ARE THERE GOVERNMENT BARRIERS TO THE HOUSING MARKET RECOVERY?

HEARING

BEFORE THE

SUBCOMMITTEE ON
INSURANCE, HOUSING, AND
COMMUNITY OPPORTUNITY

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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CONTENTS

ARE THERE GOVERNMENT BARRIERS TO THE HOUSING MARKET RECOVERY?

Wednesday, February 16, 2011

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INSURANCE, HOUSING,
AND COMMUNITY OPPORTUNITY,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:50 p.m., in room 2128, Rayburn House Office Building, Hon. Judy Biggert [chairwoman of the subcommittee] presiding.

Members present: Representatives Biggert, Hurt, Miller of California, Capito, Garrett, McHenry, Duffy, Dold, Stivers; Gutierrez, Clay, and Sherman.

Also present: Representative Green.

Chairwoman BIGGERT. Good afternoon. This hearing of the Subcommittee on Insurance, Housing, and Community Opportunity will come to order.

We will begin with opening statements. I apologize for keeping all of you waiting. I really didn't think that we were going to have 18 votes, so it did take quite a bit of time. So I will start and recognize myself for 3 minutes.

Good afternoon, and thank you for attending this hearing. It is the first hearing of the subcommittee.

Today, we will hear testimony that explores how government barriers are driving private capital away from housing while impeding market recovery. We will also examine options for promoting long-term stability in housing and moving toward a housing market that is financed by the private sector.

At no other time in our Nation's history has housing finance been so controlled and so dominated by the Federal Government. While private investors or borrowers benefit on the upside, taxpayers assume the risk and foot the bill for failure. It is a distorted equation: congressionally-created mortgage giants Fannie Mae and Freddie Mac received nearly $150 billion in a taxpayer-backed bailout, and programs like the Federal Housing Administration, or FHA, compete with the private sector businesses. In fact, according to HUD's Web site, FHA is the largest insurer of mortgages in the world, insuring over 34 million properties and over 47,000 multifamily projects, and this is since the inception in 1934.

Combined, Fannie, Freddie, and FHA have well over 90 percent of the mortgage market. And in recent years, government-created and managed mortgage programs united with the private industry and investors. They loosened underwriting standards and offered borrowers risky but low-cost loans, and all with a government guarantee. The result has been that we have seen turmoil not unlike the Great Depression. The government's role in housing and finance is unsustainable.

Thus, during today's hearing we will examine the future of housing finance: Where are we now, what government barriers are fostering uncertainty or preventing a housing market recovery? And finally, what mid- and long-term steps should the Administration and Congress take to enable the private sector to reenter the business of housing finance?

Housing is one of the most important cornerstones of our economy and we must get it right. I look forward to working with my colleagues on reforms to facilitate the private sector and reentry, eliminate the taxpayers' risk, and generate a vibrant housing finance system that serves creditworthy Americans.

So, I welcome today's witnesses and now call on the ranking member, Representative Gutierrez, for 4 minutes.

Mr. GUTIERREZ. Thank you.

Good afternoon. I want to thank our witnesses for being here today.

Before we move on to discuss the role of government in housing and what kind of barriers may be hindering the housing market recovery, I believe we need to have an honest and open discussion about the harsh realities facing hundreds of thousands of hardworking families across our Nation who have lost or are at risk of losing their homes. People are still being displaced, neighborhoods continue to fall apart in some parts of our country, and communities are still suffering due to the foreclosure crisis and the devastating economic condition facing our Nation's housing system.

Since we are all familiar with the current housing situation, I think we should use this platform as a venue to discuss ways to ameliorate the housing crisis and restore faith in America's housing system.

I would like to be clear about something; contrary to what some of my colleagues may believe, I do not believe that the government is hampering the recovery by placing burdensome barriers and driving away private investment in the housing market. Let me join the voices of those wiser and more expert on this subject—and I mean the voices of the Financial Crisis Inquiry Commission. It stated: "The government did not cause the collapse of the housing bubble."

Importantly, there is also consensus among the majority of the members of the Commission that Fannie Mae and Freddie Mac were not primary causes. And lastly, they concluded that the Community Reinvestment Act was not a significant factor.

Today, our government is serving the housing market at a time when private capital is scarce. Since the Federal Housing Authority, FHA, was created in 1934 to serve the housing market in a time of financial crisis, it has worked hard to ensure that housing finance credit is available to the American worker. And I would like to thank them, as I was able to obtain my first home because of FHA.

We are now, once again, in a time of financial crisis, and the FHA is doing what it was created to do: make housing credit available to help struggling homeowners avoid foreclosure. Our government needs to continue to play the crucial role of providing homeowners with the assistance they need during these tough economic times. At this moment, if the government were to leave the housing market, there is no assurance that private investment would take its formidable place to help families save their homes.

So as we move forward and look at ways to bring back the housing market to recovery, we need to give thoughtful consideration to real solutions that will help protect hardworking families. We have seen the devastating effect of lack of credit. Ask business people. It is my belief the same would happen in terms of housing.

I would like to just take a moment and introduce this draft. It is the summary of conclusions of the Financial Crisis Inquiry Commission. It has the majority report. I would just like to say importantly the majority, three out of the four dissenters, concluded that Fannie Mae and Freddie Mac were not primary causes, and they were Republicans. This was a bipartisan group of people, much wiser and much smarter than many others on the issues.

And I would just like to read the second dissent—there was one person who did blame Fannie Mae and Freddie Mac, and that was Mr. Wallison. This dissident blamed the crisis on the government housing policy, a factor that all the other commissioners concluded was not a primary cause, and concluded that almost all of the causes on which the majority report and the first dissent agreed were not primary clauses.

I would like to ask unanimous consent to introduce this. And thank you so much for calling this valuable hearing, Madam Chairwoman.

Chairwoman BIGGERT. Without objection, it is so ordered.

The gentlelady from West Virginia is recognized for 2 minutes.

Mrs. CAPITO. Thank you, Madam Chairwoman. And I would like to thank Chairwoman Biggert for holding today's hearing and to congratulate her on this being her first hearing as the chairman of the Insurance and Housing Subcommittee. I look forward to working with her and Ranking Member Gutierrez on the many challenges facing our Nation's housing market.

Since the start of the housing collapse, the FHA and the Government-Sponsored Enterprises, Fannie and Freddie, have grown in market share to the size where they now collectively insure or guarantee more than 90 percent of all the mortgages in the United States. While the government has played an important role in enhancing the flow of credit to targeted sectors of the economy, excessive risk exposure coupled with lax underwriting standards—and we learned more about that this morning—resulted in a government rescue at the taxpayers' expense.

I think we could all agree that the taxpayer should no longer be on the hook for losses, and that reforms to the housing finance are long overdue. In laying out a plan for housing recovery, I was happy to hear the Administration acknowledge the need to bring private sector capital back into the mortgage market while taking steps to minimize government support and housing finance.

I think generally their report, I welcomed it and thought it was a very good step towards hopefully a bipartisan solution for this. It is important to keep in mind, however, that reforms to reduce the presence of Fannie and Freddie must coincide with FHA reforms to ensure that increased market opportunities flow to the private market and not into FHA. I hope that the efforts that were made last Congress to restore the capital reserves and to enhance financial stability to its deteriorating FHA will continue this Congress so that we may see FHA return to serve its intended role in the housing market.

I believe the Commissioner shares some of those—maybe not entirely, but some of the thoughts there. And I would also like to thank him for all of the work that he did with me and our staff in crafting the FHA reform bill last year. I am sorry we didn't get it all the way through, but we are still here to fight another day.

I look forward to hearing from our panel of experts on the challenges to housing recovery and the future role both the private sector and government support will play in housing finance.

Thank you again to the chairwoman for holding this hearing, and thank you to our witnesses for their testimony.

Chairwoman BIGGERT. The gentleman from California, Mr. Sherman, is recognized for 4 minutes.

Mr. SHERMAN. The title of this hearing is, "Are there Government Barriers to the Housing Recovery?" I think the real title ought to be, "Are there Government Barriers to the Housing Market Collapse?"

Right now, there are too few buyers, the prices are lower than we saw just 2 years ago by a very significant percentage, and we are clinging to the leverage under which we fell just 2 years ago. And now some want to push us off the ledge on the theory that free flight is more ideologically consistent.

We are in a crisis here still, and I don't think we should be deciding what to do with housing finance based on ideological purity. If we were having a long-term hearing about what to do 4 or 5 years from now, I would say that then we would focus on how we want to build for the future. But right now, we are just a few headlines away from another housing collapse, another 10, 20, 30 percent, and with that would be a double-dip recession.

And so it is fortunate that the Federal Government has stepped up to the plate; they should do so in the most responsible manner. And after I am no longer obsessed with dealing with the present crisis and that crisis has passed, I look forward to hearings of this subcommittee to look at a new structure.

I want to thank our witnesses for playing an important role in preventing the collapse that would otherwise occur. I would point out that in the absence of Federal involvement, we might see this market dominated by two or three financial institutions, just as even under the current circumstance, Wells, Bank of America, and Chase originate well over half of the mortgages.

But my greater concern is that—and I see this in my own area because just outside my area, I see houses selling for such a price that they are above the conforming loan limit, even the higher conforming loan limit. If the homes are out in Malibu, the person buying them is able to get financing from their bank, which they may own. But when the home used to be worth $3 million, is now $2 million, you can't get financing for it, and that home ends up dropping further. And I can't say what it would do to the economy of

Los Angeles and so many other cities if middle-class neighborhoods were to face that kind of implosion. That is why we need to maintain the conforming loan limit at $729,000 to $750,000 for high-cost areas, and it is why we need to have Fannie and Freddie involved in every community for the next phase of our effort at economic recovery.

This economic recovery hasn't hit Main Street. We are still in a crisis, and ideological purity should not be the enemy of fiscal sanity and economic stability.

I yield back.

Chairwoman BIGGERT. I thank the gentleman for yielding back.

The gentleman from California, Mr. Miller, is recognized for 2 minutes.

Mr. MILLER OF CALIFORNIA. Thank you. Welcome, Commissioner Stevens. It is good to see you here.

This is the most difficult housing market I have seen in the 40 years I have been involved in it. I have never seen anything like this occur. We have done what we could in the past; we have increased GSE and FHA participation in high-cost areas, and basically we moved into about 92 percent of the marketplace. That, I believe, staved off an incredible crash that could have occurred had we not done that.

We have tried to encourage homeownership. We have tried to give tax credits for first-time homebuyers. We have done some things out there that I think are pretty good. And we are trying, at this point in time, to encourage more private market participation in the marketplace, but liquidity is a problem as we all see it.

The Administration has proposed three options we have to look at, and they are on pages 21 through 29 of the written testimony, I believe. The first 20 pages talk about things that are really not in the three proposals, like guaranteeing low- and moderate-income housing, stability in the marketplace, being able to move into a marketplace in case it becomes illiquid, which one, two, and three do not do. But my concern is that while we are doing this, at the same time the Administration is proposing to increase guarantee fees, reducing larger loans in the high-cost areas, requiring larger downpayments—which I understand some of these—but at the same time, when a market is illiquid, before we have an opportunity to resolve the GSE issue, we are pulling FHA back out of the marketplace.

I understand you are up to 30 percent and you would like to get back to 10, 15 percent where you should be, but these are major changes in the current market and they are going to have, I believe, a major effect and a negative impact on the market too. In this fragile marketplace, dangerous actions like this can take steps that I believe are negative, and I think they can have consequences that we don't want to see. These actions are being proposed in the short term before we ever decide what we are going to do in the long-term. That doesn't make sense to me. We need to have a long-term resolution in place before we start making short-term moves that have a dramatic impact immediately on the marketplace.

I think we need to take a step back, look at how these proposals are already impacting a fragile marketplace, and what we need to do to guarantee financing availability in the future. I just think we are moving in the wrong direction.

I yield back.

Chairwoman BIGGERT. The gentleman's time has expired.

The gentleman from North Carolina, Mr. McHenry, is recognized for 2 minutes.

Mr. MCHENRY. I thank the chairwoman. And congratulations on your first hearing as well.

Obviously, the dual mandate of Fannie and Freddie supporting both government housing policy and chasing profits for shareholders ended with predictable catastrophic results, proving that the Federal Government isn't really well equipped to deal in competing in the marketplace, especially with an unfair advantage with reduced costs of lending for the Federal Government.

Since Fannie and Freddie's failure and subsequent placement into conservatorship, the Federal Government's intrusion into the housing market has been the most expensive market intervention of the financial crisis. Surprising to most, but with taxpayers on the hook for close to $150 billion, it is a very real impact. It is time we end this disastrous bailout and let private capital get back into the marketplace. That is what we need to do in order to move forward.

I am pleased the Obama Administration supports our call to wind down Fannie and Freddie and I look forward to hearing from our witnesses about how we move forward.

Chairwoman BIGGERT. The gentleman from Virginia, our new vice chairman, is recognized for 1 minute.

Mr. HURT. Thank you, Madam Chairwoman, for the opportunity to serve in this capacity, and for holding the subcommittee's first hearing on the state of the housing finance market. I also want to thank the witnesses for being here.

In response to the financial crisis, the role of government in the housing finance market has grown dramatically. This growth not only increases the risk of substantial financial burdens on the taxpayers in Virginia's Fifth District, my district, but also across the country. It also prevents the private sector from competing in the market.

I am particularly concerned about the Administration's foreclosure and mitigation initiatives, which do not appear to be helping a sufficient number of distressed homeowners to justify the program's enormous cost. The Administration's ever-shifting strategies and massive expenditures of taxpayer dollars may only be forestalling a necessary bottoming in house prices, thereby hindering a more sustainable recovery in housing and the broader economy.

Again, I appreciate your being here, I look forward to your testimony, and I yield back my time.

Chairwoman BIGGERT. The gentleman from Ohio, Mr. Stivers, is recognized for 1 minute.

Mr. STIVERS. Thank you, Madam Chairwoman. I want to thank the chairwoman for calling this hearing today. I think it is especially timely given last week's focus on GSE reform in the Capital Markets Subcommittee and the delayed release of the Administration's report to Congress last Friday, talking about the need to limit government's involvement in the housing industry.

Due to the burst of the housing bubble and changes to FHA eligibility requirements, FHA's market share has increased in the recent past. For example, in my district in Columbus, Ohio, and central Ohio, in the 15th Congressional District of Ohio, FHA now makes up over half the loans in my district. Unfortunately, FHA, along with the rest of the market, has been facing higher mortgage defaults. So in reviewing reforms, we don't want to limit access to the American dream, but I think it is important for my constituents to understand what is going on here and to focus on what we can do to make sure that we avoid damage to the economy and make sure that we look out for the American dream.

I look forward to learning more from the witnesses today on how we can ensure the stability of the mutual mortgage insurance industry without removing this important resource from homebuyers.

Thank you. I yield back the balance of my time, Madam Chairwoman.

Chairwoman BIGGERT. The gentleman from Illinois, Mr. Dold, is recognized for 2 minutes.

Mr. DOLD. Thank you, Madam Chairwoman.

I certainly want to take this opportunity to thank the witnesses for their time, their effort, and their participation, and I look forward to hearing from each and every one of you.

All too often, well-meaning government efforts go too far and end up having unintended consequences, which are usually very negative and which frequently create more and larger problems than those that they were ostensibly intended to solve. These government policies often distort resource allocations, disrupt market mechanisms, manufacture artificial investment risk profiles, and put taxpayers on the hook for huge amounts of money. And by doing so, they frequently drive the private sector out of the market to the detriment of our families, employees, businesses, and our overall economy.

And then some say that the government must increase its role in the marketplace because it is the only marketplace participant, sometimes forgetting about why the government became and remains the only marketplace participant.

We have seen these results in the housing market, which is one of our most heavily regulated economic activities.

Right now, the Government-Sponsored Enterprises have more than 90 percent of the mortgage market, and it is not surprising that the private sector capital can't compete with this kind of political force that drives out private sector capital and misallocates resources, and that also puts taxpayers at potential risk for hundreds of billions of dollars and potential liabilities, all with, I would argue, little accountability.

Fortunately, I think we have reached a consensus in this country that we must return to a more stable mortgage market with far less potential taxpayer exposure and with far greater private sector participation. I understand that the Administration and Members of Congress on both sides of the aisle agree that we must move quickly toward this important objective.

We as Congress have some important questions to consider, including the two most fundamental questions: first, what are the existing government policies or regulations that are keeping private capital out of the mortgage market; and second, what existing government policies or regulations are extending or deepening these difficult housing market conditions? I agree with the Administration that the government must not be a barrier to the housing market recovery, and I look forward to hearing from each and every one of you.

Madam Chairwoman, thank you for the time.

Chairwoman BIGGERT. The gentleman's time has expired.

Now, I would like to ask unanimous consent for a member of the Financial Services Committee as a whole, Mr. Green from Texas, to make an opening statement for 1 minute.

Mr. GREEN. Thank you, Madam Chairwoman. I thank the witnesses for appearing today.

I think that there are some things that we agree on. I think that we agree that the VA loans are not a real problem, and my hope is that we won't disrupt that agency and the way it benefits our veterans.

Most people don't perceive FHA to be a significant problem, and my trust is that as we move forward, we will realize that there is a meaningful place for FHA. Those of us who do concur and agree that Fannie and Freddie are going to have to have some adjustments made—and we understand that we don't know exactly where we are going, but we don't want to go back to that era before Fannie and Freddie when you had to have a balloon payment every 5 to 10 years, when you had to have an enormous downpayment, when housing was for the few, not the many, in terms of ownership compared to the number of people in the United States of America. The American dream should not now be put out of reach because of the crisis.

Thank you, Madam Chairwoman. I yield back.

Chairwoman BIGGERT. The gentleman's time has expired.

And now again, let me welcome the witnesses. Thank you for being here, and thank you for spending quite a bit of time before we even got back from voting.

I would like to introduce the witnesses now from Panel I: David Stevens, the Assistant Secretary of Housing and the Commissioner of the Federal Housing Administration, U.S. Department of Housing and Urban Development, commonly known as HUD; Theodore "Ted" Tozer, President, Government National Mortgage Association, known as Ginnie Mae; and Phyllis Caldwell, Chief, Homeownership Preservation Office, U.S. Department of the Treasury.

Without objection, your written statements will be made a part of the record. You each will be recognized for a 5-minute summary of your testimony.

I will now recognize Commissioner Stevens of the FHA for 5 minutes.

STATEMENT OF THE HONORABLE DAVID H. STEVENS, ASSISTANT SECRETARY OF HOUSING/FHA COMMISSIONER, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT (HUD)

Mr. STEVENS. Thank you. Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee, thank you for the opportunity to testify here before you. It is particularly an honor for me to testify today because I have not yet had the privilege of appearing before you or many of the other new members of this committee.

I am here today on behalf of HUD and the FHA regarding the Obama Administration's efforts to encourage the return of private capital to the housing market.

It is important to understand the context of the crisis that led to government intervention in the first place. With home prices falling every month for 30 straight months, $6 trillion lost in home equity that wiped out the wealth for many families, and the loss of 750,000 jobs a month for 22 straight months of job losses, this Administration faces an economic crisis second only to the Great Depression.

