Testimony of Superintendent Richard H. Neiman

Member, Congressional Oversight Panel

before the

Senate Appropriations Committee

Subcommittee on Financial Services and General Government

Chairman Durbin, Ranking Member Collins, and distinguished members of the Subcommittee: I am Richard H. Neiman, the Superintendent of Banks for the State of New York and a member of the Congressional Oversight Panel. I appreciate this opportunity to comment on the ongoing evaluation of the Treasury Department's implementation of the Emergency Economic Stability Act (EESA) with respect to home preservation. I should note that the views expressed in this testimony are my own. I will do my best to convey the Panel's views, but my statements cannot always reflect the opinion of our five diverse thinkers.

The Panel is charged by statute to provide monthly reports to Congress assessing the effectiveness of the Treasury's implementation of the Troubled Asset Relief Program (TARP), including foreclosure mitigation efforts. Assessing Treasury's response to the housing crisis is a particular point of emphasis for the Panel and for me personally as a bank regulator and as the New York Governor's appointee to lead our state's foreclosure prevention efforts.

When the Panel examined the foreclosure crisis in October of 2009, the picture was grim. About one in eight mortgages were already in foreclosure or default, and an additional 250,000 foreclosures were beginning every month. The Home Affordable Modification Program, or HAMP, was Treasury's main program, and we knew little then about how many HAMP trial mortgage modifications would ultimately become long-term modifications. HAMP was still focused on bringing new families into the program in order to provide immediate relief.

Treasury has since taken additional steps to mitigate foreclosures. Treasury began requiring HAMP loan servicers to explain to homeowners why their applications for loan modifications had been declined, and Treasury launched a drive to convert temporary modifications into long-term, five-year modifications. In keeping with the Panel's recommendations, Treasury also announced new programs to support unemployed borrowers and to help underwater borrowers regain equity through principal write-downs.

While it is too soon to evaluate the results of these program enhancements, Treasury should be commended for its efforts to address unemployment and negative equity as drivers of default. As the recession has lingered, the crisis evolved to impact prime borrowers whose loans were originally affordable. Loss mitigation initiatives and HAMP guidelines need to keep pace with this changing nature of the problem.

However, these initiatives are in their early stage, and foreclosures have continued at a rapid pace. In total, 2.8 million homeowners received a foreclosure notice in 2009. Each foreclosure has imposed costs not only on borrowers and lenders but also indirectly on communities and the broader economy. These foreclosures have driven down home prices, and nearly one in four homeowners with a mortgage is presently underwater. Although housing prices have begun to stabilize in many regions, home values in several metropolitan areas, such as Las Vegas and Miami, continue to fall sharply. Indeed, all Americans are impacted, as taxpayers are now mortgage investors through Fannie and Freddie, so everyone faces losses from declining values.

Results from Treasury's existing programs continue to lag well behind the pace of the crisis. For every borrower who avoided foreclosure through HAMP last year, another 10 families lost their homes. Treasury's stated goal is for HAMP to offer loan modifications to 3 to 4 million borrowers, but only a portion of offers will result in temporary modifications, and even fewer of those temporary modifications will convert to final, five-year status.

Part I: Panel Findings

The Panel has issued three reports to date on foreclosures. The most recent was just released on April 14th. It lays out three primary areas of concern: the timeliness of Treasury's response to the subprime crisis, the sustainability of mortgage modifications, and the accountability of Treasury's foreclosure programs.

From the Panel's ongoing assessment of Treasury's response to the housing crisis, I would like to highlight two of these themes, namely sustainability and accountability. In both areas there are specific recommendations to improve program effectiveness.

A. Sustainability

Although HAMP modifications reduce a homeowner's mortgage payments, many borrowers continue to experience severe financial strain, which calls into question the long-term sustainability of the modified mortgage. The typical post-modification borrower pays about 59 percent of his total income on debt service, including payments on first and second mortgages, credit cards, car loans, student loans, and other obligations. Most borrowers who proceed through HAMP still face a precarious future, with severely constrained resources.

Treasury should consider whether its definition of "affordability" and the present 31 percent debt-to-income requirement for program entry adequately captures the many financial pressures facing families today. A particular concern is the existence of second mortgages, which may leave borrowers exposed to foreclosure risk even after the primary mortgage has been modified. Modification efforts should encompass the impact of second liens, which ideally would be extinguished, and any remaining other mortgage debt should be included when evaluating the sustainability of household finances.

Further, we have heard from servicers that whenever principal reduction is included as a component of the modification, even at the same debt-to-income ratio, the outcome is more sustainable. This highlights the importance of incorporating broad principal forgiveness into foreclosure mitigation programs. Treasury amended the HAMP waterfall to require consideration of principal forgiveness, which also gives servicers a liability safe harbor from investors when making modifications. Initial industry reaction indicates that voluntary principal write-downs may not result in widespread change in servicer behavior, but I strongly encourage servicers to execute write-downs as appropriate.

