For Release Upon Delivery
10:00 a.m., November 18, 2010

TESTIMONY OF

JOHN WALSH
ACTING COMPTROLLER OF THE CURRENCY

before the

SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

of the

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

November 18, 2010

Statement Required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

Introduction

Chairwoman Waters, Ranking Member Capito, and members of the Subcommittee, I appreciate this opportunity to discuss recently reported improprieties in the foreclosure processes used by several large mortgage servicers and actions that the Office of the Comptroller of the Currency (OCC) is taking to address these issues where they involve national banks. The occurrences of improperly executed documents and attestations raise concerns about the overall integrity of the foreclosure process and whether foreclosures may be inappropriately taking homes from their owners. These are serious matters that warrant the thorough investigation that is now underway by the OCC, other federal bank regulators, and other agencies.

The OCC supervises all national banks and their operating subsidiaries, including their mortgage servicing operations. The servicing portfolios of the eight largest national bank mortgage servicers[1] account for approximately 63 percent of all mortgages outstanding in the United States – nearly $33.3 million loans totaling almost $5.8 trillion in principal balances as of June 30, 2010.

To date, four large national bank servicers have publicly acknowledged procedural deficiencies in their foreclosure processes. The lapses that have been reported represent a serious operational breakdown in foreclosure governance and controls that we expect national banks to maintain. These lapses are unacceptable, and we are taking aggressive actions to hold national banks accountable, and to get these problems fixed. As soon as the problems at Ally Bank came to light, we directed the largest national bank mortgage servicers under our supervision to review their operations, to take corrective action to remedy identified problems, and to strengthen their foreclosure governance to prevent reoccurrences. At the

[1] Bank of America, Citibank, JPMorgan Chase, HSBC, MetLife, PNC, Wells Fargo, and U.S. Bank.

same time, we initiated plans for intensive, on-site examinations of the eight largest national bank mortgage servicers. Through these examinations we are independently testing the adequacy of governance over their foreclosure processes to ensure foreclosures are completed in accordance with applicable legal requirements and that affidavits and claims are accurate. As part of our examinations we also are reviewing samples of individual loan files where foreclosures have either been initiated or completed to test the validity of bank self-assessments and corrective actions, and to determine whether troubled borrowers were considered for loss mitigation alternatives such as loan modifications prior to foreclosure. Our examinations are still on-going.

My testimony provides a brief discussion of recently publicized foreclosure problems, and our most recent findings on trends in modifications, alternatives to modifications, and foreclosures from the *OCC and OTS Mortgage Metrics Report*. I then describe the OCC's actions with respect to loan modifications and problems that have arisen in the foreclosure process.

Overview – Current Foreclosure Problems

The current foreclosure problems represent another painful chapter of the recent financial crisis, stemming from a record number of borrower defaults which has strained servicer capacity to provide loss mitigation activities to troubled borrowers and ensure a large and growing number of foreclosures are properly processed.

The concerns about improper foreclosure practices initially centered on two issues that deal with the documentation required to effect foreclosure actions. The first issue involves requirements under some state laws for individuals to sign affidavits attesting *personal* knowledge of the accuracy and completion of required documentation essential to a valid foreclosure proceeding. The second issue is whether, in similar situations where required by state law, individual notaries may have violated procedures in notarizing documentation by, for example, notarizing the documents after they had been signed, rather than in the presence of the individual signing the affidavit. As the situation has evolved, concerns have broadened to include the accuracy of all information underlying the foreclosure process, and the physical possession and control over documents necessary to foreclose on a home. Our examinations are investigating all of these issues.

The signing and attestation of foreclosure documents are steps required by various state laws that govern the legal completion of a foreclosure proceeding—and as such, typically represent the final steps in what is a very lengthy and resource intensive process that banks undertake to deal with seriously delinquent borrowers. The time to complete a foreclosure process in most states can take 15 months or more and in many cases can be as long as two years. Foreclosure completion timelines are generally set by investors such as Fannie Mae and Freddie Mac, and there are penalties for servicers who do not meet the timelines mandated by these investors.