With private capital in retreat, the Administration had no choice but to intervene. The Administration kept mortgage interest rates at record lows. We also provided critical support for Fannie and Freddie while FHA stepped in to enable a robust market to emerge. The FHA's loss mitigation policies, combined with the Administration's HAMP program, set the standard for mortgage modification that the private market has finally begun to meet.

We stopped the slide in home prices. Since April 2009, nearly 13 million homeowners have been able to refinance their mortgages. Monthly foreclosures starts are down more than 30,000 per month from the same period a year ago. And we have seen 13 straight months of private sector job growth. But the time has come for the next step as we begin to reduce the government's role and develop policies that will help bring back private capital.

As you know, in the absence of private capital, FHA's role expanded significantly, from less than 4 percent of the market in 2006 to more than one-third of new home purchases today. FHA has helped over 2 million families buy a home since President Obama took office, 80 percent of whom were first-time home buyers.

FHA's role in the multifamily market is equally striking. In 2008, we supported the development of about 49,000 rental homes. In 2010, however, it was 150,000 rental homes. But as proud as we are of the historic steps we were forced to take to support American families, we are very aware of the risks of this elevated role. FHA has already made important reforms to reduce our footprint and strengthen our reserves. With new authority granted by Congress, we have been able to raise our FHA mortgage insurance premiums, including the 25 basis points additional increase we announced this week.

FHA has also implemented a two-step credit score policy for FHA purchase borrowers, requiring that borrowers with lower credit scores make significantly larger downpayments. But the result of these actions that we have already taken are clear as we reduce financial risk to taxpayers and lay the foundation of the return for private capital. The quality of loans made over the last 2 years is much improved. Fiscal year 2010 represents the highest quality book of business in FHA history.

It is clear that FHA is in a stronger position today, but more needs to be done. That is why we delivered this report to Congress last week that provides a path towards a return of a responsible private mortgage market and suggests how FHA can help make that possible.

First, returning FHA to its traditional role as a targeted lender of affordable mortgages by decreasing the maximum FHA loan size by allowing the present increase of those loan limits to expire as scheduled.

Second, continue to reform and strengthen FHA itself. The Administration will make sure that creditworthy borrowers who have incomes up to the median level for their area have access to FHA mortgages, but we will not allow the FHA to expand during normal economic times to a share of the market that is unhealthy or unsustainable.

Madam Chairwoman, I believe it is necessary for Congress to give FHA more flexibility to respond to market conditions and manage its risks more effectively.

Third, through broader commitment to affordable rental housing. To be clear, the Administration is committed to providing families with rental housing choices and believes that affordable options for the millions of Americans who rent is essential to a more balanced, sustainable housing policy.

Having spent all of my career in the private sector, I know that one of the barriers we face to reform isn't government, but rather a trust deficit that the housing finance industry faces in its relationship with everyday Americans who associate housing with exploding ARMs, predatory loans, and foreclosures. Reducing that trust deficit is one thing the government can't do alone. The Administration is not only committed to restoring a healthy balance in the housing market, it is committed to working with Congress to find the common ground we need to build a 21st Century system of housing finance rooted in a strong, healthy market for private capital that harnesses the vitality, innovation, and creativity that has been at the foundation of our system for centuries. FHA's role in restoring this balance will be critical. We look forward to working closely with Congress to ensure people have the tools they need. That is what all our efforts are about.

Thank you for this opportunity to testify here today.

[The prepared statement of Commissioner Stevens can be found on page 122 of the appendix.]

Chairwoman BIGGERT. Thank you, Commissioner.

And now, we have Mr. Tozer. You are recognized for 5 minutes.

STATEMENT OF THEODORE "TED" TOZER, PRESIDENT, GOVERNMENT NATIONAL MORTGAGE ASSOCIATION (GINNIE MAE)

Mr. TOZER. Thank you, Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee for inviting me today.

To provide context for our discussion, I would like to describe Ginnie Mae's role in the U.S. housing finance market and efforts we have taken to reduce that role.

Ginnie Mae serves as the financing arm for FHA and other government-insured or guaranteed mortgage products. We are a wholly-owned, self-financed government corporation.

Since inception in 1968, our corporation created and issued the first mortgage-backed security in U.S. history. Since then, we have guaranteed $3.7 trillion in mortgage-backed securities and we have brought liquidity and stability to the market through all economic environments.

The recent decline in housing clearly led to retreat of private label securities investors. As it has before, Ginnie Mae stepped in to ensure liquidity. That is our historic role—to provide the counter-cyclical support in times of crisis.

During this crisis, our market share rose from 4 percent to nearly 30 percent. In 2008, our total MBS outstanding stood at $577 billion, but in June of 2010, we crossed the $1 trillion mark. Currently, outstanding Ginnie Mae securities have financed the homes for 7.2 million homeowners and 1.1 million rental units.

Additionally, our corporate performance has been strong. Last year, our net income was $541 million. We have earned this profit despite increasing our loss reserve to $1 billion, and we are well positioned to deal with future market volatility with $1 billion of the loss reserve, plus we have $14.6 billion in capital.

This performance is largely due to our business model. Let me explain. We work with lenders to pull loans guaranteed or insured by FHA, VA, Rural Development, and PIH to issue Ginnie Mae MBSs, mortgage-backed securities. Although securities are commonly referred to as Ginnie Mae's, we are not the issuer. These lenders who service and manage the mortgage-backed securities are the issuers and they pay us a fee to guarantee their bonds through investors. Ginnie Mae's business model mitigates the taxpayers' risk associated with secondary market transactions.

Before Ginnie Mae's guarantee is at risk, three levels of protection have to be exhausted: first, the homeowner's equity; second, the insurance provided by the government agency to back the loan; and third, the corporate resource of the entity that issued the mortgage-backed security. We are in the fourth and last position before a guarantee comes into place. In effect, our issuers must exhaust all their corporate resources before we step in. We are the only entity involved in the housing market today that has this model.

Madam Chairwoman, our business model has positioned us well for this volatile economy, but issuers have issued Ginnie Mae's securities at levels during the past 2 years that cannot continue. We must revise the private label securities market.

To help us in that direction, we have implemented policies that increase accountability among our issuer base. We have increased capital and established new liquidity requirements across all product lines. These requirements can be looked at as a different but very effective form of "skin in the game."

We have expanded our loan data disclosures, announced changes to allow small lenders to more easily do business with us, and we have worked with the GSEs to implement standardized loan delivery requirements.

For investors, uncertainty about the future of GSEs impact their decision-making. It is difficult to plan production when you are not clear which secondary market outlets will remain. The Administration's proposal to increase the GSE guarantee fees, increase capital, and wind down portfolios will help end uncertainty and create space for the private label securities investment.

As the financing arm for the government-insured products such as FHA, the level of MBS for guarantee are directly related to the level of mortgages these agencies ensure. Commissioner Stevens outlined plans to reduce FHA's role in the market. Our mortgage-backed security bond will decrease respectively.

In recent years, financial flaws occurred at almost every link in the mortgage process. We now are aware of the advantage and disadvantage of securitization. When securitization is managed appropriately, it is a very efficient conduit for capital. However, if insufficient attention is paid to the quality of the collateral, consequences can be disastrous.

Many investors in the private label securities market believe that investing in today's market requires them to take excessive and unpredictable risk. Restoring their faith will require great transparency, standardization, and accountability.

Addressing the GSEs alone will not give rise to a market that meets the needs of investors, nor will it guarantee that private markets can effectively play a more dominant role. We must work together to map our way forward by looking at some of the additional forms I have outlined.

Thank you again very much for giving me this opportunity to testify, and I am happy to answer any questions you might have.

[The prepared statement of Mr. Tozer can be found on page 133 of the appendix.]

Chairwoman BIGGERT. Thank you.

Ms. Caldwell, you are recognized for 5 minutes.

STATEMENT OF PHYLLIS CALDWELL, CHIEF, HOMEOWNERSHIP PRESERVATION OFFICE, U.S. DEPARTMENT OF THE TREASURY

Ms. CALDWELL. Thank you.

Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee, I appreciate the opportunity to testify today. I would like to share with you some of the lessons we have learned from responding to the most serious housing crisis since the Great Depression.

To begin, I believe it is important to remember where the housing market stood just over 2 years ago. When the Obama Administration took office in January 2009, home prices had fallen for 30 straight months, home values had fallen by nearly one-third, Fannie Mae and Freddie Mac had been in conservatorship for over 4 months, and American families were struggling to buy and keep their homes.

Treasury, in partnership with other Federal agencies, responded by taking a series of aggressive steps with a strategy focused on providing stability to housing markets and giving families who can afford to stay in their homes a chance to do so.

In particular, under the Troubled Asset Relief Program, or TARP as it is better known, we launched the Making Home Affordable Programs to help responsible homeowners avoid foreclosure. Through one such program, the Home Affordable Modification Program, or HAMP, Treasury worked to leverage the private sector to bring homeowners and their mortgage servicers together to find reasonable alternatives to foreclosure. So far, HAMP has helped close to 600,000 struggling families stay in their homes, and the median monthly payment reduction in these modifications is $520 per month, or close to 40 percent. The programs only pay for successful modifications, and they pay over time as the loan remains current.

In addition, HAMP has spurred the mortgage industry to adopt similar programs that have helped millions more at no cost to the taxpayer. Mortgage assistance provided to homeowners through HAMP, the Federal Housing Administration, and private sector participation in the HOPE NOW Alliance has outpaced foreclosure sales by more than two-to-one. At the same time, implementing this program has been challenging on many fronts. I would like to share a few lessons we have learned over the past 2 years.

First, when HAMP was launched in early 2009, mortgage servicers were totally unequipped to deal with the crisis. Servicers were set up to collect payments on performing mortgages. They did not have the staff, the systems, or the procedures to help people avoid foreclosure. By participating in HAMP, servicers had to build a modification infrastructure. They had to comply with HAMP requirements on how to modify mortgages and how to deal with homeowners. This has changed the industry.

Second, engaging homeowners is key. Families facing foreclosure are often overwhelmed by their situation and frustrated by poor communication from their servicer. As such, we launched a national public service advertising campaign and outreach efforts aimed at engaging homeowners. We have also established systems designed to address homeowners' questions and complaints and improve the service they receive from their mortgage provider.

Third, homeowners need safeguards. Being evaluated for a modification at the same time one's house is being foreclosed upon can be frustrating and confusing. In response, Treasury required HAMP servicers to evaluate a homeowner for HAMP before initiating foreclosure.

And fourth, affordability matters. Mortgage modifications work only if they are affordable. Because HAMP sets a clear affordability standard, median savings for borrowers is close to 40 percent from their mortgage payments, and because of these reductions HAMP modifications have lower redefault rates. Nearly 85 percent of homeowners remain in their permanent modifications.

We have faced many challenges in developing and implementing our programs, and much work remains to ease the housing and foreclosure crisis, but that should not obscure the importance of what has been accomplished. Our housing programs have established key benchmarks and borrower protections that are now viewed as industry best practices. We will continue to reach out to as many eligible homeowners as possible through our program's expiration in 2012, while safeguarding taxpayer resources every step of the way.

Thank you for the opportunity to testify, and I welcome your questions.

[The prepared statement of Ms. Caldwell can be found on page 48 of the appendix.]

Chairwoman BIGGERT. Thank you.

We will now proceed to questions. Members will be recognized for 5 minutes each to ask questions. I will start and yield myself 5 minutes.

Commissioner Stevens, the report that was issued to Congress on modernizing the housing finance stated the goal of reducing the market share of FHA from historic high levels to a more normal level in the future.

However, at the same time, I have been hearing about discussions of the Qualified Residential Mortgage (QRM) among the regulators, involving creating a very narrow QRM, such as perhaps mandating a 20 percent downpayment requirement. Wouldn't a narrow QRM, coupled with winding down of Fannie Mae and Freddie Mac, exclude many qualified and worthy borrowers, but also drive them to FHA rather than into the private sector?

Mr. STEVENS. Yes. Thank you for that question, Madam Chairwoman.

There are two components here. As it relates to QRM, we are one of the regulators that are involved in this rulemaking process, and so to some degree, I am a bit limited in what we can discuss related specifically to what may come out there. But I would say this: Experience that has proven itself over the decades in this housing system is that FHA traditionally has always played a much smaller role in the housing market, driven mostly by curtailments around loan limits as well as a robust competitive market that was functioning well. We don't have the robust competitive market functioning well, and we have loan limits that clearly cover a much larger section of the market than what FHA was ever intended to do.

I remember buying my first home with an FHA mortgage and I paid a 3.8 percent mortgage insurance premium on my home—which is much higher than we charge today. The loan limits were far lower in terms of what we were able to qualify for. And FHA played a very important role in the housing market.

So as we go forward, whatever the QRM—Qualified Residential Mortgage—guidelines are and as we work to try to find avenues for private capital to reengage, there are measures within the FHA that can control that volume in a responsible way and remain targeted towards the purpose it would serve. Loan limits are one; mortgage insurance premiums are clearly another; and product guidelines are a third. I think those are the three primary methods that would ultimately be used, again, over time as we carefully transition to a more normalized market where private capital is reengaging.

Chairwoman BIGGERT. The White Paper also talks about phasing down Freddie and Fannie. And there is some angst about how could private investors be encouraged to increase investments in both the single-family and multifamily housing if there is no guarantee. What mortgage metrics could help investors gain confidence in investing in private mortgage-backed securities that don't have a government guarantee? Is that possible?

Mr. STEVENS. That is really the crux of what the White Paper is meant to tease out from a debate standpoint. And that is why, when we presented the three options, we clearly eliminated a couple of additional options that we debated and excluded. One was a no guarantee system and one was a much larger guarantee system. We recognize that there would be a guarantee literally in all three of those options, at a minimum for FHA and underserved families. But I have been through market cycles before and I have seen private capital exit and return. They have done so under various terms. One of those terms is to come with stabilized home prices. As home prices continue to decline, it creates trepidation from private investors to come into that market. Another is return on investment, that the credit risk has to be priced appropriately for private capital to engage.

I think the White Paper is very careful in spelling out that while we need to wind down Fannie Mae and Freddie Mac, this is a multiyear process to be done very carefully, this idea of transition. And as we transition and we begin to take the first steps, we will have test points to see how private capital reengages. But I want to be clear: I am confident—having been in these cycles before, never to this extreme, but I have been in these cycles when private capital exited markets—that capital returns when it believes that the investments are safer, sounder, and more secure and at the return rates that are needed to make sound investments. And that is what we will have to test as we engage with policy and look to see signs that market is returning.

Chairwoman BIGGERT. Then isn't one of the lessons that we have learned from the crisis that it may not be feasible for everyone to own a home at this time, and some may be in a better position to rent? In your testimony on page 2, you mention that the Administration will be looking for reforms that balance the impacts on low- and moderate-income families as you consider further FHA reform.

Can you describe what that balance would look like?

Mr. STEVENS. Yes. And I think that is absolutely critical. Everybody has to recognize that not everybody should have owned a home in this past period. We created a bubble based on stated income, 100 percent financing, exploding loans that ultimately damaged the wealth and credit histories of those families who took out those programs in search of perhaps more instant wealth in that process. That was irresponsible.

Secretary Donovan, this Administration, has been very clear that we need a much more balanced housing policy. And you can't have a balanced housing policy without a specific focus on rental housing.

And so in the White Paper, we talk about it. We look forward to engaging in a dialogue with Members of Congress on going forward and making sure that there is safe, affordable, accessible housing, and that there is explicit focus on making sure that there is liquidity behind that market.

That could come with a couple of suggestions we have in the White Paper. One is looking at smaller rental properties. Today, it is difficult to find financing for multifamily properties in the 50-unit range, particularly in many urban markets where there is older multifamily housing stock. Another is making sure that there is rental housing in rural markets where traditionally the multifamily investment market and rental investment market hasn't really concentrated. This is an area we think needs to be looked at as we look at balancing the ownership/rental markets to make sure America is well housed generally, whether they own or rent.

Chairwoman BIGGERT. Thank you. My time has expired.

Mr. Sherman is recognized for 5 minutes.

Mr. SHERMAN. Thank you.

First, I want to comment that even in good economic times, divorce, unemployment, death, illness—and we hope the health care bill will diminish the economic impact of illness, but it can cause people not to be able to work—all those things happen. They happen to such a large percentage of mortgages—not a huge percent, but a large percentage, so that the private sector is going to be reluctant to get into this market unless they are confident that if they need to foreclose, the housing market is going to be a stable market. And with the work that government is doing now, we are not going to convince the private sector that we have stabilized housing prices.

You can make the ideological argument that today's problems are because we have strayed from the principles of Ayn Rand or not, and I am not here to have that ideological argument. But we do need to prevent a collapse now in a market that is what it is, whether it conforms to anybody's ideology or not.

First, Mr. Stevens, a recent report showed, as I mentioned in my opening statement, that only three banks originated over half of the mortgages. Does this concern your department? And what can be done about it?

Mr. STEVENS. This is an absolutely important part of the discussion that we all need to engage in. Concentration risk, "too-big-to-fail", those kinds of statements are being made in headlines as we talk about the participants in the mortgage market going forward. I think we are very careful in the White Paper to express concern for community banks and smaller financial institutions to access and participate in the mortgage market.

You are absolutely correct that we have seen the market consolidate. Reports have come out in the last couple of days giving new data in that regard. And much of that has to do with the broad weakness in the financial services system and some of the larger institutions' ability to use the capital and balance sheet to continue to engage in this market.

We need to make very certain that as we think about policy going forward, particularly the options that we have laid out in the White Paper, that they don't, as a result—you talked about unintended consequences—create the unintended consequence of forcing even greater consolidation in the market. We benefit greatly by a broadly distributed housing finance system. This country has traditionally operated under that construct. Today we are in very unique times, and a policy that we think about has to address that on a go-forward basis.

Mr. SHERMAN. The FHA was designed to fill the gap when the private market is unavailable. Is that what the FHA is doing now?

Mr. STEVENS. Yes, it is. Absolutely. It is absolutely filling that gap. I think this question has to come into play: If FHA is financing 3 percent down mortgages at $729,000, is that the principle under which it was originally designed? I think the other way to ask the question is: Are there borrowers in that population who could come up with a larger downpayment and are using the FHA program simply because it doesn't require it?

And those are the considerations that we think are very important because, without question, one thing I have come to appreciate is FHA has some of the best employees and committed people I have ever seen in the housing finance system, but they are limited by appropriations and budgets, and they just can't handle an endless amount of volume and risk coming onto that balance sheet.

Mr. SHERMAN. If I could just interject, we lost a fortune, the Federal Government. We failed to prevent a collapse, we failed to prevent a bubble, and a decision was made that I certainly didn't agree with, that we would honor the implicit guarantee as if it was a real legal guarantee, penny for penny.

Those decisions have been made. The question is not whether FHA, Fannie, and Freddie may lose money on loans written up until today. The question is, how much is it costing to allow you to go forward in the future? What does the CBO think that it costs to allow the FHA to do through the end of this fiscal year exactly what you are planning to do? I know everybody can argue with the CBO, and I still think the Lakers won the game last night, but the ref said otherwise. So the CBO is the accepted referee. Go ahead.