It is also important to remember that the terms of permanent modifications only stay in place for five years. After that period, the interest rate can begin to rise one percentage point a year until it reaches the rate that prevailed at the time of modification. Even though rates will be capped at current prevailing rates, which are at an historic low, many families will experience increased payments after five years.

B. Accountability

The success of these measures to improve HAMP ultimately hinges on accountability. Treasury must take care to communicate clearly its goals, its strategies, and its specific metrics for success for its programs.

I would like to highlight four topics related to accountability: compliance, program transparency, launch of a web portal to empower borrowers, and the creation of an ombudsman or Homeowner Advocate within Treasury.

1. Compliance

The Panel's April report gets to the heart of the accountability question, by recommending that Treasury exercise greater oversight of Fannie Mae and Freddie Mac on compliance issues. In particular, the failure of servicers to consistently and accurately provide valid reasons for canceling or denying a mortgage modification has made it difficult to gather reliable data on the programs' effectiveness and Treasury should subject servicers to sanctions. Although servicers began to report on reasons why HAMP modifications were denied or cancelled beginning in February 2010, the data has been reported inconsistently. Indeed, a valid reason for a modification cancellation or denial was not provided in more than 70 percent of the cases. Treasury needs to ensure that homeowners are not improperly denied the opportunity for a modification and sent into foreclosure without their servicer accounting for their determinations. Treasury must thoroughly monitor the activities of participating lenders and servicers, audit them, and enforce program rules with strong penalties for failure to follow the requirements.

2. Program Transparency

Further, our Panel's recommendations concerning greater data collection on the HAMP process is important. The Panel has identified a comprehensive list of data that Treasury should commit to releasing publicly, including:

- Conversion rates by vintage of trial modifications and the percentage of modifications commenced in any given month that have converted;
- Average loan-to-value ratio (LTV) of all permanent modifications;
- Number of junior mortgages eliminated under the second lien program;
- Average front- and back-end debt ratios before and after permanent modification; and,
- Breakdown of trial modification denial and cancellation reasons by number and percentage on a cumulative and monthly basis.

Treasury should also release information on the status of borrowers who received notice from servicers by January 31 of the expiration of their trial modification period, and inform the public with a new data category for those who are appealing the servicer's notice.

We need improved data access to identify the choke points in the process, so the program can adapt to ensure that Treasury's new standards taking effect on June 1 meet their objective. Using this data, Treasury might consider whether some duplicative or burdensome document requests are slowing the process, such as requiring profit and loss statements.

Additionally, Treasury should pledge to release data publicly through the full term of all loan modifications, not simply until TARP expires or until HAMP stops making additional modifications.

3. Web portal

Most importantly, the data must address the most frequent concern I have heard from borrowers and housing counselors as Chair of New York State's foreclosure mitigation task force: borrowers do not know the status of their submissions and are not receiving timely updates as to whether submitted documents have been received or are deemed adequate. These problems do not go away on June 1, but the number of people who will be denied access to the program will go up if they are not addressed.

I am troubled that Treasury's expanded web portal, where borrowers could check their application status and verify whether servicers have received necessary documentation, has so far failed to launch. Although Treasury is seeking to improve the servicers' notification process, borrowers should be encouraged and enabled to be proactive in monitoring the processing of their modification request. I urge Treasury to swiftly implement this tool.

4. Homeowner Advocate within Treasury

Borrowers have to expend extraordinary effort to achieve results in the modification process, and are kept in the dark throughout much of the process. This lack of servicer responsiveness highlights the need for an ombudsman or Homeowner Advocate within Treasury to go beyond the automated tool of the web portal.

As Superintendent of Banks for New York, I am closely in touch with complaints and concerns from our residents in regard to their mortgage loans. I was especially struck by a homeowner who had faithfully made trial modification payments for six months without being notified of her status. Her HAMP modification was eventually denied, and would have been replaced with a non-HAMP workout that increased her monthly payment. She ultimately persevered in obtaining an alternate and more sustainable modification that did lower her payment, but no homeowner should be left in limbo for months on the status of their modification application. HAMP implementation must learn from the currently low conversion rate to permanent modifications.

Borrowers should also be informed about how their eligibility for HAMP is calculated, including the inputs used when denied as a result of an alleged NPV-negative loan. This degree of transparency and accountability for servicers in their decision to deny a modification will also give borrowers the information they need to make a meaningful appeal if they believe they were denied a modification incorrectly or to submit additional facts in support of their application.

