reduce preventable foreclosures.

Subprime loan mods have increased substantially

In our 2007 report, we anticipated that loan modifications would increase from "a trickle to a flood." Exhibit 2 below shows that the deluge, though slower to begin than we had expected, began in earnest in early 2008. Although mods have increased significantly this year, we think there is room for the industry to expand the scope, type and measurement of loan modification effectiveness. While this report doesn't provide all the answers, we hope it will contribute to the dialogue.

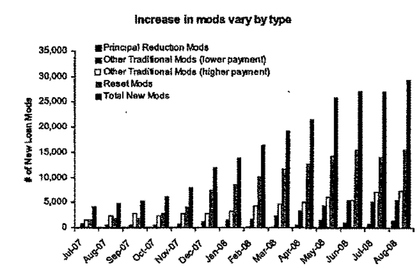
The trend of increased mods resulted from a combination of persistent deterioration in subprime loan performance, which increases the need for loan mods, and increasing government and industry efforts, such as the establishment of the Hope Now alliance and ASF streamlined loan modifications for borrowers facing reset (which became effective in January 2008). As shown in Exhibit 2, the number of new mods made per month has jumped more than six-fold from a year ago. Measured as a percentage of 60+ delinquent loans (excluding REO), new monthly loan mods rose from less than 1% to 3.5% over the same period.

Exhibit 2: New loan mods have rose more than six times from a year ago



Source: Credit Suisse, LoanPerformance

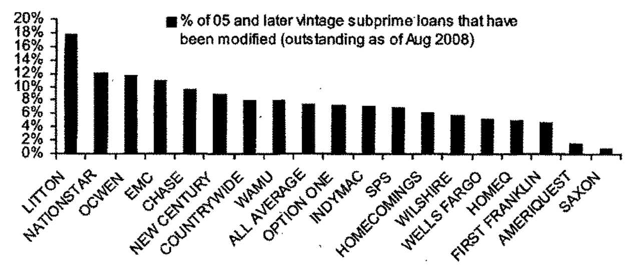
Exhibit 3: Loan mods by different forms



Source: Credit Suisse, LoanPerformance

shouldn't conclude that doing more modifications necessarily indicates higher quality servicing. There can be too much of a good thing, and some servicers could modify too much, while other servicers could be doing far too few mods. The key to rating a servicer's effectiveness in loan modifications is that they're only executing those modifications necessary to avoid a default. Obviously, this is somewhat of a judgment call, as we don't really know which loans would have defaulted absent a modification. It is clear that mods should be executed when default is highly likely under the original loan terms.

Exhibit 4: Servicer difference in loan mods is huge

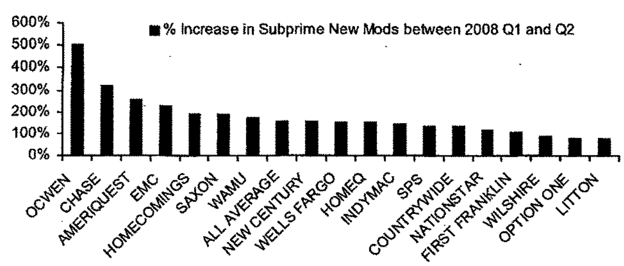


Source: Credit Suisse, LoanPerformance

Certain servicers have ramped up mods dramatically

While some servicers were slow to start their modification efforts, they too have ramped up modifications in recent months. Exhibit 5 shows the percentage increase in new loan mods from Q12008 to Q22008. Ameriquest and Saxon, which have the smallest percentage of modified loans in their subprime servicing portfolio, have increased their loan mods by almost three-fold during this period. Ocwen had the largest increase, followed by Chase.