Mr. STEVENS. I appreciate that question, Congressman Sherman. Let me just give you the critical data. At the time they scored the budget, OMB estimated—I want to show the two numbers—OMB estimated that FHA would generate $5.7 billion in negative subsidy, meaning receipts to the taxpayer. CBO scored it at $1.8 billion, a much lower number.

Mr. SHERMAN. So these folks are just arguing about how much money you make. And does that take into account the actuarially best determined cost of the guarantee you provide? That is not just a cash receipts kind of a thing—

Mr. STEVENS. No. It absolutely takes into account an actuarially sound expectation of losses against the backdrop of—

Mr. SHERMAN. So you are making money for the Federal Government on the best analysis that we can provide from OMB and CBO.

What about Fannie and Freddie, not looking at the fortune they lost on previously existing mortgages. Are they making money or losing money for the Federal Government? Best estimate of the CBO.

Mr. STEVENS. I do not have the CBO estimates of Fannie Mae and Freddie Mac.

Mr. SHERMAN. OMB? My time has expired.

Chairwoman BIGGERT. The gentleman from Virginia, Mr. Hurt, is recognized for 5 minutes.

Mr. HURT. Thank you, Madam Chairwoman.

In a report released in December of last year, the Congressional Oversight Panel wrote, "In some regards, HAMP's failure to make a dent in the foreclosure crisis may seem surprising. Yet despite the apparent strength of HAMP's economic logic, the program has failed to help the vast majority of homeowners facing foreclosure." It is my understanding that HAMP has resulted in only 483,000 permanent mortgage modifications, far short of the 3 to 4 million that the Administration predicted when the program was unveiled.

Ms. Caldwell, I was hoping that you could respond to that criticism.

Ms. CALDWELL. Thank you for the question.

First of all, I would say that HAMP has not been a failure. While it has not achieved as many modifications as we would have hoped, we have to keep in mind that close to 600,000 families have had their loans modified in an affordable and sustainable way, and that number continues to grow each month.

Second, I think we have to keep in mind that before HAMP, there were no standards for the private market to modify loans this way. And by looking at loans and running them through a net present value model, modifications are now done when it is in the best interest of the investor and the financial system to have that homeowner in a sustainable modification. So while it hasn't achieved the volume, I think it is very important to keep in mind what it has done, the successes it has had, and the families who have been helped.

Mr. HURT. An additional criticism is that the terms have been changed again and again, and servicers have said that every time, a change to HAMP requires a costly investment of time, personnel, and technology, and that the changes have created confusion in the marketplace.

Do you believe that confusion has made it more difficult to reach the 3 to 4 million that were predicted?

Ms. CALDWELL. As I said at the beginning of my testimony, the servicing industry was set up to collect payments and was ill-equipped to handle the crisis of this response.

I think when we talk about changes to the program, it is very important to keep in mind that the terms and structure of the modification for HAMP have stayed the same throughout the program. What has changed throughout this couple of years is how to get these servicers to implement the program correctly. And one of the things that we learned, we learned early on they had no way of figuring out how to reach homeowners, so we had to put systems in place to do that. They had no way to respond to checks and balances, so through our compliance mechanisms we asked them to go back and reevaluate people and do things. They could not implement a net present value model, so we had to put in procedures.

So the more procedures that we put in place, it did slow time as they made investments in systems, but had they not, millions more American families would have gone to foreclosure.

Mr. HURT. Do you think that homeowners are shopping around for the best government deal and then holding out for the best Federal assistance that they might get in trying to seek these modifications? And if so, do you think that hinders private sector capital from coming into the market?

Ms. CALDWELL. One of the things we have learned in the HAMP program is that mortgages and mortgage securities may look identical at the securitization level, but you don't know about the underlying homeowner until they pick up the phone and identify themselves.

What we see is homeowners who are struggling and confused and frustrated and sometimes in this position for the first time in their life.

Does that mean that there aren't some in a broad swath of people who may be shopping, we can't really say that. What we do say is that we have, at least for those modifications that are getting taxpayer subsidy, we have fraud controls; we have hardship affidavits; and we try to make sure that we are only using taxpayer resources for those homeowners who need help.

Mr. HURT. This morning we heard from Mr. Angelides, who is chairman of the Financial Crisis Inquiry Commission. And one of the things that I thought was surprising in his report was how government housing policy contributed very little if anything to the crisis that we are now trying to understand and prevent in the future.

Do you believe that the government housing policy contributed nothing to this, to our current crisis, and if so, why?

Ms. CALDWELL. Right now—that is a very important question and one that has been debated in the past and will continue to be debated about the future of housing finance reform.

I think the one thing that we are focused on in terms of foreclosure prevention is the one thing that we can all agree on, and that is a homeowner who is behind on their mortgage payments who doesn't get help will ultimately go to foreclosure, and it is in the best interest of the financial system to avoid those foreclosures to the extent possible.

So really I think it is—you can talk about stabilizing the market, addressing the problem now and in the future. We are focused on addressing that problem.

Mr. HURT. Ms. Caldwell, thank you for your answers.

Chairwoman BIGGERT. The gentleman's time has expired, even though the clock was off.

The gentleman from Missouri, Mr. Clay, for 5 minutes.

Mr. CLAY. Thank you so much, Madam Chairwoman, and thanks for conducting this hearing.

Commissioner Stevens, according to a recent report by the Special Inspector General for TARP (SIGTARP), only 15 FHA short refinances have been completed so far. Why has there been such a lack of participation in this program?

Mr. STEVENS. Just to be clear, the number is higher but not much higher, but that was their most recent report.

Without question, the FHA short refi program has been a difficult one to get off the ground, for several reasons. One reason is that it is optional. The participants in the program have to choose to do principal write down. But with roughly 27 percent of all American homeowners underwater today, there is certainly an opportunity.

We have begun to talk to institutions that are beginning to create the capabilities to do short refi, but it requires an operations investment. They have to invest in technology and systems. It is almost like creating a new product. We think that will have some impact on the numbers.

Without question, however, this is an area in which we continue to focus. We believe that principal write down is absolutely needed. It is one of the key variables left to address, outside of modifications, to get this housing economy right-sized. But it does require, again, the voluntary participation of servicers and investors.

These are awkward handoffs. And there has been some natural resistance to wanting to engage by some, and we continue to work with them.

Mr. CLAY. Any examples of success in prodding any of the institutions to come along?

Mr. STEVENS. I can't name institutions without—they would have to—I would prefer that they announce that they are going to participate. But I will tell you that I had conversations with the CEOs of virtually all the major lenders in this country on this process. So has the Secretary and so has Secretary Geithner.

And I do know a couple of the large ones are actually building out the capability to be able to roll out the program. We do need more. And there is no question about it that we maintain and continue to maintain that this is an area that needs continued focus and pressure to get this market right-sized.

Mr. CLAY. Thank you for that response.

Mr. Tozer, can you expand on Ginnie Mae, on how Ginnie Mae has handled the housing crisis we are facing differently from Fannie Mae and Freddie Mac?

Mr. TOZER. Thank you, Congressman Clay.

Basically, Ginnie Mae's role is completely different than the GSEs, Fannie and Freddie. Fannie and Freddie are in a situation where they insure the borrower. Like a lender that would originate a loan, Fannie and Freddie buy it; they buy without recourse. So if a lender follows the rules, the lender has no legal obligation to have any financial obligation to any losses that occur. Fannie and Freddie take all losses. They also take those loans, create a Fannie and Freddie security they are obligated for, and at that point, the security then is their obligation, and they have to make good to the investor if the borrower goes delinquent.

Ginnie Mae is different in the fact that we do not buy any loans. The lenders take their loans, and they are insured by FHA, VA, various government programs. They create a security. That security is the obligation of that lender. And what we do is, for a fee we will put a government wrap on that security so that we are guaranteeing to the investor that if that servicer cannot perform the obligation of making the principal interest payment for delinquent borrowers, we will then step in and make sure there is a servicer who will make those payments.

So we basically are almost like a surety bond making sure that the servicer performs their obligation. And what happens if an issuer cannot revoke their obligation and fails, we then would actually take the servicing, all their servicing that is Ginnie Mae and move it to another servicer. So, from that perspective, we are never taking any credit, borrower credit exposure, except for the fact however much it stresses the issuer. Because like I said, the issuer has to make all the payments to the investor, all the way through to the time that they buy it out of a Ginnie Mae security.

They can buy it out as early as the borrower being down three payments or wait all the way through to foreclosure. But as soon as they buy it out of the Ginnie Mae pool, our guarantee no longer applies to that loan. So once we move the servicing, it is pretty—it is easy to move because most of the delinquent ones have been bought out so most servicers will take on the business. That is the reason why our guarantees come into play so few times.

But in the uncertainty in the capital markets, having the government guarantee has allowed us to make markets for FHA/VA loans, to central bankers, to insurance companies because of the uncertainty in the capital markets for what they are going to get. That way, they know they get their principal and interest.

Mr. CLAY. I yield back, Madam Chairwoman.

Chairwoman BIGGERT. The gentleman's time has expired.

The gentleman from North Carolina, Mr. McHenry.

Mr. MCHENRY. Thank you, Chairwoman Biggert.

Mr. Stevens, are HUD and the Administration currently contemplating any loan modification or principal reduction programs or changes?

Mr. STEVENS. We are not contemplating at this point any new modification programs. FHA has always operated in a very unique way. We have a long history of modification programs.

Mr. MCHENRY. But certainly, you would be a part of that discussion if they changed these?

Mr. STEVENS. Absolutely.

Mr. MCHENRY. Okay. Are you aware of any—let me just restate this one more time to give you an opportunity. Are you aware of HUD or the Administration contemplating any new loan modification or principal reduction programs in connection with a possible resolution of the current Federal and State attorney general review of the robosigning related problems at the major banks?

Mr. STEVENS. Thank you for that clarification of your question. We are in discussion with 11 regulators, the State attorneys general, the Department of Justice, in talking directly about several large servicers that we have publicly mentioned in terms of this effort working together, with one possibility being enjoining in some sort of settlement with these institutions.

This is premature. There would not be necessarily any—there would not be any new program created that doesn't exist already in anything we have been discussing.

Mr. MCHENRY. Will there be new funds?

Mr. STEVENS. There would not be new funds associated with this program, with any settlement that we have been discussing to date.

Let me just step back for a moment, because what is said in this regard is very important. We have a significant foreclosure crisis. All the regulators, especially since the robosigning news that became so prevalent in the fall, have gone onsite and done various levels of investigating or looking into servicer performance standards. Most of the regulators found something that others may not have. We were very open at HUD stating that we had found some irregularities and variable performance.

And there are two ways we can proceed to a conclusion here. We can work with the other regulators to try to come up with one set of solutions, assuming the general findings are the same, or we can proceed individually, and that process is being worked through right now.

But none of this involves Federal funds in any settlement or if any fines or penalties will be assessed to institutions in due course based on the authorities that we currently have at HUD for example.

Mr. McHENRY. Can you describe—you described the consideration. Will you commit that any such programs that are proposed and funded through the regular budget process with Congress and subject to congressional authorization, will you come back to us for authorization?

Mr. STEVENS. So if I can—sorry to answer with specificity, but I would like to make sure that I am not saying something that is incorrect. If there is anything associated with a potential settlement that involves the creation of a new program or new subsidies, I will absolutely come back.

Mr. McHENRY. So with the settlement money, how will you allocate that, will you come back to Congress for authorization on how that is allocated?

Mr. STEVENS. The settlement money would be penalties assessed to institutions within existing authorities at HUD. We have assessed penalties or taken action against over 1,800 institutions since I have become FHA Commissioner. We have a mortgagee review board that assesses penalties on a monthly basis.

Mr. McHENRY. I certainly understand that.

But we are talking about a larger magnitude than those previous numbers. Will you come back to Congress with authorization of how to allocate those resources?

Mr. STEVENS. If authorization is required, we will come back to Congress.

Mr. McHENRY. I am asking you, will you come back regardless of what you think your current opportunity is under the law to ask for authorization?

Mr. STEVENS. I cannot commit to that at this time.

Mr. McHENRY. Okay.

Ms. Caldwell, I want to follow up with you about the same. Are you a part of these discussions as well?

Ms. CALDWELL. I am part of some of them but not all of them. I am generally aware.

Mr. McHENRY. Generally aware. What is your awareness on how this will come about, or what will come about, rather?

Ms. CALDWELL. I think it is important to keep in mind that while Treasury is one of the Federal agencies that is involved in the process, Treasury is not a primary regulator of any of the institutions, so we do not have the authority, as Mr. Stevens referenced that HUD may have.

Mr. McHENRY. What part of the discussions are you involved in?

Ms. CALDWELL. We are involved in both the discussions with the servicers as they relate to the HAMP program and the discussions among those agencies that have chosen to describe some of the things that they have found.

Chairwoman BIGGERT. The gentleman's time has expired.

The gentleman from Illinois, Mr. Dold, is recognized for 5 minutes.

Mr. DOLD. Thank you, Madam Chairwoman.

If I could, Mr. Stevens, I just have a quick question for you. I think you said during your testimony that about one-third is the market share that the FHA has right now in terms of single-family lending at this point in time; is that correct?

Mr. STEVENS. Actually, it has dropped. The current FHA market share levels are closer to 20 percent today.

Mr. DOLD. Closer to 20 percent.

Mr. STEVENS. Yes.

Mr. DOLD. What is the optimal market share in a normal market?

Mr. STEVENS. I would be glad to share with you as a follow up and sit down and go over market shares in the history of FHA. It has ebbed and flowed over the years. The traditional market share has been somewhere in the 10 to 15 percent range.

I do think it is important, however, to recognize, and let's just use one different market correction, the oil patch crisis, FHA's overall market share remained in the teens, but we were as much as 40 percent of the market in States like Colorado, Texas, and Oklahoma during that period. But the overall national market share was able to remain very low. And again, that is more of a normalized market.

Mr. DOLD. What policy changes would you recommend for this body to be considering to promote a more healthy role for the private sector or private capital in mortgage finance?

Mr. STEVENS. I very much look forward to that dialogue. I would like to share with you the policies we have taken over the last couple of years: three mortgage insurance premium increases; changing FICO requirements; changing actual underwriting policies of programs. Our market share from first quarter of 2010 to fourth quarter of 2010 per Inside Mortgage Finance dropped from 24 to 14 percent in the fourth quarter, 14.8 percent. That is their data.

We have already clearly seen from the policy changes we have implemented a reduction in FHA shares of market. As I said in the opening comments to the chairman, there are several levels we can work on, but clearly, pricing the risk appropriate to the mortgages we are insuring is a critical component. I think we have done an outstanding job on this with the help of Congress in giving us more authority.

Mr. DOLD. What do you deem in the next 18 months will be success if you are able to accomplish or we get what part of the private sector in, what will you deem a success in the next 18 months for FHA?

Mr. STEVENS. I would encourage us all, as we are working together on this process, to make sure that we don't act too quickly with the absence of private capital. I am a huge supporter of private capital; it is my entire background, coming into the market.

Mr. DOLD. That is why I am asking.

Mr. STEVENS. But I will say this. Ultimately, the policies we put in place, and as I said earlier, we are going to have test points along the way with loan limits will be—my estimation will be the next round, along with these price changes we have currently put into place. We will see how private capital is reengaging. Assuming a normalized rate of reentry of private capital in the market, I think we should strive to get FHA's market share level back down to its more normalized market share.

As I quoted our fourth quarter data, we actually could be on a trend of returning closer to that level rather than the levels we have been at for the last couple of years. And all of that I think we need to be sensitive about. I would love to have an ongoing dialogue with all of you, and you specifically as you are interested, to talk about what is happening in the market more broadly so we don't create this double dip or unnatural outcome that can harm families even more.

Mr. DOLD. Some have suggested, and again, I am sorry to continue to focus on you, Mr. Stevens, and I apologize to the other panelists, and please chime in if you feel it necessary.

Higher downpayments have been talked about in terms of asking homeowners. We have seen it going back to previous generations. They saved, they saved, and they had to put down 20 percent. And that obviously was a big difference, I think, in what is going on today as we have seen those capital requirements for downpayments drop significantly. What are your thoughts with regard to requiring additional capital for home buyers?

Mr. STEVENS. If I can answer it this way, I have been doing this for 3 decades in the finance system. I bought my first home with an FHA loan back in the 1970s with a 3 percent downpayment, believe it or not, because they did it the same way back then.

The problem ends up being if you have too broad a box in which you can originate FHA loans, the market people are going to naturally use that program, even when home buyers could come up with a larger downpayment and they don't necessarily meet the original objective of FHA.

I do think a small downpayment provides a value, particularly for underserved families who may not have the additional disposable income to save up, virtually trapping them in a world where they can never become homeowners because they will never be able to save for a downpayment, even though they have a good job, they have a family, and they can afford a home. So I believe targeted assistance in those markets should continue.

But I do believe, if it is the trend of the questions you are asking, that we clearly need to contain and reduce the footprint of FHA over time safely, but we do need to reduce the footprint so it isn't playing the kind of role it is today and perhaps providing financing at low cost to families who could otherwise come up with a downpayment.

Chairwoman BIGGERT. The gentleman's time has expired.

The gentleman from Ohio, Mr. Stivers, is recognized.

Mr. STIVERS. Thank you, Madam Chairwoman.

I would like to thank Mr. Stevens for what FHA has done to address their risk pricing and modernize the agency a little bit.

I do have a couple of specific questions for Mr. Stevens about FHA with regard to condominiums. You changed your rules last year with regard to spot approvals, with regard to concentration, with regard to having at least 50 percent of the units pre-sold, and I know that has reduced your concentration in condominiums. I know condominiums were part of the problem.

But I have heard from some constituents in my area that we have a lot of bank-owned condos and now it is really hard to get financing for those and they are stuck in sort of limbo, because the bank took it back. Now you can't get an FHA loan. You can't get a conventional loan, and therefore those condos are sort of stuck. Has FHA and anybody on the panel looked at that issue, and is there a way out of that, because obviously we need to get those properties in productive use?

Mr. STEVENS. Congressman, I very much appreciate the question, and it is an area that we have spent an extraordinary amount of time focusing on. I think, as you may know, we actually put a temporary extension in, we have now done it for 2 years in a row, to provide more lenient policies to the condominium market. Keep in mind most of this relates to new condominium approval.

Mr. STIVERS. Right.

Mr. STEVENS. We are currently one of the few institutions that will insure a condominium, particularly at a high loan to value. Most of the private insurers will not engage in this market. And so we are the sole source provider. And FHA has experienced some fairly significant losses on condominium buildings that went completely belly up during this last economic crisis.

But we also recognize that condominiums are often an entry point for first-time home buyers. And in underserved communities, it is really important we provide that service. It is a difficult position that we are in to be responsible to the taxpayer and to make sure we are providing needed liquidity. I meet frequently with the National Association of REALTORS and the home builders, mortgage bankers, all who constantly want to discuss these policies. I am very open to discuss them.

Today we have—I have given temporary extensions to policies at much more lenient levels because of the concerns you have, but I would be very interested in any insight or input that you or your staff would have.