The specific requirements and the legal standards applied for determining personal knowledge vary across judicial foreclosure states, and thus require servicers to ensure that their processes conform to individual state, or in some cases, local law. To assist with meeting these requirements, mortgage servicers often outsource some of the requisite legal work to law firms familiar with local standards and other third parties for input and review. Fannie Mae and Freddie Mac in fact require servicers to use law firms approved for particular geographies when preparing foreclosure filings. For large mortgage servicers that operate nationwide, this often has resulted in a panoply of documents used in their mortgage foreclosure processes: one large mortgage servicer has indicated that they use over 250 different affidavit forms. These operational challenges, however, do not absolve the banks' from their responsibilities to have the appropriate staff, quality controls, and an effective audit process in place to ensure that documents are accurate and the foreclosure process is conducted in compliance with applicable state and local laws.

Servicers typically move forward with foreclosure proceedings only after thoroughly evaluating a borrower's eligibility for loan modifications and other alternatives, such as short sales or deed-in-lieu-of-foreclosures.[2] As a practical matter, many investors for whom loans are serviced, including Fannie Mae and Freddie Mac, require servicers to attempt loss mitigation actions, including modifications, prior to foreclosing on a home. The largest national bank mortgage servicers are participants in Treasury's Home Affordable Modification Program (HAMP) and are required to evaluate troubled borrowers to determine their eligibility for a HAMP modification. For borrowers that fail to qualify for a HAMP loan modification, servicers also typically consider whether the borrowers would qualify for a modification under their proprietary programs. In the vast majority of cases, it is only after these loan modification efforts have been exhausted that final foreclosure actions are taken.

Recent Trends in Mortgage Modifications and Foreclosure Activity

Since 2008, the OCC has collected loan level data from the large national banks we supervise and published this information in quarterly mortgage metrics reports. We have since expanded our data collection and reporting efforts and joined with the Office of Thrift Supervision (OTS) to publish data on the performance of loans and loan modifications, and to highlight trends in loss mitigation activities, foreclosures, and re-defaults occurring on mortgages serviced by large national banks and federally regulated thrifts. Our most recent

[2] Short sales refer to sales of mortgaged properties at prices that net less than the total amount due on the loans. Servicers and borrowers negotiate repayment programs, forbearance, or forgiveness for any remaining deficiency on the debt. Short sales typically have less adverse impact than foreclosures on borrowers' credit records. Deed-in-lieu-of-foreclosure actions refer to actions in which borrowers transfer ownership of the properties (deeds) to servicers in full satisfaction of the outstanding mortgage debt to lessen the adverse impact of the debt on borrowers' credit records.

report, released in September, provides data through second quarter 2010 for nearly 34 million first-lien mortgages, totaling nearly $6 trillion in outstanding balances—representing approximately 65 percent of all first-lien residential mortgages in the country.[3] Key trends from that report are summarized below.

Overall Mortgage Performance

As shown in Table 1, the percentage of current and performing mortgages remained unchanged from the previous quarter at 87.3 percent. The percentage of mortgages 30 to 59 days delinquent increased to 3.1 percent at the end of the second quarter of 2010, compared with 2.8 percent at the end of the previous quarter and 3.2 percent a year ago. The percentage of seriously delinquent mortgages[4] was 6.2 percent, a decrease of 5.3 percent from the previous quarter but up 16.1 percent from a year ago. Foreclosures in process were 3.4 percent of the total portfolio, a 1.4 percent decrease from the previous quarter but a 16.1 percent increase from a year ago.

Table 1. Overall Portfolio Performance
(Percentage of All Mortgages in the Portfolio)

	6/30/09	9/30/09	12/31/09	3/31/10	6/30/10	1Q %Change	1Y %Change
Current and Performing	88.6%	87.2%	86.4%	87.3%	87.3%	0.1%*	-1.4%
30–59 Days Delinquent	3.2%	3.4%	3.4%	2.8%	3.1%	11.0%	-3.5%
Seriously Delinquent	5.3%	6.2%	7.1%	6.5%	6.2%	-5.3%	16.1%
Foreclosures in Process	2.9%	3.2%	3.2%	3.5%	3.4%	-1.4%	16.1%
Overall Portfolio Performance (Number of Mortgages in the Portfolio)							
Current and Performing	29,962,265	29,666,568	29,217,743	29,574,957	29,483,014	-0.3%	-1.6%
30–59 Days Delinquent	1,078,663	1,154,825	1,138,822	939,306	1,038,422	10.6%	-3.7%
Seriously Delinquent	1,798,532	2,111,588	2,388,938	2,210,393	2,083,585	-5.7%	15.8%
Foreclosures in Process	992,554	1,091,620	1,079,386	1,170,785	1,149,770	-1.8%	15.8%