Exhibit 5: Some servicers have recently ramped up their mods efforts



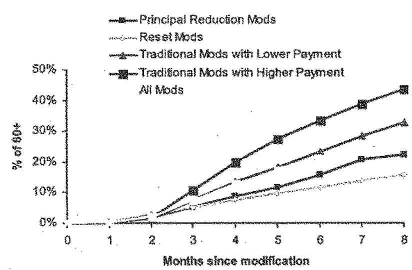
Source: Credit Suisse, LoanPerformance

Rate mods and principal reduction mods perform much better

Exhibit 9 shows the difference in post-mod performance by mod type based on a sample of new mods made in Q42007. Reset mods have had the best performance, followed by principal reduction mods. But the strong performance from reset mods is biased by their good payment status prior to modification, as shown in Exhibit 10. Specifically, about 90% of reset mods were current prior to modification, compared to only 15%-20% for other type of mods. The high percentage of current loans prior to reset is expected because borrowers are required to be able to pay the initial payment under the streamlined modification plan (it remains to be seen whether the streamlined rate freeze plan results in too many modifications). On the other hand, the post-mod performance of principal reduction mods has actually been impressive considering their very high delinquency ratio prior to modification. Specifically, about 80% of principal mods were delinquent prior to modification, while only 23% were delinquent eight months after modification.

Exhibit 9: Post-mod performance varies greatly by type

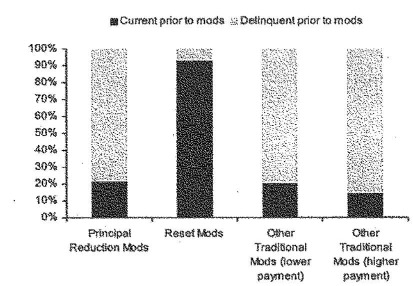
Looking at loan mods made in Q42007



Source: Credit Suisse, LoanPerformance

Exhibit 10: Strong performance of post-reset mods biased by their current payment status prior to mods

Looking at all mods made since Q42007



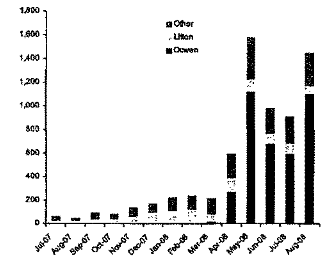
Source: Credit Suisse, LoanPerformance

An important issue in evaluating the effectiveness of modification programs is whether the loss of interest or principal resulting from reset or principal mods would be compensated by lower default rate, compared to other borrowers who don't receive a modification. In other words, modifications give up something (interest or principal and possibly higher severity on redefault) to get something (reduction in default frequency). If most modified loans would otherwise have defaulted absent a loan mod, our modification data shows that modifications appear to be an effective tool to reduce total defaults and losses. However, we need much more data and a longer time series in order to conclude with certainty that modifications are universally good for investors.

Principal reduction mods – a new frontier

Ocwen has been primarily responsible for the significant increase in principal reduction mods in the past few months. Principal mods continue to be the poor stepchild in the mod toolkit, however, as they represent a very small percentage of overall mods (see Exhibit 2). Ocwen currently accounts for about 70% of the total principal mods. The average balance decline for first-lien principal mods is about 20% and it is 55% for second-lien principal mods. As the number of borrowers having negative equity keeps rising, we are seeing a growing need for such modifications. Principal modifications not only reduce the monthly payment, but they also reduce borrowers' negative equity, thereby increasing their willingness to stay in the home.

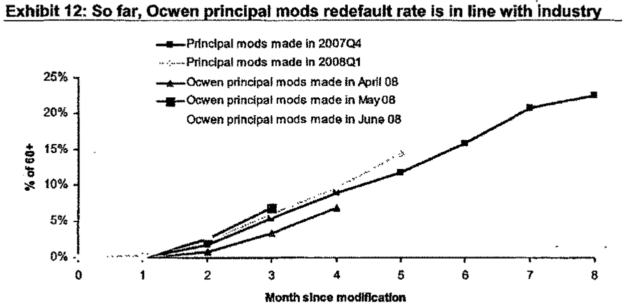
Exhibit 11: Ocwen contributed most of the increase in principal mods



Source: Credit Suisse, LoanPerformance

As shown in Exhibit 9 above, the post-mod performance of principal mods is materially better than that of other more traditional modifications. Given ~~the significant increase in principal mods~~ by Ocwen since April, we thought it would be useful to present an early preview of the post-mod performance of these loans. Exhibit 12 shows the 60+ delinquency rate for principal mods made by Ocwen in recent months, compared to earlier principal mods made by other servicers. As the chart shows, Ocwen's principal mods appear to be performing roughly in line with principal mods of other servicers and much lower than other traditional mods. Hence, despite the dramatic ramp-up in principal mods at Ocwen (not to mention the fact that the mods were increased in part, we believe, to alleviate servicing advance expenses), the mods thus far seem to be performing comparable to the industry. However, given the recent initiation of Ocwen's mod program any such conclusions need be considered preliminary, pending more data.