Mr. STIVERS. I do have some input. Is there some flexibility we could give you to charge risk-based pricing on those condominiums that are obviously different because your risk is higher than other places? And I know currently you don't offer a lot of differentiation. Have you looked at that as a way to offset that—

Mr. STEVENS. You know, Congressman—

Mr. STIVERS. —and have people pay for what they need.

Mr. STEVENS. We have been looking at ways to implement a risk-based pricing pilot, as we are authorized to do by Congress. Actually, it is an interesting idea. It is one I would like to go back and look into, and I would be glad to follow up with you on how and if we could do something like that.

Mr. STIVERS. And I would love if you could follow up with me in my office because it is impacting a lot of our districts, but especially, again, on whole projects that have fallen into bank foreclosure now, if over 50 percent of them are—it is just hard. They can't get private financing. They are having trouble getting FHA financing. I sympathize with folks trying to get that property in productive use.

So that was the thing I really wanted to get at in today's hearing because I heard from a constituent on this issue and wanted to follow up on it, and I would love to follow up with you.

I yield back the balance of my time, Madam Chairwoman.

Chairwoman BIGGERT. Thank you.

Mr. Duffy from Wisconsin, you are recognized.

Mr. DUFFY. Thank you, Madam Chairwoman.

I yield my time to my colleague from North Carolina.

Mr. MCHENRY. I thank my colleague from Wisconsin for yielding, and just wanted to follow up on my previous line of questioning.

Mr. Stevens, in terms of the settlement contemplated or being discussed that you mention with the 11 regulators and the servicers, what is the magnitude and dollar amount that we are talking about?

Mr. STEVENS. I am actually glad you got the time back because I wanted to—this is a great opportunity to follow up. First of all—

Mr. MCHENRY. What is the magnitude and dollar amount?

Mr. STEVENS. The magnitude is in a broad range.

Mr. MCHENRY. What is the broad range we are talking about?

Mr. STEVENS. It would be premature to even give a dollar amount because we are not there yet.

Mr. MCHENRY. Are you talking billions?

Mr. STEVENS. We are talking a range that could be above or below.

Mr. MCHENRY. Okay, I am hearing ranges in the tens of billions range. Is that—would you say that is not correct.

Mr. STEVENS. Here is what I can tell you. That the range—this comes down to, what are the actual violations that have been identified? We haven't aggregated those. What are the potential costs that each individual agency and State attorney general could ultimately assess against these institutions? We need to understand what that total potential estimation could be. And off of that, that is what we will have to work on to determine if there is a way we can come together and make this less disruptive in the market. So I cannot give you the—

Mr. MCHENRY. Okay. I understand that, I understand that. Is there a timeframe we are looking at? Is this something that is going to happen in the next month?

Mr. STEVENS. We would like it to be sooner rather than later. As you can imagine, I am relatively new to government, but we are working with multiple agencies, multiple regulators that have different obligations, but we would like it to be sooner rather than later.

Mr. MCHENRY. Is it this quarter? Is it this month?

Mr. STEVENS. I would say a month timeframe is probably in the reasonable range if we are to reach some sort of conclusion.

Mr. MCHENRY. Are there discussions about what the money will then be used for in this settlement?

Mr. STEVENS. There are a variety of discussions. There are different views that we are working on.

Mr. MCHENRY. Are there some options that you are contemplating or you are recommending?

Mr. STEVENS. There are options that we are contemplating. It could include anything from what you suggested in terms of having them modify loans so they stay performing in the market, which would improve the economy. There are options also just to purely collect penalties and have those deposited in the Treasury, and there are whole varieties of—

Mr. MCHENRY. Are principal reductions being one of the options?

Mr. STEVENS. Yes.

Mr. MCHENRY. Thank you.

Ms. Caldwell, in terms of your involvement, have you been involved in these discussions that I have questioned Mr. Stevens about?

Ms. CALDWELL. I have been involved in some of them, yes.

Mr. MCHENRY. Have you been in the room with various regulators when these discussions are going on.

Ms. CALDWELL. With some, yes, particularly as—

Mr. MCHENRY. What regulators?

Ms. CALDWELL. —it relates to foreclosure prevention. As you said earlier—

Mr. MCHENRY. What regulators, if you might inform us?

Ms. CALDWELL. Actually, most of the Federal regulators that regulate these institutions.

Mr. MCHENRY. Okay. Are you there in terms of, using this in terms of HAMP or a different type of HAMP program, using the settlement money towards that?

Ms. CALDWELL. At this stage, there are no contemplated changes to HAMP in terms of—

Mr. MCHENRY. No, I mean, in these discussions, why are you there?

Ms. CALDWELL. Primarily because of my expertise and experience in foreclosure prevention servicing practices and loss mitigation in overall housing finance.

Mr. MCHENRY. So the regulators don't have that expertise is what you are saying, so you have to be brought in from Treasury to provide that?

Ms. CALDWELL. No. Treasury is there in Treasury's role. And you asked specifically what role I am playing. There are a number of people at Treasury who participate, and you asked specifically for mine, and it is with respect to that area of expertise.

Mr. MCHENRY. Okay. In terms of HAMP, have there been discussions about a second HAMP, a HAMP 2?

Ms. CALDWELL. That is a good question. I think it is important to remember—

Mr. MCHENRY. And that is why I am asking. I hope you give me a good answer.

Ms. CALDWELL. I think the answer is, based on the authority we have under EESA, there cannot be any new programs in HAMP that were not in place as of June of 2010. We do not have authority for new programs. We continue to get ideas.

Mr. MCHENRY. Could you use settlement money in order to create a new program?

Ms. CALDWELL. As I said, at this point, there are—we do not have authority for new programs.

Mr. MCHENRY. Even if you have a settlement in the terms of billions of dollars, that could not be used for principal reduction is what you are saying?

Ms. CALDWELL. I would just say one of the focuses of HAMP has not been the need for more funds. The focus of HAMP has really been getting more attention on homeowners to make sure we use the funds that are available.

Mr. MCHENRY. Madam Chairwoman, I know my time has expired. If I may ask Ms. Caldwell one final question? Do you believe that HAMP has been a success?

Chairwoman BIGGERT. Mr. McHenry—

Mr. MCHENRY. It is a simple yes-or-no answer, Madam Chairwoman. Do you believe that HAMP has been a success?

Ms. CALDWELL. I believe that HAMP has been a success at reaching the people it was intended to reach with a modification that is sustainable in changing the industry.

Chairwoman BIGGERT. The gentleman from New Jersey, Mr. Garrett, is recognized for 5 minutes.

Mr. GARRETT. Thank you. I may not use the whole 5 minutes, but thank you.

Mr. Tozer, I just came back from another hearing. Secretary Geithner is just down the hall, actually in the other building, and made reference to the fact that we just had a hearing in the committee with regard to the GSEs and GSE reform and the like. And in that hearing, we discussed ways to treat the book of the GSEs and basically put it on the book of the Federal Government, the liabilities and the assets. And one of the comments that was made by one of the witnesses was that if you do that, it may actually have a negligible impact on the balance sheet, so to speak, because the assets basically would offset the liabilities.

And that if you put it on the books of the U.S. Government as the GSE securities began, the short-term securities would begin to run off, right, you would reissue U.S. securities to back it, okay. And the reason you would do that is because the spread is a little bit different between them, about 25 basis points, and theoretically you would save money over time which would be good for the taxpayers because we are basically funding them right now.

So just if you could comment: (a) on a proposal about putting it all on the balance sheet; and (b) are there any practical implications with regard to if we did all that over here with the GSEs and how that might affect the pricing of Ginnie Mae securities?

Mr. TOZER. Again, since I really haven't seen the proposal, but as I understand what you are saying is that as GSE's liabilities roll off, you would replace them with government-guaranteed liabilities on the liability side of the balance sheet, as I understand what you are saying.

Mr. GARRETT. Yes.

Mr. TOZER. From my perspective, I would indicate from Ginnie Mae, it should probably have a negligible impact. The reason I would say that is, and again not understanding all the facts of it, but the fact that since we are in a situation where we are dealing pretty much with a 30-year fixed-rate market and our issuers are creating 30-year securities, you are really dealing with two different investor bases. You have people who invest in short-term assets, which are going to be more banks, money markets and so forth. Our investor base is more central bankers, pension funds, insurance companies. So I would think from that perspective from what you said, I would say it would have a negligible impact because of the long-term investors for us and short-term ones for the short-term liabilities.

Mr. GARRETT. Okay.

And the second question is for Commissioner Stevens. You made some more comments which I agree with, with regard to as we all go through the process here of GSE reform, we sort of have to do it at the same pace or track, if you will, with regard to FHA reform at the same time, right.

Mr. STEVENS. Yes.

Mr. GARRETT. And I think that is crucial because I guess if you don't do that, if all of a sudden we do all the reform tomorrow and that is not a timeline, but on the GSEs, then what, everything will just—if you begin to do as the Administration says, try to move that in a more private fashion that could have the effect of funneling a lot of the business over to FHA, right.

Some of the Treasury proposal says that over time their proposal is to change the downpayments for the GSEs to 10 percent. So if you have that effect over here in the GSEs and you guys are over here at what, 3.5 percent, the natural implication is that part of that book will just extend over to you folks. They also—I think they discussed in their proposal as far as raising the GPs over at Fannie and Freddie, so the same thing. If it is getting more costly over here, what is the natural implication of that? Folks are just going to be coming over to FHA, right?

Mr. STEVENS. If we do nothing, that is correct. We have done three premium increases at FHA in the last year alone, and I just increased premiums on Monday one more time. And so I think, to that extent, there are levers you can address within FHA to make sure that there is balance in any steps that take place to change the size and scope of the FHA footprint.

On the downpayment piece, we are looking forward to the dialogue on downpayments. Today, FHA doing minimum downpayments up to $729,000 is something that we clearly endorse with a White Paper to say that needs to scale back. And that is why we do believe, however, there needs to be—

Mr. GARRETT. Scale back?

Mr. STEVENS. Scale back at least at a minimum at the end of the year to HERA levels. And as the White Paper states, we believe we should have a discussion about whether we should increase those further.

Mr. GARRETT. As far as those limits. And as far as the downpayments then for them, how would that go?

Mr. STEVENS. The same issue on the downpayments. I think there is a good dialogue in the White Paper that gives this as a suggestion: We need to make sure that we provide within the role of FHA a much reduced footprint that has explicit support for underserved families that otherwise would not have the disposable income or means to potentially ever buy a home. So you can scale that market down by looking at loan limits and other measures. And for the remainder of the portfolio, you could theoretically change downpayment requirements.

We talk about an explicit funding mechanism that would be budget-neutral in the White Paper that would help support downpayment assistance. And if that was created, you could clearly adjust loan to values within the FHA program.

Chairwoman BIGGERT. The gentleman's time has expired.

The gentleman from Texas is recognized for 5 minutes.

Mr. GREEN. Thank you, Madam Chairwoman.

Again, I thank the witnesses for appearing. And I also thank the witnesses on the second panel, and apologize that I may not be here to hear your testimony, but I assure you I will review it.

Just for edification purposes I would like to take a moment and explain that when we talk about reforming a system, we impact more than the buyers and the sellers. I think it is important to what we do at the banks, especially small banks, and what we do with the consumers, the actual persons who are purchasing homes, is important.

But also we have Realtors who are in this process. And I can tell you—I meet with them, talk to them—Realtors are very much concerned about how we will reform this system because they understand how the loans move from the portfolio of the bank to some other entity, and then it gets securitized. They have a lot of consternation about this. And we don't hear a lot from them. I suppose they are quietly suffering, to a certain extent.

But I want to be a voice for them and let people know that Realtors are very much concerned about what will happen when we start to reform, if you will, the system.

And I do advise, as I have been advised, that we proceed with a great degree of caution because the system is very fragile right now. And while there is a movement toward recovery, we can, if we are not careful, do things that may thwart the recovery in an effort to be helpful. So we have to be very careful as we move.

I would like to move next to Mr. Tozer. Am I announcing that correctly, sir?

Mr. TOZER. Yes, you are.

Mr. GREEN. Okay.

Mr. Tozer, sir, some things bear repeating. You have given us a good deal of intelligence about Ginnie Mae. We understand that it originated out of Fannie Mae: Fannie Mae in 1938; Ginnie Mae in 1968. But you talked about the layers of protection and you talked about how you don't come into play as often as some of the other agencies. Can you better define for us how often you come into play with these mortgage-backed securities?

Mr. TOZER. In the past year, we have had four issuers we had to deal with their servicing. And in reality, out of the four, two of them were ones where they were banks that received the FDIC. So the servicing was fine. There was no problem with servicing. We were able to move it, because again, it was an FDIC issue that made us move them. The other one, we actually were able to move the servicing to someone else, too; then put a mortgage banker. So really we have had to deal with our guarantee as far as ceding the servicing four times. Only one time we even had to even get involved long term. And even with that, it didn't cost us anything. Because what we did was we took the servicing. We have two backup servicers, people who are willing to service for a fee for us, and they are servicing on our behalf.

So as of this point, the four organizations that have failed this year to this point have not cost the guarantee any money because we were able to replace the servicing. Because that is the key. Our guarantee comes into play if the servicing—the whole servicing pool, not just the ones that are bad, but the whole servicing pool, because these servicers are paid a fee to service a portfolio, and it is a very lucrative fee.

So when we go out to put the servicing out to the private market, as long as there is enough current loans, we can place it and not cost our fund any money at all. It has really not come into play, and it has worked very well.

Mr. GREEN. You have indicated, and I will restate this, you don't originate loans. You don't purchase loans. You don't sell securities. As a matter of fact, you really are not involved in derivatives, are you?

Mr. TOZER. No. Again, our whole position is that we have lenders that have taken FHA/VA insured or guarantee loans, government housing, and they have created pools, basic almost like private label pools. What we have done is we have wrapped those securities. So really we don't get involved in derivatives.

The only thing we are involved with is we do offer a REMIC program, again to help create liquidity for the Ginnie Mae security. But it is not really a derivative; it is more of a situation of just kind of helping the market. But overall, we are not involved with derivatives. Again, we are truly just an insurance company.

Mr. GREEN. My time is about to expire. Let me just ask you one additional thing. You deal with institutional investors, correct?

Mr. TOZER. That is correct.

Mr. GREEN. Could you just quickly define this so that there won't be any question as to what an institutional investor is, please?

Mr. TOZER. The institutional investors that buy our securities are mutual funds like Vanguard. It is central bankers around the world. It is pension funds. It is insurance companies. It is the people who have a natural interest in long-term investments and that like the government guarantee because that way they know they have liquidity to get in and out of the security business. But it is mainly like central bankers, insurance companies, mutual fund owners.

Mr. GREEN. Thank you, sir. My time has expired.

Thank you, Madam Chairwoman.

Chairwoman BIGGERT. Thank you.

The Chair notes that some members may have additional questions for this panel which they may wish to submit in writing. So, without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

And I would like to thank the panel for spending this time with us and for being very patient before we started. So, with that, thank you, thank you very much.

We will move to the second panel as quickly as possible. While we are moving quickly to the second panel, I do want to acknowledge something, so if I could have your attention please. This committee has also acknowledged this, but I would like to recognize a senior professional staff member, Cindy Chetti, for her decades of service to this committee and this institution.

Cindy, thank you, thank you, thank you for your service to this committee. And as you all know, Cindy is leaving us or retiring, we could say, but to a new career, and we wish her the best, and thank you so much.

I now recognize the second panel. And I thank you for your patience. Certainly, I hope there weren't any airplanes that were leaving now.

Our second panel consists of: Douglas Holtz-Eakin, president, American Action Forum, and former Director of the Congressional Budget Office from 2003 to 2005; Michael Farrell, chairman, CEO, and president of Annaly Capital Management, Incorporated; Faith Schwartz, executive director, HOPE NOW Alliance; and Julia Gordon, senior policy counsel, Center for Responsible Lending.

And as we said to the first panel, without objection, your written statements will be made a part of the record, and you will each be recognized for a 5-minute summary of your testimony.

We will begin with Mr. Holtz-Eakin for 5 minutes.

STATEMENT OF DOUGLAS HOLTZ-EAKIN, PRESIDENT, AMERICAN ACTION FORUM, AND FORMER DIRECTOR OF THE CONGRESSIONAL BUDGET OFFICE FROM 2003 TO 2005

Mr. HOLTZ-EAKIN. Madam Chairwoman, Mr. Clay, and members of the subcommittee, thank you for the chance to be here today.

You do have my written statement, so I will be brief. Let me make two major points about the role of government policy in housing recovery. And the first has to do with the broad macroeconomic recovery that the United States is engaged in at the moment where I think housing enters in two important ways.

The first is that an important feature of this economic setting is the bad damage to household balance sheets during the financial crisis and recession, housing being a key part of that. It is one of the reasons that I do not believe that any consumer-led strategy will be successful in generating faster economic growth.

Housing policy enters there in that the sooner the valuations are settled in the housing market, the better. And I at least have come to the conclusion that I am skeptical that any government intervention can speed the clearance of excess inventories from the market and otherwise stabilize housing values. The quicker this gets done, the better, and I think getting government out of the way is the fastest way for that to happen.

The second is that in the end, this recovery will be powered by investments, business spending in workers, plant equipment, and in residential and nonresidential construction. There, I think the most important thing is to settle the rules of the road. Some of this debate is familiar. What will be the future of tax policy past 2012 now? What will be the nature of regulatory burdens, where we have seen over the past year a record number of Federal Register pages with regulations coming from Dodd-Frank, now the Affordable Care Act, EPA, all of which have impacts on housing construction, but also the future of mortgage finance, where it will be essential for folks to understand how exactly this is going to be operated?

There I think it is worth stepping back quite a bit and looking at what the objectives are. And I would say, broadly speaking, the U.S. tradition of subsidizing debt-financed owner-occupied housing in ways which are invisible and not transparent for the taxpayer has been a great disservice to the taxpayer, certainly to homeowners in the end and to those in the housing community.

The mortgage interest deduction is a classic example of rewarding debt finance of owner-occupied housing, not merely owner-occupied housing. And the implicit subsidy provided through the GSEs with affordable housing goals off the books that left taxpayers massively exposed is a very indirect and inefficient subsidy to policy goals.

And so I think the primary objective for the members would be to identify policy roles clearly. Are they to subsidize housing or is it owner-occupied housing, or is it debt financing of owner-occupied housing where we reward leverage? But identify the goal and provide those subsidies in a budgeted fashion, put them on the budget so that they are transparent to taxpayers and to members, and they control those subsidies; target them as directly as possible on the communities you wish to affect, low-income Americans, veterans, as it may be, and not indirectly through secondary mortgage markets, which make it very difficult to have efficient subsidies and end up costing very, very much.

So I think that there is a lot to be done and it must be done relatively quickly. Because until this is settled, where the housing finance industry is going, what then you can plan in the way of sensible transitions in phasing out, clearly, the taxpayer finance hedge fund that was Fannie Mae and Freddie Mac portfolios, and indeed, in some circumstances, phasing out the guarantee function, which you could easily do in a future government-free housing finance world; the sooner that is settled, the more clarity you will have and the faster we will get genuine recovery in both the housing sector and also the larger economy of which it is such an important part.

I thank you for the chance to be here today and I look forward to answering your questions.