[3] A full copy of the *OCC and OTS Mortgage Metrics Report, Second Quarter 2010* is available at: http://www.occ.gov/publications/publications-by-type/other-publications/mortgage-metrics-q2-2010/mortgage-metrics-q2-2010-pdf.pdf.

[4] Seriously delinquent loans are those mortgages that are 60 or more days past due and all mortgages held by bankrupt borrowers whose payments are 30 or more days past due.

Home Retention Actions

As shown in Table 2, servicers implemented 902,800 permanent loan modifications (shown as “Other Modifications” and “HAMP Modifications”) over the past five quarters with HAMP modifications accounting for approximately 26 percent of this total. During the second quarter 2010, servicers initiated or implemented 504,292 home retention actions. This included 273,419 HAMP and other permanent loan modifications, an increase of 18.1 percent from the first quarter of 2010. Loan modifications implemented in second quarter 2010 represent 13.1 percent of seriously delinquent borrowers, up from 7.9 percent in the second quarter 2009. While the number of permanent modifications increased, the number of trial modifications and other payment plans declined as servicers worked through their portfolio of seriously delinquent mortgages to determine borrower eligibility under HAMP and each servicer’s own proprietary loan modification programs.

Table 2. **Number of New Home Retention Actions**

	6/30/09	9/30/09	12/31/09	3/31/10	6/30/10	1Q %Change	1Y % Change
Other Modifications	142,362	130,464	103,617	131,207	164,473	25.4%	15.5%
HAMP Modifications	--	783	20,679	100,269	108,946	8.7%	--
Other Trial Period Plans	64,201	127,902	96,048	101,764	73,673	-27.6%	14.8%
HAMP Trial Period Plans	79,994	272,709	259,015	188,503	64,666	-65.7%	-19.2%
Payment Plans	131,974	163,551	121,722	120,587	92,534	-23.3%	-29.9%
Total	418,531	695,409	601,081	642,330	504,292	-21.5%	20.5%

Changes to Borrowers’ Monthly Payments Resulting from Modifications

Early in the mortgage crisis, servicers’ informal payment plans and loan modifications were done in low volume and often resulted in mortgage payments that increased or did not change. This traditional approach to loss mitigation gave delinquent borrowers experiencing temporary financial problems a chance to catch-up on making their loan payments. However, as the mortgage crisis deepened, unemployment climbed, and the number of delinquent borrowers increased to unprecedented levels, it became clear that more formal and permanent modifications were needed. The OCC's mortgage metrics data provided factual evidence that loan modifications completed in 2008 were experiencing high re-default rates. As a result of those high re-default rates, in March 2009, the OCC directed the largest national banks to take corrective action to implement loan modification programs designed to achieve more sustainable modifications.

As a result, servicers have focused efforts on improving the quality of their loan modifications and the performance of those modifications over time. This is evidenced by the increase in modifications that are reducing borrowers' monthly mortgage payments and the corresponding decline in re-defaults (as measured by serious delinquencies) subsequent to modification since the OCC's direction to servicers in 2009. As shown in Table 3, mortgage modifications that lowered monthly principal and interest payments increased to more than 90 percent of all modifications during the second quarter 2010. The emphasis on payment affordability and sustainability has resulted in a 62 percent increase in the average monthly savings in mortgage payments from mortgage modifications from a year ago. As shown in Table 4, modifications made during the second quarter of 2010 reduced monthly payments by an average of $427. Further, 56 percent of the modifications made during the second quarter reduced the borrower's monthly payment by 20 percent or more, representing an average savings to the consumer of $698 a month. These actions for more sustainable payments are also reflected in lower re-default rates for more recently modified loans. Modifications made after the end of the first quarter of 2009 have experienced about half the re-default rates of modifications made prior to that time.[5]

[5] *See OCC and OTS Mortgage Metrics, Second Quarter*, page 7.