Exhibit 12: So far, Ocwen principal mods redefault rate is in line with industry



Source: Credit Suisse, LoanPerformance

Greater coordination needed among first- and second-lien servicers – TARP could help

On a related note, as we have written about previously, one component clogging the system is the difficulty in coordinating between second-lien and first-lien servicers. We believe that greater coordination is needed prior to considering a first-lien mod. However, as a result of the Rube-Goldberg-like servicing industry architecture, 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. Obviously, to the extent that TARP can purchase both liens, there would be far greater flexibility relative to the current state of play in the servicing industry. Should TARP be successful in buying both liens, given their greater servicing flexibility, they might actually be able to pay an above-market price for both loans (i.e., the first and second liens) and still improve total recoveries relative to the private sector solution. We note that 30% (by count) of the principal reduction mods we found were actually second liens vs. only 5% of other mods were second liens, so it does appear that second-lien principal mods are getting done. We are not sure whether this is happening only where the first and second liens are serviced by the same servicer (and perhaps in the same securitization trust). Given that Ocwen and Litton service 80% of the loans receiving a principal reduction mod, we suspect that the mods on second liens are largely happening because there is only one servicer on both loans.

Accounting for principal reduction mods still in flux

The sudden increase in principal reduction mods also brought to light the issue of how to recognize losses in securitizations related to principal mods. Our review of several deal documents shows that the PSAs usually don't consider losses from principal mods as part of net realized losses, which are limited to liquidated loans only. As a result, trustees initially used interest collections to cover the forgiven principal, which caused large bond interest shortfalls, even affecting AAA bonds, in deals that had many principal mods, such as Nomura 2007-2 (with Wells Fargo as trustee) and MASTR 2005-NC2 (with US Bank as trustee). In response to the industry consensus on best practice, these trustees have begun adding forgiven principal into realized losses instead of using interest collections to cover forgiven principal. This approach resulted in write-downs of subordinations.

Conclusion

Despite all the discussion of modifications, we believe there is relatively little publicly available data addressing modified loan redefault rates, particularly controlling for vintage and modification type. Our data shows that certain mods perform better than others, and therefore the "one size fits all" approach to loan modification dialogue needs to be dramatically rethought. Our analysis is only the tip of the iceberg as far as answering whether loan mods can meaningfully contribute to the clean-up of the housing mess. Our analysis does indicate some hope that indeed loan mods are a very useful tool in the housing rescue toolkit. Therefore, the fact that TARP includes mods in its program should create a new paradigm of how the industry uses mods effectively to minimize losses.

Further, the coming FHA Hope for Homeowners refinancing program essentially takes an approach similar to principal mods by giving borrowers a certain amount of home equity to keep them in their homes and reduce default probability.

Finally, as we discussed in our 2007 report, loan mods are a double-edged sword when considering relative value among bonds. Our data indicates that servicers who dramatically ramp up modifications may actually experience lower lifetime losses relative to servicers who are more timid in their use of mods (although we suspect few investors are willing to pay up for Ocwen-serviced paper at this point). On the other hand, overly aggressive use of modifications may result in the benefit of a lower redefault rate being offset by a greater reduction in cash flow (either interest or principal), and therefore a net negative for investors. We suspect that few servicers are in this category, however. Although the jury is still out, we believe an effective modification program could be accretive to value for bondholders, whereas those that abuse mods and those that ignore mods are likely to detract from bond value. The sweet spot is found by the goldilocks servicer – not too many, not too few, but just right (the latter is easier said than done).

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November 12, 2008

Chairman Barney Frank and Ranking Member Spencer Bachus
House Financial Services Committee
2129 Rayburn House Office Building

Dear Chairman Frank and Ranking Member Bachus:

My name is William Frey and I am Principal and CEO of Greenwich Financial Services (GFS). My firm is a broker dealer that specializes in the structuring and distribution of Mortgage Backed Securities (MBS). I ask that this letter be made a part of the record of the hearing of the House Committee on Financial Services entitled, "Private Sector Cooperation with Mortgage Modifications-Ensuring That Investors, Servicers and Lenders Provide Real Help for Troubled Homeowners," on Wednesday, November 12, 2008, at 10:00 a.m., in room 2128 of the Rayburn House Office Building.