[The prepared statement of Mr. Holtz-Eakin can be found on page 96 of the appendix.]

Chairwoman BIGGERT. Thank you so much.

Mr. Farrell, you are recognized for 5 minutes.

STATEMENT OF MICHAEL A.J. FARRELL, CHAIRMAN, CEO, AND PRESIDENT, ANNALY CAPITAL MANAGEMENT, INC

Mr. FARRELL. Chairwoman Biggert, Mr. Clay, and members of the subcommittee, my name is Mike Farrell. I run Annaly Capital Management. I am the chairman and CEO and the founder.

We are a large residential mortgage real estate investment trust, or a REIT, listed on the New York Stock Exchange. Collectively, between Annaly and the other companies that we run, we run about $100 billion worth of mortgage-backed securities and mortgage loans through our portfolios as investors.

I represent an important constituency in the housing market, the secondary mortgage investors, who provide a majority of the capital to finance America's homeowners. Just for the Annaly family companies, we estimate our shareholders collectively help finance the homes of 1 million American households or 3 million American citizens.

I would like to begin by focusing on the fact that the secondary mortgage market investors provide 75 percent of the U.S. housing market capital. That is approximately, of the $10 trillion in outstanding home mortgage debt, about $7.5 trillion is funded by mortgage-backed securities and investors that fund those securities. Of that $7.5 trillion about $5.5 trillion is in the government-guaranteed mortgage-backed securities and about $2 trillion in so-called private label mortgage-backed securities. The balance, or $2.5 trillion, is held in loan form, primarily on bank balance sheets.

Since our country's banks have about $12 trillion in total assets, there is not enough money in the banking system to fund our Nation's housing stock for cash, at least not at today's current levels. It is axiomatic that without a healthy securitization market, our housing finance system would have to undergo a radical transformation.

Right now, securitization is attracting significant amounts of private capital, at least to that part of the NBS market that is government guaranteed. The problem is that in the nonagency part of the sector or the so-called private label market, it is dormant, and only one small deal has been done in the last 2½ years.

I now would like to discuss several reasons why the private label market is not restarting. First, the economics don't work, for a number of reasons but mainly because mortgage rates have to rise in order to compensate investors for the risk that they are taking in those securities.

Second, there is a higher yielding alternative for investors who want to take a residential mortgage credit risk, older private label mortgage-backed securities and seasoned loans that have been repriced and are cheaper by the market after the events of the past few years. As long as this disparity exists it will impede the restart of the new issue of private label market.

The third reason is the difficulty in sourcing enough newly originated loans. Without the outlet to sell mortgages and securitizations, banks have gotten more comfortable holding nonconforming loans on their balance sheet, not only by tightening underwriting standards but including sizable downpayments. In short, banks are only willing to make loans to highly capitalized borrowers.

The fourth reason is the uncertainty over the future regulatory environment. The many different mortgage modification programs and delays in foreclosures have made it difficult for investors to analyze cash flows.

Finally, I want to get to the heart of the current debate. Can the private label mortgage-backed securities market come back and fill the gap that is currently filled by the GSEs? The short answer is, yes, it can, but not at the same price and not in the same size.

Most investors in agency mortgage-backed securities won't invest in private label mortgage-backed securities at any price or only in much reduced amounts because their investment guidelines preclude taking credit risks. These investors include money market funds, mutual funds, banks, foreign investors and governmental agencies. Some investors could cross over, but we don't know how many or at what price, and we won't know until we have a lot more information to make that analysis clear.

But back at the end of the day, I have to refer to my two market truths: first, securitization is a source of about 75 percent of the capital to the housing market; and second, the private label securitization market is not working right now.

I thank you for your time today, and I look forward to your questions.

[The prepared statement of Mr. Farrell can be found on page 56 of the appendix.]

Chairwoman BIGGERT. Thank you.

Ms. Schwartz, you are recognized for 5 minutes.

STATEMENT OF FAITH SCHWARTZ, EXECUTIVE DIRECTOR, HOPE NOW ALLIANCE

Ms. SCHWARTZ. Thank you, Chairwoman Biggert, and members of the subcommittee.

Thank you for having me come today and testify before you. I am Faith Schwartz, the executive director of the HOPE NOW Alliance. And I have served in that capacity since 2007, where I work with servicers, nonprofit housing counselors, regulators, and the government to help homeowners avoid foreclosure.

The comments I make today are my own and represent my experience at HOPE NOW and my breadth of experience in the capital markets prior to HOPE NOW. I will focus my oral testimony on the HOPE NOW data collected over the past 3 years; the state of the market, including government programs; and summarize issues to consider associated with a return of private capital.

Foreclosure intervention programs have contributed to a record number of borrowers seeking help to avoid foreclosure and have assisted millions of borrowers stay in their homes. These public-private efforts have also contributed to longer foreclosure timelines across the country. The information shared today should assist you as you think about the important issue of bringing the private capital back.

In early 2010, we had over 4 million borrowers who were 60 days or more past due on their mortgages. The industry completed 1.7 million loan modifications. Of that, 1.2 million were private industry modifications and another half million modifications were done through the HAMP program, the government program. To keep it in context, you should compare that with 1 million foreclosure sales that happened through the same year of last year.

What has changed from 2007 through 2011? Early on, the efforts on foreclosure prevention were focused on subprime securitizations, freezing interest rates, capitalizing arrearages, and extending terms of mortgages to keep them intact. There were few government program resources focused on foreclosure prevention, and the industry did pull together with government to collaborate and with nonprofits to keep people in their homes. The scale of the problem remained large, and the government got more involved.

Some of the government programs rolled out were as follows: FHA HOPE for Homeowners. It is a targeted refinance program with servicers and investors willing to write down principal and consumers have to equity share with the U.S. Government. The HARP program was a GSE refinance program targeted at loans at 80 percent up to 120 percent for negative equity borrowers at risk of default. Making Home Affordable, HAFA, a short sales and deed in lieu program focused on detailed processes for many players, forgiveness of a deficiency if you sell the home lower than what is owed on the loan and extending the timeline of loans up to 120 days.

Making Home Affordable. HAMP—government loan modifications that set standards; safe harbors and PB tests focused on affordability; tools including 31 percent DTIs; rate reduction to 2 percent; extension of terms of 40 years. And a detailed review on HAMP is in my lengthier written testimony.

Treasury also rolled out $7.5 billion to the hardest hit States—18 States and the District of Columbia—to address unemployment, principal reductions, and other modification supplements to the current modification efforts going on.

Lastly, on the government intervention, we have had the State mediation guidelines that have been rolled out from 26 States that have a lack of uniformity in them, but their intentions are good: to keep people meeting with each other prior to going to foreclosure. What we recommend, however, is a comprehensive review for the various programs which are all unique to create universal documentation requirement standards and agreements on how to measure success.

Our proprietary solutions and modifications have been up to 3.5 million since July of 2007. This is without taxpayer dollars, and it happens only after a loan has been considered for a government modification and is ineligible for a government modification.

The efforts have improved, and the modifications are more sustainable and affordable. And permanent solutions for borrowers who are seeking to stay in their home are now getting permanent affordable payments: 84 percent of the proprietary mods have an initial duration of set rate of 5 years or greater; 81 percent have lower principal and interest payments; and 80 percent of the proprietary mods, on average, are less than 90 days past due that have been performed over this past year.

Summary and recommendation: Foreclosure timelines have increased considerably. While effective interventions have made a difference to millions of homeowners and investors, homeowners and communities have also experienced tremendous losses. Vacant housing abounds, and the foreclosure process remains drawn out. The average delinquency of a foreclosure in 2008 was 300 days, and in September 2010, it was 500 days across the country.

Measuring risk has been difficult in the changing marketplace. Investors will want to see standards and uniformity. Whether it is State or Federal programs, uniformity and improved execution will be important to improve the cost of servicing, managing multiple programs, and mandates.

Clear reps and warranties need to be in place. Identification of roles and responsibility of the servicer, of the borrower, and of the investor will be spelled out and the terms of the contract must be enforceable.

Duration and prepayment risk, credit risk, and all of the Federal programs will also add to the uncertainty for investors.

Thank you.

[The prepared statement of Ms. Schwartz can be found on page 101 of the appendix.]

Chairwoman BIGGERT. Thank you.

Ms. Gordon, you are recognized for 5 minutes.

STATEMENT OF JULIA GORDON, SENIOR POLICY COUNSEL, CENTER FOR RESPONSIBLE LENDING

Ms. GORDON. Thank you, Chairwoman Biggert, Mr. Clay, and members of the subcommittee. I serve as senior policy counsel of the Center for Responsible Lending, a nonprofit research and policy organization dedicated to protecting homeownership and family wealth. We are an affiliate of Self-Help, a CDFI that finances safe and affordable mortgages and small business loans.

Over the next several years, the toxic combination of unsustainable loans, high unemployment, and underwater borrowers could mean a stunning total of more than 13 million foreclosures during this crisis, which is about a quarter of all the mortgages in the country. The spillover effects of these foreclosures will cost our Nation billions if not trillions of dollars, and the additional excess supply of homes will drive still further declines in home values.

Things did not need to be this bad. Mortgage servicers are supposed to be capable of handling loans even when problems arise, but the profits made during the years when servicing was simple were not reinvested to prepare for the rainy days. Instead, nearly 4 years since the start of the crisis, the industry is still struggling to catch up to the new reality.

If market principles applied here, customers would have voted with their feet by now. But mortgages are not like cell phones; homeowners do not get to choose their servicer or switch providers if service is poor. Even investors have very little control over the servicing of the loan pools on which their income depends. For this reason, it made a lot of sense for the government to offer tools to help servicers do a better job of protecting the assets of both investors and homeowners.

HAMP, the principal government effort, has proved disappointing, in large part because it is a voluntary rather than a mandatory program. And servicers who failed to make the modifications they were supposed to suffered little consequence for these failures. But it is not productive to respond to HAMP's tepid performance by throwing our hands up and declaring that we will just let foreclosures continue to wreak havoc on America's families, neighborhoods, and cities.That is reckless endangerment of the housing market, not to mention an abandonment of the interests of every homeowner in the Nation, all of whose wealth is reduced by continued foreclosures. Rather, it is time to do what we should have done all along: require all servicers across the entire industry to review all loans for alternatives to foreclosure and enforce that requirement.

There is little disagreement that affordable loan modifications are a win-win. Not only do they give families a shot at keeping their homes, but they provide greater returns to investors even when many of those homeowners redefault. There is also consensus that for vacant homes and for homes that the borrower cannot possibly afford, it is best to free up that home for a new family. But the servicing system simply cannot sort out which is which right now. It is crippled by overwhelming volume, and the financial incentives don't line up with investor and homeowner interests. More than 60 percent of borrowers in trouble have had no evaluation of their situation at all. In other words, many foreclosures that shouldn't happen, happen; and foreclosures that should happen languish in the vast shadow inventory.

A few commonsense principles are crucial. Servicers should review loans for alternatives even before foreclosure proceedings are started, and loss mitigation and foreclosure processes should not go forward on a dual track. Servicers should provide borrowers a single point of contact to guide them through the modification maze. Banking regulators should enforce existing rules and establish additional duties and standards to prevent detrimental servicing practices.

Last but not least, as we retool the mortgage finance system, consider that any market needs a continuous influx of new customers, especially at a time when we suffer from an oversupply of homes. The failure to meet the needs of first-time homebuyers and customers from low-wealth backgrounds could be catastrophic for market recovery and growth. It is important to note that the current crisis was not caused by first-time homebuyers who constituted only 10 percent of those who received risky subprime loans. Rather, it was caused by existing homeowners being refinanced by predatory lenders into bad products.

Excessive fees and large mandatory downpayments that keep people out of the market are the wrong way to keep the market safe. Instead, a healthy market needs sensible rules resulting in affordable, safe, sustainable loans. And we should make sure that lenders don't discriminate against people who have the ability to pay for a mortgage but who live in a low-wealth or minority neighborhood.

Thank you for your time. And I look forward to your questions and to working with you to restore health to the housing market and economy.

[The prepared statement of Ms. Gordon can be found on page 60 of the appendix.]

Chairwoman BIGGERT. Thank you.

I now recognize the committee for 5 minutes for questions, and I will yield myself 5 minutes.

Uncertainty seems to be the word that I am hearing here and we heard in the former panel. Uncertainty is a theme.

Ms. Schwartz, can you just tell a little bit from your own experience about the impact uncertainty is having on participation of private capital in the mortgage finance?

Ms. SCHWARTZ. I am relating it to servicing and the investment. In a mortgage as a whole, you have to have care of how you process a loan in the servicing department and also through the foreclosure process. And the uncertainties abound in the length of time it takes to just foreclose on a loan, and someone might have abandoned the house. So we have overlapping government programs in that Fannie, Freddie, FHA and HAMP, all really well-intentioned, I work well with all of them, but they have different processes and procedures to do likely the same type of things. We would really benefit from more uniformity and create less uncertainty in timelines and getting through the system.

Chairwoman BIGGERT. Thank you.

And Mr. Farrell, in your testimony you talk about uncertainty over the future regulatory environment, and the many different mortgage modification programs and delays in foreclosure have made it difficult for investors to analyze cash flows.

Could you elaborate a little bit about how the Administration is exploring the option of implementing national servicing standards with no real timeframe for a decision? And the avalanche of rules resulting from Dodd-Frank are still in the pipeline. So are you concerned that this will really make much more uncertainty about private capital coming into the market?

Mr. FARRELL. I think that the uncertainty of regulatory capital, charges on banks, the changes that have emerged in coordination with other central banks, Basel 3, etc., are unquestionably creating an uncertainty of commitment of capital to the market in some respects and in some asset classes.

If we go back to 2008 during the middle of the crisis, virtually every mortgage security—which is unquestionably just a cash flow that needs to be analyzed by investors and compared to other allocations of other cash flows—all of the mortgages in the United States at that point in time were considered to go bad by investors. And the assumptions that were being taken into the market for secondary mortgages as well as for primary mortgages was that there was going to be a much higher default rate than actually what has occurred, the severity rates, the recovery rates, etc. That uncertainty only bleeds over into the kind of dialogue that we have had about the servicing standards that are going to emerge out of this, the continuation of Fannie Mae and Freddie Mac.

We have to complete globally for this capital when we go out and we try to raise it to compete for other asset allocations. When we look at the influence of cash flows on our earnings and our returns to our investors—who are primarily domestic investors, everyone from individual investors to institutional funds—we need to be able to clearly explain to them what we think the variance in those earnings are going to be. And the uncertainties of policy, modification, tinkering with the cash flows, all lead to us having to essentially take a discount and hair-cut those cash flows, and therefore raise interest rates, in effect, in the private market.

So my short answer is yes, that uncertainty is there. There is capital to do that, but it is exacting a higher toll in terms of the absolute rates that people need to pay for their mortgages.

Chairwoman BIGGERT. Thank you.

And then I would like to move on to Dr. Holtz-Eakin. You also talk about the uncertainty and the stress. You talk about the stress that housing valuations have caused homeowners and how they restrict their spending.

Have you identified any policies as having a destabilizing effect on the housing valuations?

Mr. HOLTZ-EAKIN. I think at this point, the sad reality is the best thing we can do is to let housing markets clear. And prices will decline where they have to to get excess inventories off the market, and at that point they will stabilize and we will also hopefully begin to create some jobs. You will get a somewhat closing of the gap between the underlying household formation and demographic demand for housing, which is probably double the housing starts we have right now and the actual demand we see due to diminished wealth and low income.

So I have thought for 2 years now, if not longer, about housing policies that might speed this, and I have come to the reluctant conclusion that there are no magic bullets out there. You can't fool Mother Nature. We are going to have to just let this play out.

Chairwoman BIGGERT. Thank you. I yield back my time.

The gentleman from Missouri is recognized for 5 minutes.

Mr. CLAY. Thank you, Madam Chairwoman.

And let me start with Ms. Schwartz on a district-specific question. Would you be able to supply me with any data on how many permanent loan modifications HOPE NOW has performed in the First District of Missouri?

Ms. SCHWARTZ. I can't on a district basis, but I can on a State basis. I can have that data for you.

Mr. CLAY. That would be fine. Thank you.

Let me ask you a series of questions to get a feel for your take on servicing reform, and these are basically yes-or-no questions.

Would you support servicing reform that mandates a single point of contact for borrowers for the life of their loan modification?

Ms. SCHWARTZ. I would support reform to make sure borrowers had someone to talk to, who knew their situation and could help them, but that might look differently to different companies.

Mr. CLAY. Okay. How about would you support mandates, disclosure of the complete chain of title, and whether or not the servicer used a loss note affidavit in the notice of default? Support or oppose?

Ms. SCHWARTZ. I think that there should be a clear chain of title, and you should be able to find it and use loss note affidavits as needed.

Mr. CLAY. Would you require in contracts a formula that would govern how second liens had to be written down in the event of a first-lien modification?

Ms. SCHWARTZ. I support the co-modification of a second lien and a first lien in the new MP program level.

Mr. CLAY. Would you require that an independent master servicer provide oversight and resolve disputes regarding servicers' actions?

Ms. SCHWARTZ. I am probably not familiar enough with the master servicer rule to answer that.

Mr. CLAY. What in Ms. Gordon's suggestions would you support to improve modification?

Ms. SCHWARTZ. We both were talking and we both were in firm agreement that simplicity—and this complex system of modifications can be simplified to help more people and be more effective.

Mr. CLAY. I see. Thank you for your responses.

Ms. Gordon, the Federal Housing Finance Agency has announced that it would like to make changes to how servicers of loans guaranteed by Fannie and Freddie are compensated. The reason for this change is that the FHFA has recognized that servicer compensation leads to misaligned incentives and harm the investor and the homeowner. Can you comment on FHFA initiative and the impact it would have on changing the misaligned incentives?

Ms. GORDON. We welcome this initiative, which is not just FHFA, it is also FHA and VA as well. That is a conversation we hope to be participating in, because we do think the question of servicer incentives has likely impacted the performance of the servicers during this crisis.

Mr. CLAY. All right. Thank you for that response.

And Mr. Farrell, the future of the housing market going forward, according to your testimony, does not look that promising. Not to say that your testimony brought a dark cloud, but I guess it is more realistic than anything else as far as what we can expect going forward with homeownership and people actually securing mortgages. Is that what I heard? Did I hear that correctly?

Mr. FARRELL. I would say I am a realist, but I would also say I am a total optimist. I think that this clearance will happen. I think that at the end of the day, as an asset allocator and a cash flow allocator, the resounding message that we have received from the markets in our business model—which is a very circular business model, the Reid model—and I would congratulate Congress for the 1960 rule that put Reid in place, which I think have really served the Nation very well over the past few years and helped stem some of the crisis in terms of capital raising and allocation.

But when we talk to investors, they have to make a choice about where they are going to put their money and what that return is going to look like. And the resounding message that we have heard from investors is that they would rather lend to their neighbors at 6 percent than to another sovereign credit at 6 percent. It is up to us as a Nation to figure out what is the process and the price of that credit and how that sovereign credit will work versus the private market credit, but I am confident that we will figure it out.

Mr. CLAY. Thank you, Mr. Farrell.

I yield back.