***Table 3.* Changes in Monthly Principal and Interest Payments Resulting from Modifications**							
(Percentage of Modifications)*							
	6/30/09	9/30/09	12/31/09	3/31/10	6/30/10	1Q %Change	1Y %Change
Decreased by 20% or More	38.8%	37.0%	41.8%	54.9%	56.4%	2.9%	45.5%
Decreased by 10% to Less than 20%	19.6%	18.3%	19.1%	17.7%	17.6%	-0.4%	-10.2%
Decreased Less than 10%	19.9%	24.4%	21.1%	14.9%	16.1%	8.1%	-19.3%
Subtotal for Decreased	**78.3%**	**79.7%**	**82.0%**	**87.4%**	**90.1%**	**3.1%**	**15.1%**
Unchanged	4.3%	3.6%	4.8%	2.7%	1.9%	-30.8%	-55.8%
Increased	17.4%	16.8%	13.2%	9.9%	8.0%	-18.9%	-54.0%
Subtotal for Unchanged and Increased	**21.7%**	**20.3%**	**18.0%**	**12.6%**	**9.9%**	**-21.4%**	**-54.4%**
Total	100.0%	100.0%	100.0%	100.0%	100.0%		
(Number of Modifications)							
Decreased by 20% or More	54,860	48,151	51,036	126,379	153,730	21.6%	180.2%
Decreased by 10% to Less than 20%	27,691	23,786	23,338	40,663	47,875	17.7%	72.9%
Decreased Less than 10%	28,213	31,707	25,748	34,271	43,827	27.9%	55.3%
Subtotal for Decreased	110,764	**103,644**	100,122	201,313	245,432	21.9%	121.6%
Unchanged	6,038	4,630	5,822	6,273	5,136	-18.1%	-14.9%
Increased	24,665	21,829	16,142	22,750	21,831	-4.0%	-11.5%
Subtotal for Unchanged and Increased	30,703	**26,459**	21,964	29,023	26,967	-7.1%	-12.2%
Total	141,467	130,103	122,086	230,336	272,399	18.3%	92.6%

*Payment change information was not reported on 895 modifications in the second quarter of 2009; 1,144 in the third quarter of 2009; 2,210 in the fourth quarter of 2009; 1,140 in the first quarter of 2010; and 1,020 in the second quarter of 2010.

***Table 4.* Average Change in Monthly Payments Resulting from Modifications**							
All Modifications							
	6/30/09	9/30/09	12/31/09	3/31/10	6/30/10	1Q %Change	1Y %Change
Decreased by 20% or More	$617	$623	$626	$664	$698	5.0%	13.1%
Decreased by 10% to Less than 20%	$193	$196	$185	$189	$187	1.2%	-2.9%
Decreased Less than 10%	$61	$55	$62	$67	$68	0.8%	11.7%
Unchanged	--	--	--	--	--	--	--
Increased	$145	$146	$153	$163	$132	-19.0%	-8.7%
Overall	$264	$258	$290	$392	$427	8.9%	61.8%

Home Forfeiture Actions – Short Sales, Deed-in-Lieu-of-Foreclosures, and Foreclosures

As previously noted, mortgage servicers generally do not proceed with home forfeiture actions until they have evaluated the borrower's eligibility for a loan modification that would allow the borrower to stay in his or her home. Unfortunately, loan modification programs cannot help borrowers who simply cannot make even reduced mortgage payments. In these cases, servicers turn to home forfeiture actions to protect the interests of lenders and investors.

Completed home forfeiture actions—foreclosure sales, short sales, and deed-in-lieu-of-foreclosure actions—totaled 221,474 during the second quarter, an increase of 14.2 percent from the previous quarter (see Table 5). Short sales and deed-in-lieu-of-foreclosure actions increased significantly during the quarter, but they remain only 26 percent of home forfeiture actions overall. While home forfeiture actions increased in the second quarter, servicers implemented about 2.3 times more home retention actions—loan modifications, trial period plans, and payment plans—than total home forfeiture actions.