Because this Committee is interested in MBS, it is important to note that I have worked in the securitization industry since the industry's infancy in 1981. My experience encompasses virtually every aspect of securitization, from structuring and trading MBS to researching and analyzing the securitization market. After nearly 15 years with major firms including Morgan Stanley, Smith Barney, and Bear Stearns, I founded GFS in 1995. I received my B.S. from Cornell University in 1979 and my MBA from Carnegie Mellon University in 1981. At my present firm, I have structured and sold billions of dollars of MBS securities with various types of collateral. I also acted as a financial advisor to GNMA for more than 5 years, ending in 2004. In that capacity I was responsible for working with GNMA to select new product and program offerings as well as assessing various types of market and credit risks. GFS was awarded this contract with KPMG as its partner.

As mentioned above, I own a broker dealer, GFS, which puts together MBS transactions. I have never put together a transaction using subprime collateral, and the last alternative-A (alt-A) transaction I structured was over five years ago. I chose to not structure deals backed by subprime and alt-A mortgages because I believed that they were of low quality and I did not want my business to be associated with them.

I am submitting this statement for the record because on October 24th, six members of this Committee issued a letter in response to my comments in a *New York Times* article regarding investors' objections to the restructuring of mortgage loans (Tab 1). The letter requested that I appear at this hearing. Early this week I was told that my testimony was no longer needed but that a written statement could be submitted for the record. My written statement consists of two parts. The first part seeks to clarify the record regarding what I believe are inaccurate characterizations of my work. The second part seeks to offer specific recommendations on how to improve the American mortgage-backed securitization process in an effort to prevent similar crises in the future.

For the record, I would like to clarify that I do not manage a hedge fund, as erroneously assumed in the letter to me dated October 24. I hasten to add that there is nothing wrong with hedge funds, given that they invest the retirement and education funds of millions of average Americans. I am an individual investor and I manage a family fund. What this means is that I invest my own money in the U.S. and international capital markets, and I do so judiciously and carefully after much research and analysis.

All of the credit support securities I own were originated before 2004 and are not based on subprime or alt-A collateral. The loans backing the securities I own have low loan-to-value ratios (meaning high levels of equity) and are performing well. The borrowers were not tricked by teaser rates or encouraged to misrepresent their incomes. These are securities backed by mortgages secured by the homes of thousands of ordinary hard working Americans who are making their payments as agreed, honoring their contractual commitments.

The reason I have no exposure to subprime is that I simply did not believe that the credit risk of those securities and collateral was justified. Being involved in making loans to people that cannot repay those loans has never made business sense to me. Contrary to popular opinion, there were some investors in this market that elected not to participate in the unsound securities that triggered to the current economic crisis.

Before proceeding, I would like to applaud Congress and this Committee for their expressed desire to provide relief to homeowners, many of whom are holding mortgages that are now 'underwater.' Eight months ago – before Fannie Mae and Freddie Mac failed – I proposed a solution to this critical issue with a similar goal. Indeed, in March of this year, I sent a letter to Secretary Paulson and Chairman Bernanke (Tab 2) suggesting a sensible, balanced and economically viable course of action. In that letter I explained an unfortunate fact of life: if a homeowner's loan is included in a mortgage security, he will have a more difficult time receiving the necessary relief than if his loan is owned directly by a bank. This is why FDIC Chairman Sheila Bair has been having more success modifying loans on Indy Mac's balance sheet than modifying loans in securitizations.

Proposed Solutions

Mortgage securitizations are managed by a contract called a "Pooling and Servicing Agreement" (PSA). A PSA is the basis for the securitization and binds investors, as the providers of capital, with the issuers, as the consumers of capital. This is not the contract of the homeowner with either the bank or the firm that originated the loan. Instead, a PSA may cover thousands of loans and is the contract that specifies a Servicer's obligations to bondholders and spells out a Servicer's authority and ability to restructure mortgages. The contract that I was, and am still, seeking to ensure that Congress remains focused on is the PSA. Let me offer some recommendations of how the Hope for Homeowners (HHO) program may be improved, given the existence of these contracts.