Chairwoman BIGGERT. The gentleman's time has expired.

The gentleman from Virginia, Mr. Hurt, is recognized.

Mr. HURT. Thank you, Madam Chairwoman.

This is really a question for all four, and maybe we can start with Dr. Holtz-Eakin.

This morning we heard from the Chairman and the Vice Chairman of the Financial Crisis Inquiry Commission, and one of the statements that was made in the majority report that I found interesting was that government housing policy did not play any significant factor, was not a significant factor in the crisis that we are now going over with a fine-toothed comb and trying to assess and trying to find ways to make sure that we prevent this in the future.

I was wondering, in light of the fact that I think certainly my constituents would believe that irresponsible lending led to the subprime mortgage crisis, it seems to me that government housing policy may actually have a lot to do with where we are and how we got here. I was wondering if each of you could maybe speak on that briefly and maybe offer the top government policy that you think that we need to examine, change, and shoot for in order to address this.

Mr. HOLTZ-EAKIN. I will try to be brief.

Having issued a dissenting report from the majority, I will not relitigate all of the things I think they got wrong. But I would point out that Fannie Mae and Freddie Mac may not have caused the financial crisis, but they are the poster child for many of the phenomena that we highlighted in our dissent. They were key in the securitization chain, which during the panic did not serve us well. Its opacity contributed to what was a plain financial panic. They are the poster children for excess leverage, very little capital backing, implicit backing only by the taxpayer. They were the biggest phenomenon of "too-big-to-fail", and the quandary that policymakers were faced with in September 2008 about which institutions to aid and not to aid, and they were the most expensive to rescue.

So the policy that I think is absolutely imperative to reexamine is those housing subsidies which are off the Federal budget, which are implicit in their nature, which in the end become most dramatic when things fall apart. They are the best example of that and certainly worth reconsidering.

Mr. HURT. Thank you.

Mr. FARRELL. I would say that my view of the crisis as an investor was and is being addressed by the legislature now, which is the amount of leverage that was embedded in the balance sheets of the GSEs. As they were reporting to the twin masters of Congress and to the capital markets. The allocation and the misallocation of pricing in terms of allowing their balance sheets to grow to $1 trillion-plus balance sheets forced other lenders to do things that were creative and modify loans and loan terms and make reps and warranties that were incorrect.

I think that it is wise to downsize those portfolios. I don't think that the government should be in the portfolio business. People like me do that for a living. We live with the consequences of that, day to day, in terms of the scrutiny of not only regulators, but the shareholders and the investors who have to allocate capital to do that.

So I think that if I had to point towards one critical moment during the past 25 years of looking at the market, I would think it is once those balance sheets began to balloon to levels of unsustainable growth, that is when lending practices were forced into different players that do different things. And I commend the Congress and the Administration for looking to downsize those.

My one recommendation as an investor to remove the uncertainty would be to not let that take a long time, because that inventory overhang is just as serious in the securities market as it is in the actual allocation of houses that we have in inventory around the Nation. Those securities need to be cleared; we have to find clearing prices for them.

The capital markets are ready to do that. We prove that every day, and we raise money against that every day. And the quicker that uncertainty is out, at that time we will know the true price of what that premium is worth.

Mr. HURT. Thank you.

Ms. SCHWARTZ. I think it is fair to say that the early part of this crisis was led by risk-layering on loans that fell largely outside of the GSEs, Alt A, and subprime; however, they participated in some of that as well.

My recommendation on how to think about government involvement in all of this is, had we been able to detect things earlier, systemwide, on performance of loans in addition to the front end of the loans, and linking the two makes some sense for the regulatory review of systemic risk. So that would be my other observation.

Mr. HURT. Thank you.

Ms. GORDON. Much of what I would say was already said by Mr. Farrell and Ms. Schwartz. Irresponsible lending was most certainly a key driver of the crisis, but most of that lending was backed by private capital. And the GSEs actually maintained standards for their loan purchases that would have excluded many of the toxic loans that were so problematic. It was an instance here where the bad money was crowding out the good money. And without the standards that Fannie and Freddie did have, I don't know how much farther these bad products, these toxic products, unsustainable loans, could have gone.

That said, going forward, the Dodd-Frank Act creates a framework for safer lending, and that should provide some protections. But the system is always evolving. New ideas come up, and it is important to—the government has an interest in making sure that lending is safe beyond just protecting the individual homeowner. As a Nation, we have an interest in helping people build wealth and in helping people be housed.

And so as we go forward in reforming this system, it is important to remember that government has played an important role in that for a very long time now. Really, nobody here remembers the time before that.

Mr. HURT. Thank you.

Chairwoman BIGGERT. Thank you.

The gentleman from Wisconsin, Mr. Duffy, is recognized for 5 minutes.

Mr. DUFFY. Thank you, Madam Chairwoman.

I appreciate the witnesses coming in this afternoon and testifying.

Ms. Gordon, just to clarify your testimony, is it your position that folks who have come into risk with other mortgages and are potentially near foreclosure, that we should provide them alternatives to modify their loans; is that right?

Ms. GORDON. When it would return a greater amount of cash flow to the investor to modify the loan rather than not modify it—and if you don't modify it, generally it goes on to foreclosure—then it does make economic sense to modify that loan. That is why all of the contracts that you look at will contemplate the possibility of modifying loans.

Mr. DUFFY. But should that be the choice of the investor or should that be the choice of government to step in and dictate that cash flow?

Ms. GORDON. Right now it is—the spread sheet that the servicers run has to do with the amount that would be returned to the investor. The government actually doesn't play a role in making that decision.That decision is made by the private servicer.

Mr. DUFFY. So you are not advocating that government should step in and help play a bigger role in writing down principal or being part of renegotiating interest rates, are you?

Ms. GORDON. Unfortunately, the private system has failed us here in terms of their capacity and their competence.

Mr. DUFFY. But government does have a role in doing that?

Ms. GORDON. I think that government has a role in helping the servicers figure out a way to make the choices that help not just investors, but help the whole housing market recover. Honestly, I don't think that government has deployed the right tools to do that or deployed them forcefully enough.

Mr. DUFFY. So even when a homeowner and a bank have entered into an agreement, two private parties, you believe that it is the role of government to step in and potentially negotiate a resolution by a potential principal writedown or a decrease in interest rate?

Ms. GORDON. I should add that in the HAMP program, for example, as one of the principal government programs, the servicers have entered into a contract there with Treasury, under which they receive financial incentives to do the job that, frankly, they are obligated under all of their contracts with private parties to do anyway.

Mr. DUFFY. And Ms. Schwartz, one part of your testimony, you indicated that the foreclosure times from 2008, 300 days, have gone up to now 500 days in 2010. What impact does this have on prolonging this housing crisis?

Ms. SCHWARTZ. I think it gets at the bigger issue, that we kind of have overlapping inefficient processes through the foreclosure prevention. And some of it is good because you are protecting consumers who might have fallen through the cracks, but a lot of it has drawn out housing that otherwise should go to foreclosure, like abandoned houses. And the deterioration of neighborhoods happens when you have longtime lines of empty houses of 2 years, because that is an average of 500 days. So investors need certainty on what they are investing in in the mortgage business, in the mortgage markets, to get back to kind of normal timelines.

Mr. DUFFY. Is it fair to say that we want to work through this crisis as quickly as possible, hit our bottom, and hopefully rebound? Is that a fair assessment of what you think is an appropriate—

Ms. SCHWARTZ. I think that is right. I think we have to get through the delinquent and past-due loans and get through them and hopefully save as many people who are eligible for a loan modification, and then get them foreclosed—or do a short sale and a deed in lieu. There are other methods; it is not just a foreclosure.

Mr. DUFFY. And maybe to the whole panel, are the policies that we have in place right now facilitating a movement of these bad mortgages through the process so that we can bottom and hopefully come back up? Are the policies helping or hurting the movement?

Ms. GORDON. Something that I think is important to recognize is that there is no bottom that you and I can look at and say, oh, look, the bottom is right over there, we need to get into it. Foreclosures beget more foreclosures. As you have more foreclosures in the neighborhood, there are price declines. As people are underwater on their mortgages, they are more vulnerable to any kind of income interruption, and in that case, they end up going to foreclosures.

We can talk about letting the markets clear, but the markets can clear at various levels. And the importance of keeping people in loans when they can afford them and when they return a greater value for their investment—

Mr. DUFFY. My time is almost up. When we have this timeframe go from 300 days to 500 days, when it prolongs the foreclosure process, doesn't that put more pressure on the housing market because there are more foreclosures on the market and we haven't worked through them, Mr. Holtz-Eakin?

Mr. HOLTZ-EAKIN. I would say yes. Everyone has the ideal notion that if there is an economically rational workout that could be done between private parties, it should happen. When you start intervening in dramatic ways, two things happen: one, the rules aren't clear and it leads to uncertainty; and two, there is an actual incentive to wait for a better deal. Maybe taxpayers will stick a little more money on the table. What happens next? And this has slowed down, not speeded up, the overall housing adjustment.

Mr. DUFFY. Thank you.

Chairwoman BIGGERT. The gentleman yields back.

I would like to thank the panel for their expertise. And the Chair notes that some members may have additional questions for this panel that they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

Again, thank you very much for being here, and thank you for your patience.

This hearing is adjourned.

[Whereupon, at 5:15 p.m., the hearing was adjourned.]

A P P E N D I X

February 16, 2011

Embargoed until delivery

Written Testimony of Phyllis Caldwell,
Chief of Homeownership Preservation Office,
U.S. Department of the Treasury
Hearing before the House Committee on Financial Services
Subcommittee on Insurance, Housing and Community Opportunity
on
"Are There Government Barriers to the Housing Market Recovery?"

February 16, 2011

Chairwoman Biggert, Ranking Member Gutierrez and Members of the Subcommittee, thank you for the opportunity to testify today. I appreciate the opportunity to share insights resulting from the Administration's efforts to mitigate the effects of the most serious housing crisis since the Great Depression.

Rationale behind the Administration's Efforts to Prevent Avoidable Foreclosures

As the Subcommittee examines the role of the government in the housing market, including the housing programs supported by the Troubled Asset Relief Program (TARP), it is important to remember where the housing market stood just over two years ago. When the Obama Administration took office in January 2009, the economic crisis had developed into the most serious housing crisis since the Great Depression. Home prices had fallen for 30 straight months. Home values had fallen by nearly one-third and were expected to fall by another five percent by the end of 2009. Stresses in the financial system had reduced the supply of mortgage credit, limiting the ability of Americans to buy homes. Fannie Mae and Freddie Mac had been in conservatorship for over four months. And millions of American families faced increasing difficulties in making their monthly mortgage payments – having lost jobs or income – and were unable to sell, refinance, or find meaningful modification assistance.

During its first month in office, the Administration took aggressive action to address the housing crisis, such as bolstering the Government's commitment to support to Fannie Mae and Freddie Mac, which originated during the Bush Administration, to ensure continued access to mortgage credit, and through the Federal Housing Administration (FHA), both of which provided liquidity for housing purchases at a time when private lending had almost evaporated. As part of the Administration's response, the Treasury Department immediately began work on a program that would improve the affordability of mortgages for responsible homeowners, consistent with the mandate of the Emergency Economic Stabilization Act of 2008 (EESA) to promote financial stability while protecting taxpayers.

Key Challenges of the Administration's Response to the Foreclosure Crisis

My testimony today will highlight some of the key challenges addressed in responding to the housing crisis and discuss how best to help homeowners. First, the industry did not have the capacity to effectively respond to the complexity of the foreclosure crisis. Mortgage servicers were ill-equipped to provide meaningful assistance to homeowners while maintaining their responsibility to investors and still struggle to balance the two. Second, effective outreach to homeowners is difficult due to the complexity of the challenges they face, and their understandable mistrust of servicers. Homeowners often are not aware of the free resources available to them, and servicers all must increase efforts to reach them. Third, homeowners need safeguards. We have learned that the foreclosure process has to pause long enough to allow homeowners enough time to find help and work out a solution. Fourth, modifications need to be affordable to work. In order to modify loans effectively – and sustainably – servicers must focus first and foremost on reducing monthly mortgage payments. And lastly, because the foreclosure crisis is complex, we had to remain flexible as we looked for solutions that could reach the maximum number of struggling homeowners.

We are working to address these challenges within the framework of the Making Home Affordable Program (MHA), which is predicated upon voluntary agreements between Treasury and mortgage servicers. The MHA program was designed to incentivize long term sustainable modifications by aligning incentives within the existing mortgage servicing framework of borrowers, servicers and investors thereby minimizing potential adverse market impacts.

Mortgage Servicers Did Not Have the Capacity to Respond to the Crisis

The mortgage industry at the outset of the foreclosure crisis was ill-equipped to respond the housing crisis adequately. Mortgage servicers had insufficient resources to address the needs of a market that was reeling from increasing foreclosures. In addition, their servicing expertise and infrastructure was limited to overseeing collections and foreclosing on those who failed to pay. While that model may have been sufficient for the industry during times of economic growth and house-price appreciation, it quickly proved seriously inadequate in 2007, when the industry experienced rapidly rising defaults and declining home prices.

In addition, there was no standard approach among loan servicers or investors about how to respond to responsible homeowners who wanted to continue making payments, but were in need of mortgage assistance. Most solutions offered by servicers before the crisis simply sought to add unpaid interest and fees to the mortgage balance. These options often resulted in higher, not lower, payments for homeowners. Although many of these early modifications may have attempted to address temporary hardships experienced by homeowners such as a medical emergency or divorce, they did not generally help over the longer term, because they did not make homeowners' monthly mortgage payments more sustainable. As a result, millions of responsible American families simply lost their homes.

The program that Treasury launched in March 2009, the Making Home Affordable program, includes the first lien modification program – the Home Affordable Modification Program (HAMP). Its goal was to offer homeowners who are at risk of foreclosure reduced monthly mortgage payments that are sustainable over the long-term. HAMP provided servicers with standards that could be applied to all modifications. As a result, these standards soon became national, industry wide models that were applied to the servicers' own proprietary modifications as well.

At the same time, it is important to emphasize that HAMP was not intended to help all homeowners. Nor was HAMP intended to stop all foreclosures. The program was intended to support financial stability by helping a segment of homeowners who were at risk of foreclosure or who would be at risk before the end of 2012. Today, there are approximately 5 million delinquent mortgages. Only about 1.5 million are eligible for HAMP, because HAMP eligibility is not extended to:

- high cost mortgages in excess of $729,750;
- mortgages on vacation, second homes or investor-owned properties;
- mortgages on vacant homes;
- homeowners who can afford to pay their mortgage without government assistance; and
- homeowners with mortgages that are unsustainable even with government assistance.

Additionally, not every mortgage servicer participates in HAMP and not every contract between servicer and investor allows for modifications. And HAMP is just one program in the waterfall of foreclosure prevention options at other federal agencies like the FHA and the Department of Veterans Affairs (VA).

Over the last two years, we have worked to develop policies and procedures in the MHA program to ensure that responsible homeowners who meet the eligibility criteria are offered meaningful modifications and other alternatives to a foreclosure. To address servicer shortcomings, we have required servicers to rapidly increase staffing and improve customer service. We have developed specific guidelines and certifications on how and when homeowners must be evaluated for HAMP and other options before foreclosure. We developed a clear process for promptly and fairly resolving homeowner complaints. We also have a comprehensive compliance program to make sure that homeowners are fairly evaluated for HAMP, and that servicer operations reflect Treasury guidance.

Today, HAMP continues to play a critical role in the market as the standard which servicers can use to evaluate assistance for struggling homeowners. Servicers have had to make significant operational changes to the way they handle foreclosure prevention. As a result, modifications made outside of HAMP generally follow HAMP's basic criteria. For the first time ever, making monthly mortgage payments affordable for the homeowner is now a touchstone of modifications across the industry.

Engaging Homeowners is Key

Homeowners facing foreclosure are often overwhelmed by the complexity of the challenges they face. They are stressed and often embarrassed by their financial difficulties, and may find it difficult to ask for assistance. As a result, we believe many homeowners fail to reach out for help.

Many homeowners facing foreclosure have lost their jobs. Others have reduced income due to underemployment or a new job that is lower-paying and are struggling to pay their bills. Often these homeowners exhaust their savings, fall into debt, and become delinquent on their mortgage before contacting their mortgage servicer for help.

Across the board, homeowners' experience with servicers has been frustrating. Servicers have had trouble keeping track of homeowner communication; different customer service representatives often do not have records of a homeowner's prior contact with their organization. Servicers lose documents or are difficult to contact. Through public reporting and compliance reviews, Treasury strives to improve the borrower experience when it comes to HAMP consideration.

Almost two years into the HAMP program, over 1.4 million families have received a trial modification which provided temporary relief, and most of those then received some form of further assistance, whether within or outside of HAMP. Nearly 580,000 homeowners have converted to permanent modifications and on average over the past six months, 30,000 more are being added each month. We know that many more families need help and we are working to bring as many eligible borrowers into the program as possible. Treasury has stepped up efforts to reach out to homeowners and guide them through the HAMP process. We recently launched a Public Service Advertising campaign across TV, radio, internet and billboards which has been viewed approximately 53 million times. We recently held our 50th homeowner outreach events, with more to come. We have trained close to 7,000 housing counselors. We continue to strengthen our resources at the HOPE Hotline and the HAMP Solution Center, enabling us to better support homeowners as they work with their mortgage servicer.

These efforts come on top of important policy changes that are designed to ease access into the program while making sure that we still use taxpayer funds prudently. First, we set requirements to reach out to homeowners as part of our homeowner protections guidance, and comprehensively review their compliance. Second, we simplified the HAMP documentation requirements. Third, we required that all trial modifications start only after fully documented requests for assistance, and that homeowners have their income verified by servicers before they can receive a HAMP trial modification. These changes were designed to simultaneously help homeowners get access to the program and ensure that those who enter the program are much more likely to convert to permanent modifications after completing the three month trial period.

Treasury is also working to make sure homeowners know that help is available. Homeowners can call their servicers and ask about a HAMP modification, or the HOPE Hotline at 888-995-HOPE, where they can talk to a free HUD-approved housing counselor who can guide them through the process and serve as an advocate in working with the servicer.

When asked what advice he would give to others, a homeowner from Cleveland who received a permanent HAMP modification said, "Don't be ashamed to ask for help. These are tough times and there is help out there. I am so grateful for the housing counselor I worked with. There is no charge to work with a housing counselor. The government has a lot of good resources that are all free." We are working hard to spread this message to more struggling homeowners.

Homeowners Need Some Safeguards

Early in the HAMP program, Treasury guidelines prohibited a foreclosure sale until a homeowner was fully evaluated for a HAMP modification. This rule protected homeowners in many cases, but permitted servicers to start the foreclosure process while simultaneously evaluating homeowners for HAMP. The servicer rationale for allowing this "dual track" was to expedite the foreclosure process in the event that homeowners fail their trial modifications, particularly in those judicial states that had long foreclosure timelines. However, this "dual tracking" of homeowners can cause enormous stress and confusion for individuals already in a difficult period.