Table 5. Completed Foreclosures and Other Home Forfeiture Actions

	6/30/09	9/30/09	12/31/09	3/31/10	6/30/10	1Q %Change	1Y %Change
Completed Foreclosures	106,004	118,606	128,859	152,654	162,812	6.7%	53.6%
New Short Sales	25,128	30,766	37,583	40,043	56,926	42.2%	126.5%
New Deed-in-Lieu-of-Foreclosure Actions	1,120	1,233	1,054	1,185	1,736	46.5%	55.0%
Total	132,252	150,605	167,496	193,882	221,474	14.2%	67.5%
Newly Initiated Home Retention Actions Relative to Completed Foreclosures and Other Home Forfeiture Actions	316.5%	461.7%	358.9%	331.3%	227.7%	-31.3%	-28.1%

The number of newly initiated foreclosures decreased by 21.2 percent, to 292,072, during the second quarter of 2010, the lowest level in more than a year. The lower number is partly attributable to the increase in permanent modifications made during the quarter. In addition, HAMP guidelines now preclude the servicer from initiating a foreclosure action until the borrower has been determined to be ineligible for a HAMP modification. Similarly, the number of loans in process of foreclosure decreased by 1.8 percent from the previous quarter to 1,149,770, reflecting the increases in permanent modifications and completed foreclosures during the quarter as well as the drop in newly initiated foreclosure actions. Notwithstanding these positive trends, we expect the number of foreclosure actions will remain elevated as the large inventory of seriously delinquent loans and loans in process of foreclosure works through the system.

Table 6. Number of Newly Initiated Foreclosures and Foreclosures in Process

	6/30/09	9/30/09	12/31/09	3/31/10	6/30/10	1Q %Change	1Y %Change
Number of Newly Initiated Foreclosures							
Total	369,226	369,209	312,520	370,536	292,072	-21.2%	-20.9%
Number of Foreclosures in Process							
Total	992,554	1,091,620	1,079,386	1,170,785	1,149,770	-1.8%	15.8%

OCC Supervisory Efforts

Emphasis on Sustainable Loan Modifications and Accurate Financial Reporting

As the volume of problem loans surged to record levels and has worked its way through the financial system, servicers have struggled to maintain the needed capacity and resources to effectively deal with the number of consumers who require assistance. We have used our examination process and our Customer Assistance Group (CAG) to address issues as they have arisen.

Our primary supervisory focus in assessing how servicers work with borrowers experiencing payment problems over the past two years has centered on their efforts to offer sustainable loan modifications that avoid foreclosure and allow troubled borrowers to remain in their homes. As previously noted, when our mortgage metrics data showed that an inordinately high percentage of loan modifications made in 2008 were re-defaulting, we directed large national bank mortgage servicers to take corrective action and revise their loan modification programs to produce loan modifications that resulted in more sustainable loan payments. In most cases, this requires concessions to the terms of the loan, rather than simply granting a borrower a payment deferral that capitalizes arrearages, which was typical in many traditional modifications.

Some observers have stated that the banking agencies' accounting policies and supervisory treatment of second-lien mortgages are preventing servicers from being more aggressive in their loan modification efforts. We do not agree with this assertion. We have repeatedly encouraged banks to work with troubled borrowers, but have also stressed that bankers cannot use loan modifications as a means to mask or defer recognition of losses. In this regard, we have told our examiners that we expect loan modifications to be undertaken in a manner that improves the likelihood that a borrower can repay the restructured credit under the modified terms and in accordance with a reasonable repayment schedule. Regardless of whether a loan is modified or not, we expect banks to maintain systems to identify problem assets, estimate incurred credit losses for those assets, and establish loan loss reserves and/or initiate write-downs sufficient to absorb estimated losses consistent with generally accepted accounting principles and regulatory policies.

We apply the same expectations to second-lien mortgages held by national banks, and have noted that the presence of second liens does not impede servicers' ability to modify first-lien mortgages because modifications do not adversely affect the first-lien position of lenders or investors. As with first-lien mortgages, we expect banks to work with borrowers and to hold appropriate loan loss reserves against the elevated risks facing second-lien mortgages. Over the last two years, national banks have recognized $43.5 billion in losses from nonperforming second mortgages according to the federal financial call report, more than five times the losses recognized over the previous five years.