The HHO program allows Servicers to renegotiate loans to the lesser of 90% of market value or 31% of the homeowner's income as a loan payment in cases where such renegotiation is a better outcome than foreclosure. The question, though, is who determines what is the better outcome? Renegotiations are in the hands of the Servicers, who have financial incentives to avoid foreclosure, regardless of the outcome. Keeping someone in their home is cheaper than foreclosure for the Servicer, even if it creates greater losses for the mortgage investor. Furthermore, there may be other financial benefits to Servicers for each loan that is renegotiated. Finally, all participants in the mortgage market are under political pressure to have homeowners stay in their houses. One need look no further than the letter I received from this Committee on October 24th to see evidence of the intensity of this political pressure (Tab 1).

In the current form of the HHO program, there is effectively no oversight for objectively determining the better outcome. Servicers that have much to gain from the renegotiation of mortgages have an incentive to pass unjustifiable losses onto investors. Supposedly, investors' interests are protected by the Trustee of the mortgage securitization. However, in all PSAs with which I am familiar, the Trustee is indemnified for servicing errors. There is no party watching out for the bondholders' interests and decisions are left in the hands of the Servicers, which often created these problems in the first place through fraudulent loan originations.

If the HHO program is seen as encouraging Servicers to restructure mortgages beyond the limits in the PSA contracts, the program could create serious new liabilities for the Servicers. These Servicers, which are largely banks looking for ways to increase fee income and reduce expenses, have strong incentives to engage in mortgage restructuring at the expense of bondholders.

In the context of our current housing crisis, it is essential to be clear about who are the investors in residential MBS. These investors are not only investment banks, college endowment funds, and sovereign wealth funds, but ordinary Americans in significant numbers. Investors in private label MBS include pension funds, public retirement systems, private sector retirement funds, and individual investors from all walks of life. To hold MBS does not automatically make one a "hedge fund" investor, but more likely an everyday, investor investing in the fabric of American life.

There are some PSA agreements that contemplate restructuring of loans, but many do not. If a Servicer were to restructure a loan covered by a PSA that did not allow for the restructuring of loans, the Servicer exposes itself to a lawsuit. In aggregate, such legal liabilities are likely to be so large that most Servicers would not accept them. Even if a Servicer is on reasonably solid ground, it is difficult to believe that many would risk the legal exposure that could result.

Larger Issues

The hazards to bondholders and Servicers point to the even larger issue at stake; whether the HHO program will be viewed as conferring the ability to alter legally binding agreements, often years after they are made, without the consent of all the affected parties. The ability to summarily alter binding legal agreements flies in the face of protecting contracts, which is a concept the Founding Fathers felt was important enough to reference in the Constitution. Despite recent rhetoric, I emphasize that the primary issue is not about a few rich guys get hurt when mortgages are restructured, but rather the US Government can tamper with their investments contracts. As any US lawyer will tell you, contract rights are an integral part of the US economy. Investors from around the world are watching and asking: if they buy US securities, will they need to factor in a risk they never before anticipated – that the US Government will alter the contracts supporting their investments without compensation? If this is the case, investors may start to demand political risk insurance, as is common for securities from developing countries.

Further, without a solution that protects existing US contracts, there is little chance that any material amount of loans will be restructured under the HHO program. I am not the only one with these doubts; Edward Murphy of the Congressional Research Service concluded in an October 22, 2007 report that "Further clarifications may be required to assure Servicers and trusts that they will not be subject to investor lawsuits if they provide workouts to troubled borrowers." (Tab 3) What policymakers must do is to remove the legal uncertainties for the Servicer. I think that this can be accomplished in one of two ways:

- The Government has the ability to indemnify, either partially or totally, the Servicer and Trustees for potential lawsuits that will result from the loan modifications.
- The Government could step up and purchase the loans directly from the MBS trusts. Given the contractual realities, public policymakers may wish to consider this option as an alternative to the inevitable foreclosure for pools of collateral that cannot be restructured within the MBS trust.