To address these concerns, Treasury issued guidance that limited "dual tracking". This guidance became effective with trial modifications started on and after June 1, 2010. Specifically, program guidelines require participating mortgage servicers of loans that are not owned or guaranteed by Fannie Mae or Freddie Mac (referred to as the GSEs) to:

- evaluate homeowners for HAMP modifications before referring them for foreclosure. The focus here is on early intervention. Servicers must reach out to all potentially eligible homeowners when they are only two months delinquent and there is a still a viable opportunity to save the loan;
- suspend foreclosure sales against homeowners who have applied for HAMP modifications, while their applications are pending;
- halt all pending foreclosure actions when a homeowner makes the first payment under a fully verified trial plan;
- evaluate whether homeowners who do not qualify for HAMP (or who have fallen out of HAMP) qualify for other programs to prevent a foreclosure, such as a servicer's own proprietary modification program;
- evaluate whether homeowners who cannot obtain alternative modifications may qualify for a short sale or deed-in-lieu of foreclosure, including through Treasury's program, the Home Affordable Foreclosure Alternatives program (HAFA); and
- provide a written explanation to any homeowner who is not eligible for a modification, and thereafter delay foreclosure for at least 30 days to give the homeowner time to appeal.

Servicers may not proceed to foreclosure sale unless and until they have followed these guidelines. They must also first issue a written certification to their foreclosure attorney or trustee stating that "all available loss mitigation alternatives have been exhausted and a non-foreclosure option could not be reached."

In addition, Treasury instituted a comprehensive compliance program to make sure that homeowners are fairly evaluated for HAMP, and that servicer operations reflect Treasury guidance. The MHA compliance program is designed to ensure that servicers are meeting their obligations under the MHA servicer contracts for loans where Fannie Mae or Freddie Mac is not the investor. Treasury's compliance activities focus on ensuring that homeowners are appropriately treated in accordance with MHA guidelines and servicers are subject to various compliance activities, including periodic, on-site compliance reviews as well as on-site and off-site loan file reviews. Treasury has engaged a separate division of Freddie Mac, Making Home Affordable-Compliance (MHA-C), to perform these compliance activities. Compliance activities are performed by more than 200 staff at MHA-C using a risk-based approach. MHA-

C's compliance reviews range from generally monthly for the largest servicers, to at least twice annually for the smaller-sized servicers.

MHA-C has performed more than 250 compliance reviews on participating servicers, many of which shaped servicer behavior in order to address the most vital issue: the ultimate impact on the homeowner. Examples of actions MHA-C has taken include requiring servicers to re-evaluate homeowners for HAMP, requiring servicers to make process and systems changes to accommodate MHA guidelines, and corrections to the servicer's net present value calculations. In one case, for example, MHA-C required a servicer to reevaluate more than 150,000 homeowners, with 150,000 letters sent out and more than 3 million follow-up phone calls made. In addition, this servicer was required to re-engineer certain HAMP processes and provide additional training for the servicer's staff in order to make sure that eligible homeowners were being reached.

Modifications That Focus on Making Monthly Payments Affordable for the Homeowner Are More Sustainable

The most recent Office of the Comptroller of the Currency (OCC) Mortgage Metrics Report found that modifications that provide deeper payment reductions tend to have lower re-default rates and that HAMP provides significantly more assistance than servicers' own proprietary modifications: "HAMP modifications made during the quarter reduced payments by an average of $585, compared with other modifications that reduced average monthly payments by $332 overall." Over the life of the program MHA data show that homeowners are experiencing a 37 percent median reduction in their mortgage payments – amounting to an estimated total, program-wide savings of over $4.5 billion to date for homeowners.

Homeowners in HAMP permanent modifications continue to perform well over time, with re-default rates lower than industry norms. December 2010 data for HAMP shows that after 12 months, nearly 85 percent of homeowners remain in a permanent modification. The OCC recently stated that "HAMP modifications were performing better than other modifications implemented during the same periods at the end of the third quarter of 2010. These lower post-modification delinquency rates reflect HAMP's emphasis on the affordability of monthly payments relative to the homeowner's income, verification of income, and completion of a successful trial payment period." Because of MHA, servicers have developed more constructive private-sector options as well. MHA's programs provided a model that servicers adapted to their own foreclosure prevention solutions. In the year and a half following the initiation of HAMP, servicers' home retention strategies changed dramatically. According to the OCC, in the first quarter of 2009, nearly half of proprietary mortgage modifications increased homeowners' monthly payments or left their payments unchanged. By the third quarter of 2010, almost 90 percent of proprietary mortgage modifications lowered payments for the homeowner and the average monthly savings has increased more than 50 percent from a year ago. This change means homeowners are receiving better solutions. Modifications with payment reductions have historically performed materially better than modifications that increase payments or leave them unchanged.

We Had To Remain Innovative

During the fall of 2009, the MHA program faced a number of challenges. The administrative complexity and unprecedented scope of HAMP, unexpected servicer execution challenges, and the lack of cooperation from servicers and investors tempered the potential impact of HAMP. In addition, as a result of the changing nature of the economic crisis, sustained unemployment challenges and negative equity mortgages became main causes of mortgage defaults and required greater attention. As a result, Treasury created new programs and designed the next phase of HAMP, with input from various constituencies, to better address these challenges.

Any modification program seeking to avoid preventable foreclosures has limits, HAMP included. HAMP was never intended to address every delinquent loan. In certain instances, the homeowner may benefit from an alternative that helps them transition to more affordable housing and avoid the substantial costs of a foreclosure. Consequently, the Administration launched the HAFA program, in which Treasury provides incentives for short sales and deeds-in lieu of foreclosure for circumstances in which homeowners are unable or unwilling to complete the HAMP modification process. HAFA sets out an important simplified industry standard for the complex process of a short sale or deed-in-lieu of foreclosure. These foreclosure alternatives have better outcomes than foreclosures for borrowers, neighborhoods and communities, and investors. The HAFA program applies only to non-GSE loans. In the coming months we hope to see increased servicer participation in the HAFA program.

In March 2010, the Obama Administration announced enhancements to HAMP aimed to more effectively address unemployment and negative equity, including providing temporary mortgage assistance to some unemployed homeowners, encouraging servicers to write-down mortgage debt as part of a HAMP modification, allowing more homeowners to qualify for modifications through HAMP, and helping homeowners move to more affordable housing when a modification is not possible.

The Unemployment Program (UP) requires servicers to grant qualified unemployed homeowners of non-GSE mortgage loans a forbearance period to have their mortgage payments temporarily reduced for a minimum of three months, and up to six months or longer when permitted by regulatory or investor guidelines, while they look for new jobs. Servicers are not reimbursed by TARP for any costs associated with UP, and there is no cost to government or taxpayers from the forbearance plans.

Under the Principal Reduction Alternative (PRA), servicers are required to evaluate the benefit of principal reduction and are encouraged to offer principal reduction whenever the net present value (NPV) result of a HAMP modification using PRA is greater than the NPV result without considering principal reduction. Incentives are based on the dollar value of the principal reduced. The principal reduction and the incentives are earned by the homeowner and investor based on a pay-for-success structure.

For many homeowners who want to stay in their home, we have learned that a modification is not always the most effective solution for the homeowner or the investor. A refinance can be a very effective tool to lock in a lower interest rate based and restructure the debt to be affordable for the homeowner over the long term. Treasury has worked with the FHA to establish the FHA Short Refinance option. It requires that the mortgage investor write off the unpaid principal balance of the original first lien mortgage by at least 10 percent. The new FHA loan must have a balance less than the current value of the home, and total mortgage debt for the homeowner after the refinancing, including both first and any other mortgages, cannot be greater than 115 percent of the current value of the home – giving homeowners a path to regain equity in their homes and an affordable monthly payment. Treasury has allocated nearly $11 billion of TARP funds to the FHA Short Refinance option.

Finally, the Administration has allocated $7.6 billion to the Hardest Hit Fund (HHF), to allow State Housing Finance Agencies (HFAs) in the nation's hardest hit housing markets to design locally targeted foreclosure prevention programs. The HHF has been rolled out to 18 states and the District of Columbia. Most states are using the funds to help unemployed homeowners make their mortgage payments, as well as to offer principal reduction for homeowners with high negative equity.

Looking Ahead for Housing

As a result of the Administration actions, homeowners have more viable tools available to them to avoid foreclosure. These programs have also established key benchmarks and homeowner protections that are now viewed as industry best practices. As a direct and indirect result, millions of families are still in their homes today because of these programs. Or, they have had the opportunity to relocate quickly to more affordable housing through a foreclosure alternative, such as a short sale. Their neighbors and their local communities have benefited as well. A vacant home can be dangerous and costly to a neighborhood. Therefore, we will continue to try to help as many eligible homeowners as possible, in a manner that safeguards taxpayer resources.

Yet, as we deploy a comprehensive suite of options to help families avoid foreclosure, we must remember, as the President noted, that not every foreclosure can be prevented nor should we try to avoid every foreclosure. That is why the TARP-funded Treasury housing programs aim to strike a balance between giving homeowners opportunities to avoid foreclosure and protecting taxpayers by paying incentives only when modifications are successful. In those cases where homeownership is no longer economically viable or appropriate to the homeowners' circumstances, our focus is on easing the transition to a sustainable housing situation. In so doing, these programs aim to limit market disruptions caused by rising foreclosures, while allowing the housing market to recover.

Testimony of

Michael A.J. Farrell

Chairman, Chief Executive Officer and President

Annaly Capital Management, Inc.

Before the

U.S. House of Representatives

Insurance, Housing and Community Opportunity Subcommittee

of the Committee on Financial Services

Hearing on

"Are There Government Barriers to the Housing Market Recovery?"

February 16, 2011

Washington, DC

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Good afternoon, Chairwoman Biggert, Ranking Member Gutierrez, and Members of the Committee. My name is Michael Farrell, and I run Annaly Capital Management, the largest residential mortgage Real Estate Investment Trust (or REIT) on the New York Stock Exchange. I also oversee the management of Chimera Investment Corporation, the second largest mortgage REIT. Annaly and our subsidiaries and affiliates together own or manage about $100 billion of primarily Agency and non-Agency residential mortgage-backed securities (or MBS).

I represent an important constituency in the housing market, the secondary mortgage market investors who provide the majority of the capital to finance America's homeowners. Just for the Annaly family of companies, we estimate that through our MBS holdings our shareholders collectively help finance the homes of almost one million American households.

I'd like to begin by focusing on the fact that secondary mortgage market investors provide 75% of the capital to the US housing market. That is, of the approximately $10 trillion in outstanding home mortgage debt in the US, about $7.5 trillion is funded by investors in MBS. Of that $7.5 trillion, about $5.5 trillion is held by rate-sensitive investors in Agency MBS, with about $2 trillion in credit-sensitive private-label MBS. The balance, or about $2.5 trillion, is held in raw loan form, primarily on bank balance sheets. Since our country's banks have about $12 trillion in total assets, there is not enough money in the banking system to fund our nation's housing stock, at least not at current levels. It is thus axiomatic that without a healthy securitization market our housing finance system would have to undergo a radical transformation.

Right now, securitization is attracting significant amounts of private capital, at least to the part of the MBS market that is government wrapped. This is to be expected, as this market always gains market share in counter-cyclical fashion. The problem is that the credit-sensitive, non-Agency sector of the market, or the so-called private-label market, is dormant, with only one small deal done in the last 2 ½ years.

I will now discuss several reasons why the private-label market is not restarting.

First, the economics don't work. In order for the math to work, either primary mortgage rates have to rise, the rating agencies' senior/subordinate splits have to come down, and/or return requirements by the secondary market have to decline. And yes, for good or for ill, the private-label market is still critically dependent on the rating agencies as the arbiter of credit quality.

Second, there is a higher yielding alternative for investors who want to take residential mortgage credit risk—legacy private label MBS and seasoned loans that have been repriced by the market after the events of the last few years. The return to investors from re-securitizing legacy MBS is higher than securitizing new mortgage loans. As long as this relative value disparity exists, it will impede the restart of the new-issue private-label market.

The third reason is the difficulty in sourcing enough newly-originated loans. Without the outlet to sell mortgages into securitizations, banks have gotten more comfortable holding non-conforming loans on their balance sheets, but only by tightening underwriting standards, including requiring sizable downpayments. As long as underwriting standards are so stringent, I don't see a vibrant private-label market developing.

The fourth reason is the uncertainty over the future regulatory environment. The many different mortgage modification programs and delays in foreclosures have made it difficult for investors to analyze cash flows. The uncertainty over the capital rules related to the definition of "Qualified Residential Mortgages" and risk retention and Basel III is also putting a chill on the lending markets and concentrating origination in only the few largest banks.

Will lowering the conforming loan limit, reducing FHA's reach or raising guarantee fees help re-start the private label market? That is unclear. These efforts are a step in the right direction toward giving lenders more options and reducing the government's footprint, but they don't necessarily address the issues I have discussed. Those no-longer conforming borrowers could face much tighter underwriting standards, and higher guarantee fees for conforming mortgages will likely just show up in non-conforming mortgage spreads.

Finally, I want to get to the heart of the current debate: Can the private label MBS market come back to fill the credit gap that is currently filled by the GSEs? The short answer is: Yes it can, but not at the same price and not in the same size. Most investors in Agency MBS won't invest in private label MBS at any price or only in much reduced amounts, because their investment guidelines preclude taking credit risk. These investors include money market funds, mutual funds, banks, foreign investors, and governmental agencies. Some rates investors could cross over, but we won't know how many or at what price until we know a lot more about a lot of things. But at the end of the day I have to refer back to my two market truths: Securitization is the source of 75% of the capital to the housing market, and the private label securitization market isn't working right now.

I welcome any questions you may have.

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Biography of Michael A.J. Farrell

Mr. Farrell is the Chairman, CEO and President of Annaly Capital Management, Inc. (NYSE: NLY). Annaly is the largest mortgage REIT listed on the New York Stock Exchange, with a market capitalization of $13 billion. Annaly and its subsidiaries and affiliates own or manage approximately $100 billion in assets, primarily residential and commercial mortgages and mortgage-backed securities. Prior to founding Annaly, Mr. Farrell was a Managing Director for Wertheim Schroder and Co., Inc. in the Fixed Income Department, served on the Executive Committee of the Public Securities Association Primary Dealers Division and as former Chairman of the Primary Dealers Operations Committee and its Mortgage Backed Securities Division. Currently, in addition to his responsibilities at Annaly, Mr. Farrell serves on the Executive Board of the National Association of Real Estate Investment Trusts (NAREIT), as a director of the U.S. Dollar Floating Rate Fund, a trustee of the Oratory Preparatory School in Summit, NJ and on the Board of Visitors of the Wayne Calloway School of Business and Accountancy, Wake Forest University.

Testimony of Julia Gordon
Center for Responsible Lending

Before the U.S. House of Representatives
Committee on Financial Services
Subcommittee on Insurance, Housing and Community Opportunity

"Are There Government Barriers to the Housing Market Recovery?"

February 16, 2011

Good afternoon Chairman Biggert, Ranking Member Gutierrez, and members of the subcommittee. Thank you for the invitation to discuss the very important issue of the continued weak performance of the country's housing market, which has been devastated by a foreclosure crisis that has impoverished families, destroyed neighborhoods, and triggered a global financial crisis.

I serve as Senior Policy Counsel at the Center for Responsible Lending (CRL), a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth. CRL is an affiliate of Self-Help, a nonprofit community development financial institution. For thirty years, Self-Help has focused on creating asset building opportunities for low-income and minority families, primarily through financing safe, affordable home loans that have enabled thousands of families to build assets for the first time. In total, Self-Help has provided over $5.6 billion of financing to 64,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across America.

You have asked us today to consider government barriers to the housing market recovery. In our view, the biggest barrier to recovery right now is the continued rapid pace of unnecessary foreclosures. The failure to prevent these foreclosures is largely due to the poor performance of the mortgage servicing industry. However, the government also bears some responsibility for the continuation of the crisis, particularly those government agencies that oversee the mortgage servicers. Government has not yet used all the tools at its disposal to ensure that mortgage servicers perform their core functions efficiently and effectively, thereby preventing unnecessary financial losses to investors and other financial institutions holding mortgages and saving crucial tax dollars for strapped municipalities. At the same time as the supply of foreclosed homes is increasing more than it should, demand is lower than it should be due to a dramatic tightening of credit has prevented many potential first time homebuyers from entering the market.

It is CRL's view that until we get far more serious about addressing the foreclosure crisis, we will not see the housing market recovery in a meaningful way. What's more, the fate of foreclosed homeowners impacts far more than the housing market. Foreclosures bring down home values across the board and devastate communities and municipal budgets. Even worse, since housing historically has led the way out of economic downturns, weakness in the housing sector is slowing economic recovery and hampering efforts to create jobs and reduce unemployment.

I. Introduction and Summary

Almost four years ago, our organization released a report warning that the reckless and abusive lending practices of the previous two decades would lead to approximately 2 million subprime foreclosures. At the time, our report was denounced by the mortgage industry as absurdly pessimistic. Sadly, the system was even more larded with risk than we had understood, and the damage has been far worse, spreading from the subprime to the prime sectors, catalyzing a housing-lead recession, and triggering historic levels of unemployment.

Since we issued that 2006 report, there have already been as many as 3 million homes lost, and Wall Street analysts recently predicted there could be as many as 11 million more foreclosures filed.[1] The foreclosure crisis has had catastrophic consequences for families and communities. The first wave of homeowners ended up in dire straits due to abusive mortgage originations, incompetent and predatory mortgage practices, ineffective government oversight, and a complex securitization system that lacks accountability all the way up and down the chain. Now, millions more are in danger due to the toxic combination of underwater loans and unemployment that festers in so many areas.

In this dire situation, the private system of mortgage servicing is should be serving as the key resource for both homeowners and investors. Instead, the servicing system is compounding the problem. It has become crystal clear to even the casual observer that the servicing system cannot or will not serve either the best interests of homeowners or investors for a variety of reasons, including that the system's capacity is too strained to function correctly and that crosscutting financial incentives create conflicts between the best interest of the servicers and the best interest of investors and homeowners.

In analyzing what has gone wrong, consider whether the servicing system is properly distinguishing between those instances where foreclosure is unavoidable and those where another option would produce a more favorable financial result. Every available piece of evidence suggests the system cannot yet reliably make this distinction. Part of the problem is the practice of continuing with foreclosure proceedings even while evaluating a homeowner for loss mitigation, a practice now termed "dual track." The failure to prevent foreclosures that would save money for both investors and homeowners is both perverse and bad for economic recovery.

Beyond loss mitigation failures, mortgage servicers also are engaging in other shoddy, abusive, and even illegal practices that are clogging up the foreclosure system and exacerbating the servicers' reputational problems. The so-called "robosigning" scandal, in which employees have lied about having personally reviewed the information alleged in their summary judgment affidavits, was not just a cosmetic corner-cutting exercise, but was a symptom of the servicer's underlying systems failures. To get the housing market back on track, buyers need assurances that foreclosures are legal and not vulnerable to challenge. Having banks claim to "fix" thousands of mortgages within a couple of weeks without more information has so far failed to restore public confidence in the system.