As a final point on accountability, Treasury needs to be clear on the amount of funding it intends to allocate for foreclosure mitigation. Treasury originally stated that $50 billion would be designated; yet, previous apportionments plus the amounts related to recent program enhancements total more than $61.6 billion. Treasury should clarify whether it intends to increase its spending or scale back its initiatives.

<u>**Part II: Areas for Additional Action**</u>

In my supplemental views supporting the Panel's April report, I identified two areas beyond HAMP where I believe more can be done to prevent foreclosures:

1. Assisting homeowners who are experiencing temporary unemployment or other hardship; and,
2. Creating a national mortgage performance database.

<u>1. The Country Needs a National Emergency Mortgage Support Program (EMS)</u>
Even prime borrowers with loans made on prudent terms are facing increasing pressure as the crisis has continued. Unemployment and reduced earnings is the number one reason for prime defaults according to Freddie Mac.

The State Foreclosure Prevention Working Group, a multi-state effort of state attorneys general and state banking supervisors, has conducted additional research that brings the impact on prime loans into sharp focus. The number of prime loans in foreclosure has doubled in each of the past two years and now account for 71 percent of the increase in the total number of loans in foreclosure.

The Administration's Help for the Hardest-Hit Housing Markets is a step in the right direction, both in terms of assisting those most in need and in leveraging states as partners. The recent enhancements to HAMP will also help unemployed borrowers through temporary payment reductions and expanded eligibility for permanent modifications.

As positive as these steps are, these measures do not replace the need for a nationwide Emergency Mortgage Support system (EMS). The Help for the Hardest-Hit Housing Markets program by design is limited to target geographies. And the recently announced three to six-month reprieve for the unemployed under HAMP, although very helpful, is an insufficient time frame to stabilize household budgets that have been ravaged by sharply reduced income. The scope of impacted borrowers is simply too great for anything short of a national program, which should be administered by the states with the support of the nonprofit housing community.

Pennsylvania, Delaware, North Carolina, New Jersey, and Connecticut currently have state programs to assist the unemployed facing foreclosure that can help inform a national model. They take different approaches to making short-term loans accessible for those who need temporary help while seeking to ensure a borrower will repay their loans once their hardship has passed.

An evaluation of these differing states approaches suggests that underwriting criteria should be based on bright lines for easy administration and program sustainability, but within a sufficiently flexible framework so that the program can truly help those it is intended to. For example, the number of past missed payments by a borrower should be evaluated on a bright line basis as most of the states do. However, the states differ about the number of missed payments that should be permitted, thus demonstrating the need for a guiding principle. The principle should perhaps be based on the age of the mortgage loan, whereby newer loans allow for fewer missed payments. This flexible framework, by incorporating a bright line, better protects the program from early payment default or fraud on newly-originated mortgages while allowing appropriate discretion for aged loans to take account of servicer delays in payment processing or occasional borrower oversight.

A full set of underwriting criteria is beyond the scope of my remarks today, but I mention this one example of how expanded assistance could be achieved within a prudent program framework. Emergency mortgage support should also involve lender and investor concessions, including eventual HAMP modification and perhaps waiving arrearages for unemployed borrowers.

2. A National Mortgage Performance Database Is Needed

The gaps in data access for borrowers seeking modifications highlight the general lack of data about the mortgage market. Access to complete information on existing mortgages does not exist, and the reason is simple: there is no mortgage loan performance reporting requirement for the industry.

Once a new loan has been initially reported under the Home Mortgage Disclosure Act (HMDA), it is no longer tracked in any public database. HMDA has been a powerful tool for combating housing discrimination and predatory lending in mortgage origination, but a performance data reporting requirement would provide a similar window on servicing practices after the loan has been made. Because lenders and servicers already report the payment status of open loans to credit bureaus, a performance data standard could be put into operation quickly.

Currently, Congress, banking regulators, consumer advocates, and other policymakers are left with incomplete or unreliable data purchased from third-party vendors or with limited data provided voluntarily by the industry. This lack of a public database has hindered the response to the housing sector. Improved intelligence on the mortgage market is critical to preventing future crises.

That is why I believe that Congress should create a national mortgage loan performance reporting requirement applicable to banking institutions and others who service mortgage loans, to provide a source of comprehensive information. Federal banking or housing regulators should be mandated to analyze such data and share the results with the public.

Conclusion

Foreclosure prevention is not just the right thing do for suffering Americans, but it is the lynchpin around which all other efforts to achieve financial stability revolve. We cannot solve the financial crisis without dealing with the root of the problem: the millions of American families who are at risk of losing their homes to foreclosure.

I appreciate the opportunity to share my views. I would be pleased to provide more details on the Panel's assessment of Treasury's foreclosure mitigation efforts or to answer any questions. Thank you.