Both of these options will shift much of the loss from investors and homeowners (who would normally bear this loss) to the US Treasury. While this would be unfortunate, the Government appears to have few other options if it wishes to avoid many of the foreclosures that are in process. Moreover, the liquidity and credit crises experienced in the last year are overshadowed by a crisis in confidence today. These crises can only be exacerbated if there is also uncertainty about whether or not legal contracts are honored in the United States.

Suggestions for the Future
In addition to the suggestions above regarding the HHO, I also submit that this committee should take new steps to create a more stable mortgage securitization system for the United States in the future. In order to prevent a recurrence of today's problems in the US mortgage market, a number of changes must be made to the mortgage origination and securitization process. These changes include:

1. **The current 30 year fixed rate prepayable loan must be reconsidered.** This type of loan places great risk on the shoulders of the mortgage investor. Prepayments can devastate a portfolio regardless of whether the portfolio is prudently hedged or not. Investors cannot manage the option value in these investments without great residual risk. This is the risk that ultimately led to the financial problems with the Savings and Loans in the 1980's and was a root cause of the "accounting scandals" with FNMA and FHLMC. This risk is somewhat channeled to appropriate investors with the MBS "slicing and dicing" of cashflows, but the creation of this systemic risk is very real and not possible to hedge for the economy as a whole.

   Possible solutions include issuing five year loans with 30-year amortization schedules that are renegotiated at the end of the term. These types of loans are common in Canada and other countries. Also, prepayment penalties based on the then-current interest rates would also mitigate the risk to the investors. Ultimately, risk reduction to investors will bring investors back to this market in the volumes needed to properly fund America's housing needs. Furthermore, because the loan would be less risky for the investor, the interest rates homeowners would pay on their loans would decrease.

2. **Minimum credit underwriting standards must be applied to loans that are securitized and sold in the public capital markets.** Since investors and rating agencies seem to have difficulty making judgments on the appropriateness of loans in public offerings, a minimum loan-to-value (LTV) underwriting standard for public transactions would insure that massive amounts of inappropriate collateral would not be originated and placed in the public markets. This standard LTV, while subjective, should probably be 80%. Loans originated above this threshold should have to remain in unsecuritized form and would likely stay on the originator's balance sheet. This would force more careful credit review by originators of such loans. Loans originated for the GSE's (currently FNMA and FHLMC) should have similar stringent LTV standards with some accommodations for first time homebuyers. This could link to suggestion number 3 detailed below.

3. **The Government should stop subsidizing home mortgage debt by ending, or phasing out, the home mortgage deduction.** A tax subsidy encourages homeowners to take on too much leverage, thereby placing a large risk on society in general. Equity could be subsidized by having homeowners receive some sort of tax credit for the first home purchase. This credit would be applied to the down payment. This credit would obviously need limits, but the concept of subsidizing equity, as opposed to the debt, would remove some of the systemic risk placed on society by high LTV mortgages. Furthermore, additional periodic principal paydowns could trigger some sort of partial tax credit in the first few years of a loan's existence. This period has historically been the time in which defaults have occurred.

4. **The Government must limit the use of home equity loans.** The logical limit for the use of home equity loans would be to forbid their use in the purchase of a home. Instead of using home equity loans as down payments, prospective homeowners would have to actually save and place their savings into a house as a down payment. While this concept may seem logical, it was forgotten over the last several years. Furthermore, post-purchase limits based on home purchase price or current market value should also be in place. Large scale use of homes as piggy banks places the financial system at an unacceptable level of risk.

5. **The SEC should remove conflicts of interest in MBS transactions by requiring Servicers own portions of their securities.** Currently there is an accounting disincentive to retain the first loss bond in a securitization by the originator or Servicer. This leads to inordinate amounts of risk being passed to the capital markets as the Servicer does not retain "skin in the game". This is a simple aspect of securitization to fix. The minimum percentage a Servicer should own should be 1% of the transaction in a subordinated position. The number need not be huge, but ownership is important. The Servicer should be required to hold this position for no less than three years. This would insure that any underwriting errors would be taken as a loss by the party that is best able to avoid the bad loan decision.