Lenders must also reserve against the elevated risk of default and loss associated with current and performing second liens that stand behind delinquent or modified first liens. The volume of current and performing second liens held by national banks behind delinquent or modified first liens remains relatively small. The OCC analyzed second liens held by national banks and matched more than 60 percent of them ($293 billion) to first-lien mortgages. Of these 5,000,000 matched second mortgages, about 6 percent, or 235,000, were current and performing but behind delinquent or modified first liens. The balance of those current and performing second liens behind delinquent or modified first mortgages totaled less than $18 billion. The OCC has directed national banks that hold such performing second liens to properly reflect the associated credit impairment for those second liens through an increase in the allowance for loan losses, or in many cases, a charge-off of the loan where appropriate.

Oversight of and Responses to Foreclosure Documentation Issues

When reviewing a bank's foreclosure governance process, such as practices involved with the preparation and filing of affidavits for foreclosure proceedings, examiners determine if the bank has appropriate policies, procedures, and internal controls in place to ensure the accuracy of information relied upon in the foreclosure process and compliance with federal and state laws. An appropriate governance process would include the testing of those policies and procedures through periodic internal audits and the bank's on-going quality control function. Examiners generally do not directly test standard business process or practices, such as the validity of signed contracts, or the processes used to notarize documents or the actual physical presence of notes with document custodians, unless there is evidence of a material weakness or breakdown in governance and internal controls over these activities. In making such a determination, examiners will review on-going quality control activities, internal or third-party audits, and consumer complaints. In this regard, neither internal quality control nor internal or third party audits at the largest servicers, or our CAG data revealed that foreclosure document processing was an area of concern.

When the problems at Ally Bank – an institution that is not supervised by the OCC – became public, the OCC took immediate action to determine if procedural breakdowns at national bank servicers could be resulting in similar foreclosure affidavit problems. On September 29, 2010, we ordered the eight largest national bank servicers to conduct a comprehensive self-assessment of their foreclosure management processes, including file review and affidavit processing and signature. We also made clear that where deficiencies were identified, the servicers needed to take prompt action to remedy any improper documentation, including as applicable, making appropriate re-filings with local courts. Equally important, we also directed banks to strengthen foreclosure governance to ensure the accuracy of the information relied upon in the foreclosure process and prevent re-occurrences of documentation problems.

Concurrent with this directive, we began logistical plans for on-site examinations at each of these large servicers and their mortgage servicing operational centers. Our objectives are to independently test and verify the adequacy and integrity of bank self-assessments and corrective actions; the adequacy and effectiveness of governance over servicer foreclosure processes to ensure foreclosures are completed in accordance with applicable legal requirements and that affidavits and claims are accurate; and to determine whether troubled borrowers were considered for loss mitigation alternatives such as loan modifications prior to foreclosure.

These examinations are now underway at each of the eight servicers. The Federal Reserve Board (FRB) and Federal Deposit Insurance Corporation (FDIC) are participating in these examinations. The examination teams include examiners from the OCC, FRB, and FDIC. The OCC has approximately 100 examiners working on this effort. Legal support is provided by staff attorneys from both the OCC and FRB. We have established an interagency foreclosure review team to provide oversight and direction to on-site examination teams to ensure consistency in our examination work.

As noted above, a key objective of our examinations is to determine the adequacy and effectiveness of governance over the foreclosure process. The scope of work to assess governance is extensive and includes an assessment of each servicer's foreclosure policies and procedures, organizational structure and staffing, vendor management, quality control and audit, loan documentation including custodial document management, and foreclosure work flow processes. As part of these reviews, examiners are conducting interviews with personnel involved in the preparation, review, and signing of foreclosure documents. Our objective in conducting these interviews is to understand current and past practices with respect to preparation of foreclosure documents, whether the staff conducting these functions had sufficient knowledge and training, including training in relevant requirements, to effectively complete and sign-off on foreclosure affidavits, and to help assess the underlying cause of any identified deficiencies.

Examiners will also be reviewing samples of individual borrower foreclosure files from judicial and non-judicial states that include both in-process and completed foreclosures.