6. **MBS issuers should remove, or limit, the Trustee indemnification that is common in virtually all securitizations**. Legally, the Trustee for a securitization is responsible for enforcing the contract rules as a fiduciary of the bondholders. However, in most PSAs Trustees are indemnified by Servicers for any bondholder lawsuits that result from improper servicing or other servicing errors. This has the effect of the fox buying off the guard of the hen house. Speaking bluntly, there is no one guarding the interests of the bondholders.

7. **Laws must prevent borrowers from avoiding personal liability in the event of foreclosure**. Such laws would encourage homebuyers that run into trouble to not abandon their homes. Post foreclosure liabilities are common in England and discourage homeowners from walking away from their obligations. Such liabilities could, of course, be dismissed in the event of bankruptcy.

While these changes may sound radical, they are essential to reducing the probability of a systemic housing meltdown and in mitigating that downturn, should this type of housing problem recur in the future.

Conclusions

The major point in the letter I received from six members of this Committee on October 24, 2008 was the fact that I sent letters to mortgage Servicers instructing them to make sure that their actions were in absolute conformity with the contract in which the Servicer and I are both a party. The precedents for honoring contracts, and the Government insistence on the enforcement of contracts through the courts, is deeply ingrained in American business and American life, and it is enormously respected abroad. I will therefore continue to make absolutely certain that parties with whom I contract will fulfill their contractual responsibilities, just as I will fulfill mine under extant US law.

In conclusion, I intend no disrespect to this Committee in its discharge of business. Because of my respect and admiration for this body, I think it is important to be a voice for contractual rights. It is not in the interest of the United States, either now or in the future, for there to be any suggestion to its citizens and the world at large, that US contract rights are in any way insecure.

Sincerely,

William Frey

MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC : NEW YORK

November 25, 2008

The Honorable Spencer Bachus
Ranking Member
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

MFA follow-up from November 12th Hearing – Private Sector Cooperation with Mortgage Modifications – Ensuring that Investors, Servicers and Lenders Provide Real Help for Troubled Homeowners

Dear Congressman Bachus:

At the hearing before the House of Representatives Financial Services Committee on November 12th, you requested that MFA provide its views on the potential impact on markets and the availability of credit of a 90-day foreclosure moratorium and changes to bankruptcy laws that would permit a bankruptcy judge to re-write the terms of homeowner mortgages, so-called "cram downs." Specifically, you asked for MFA's views on whether a moratorium or bankruptcy cram-downs would have the effect of restricting credit and driving up costs for mortgages. We have discussed these issues with our members and our responses are set out below.

As stated in our testimony at the hearing, our fundamental belief is that effective mortgage modifications are preferable to foreclosure whenever possible. We believe, however, that both a mandatory 90-day moratorium and bankruptcy cram-downs increase risks to investors, which will likely have negative consequences for the mortgage and credit markets.

While we appreciate the intent of proposals such as a 90-day moratorium, we believe such initiatives may provide an incentive to homeowners to stop making payments on their mortgage, which could lead to the loss of a significant source of revenue for investors and lenders. Such loss would likely further restrict the ability of lenders, and investors, to provide credit and liquidity to already constrained mortgage and credit markets, which would further exacerbate ongoing instability in each.

With regard to granting a bankruptcy judge the authority to unilaterally alter the terms of mortgage contracts, in our view such action add additional uncertainty and risk into the mortgage market for lenders and investors in mortgage-backed securities. This additional uncertainty and risk would adversely affect liquidity and availability of credit as some market participants would likely opt to stay out of the market as a result of the uncertainty, the additional risk, or both. Moreover, those who continue to participate in the market would be likely to charge their other customers higher rates in order to offset the additional level of risk, and cost, they would assume because of bankruptcy cram downs. These scenarios each would likely result in higher costs for prospective homeowners, an outcome which runs counter to the policy objective of liquid and stable mortgage markets. We believe a more prudent policy approach would be to promote reasonable, proactive efforts to keep families in their homes, either through modifications or other alternatives, before one gets to the point of distress that bankruptcy is needed.

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MFA and its members understand the importance of taking proactive steps to address the problem of rising foreclosures and the resulting instability in our credit and mortgage markets. We believe that a mandatory 90-day moratorium on foreclosures and bankruptcy cram downs are likely to create additional instability and further reduce liquidity in our markets. They also add uncertainty to markets and risk to investors in mortgage-backed securities and are likely to have the effect of raising the ultimate cost to homeowners as fewer entities participate in these markets in the future or participating entities charge higher rates to offset the additional level of risk they assume.

If you have any further questions with respect to these issues, or if MFA can be of further assistance, please do not hesitate to contact me at (202) 367-1140.

Respectfully submitted,

Benjamin Allensworth
Senior Legal Counsel

Cc: The Honorable Barney Frank

The New York Times
Executive Suite
Joe Nocera Talks Business

NOVEMBER 11, 2008, 4:42 PM

Can Anyone Solve the Securitization Problem?

By JOE NOCERA

So now the mortgage finance giants Fannie Mae and Freddie Mac say they are going to institute a mortgage modification program. Well, good for them. Announced this afternoon, the plan calls for struggling homeowners with mortgages held by Fannie and Freddie to have their payments reduced to 38 percent of their gross income through a combination of interest rate reductions, principle reductions and longer repayment terms. This comes on the heels of Citigroup's announcement on Monday that it would undertake a mortgage modification program, which came on the heels of a similar announcement last week from JPMorgan Chase, which came on the heels of Countrywide's announcement, and so on.

In other words, just about everyone in the mortgage business has come to see the wisdom of mortgage modification — except one important player: Wall Street.

You see, all of these programs deal only with "whole loans" — that is loans on the books of the institutions, unencumbered by securitizations. So far, the attitude of all involved when it comes to securitized mortgages is to throw up their hands and say — "it's too hard to deal with!" And it may well be: mortgages that were sold to Wall Street and wound up in mortgage-backed securities have been sliced and diced and sold and resold to investors with varying risk tolerances. They are serviced by people who owe a fiduciary duty to all these investors, no matter what their place on the risk continuum.

James Grosfeld, the former chief executive of Pulte Homes, summed up the problem in a recent e-mail message:

There are well over $1,000,000,000,000-$1,500,000,000,000 of mortgages trapped within mortgage-backed securities. These are the most risky mortgages ever issued — mortgages poorly underwritten and often with unaffordable payment shock at the end of teaser rate periods. Pool losses will be unprecedented.

However, there has been no successful effort on a broad scale to reform these mortgages because of contractual obligations of trustees and servicers to bondholders. Simply put these fiduciaries are scared of being sued by bondholders if they modify loans into affordable new mortgages. Every effort to jawbone trustees/servicers to reform these mortgages quickly and on a mass basis has failed and will fail. These fiduciaries fear financial liability, and servicers are overworked and have no meaningful financial incentive to provide this desperately needed refinancing.

Recently, certain hedge funds have threatened to sue fiduciaries of these securitizations if they refinance loans. Congressional hearings are taking place with respect to these threats. Nothing to prevent mass foreclosures of these loans will be effective unless Congress acts affirmatively to remove liability and provide financial incentives for refinancing. Jawboning bondholders and fiduciaries has not and will not work.

The situations borders on the absurd. Investors will not allow mortgage modifications that would hurt them more than some other investors — thereby insuring that everyone gets hurt even more as foreclosures continue. And as foreclosures continue, the financial crisis continues to deepen because foreclosures on Main Street mean billion-dollar write-offs on Wall Street. And struggling homeowners can only pray that their mortgage is still held by the bank and not sold to Wall Street — in which case they are out of luck. It is like flipping a coin to see if you can hold onto your home.

Wednesday, the House Financial Services Committee will hold a hearing on the issue of what, if anything can be done about the securitization problem. The hearing came about because the committee chairman, Representative Barney Frank of Massachusetts, read in The New York Times about two hedge funds that were telling mortgage servicers they would sue if the servicers tried to modify any mortgages. Inexplicably, the two hedge fund managers whose heads Mr. Frank seemed to demanding on a platter are not being called to testify. But maybe that is a good thing. Maybe it means the committee genuinely wants to see if this is a solvable problem (which would almost surely require legislation), rather than turn the hearing into an exercise in hedge-fund bashing. The problem is real, and it deserves serious consideration. I'll be writing about Mr. Frank's hearing in my column on Saturday.