In reviewing these files, examiners will determine whether foreclosed borrowers were appropriately considered for alternative loss mitigation actions such as a loan modification. Examiners will also check for the following:

- A documented audit trail that demonstrates that data and information (e.g., amount of indebtedness and fees) in foreclosure affidavits and claims are accurate and comply with state laws;
- Possession and control over the underlying, critical loan documents such as original note, mortgage, and deed of trust to support legal foreclosure proceedings; and
- Evidence that the affidavit and documents were independently and appropriately reviewed, and that proper signatures were obtained.

In addition to these loan file reviews, examiners will review the nature, volume, and resolution of foreclosure-related complaints. These will include complaints received by the OCC's Customer Assistance Group as well as complaints received by the banks.

Finally, examiners will assess the adequacy of each bank's analysis and financial reporting for the potential adverse impact on the bank's balance sheet and capital that may arise from the increased time and costs needed to correct any procedural errors; losses (if any) resulting from inability to access collateral; and expected litigation costs. We are directing banks to maintain adequate reserves for potential losses and other contingencies and to make appropriate disclosures, consistent with applicable Securities and Exchange Commission's disclosure rules.

Using our authority under the Bank Service Company Act, we also are conducting interagency examinations of two major non-bank mortgage service providers. The OCC, in coordination with the FRB, FDIC, and Federal Housing Finance Agency, is leading an on-site examination of the Mortgage Electronic Registration System (MERS). A key objective of the MERS examination is to assess MERS corporate governance, control systems, and accuracy and timeliness of information maintained in the MERS system. Examiners assigned to MERS will also visit on-site foreclosure examinations in process at the largest mortgage servicers to determine how servicers are fulfilling their roles and responsibilities relative to MERS.

We are also participating in an examination being led by the FRB of Lender Processing Services, Inc., which provides third-party foreclosure services to banks.

We expect to have most of our on-site examination work completed by mid to late December. We then plan to aggregate and analyze the data and information from each of these examinations to determine whether or what additional supervisory and regulatory actions may be needed. We are targeting to have our analysis completed by the end of January.

We recognize that the problems associated with foreclosure processes and documentation have raised broader questions about the potential effect on the mortgage market in general and the financial impact on individual institutions that may result from litigation or other actions by borrowers and investors. Obviously, for a host of reasons – from fair treatment of borrowers to the fundamentals of the mortgage marketplace – mortgage servicers must get this right. We are directing banks to take corrective action where we find errors or deficiencies, and we have an array of informal and formal enforcement actions and penalties that we will impose if warranted. These range from informal memoranda of understanding to civil money penalties, removals from banking, and criminal referrals.

H.R. 3451

The Subcommittee has requested the OCC's views on H.R. 3451, which requires lenders and servicers to engage in loss mitigation activities and prohibits foreclosure unless that requirement is satisfied. The OCC supports initiatives that seek to prevent avoidable foreclosures by assisting troubled borrowers with effective and sustainable loan modifications. As bank supervisors, however, we are concerned that the loss mitigation framework that would be established by H.R. 3451 has the potential to raise serious safety and soundness issues. For example, the legislation prohibits lenders or servicers from considering a borrower's prior default history when evaluating the borrower's eligibility for a loan modification. Such a provision could require lenders to engage in a protracted series of loan modifications even in those circumstances where the borrower lacks the resources to pay and can show no reasonable prospect of being able to make even reduced mortgage payments going forward. Moreover, the legislation lacks a standard for determining when, if at all, a lender or servicer will be deemed to have satisfied its obligation to engage in reasonable loss mitigation activities. Courts may well differ in their application of that requirement, and the resulting uncertainty may have the practical effect of precluding foreclosures – and the lender's or servicer's ability to mitigate its losses. We would be happy to provide more detailed comments on H.R. 3451, and OCC staff are available to work with Subcommittee staff to address concerns such as these.

Conclusion

The OCC is focused on identifying and rectifying problems so that the basic function and integrity of the foreclosure process is restored; the rights of all homeowners subject to the foreclosure process are protected; and the basic functioning of the U.S. mortgage market is not disrupted. As we move forward we will continue to cooperate with the many inquiries and investigations that are taking place and provide updates to the Congress.