Today, we urge everyone concerned about the stability of the housing market and the sustainability of our economic recovery to address the foreclosure problem head-on with every tool available. For too long, we have listened to the insistence of the servicers that they can solve this problem on their own. While it always seemed improbable that would be the case, after almost four years, we now know that is impossible.

At the same time, as we retool the entire system of mortgage finance, it is important to consider that a healthy market needs a continuous influx of new customers. The failure to consider the needs of first-time homebuyers and customers from low-wealth backgrounds when we create any new system could be catastrophic for future growth.

It is high time for Congress, the Administration, banking regulators, federal and state law enforcement officials, and state legislatures to employ *every tool at their disposal* to end a crisis that has spiraled out of control for years now, unnecessarily, wasting billions (maybe even trillions) of dollars and standing in the way of broad economic recovery . In these recommendations, we describe many ways in which these various actors can help produce the results that will best serve investors, homeowners, and the market as a whole.

Recommendations for Congress

- Mandate loss mitigation prior to foreclosure.
- In making changes that impact housing finance and mortgage origination going forward, consider the needs of first-time homebuyers and customers from low wealth backgrounds who have the ability to repay safe and sustainable loans.
- Level the playing field in court by funding legal assistance for homeowners.
- Ensure that homeowners receiving mortgage debt forgiveness or modifications do not find their new financial security undermined by a burdensome tax bill.
- Change the bankruptcy code to permit modifications of mortgages on principal residences.

Recommendations for Federal Agencies

- The federal prudential banking regulators should immediately focus on the servicing operations of their supervisees and insist that servicers adhere to the loss mitigation requirements of their contracts.
- HUD, VA, and other government housing programs should aggressively enforce their servicing rules, especially those related to mandatory loss mitigation.

- The Consumer Financial Protection Bureau should make servicer oversight and enforcement a top priority.
- Fannie Mae and Freddie Mac should serve as models to the industry, participating in all HAMP and other loss mitigation programs.
- Treasury should take steps to improve HAMP so that it can help as many people as possible before its expiration next year.
- The regulators involved in creating the qualified residential mortgage exception to new "skin in the game" rules should not impose a hard down payment requirement on all borrowers.

Recommendations for Improving HAMP

- Aggressively enforce HAMP guidelines through serious penalties and sanctions for noncompliance.
- Create an independent, formal appeals process for homeowners.
- Evaluate all borrowers for HAMP, 2MP, and HAFA or other sustainable proprietary solutions before proceeding with foreclosure.
- To ensure that loan modifications are sustainable, require servicers to reduce principal whenever the alternative waterfall yields a positive net present value (NPV) or at least to disclose the positive NPV to investors, require servicers to reduce principal on second liens proportional to any reduction of principal undertaken with respect to the first lien, and require servicers to reduce principal appropriately when the underlying mortgage exhibits predatory characteristics.
- Increase the mandatory forbearance period for unemployed homeowners to twelve months and reinstitute the counting of unemployment benefits as income.
- Mandate automatic conversions of successful trial modifications and reimburse homeowners who pay their trial modifications but are not converted for any interest and fees paid during that period.
- Require servicers to provide the homeowner with the relevant written documentation any time a modification is denied due to investor restrictions.
- Permit homeowners who experience additional hardship to be eligible for a new HAMP review and modification.
- Mandate an additional 30 days after HAMP denial to apply for Hardest Hit Program monies and HAMP reconsideration if the HHP application is approved.
- Clarify existing guidelines to streamline the process and carry out the intention of the program.

Recommendations for States

- State legislatures should mandate loss mitigation prior to foreclosure.
- States should exercise their supervisory and enforcement authority over servicers doing business in their jurisdiction.

II. Background: The foreclosure crisis has impacted tens of millions of people directly or through spillover effects, with a particularly severe impact on minority communities, and mortgage servicers have routinely engaged in careless, predatory and illegal practices.

A. The foreclosure crisis impacts millions of people, both directly and through spillover effects.

With one in seven borrowers delinquent on their mortgage or already in foreclosure[2] and more than one in four mortgages underwater,[3] continued weakness in the housing sector is already impairing economic recovery and hampering efforts to create jobs and reduce unemployment. According to industry analysts, the total number of foreclosures by the time this crisis abates could be anywhere between 8 and 13 million.[4] A recent study by CRL estimated that 2.5 million foreclosure sales were completed between 2007 and 2009 alone, while another 5.7 million borrowers are at imminent risk of foreclosure[5]

Beyond the impact of the foreclosures on the families losing their homes, foreclosure "spillover" costs to neighbors and communities are massive. Tens of millions of households where the owners have paid their mortgages on time every month are suffering a decrease in their property values that amounts to hundreds of billions of dollars in lost wealth just because they are located near a property in foreclosure. Depending upon the geography and time period, the estimated impact of each foreclosure ranges from 0.6 percent to 1.6 percent in lost value to nearby homes. CRL estimates that the foreclosures projected to occur between 2009 and 2012 will result in $1.86 trillion in lost wealth, which represents an average loss of over $20,000 for each of the 91.5 million houses affected.[6] These losses are on top of the overall loss in property value due to overall housing price declines.[7]

Furthermore, since African-American and Latino borrowers have disproportionately been impacted by foreclosures, these spillover costs will disproportionately be borne by communities of color. CRL has estimated that African-American and Latino communities will lose over $360 billion dollars in wealth as a result of this spillover cost.

In addition, foreclosures cost states and localities enormous sums of money in lost tax revenue and increased costs for fire, police, and other services because vacant homes attract crime, arson, and squatters. As property values decline further, more foreclosures occur, which only drives values down still more. The Urban Institute estimates that a single foreclosure results in an average of $19,229 in direct costs to the local government.[8]

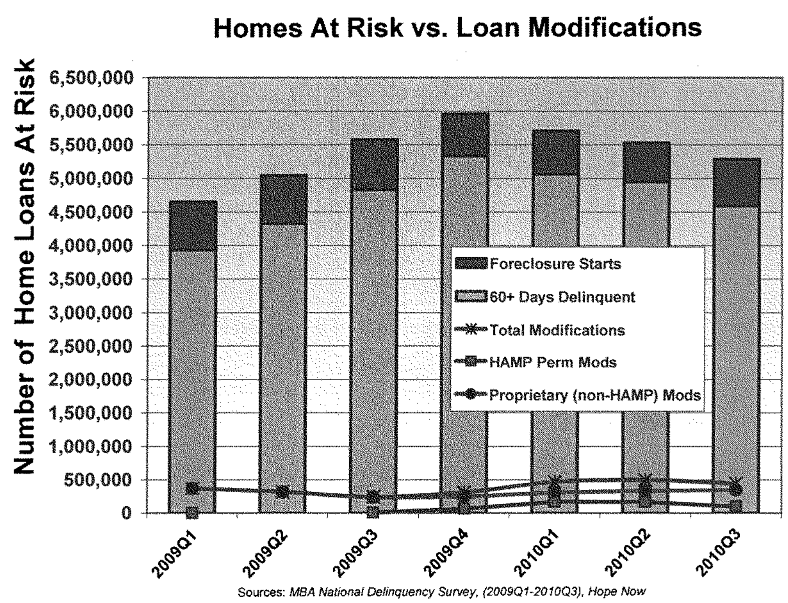
The crisis also severely impacts tenants in rental housing. According to the National Low-Income Housing Coalition, a fifth of single-family (1-4 unit) properties in foreclosure were rental properties and as many as 40 percent of families affected by foreclosure are tenants.[9] While tenants now have some legal protection against immediate eviction,[10] most of them will ultimately be forced to leave their homes.[11] Furthermore, a great deal of housing stock is now owned by the banks rather than by new owners. Banks are not in the business of renting homes and are not well suited to carry out the duties required of a landlord.

Compounding the problem of renters losing homes to foreclosures is the impact that the crisis has on other sources of affordable housing. A policy brief from the Joint Center for Housing Studies reports that dramatic changes at Freddie Mac and Fannie Mae and coincident changes in credit markets have disrupted and increased the cost of funding for the continued development of multi-family (5+ units) properties, despite the fact that underwriting and performance has fared better in this segment than in single-family housing.[12] As a result, even though a general over-supply of single-family housing persists, the deficit in the long-term supply of affordable rental housing is at risk of increasing.[13]

B. Foreclosures continue to outstrip loan modifications.

Despite both HAMP and proprietary modifications, the number of homeowners in foreclosure continues to overwhelm the number of borrowers who have received a permanent loan modification (see Figure 2).

Figure 2. Demand for Relief Continues to Outpace Loan Modifications



About 4.3 million mortgages are in foreclosure or 90 days or more delinquent as of September 30, 2010.[14] The third quarter of 2010 saw more than 215,000 new foreclosure

starts per month; by comparison, in August, there were roughly 30,000 permanent HAMP modifications and 76,000 proprietary modifications.[15] According to the State Foreclosure Prevention Working Group, more than 60% of homeowners with serious delinquent loans are still not involved in any loss mitigation activity.[16]

C. Toxic loan products lie at the heart of the mortgage meltdown.

In response to the foreclosure crisis, many in the mortgage industry have evaded responsibility and fended off government efforts to intervene by blaming homeowners for mortgage failures, saying that lower-income borrowers were not ready for homeownership or that government homeownership policies dictated the writing of risky loans.[17] This argument is both insulting and wrong. Empirical research shows that the elevated risk of foreclosure was an inherent feature of the defective nonprime and exotic loan products that produced this crisis, and that these same borrowers could easily have qualified for far less risky mortgages that complied with all relevant government policies and regulations.

A number of studies demonstrate that loan performance and loan quality are strongly related. For example, Vertical Capital Solutions found that the least risky loans[18] significantly outperformed riskier mortgages during every year that was studied (2002-2008), regardless of the prevailing economic conditions and in every one of the top 25 metropolitan statistical areas.[19] That study also confirmed that loan originators frequently steered customers to loans with higher interest rates than the rates for which they qualified and loans loaded with risky features, and that 30 percent of the borrowers in the sample (which included all types of loans and borrowers) could have qualified for a safer loan. The Wall Street Journal commissioned a similar study that found 61 percent of subprime loans originated in 2006 "went to people with credit scores high enough to often qualify for conventional [i.e., prime] loans with far better terms."[20]

Even applicants who did not qualify for prime loans could have received sustainable, thirty-year, fixed-rate subprime loans for—at most—half to eight tenths of a percent above the initial rate on the risky ARM loans they were given.[21]

CRL's own research has demonstrated that common subprime loans with terms such as adjustable rates with steep built-in payment increases and lengthy and expensive prepayment penalties presented an elevated risk of foreclosure *even after accounting for differences in borrowers' credit scores.*[22] A complementary 2008 study from the University of North Carolina at Chapel Hill supports the conclusion that risk was inherent in the structure of the loans themselves.[23] In this study, the authors found a cumulative default rate for recent borrowers with subprime loans to be more than three times that of comparable borrowers with lower-rate loans. Furthermore, the authors found that adjustable interest rates, prepayment penalties, and mortgages sold by brokers were all associated with higher loan defaults. In fact, when risky features were layered into the same loan, the resulting risk of default for a subprime borrower was four to five times higher than for a comparable borrower with the lower- and fixed-rate mortgage from a retail lender.

Finally, CRL conducted a more targeted study to focus on the cost differences between loans originated by independent mortgage brokers and those originated by retail lenders. In that study, we found that for subprime borrowers, broker-originated loans were consistently far more expensive than retail-originated loans, with additional interest payments ranging from $17,000 to $43,000 per $100,000 borrowed over the scheduled life of the loan.[24] Even in the first four years of a mortgage, a typical subprime borrower who used a broker paid $5,222 more than a borrower with similar creditworthiness who received a loan directly from a lender.[25] The data overwhelmingly supports that irresponsible lending and toxic loan products lie at the heart of the crisis.

D. Minority families and communities of color bear a disproportionate burden of the foreclosure crisis.

It is well documented that African-American and Latino families disproportionately received the most expensive and dangerous types of loans during the heyday of the subprime market.[26] New CRL research released this summer shows that, not surprisingly, minorities are now disproportionately experiencing foreclosure.

In June, our report entitled "Foreclosures by Race and Ethnicity: The Demographics of a Crisis" shows that African-Americans and Latinos have experienced completed foreclosures at much higher rates than whites, even after controlling for income.[27] While an estimated 56% involved a white family, when looking at rates within racial and ethnic groups, nearly 8% of both African-Americans and Latinos have already lost a home, compared to 4.5% of white borrowers. We estimate that, among homeowners in 2006, 17% of Latino and 11% of African-American homeowners have lost or are at imminent risk of losing their home, compared with 7% of non-Hispanic white homeowners. The losses extend beyond families who lose their home: From 2009 to 2012, those living near a foreclosed property in African American and Latino communities will have seen their home values drop more than $350 billion.

Another CRL report issued in August, "Dreams Deferred: Impacts and Characteristics of the California Foreclosure Crisis," shows that more than half of all foreclosures in that state involved Latinos and African Americans.[28] Contrary to the popular narrative, most homes lost were not sprawling "McMansions," but rather modest properties that typically were valued significantly below area median values when the home loan was made.

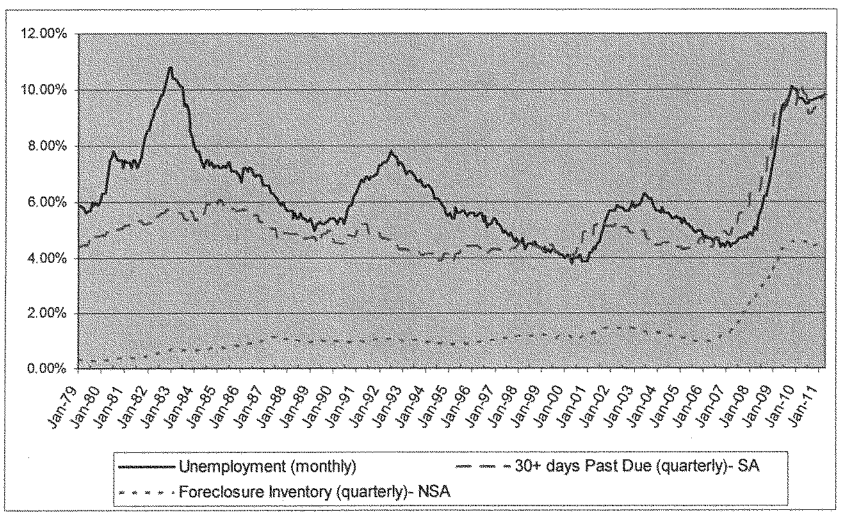
The impact of this crisis on families and communities of color is devastating. Homeownership is the primary source of family wealth in this country, and people often tap home equity to start a new business, pay for higher education and secure a comfortable retirement. In addition, home equity provides a financial cushion against unexpected financial hardships, such as job loss, divorce or medical expenses. Perhaps most important, homeownership is the primary means by which wealth is transferred from one generation to the next, which enables the younger generation to advance further than the previous one. Minority families already have much lower levels of wealth than white families, and therefore this crisis is not only threatening the financial stability and mobility of individual families, but it is also exacerbating an already enormous wealth gap between whites and communities of color.[29]

E. Unemployment is exacerbating the crisis but didn't cause it.

High unemployment did not cause the foreclosure crisis, but because of the crash of the housing market, unemployment is now far more likely to trigger mortgage default than in the past, largely due to widespread negative equity. In past recessions, homeownership served as a buffer against income interruptions because homeowners facing unemployment could sell their homes or tap into their home equity to tide them over. Today, selling homes is difficult to impossible in many markets, and even when sales take place, the seller sees no net proceeds from the sale. Figure 1 below shows that during previous periods of very high unemployment, foreclosure numbers remained essentially flat. Delinquency levels did rise somewhat, but they rose far less than they have risen during the recent crisis.[30] Other research confirms that the risk of default due to unemployment rises when homeowners are underwater on their mortgage.[31]

And why are so many homeowners underwater? It is because the glut of toxic mortgages contributed to inflating the housing bubble and then led to the bursting of the bubble, followed by a self-reinforcing downward spiral of home prices.

Figure 1: Historical relationship of unemployment and foreclosure rate



Sources: MBA National Delinquency Survey, Bureau of Labor Statistics.

F. Although Fannie Mae and Freddie Mac should not have purchased subprime MBS, their purchases did not cause the crisis.

The roles of Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") have certainly had an impact on the shape of the housing market and the availability of certain products over the course of their existence. However, Fannie and Freddie did not cause the subprime crisis.

While Fannie Mae and Freddie Mac should not have purchased subprime mortgage-backed securities (and organizations such as ours urged them not to), their role in purchasing and securitizing problem loans was small in comparison with that of private industry. *All subprime mortgage backed securities were created by Wall Street.* Fannie Mae and Freddie Mac did not themselves securitize any of these loans because the loans did not meet their standards.[32] When they finally began to purchase the MBS, they were relative late-comers to a market that had been created by private sector firms, and they also purchased only the least risky tranches of these securities.[33]

Ironically, as subprime lending rose, the GSEs' role in the overall mortgage market diminished substantially. As of 2001, Fannie Mae and Freddie Mac funded almost two-thirds of home mortgage loans across the United States. These were loans that Fannie Mae and Freddie Mac purchased directly from originators who met the GSE guidelines and either held on their balance sheets or securitized and sold to investors. Subprime loans accounted for just 7 percent of the market. Around 2003, private issuers were beginning to introduce new, riskier loan products into the market, and began to displace the GSEs. In early 2004, private-issue MBS surpassed the GSE issuances of all loans, and by early 2006, Fannie and Freddie's market share of new issuances had dropped to one-third of the total. As the role of the GSEs was declining, the percentage of subprime loans in the mortgage market almost tripled.[34]

Eventually, Fannie and Freddie eventually guaranteed and securitized Alt-A loans—loans to relatively wealthier borrowers with higher credit scores and risky features such as limited documentation. These investments are the primary source of the GSEs' losses, and are the reason why the GSEs were placed into conservatorship.[35] But here too, the GSEs did not lead the market; rather, they followed the market into these loans. The market did not depend on the GSEs.

Finally, it is important to note that GSE loans—including loans to "riskier" borrowers—are performing better than the private market. As of June 2010, 13.35% of GSE loans to borrowers with credit scores under 660 were 90+ days delinquent or in foreclosure. By comparison, the Mortgage Bankers Association reports that the serious delinquency rate for subprime loans was *over 28%*.[36]

G. The Community Reinvestment Act did not lead to the foreclosure crisis

Critics of the Community Reinvestment Act ("CRA") claim it caused the crisis by "forcing" lenders to make risky loans to low- and moderate-income families and to communities of color. Yet – even apart from the fact that the CRA requires loans to qualified buyers, not risky ones – most subprime lending was done by financial institutions that are not even subject to CRA requirements. CRA covers banks and thrifts. These institutions did not make many subprime loans. In fact, fully 94% of subprime mortgage loans were made by institutions not covered by CRA, or outside the institutions' CRA assessment areas, including affiliates that were excluded from CRA compliance review.[37] Moreover, the CRA was passed in 1977, and was in effect for more than two decades before subprime lending appeared.[38]

Nor can CRA be blamed for the big banks' disastrous investment in mortgage-backed securities backed by subprime loans. These investments were not covered by CRA—they did not produce CRA credit and were not encouraged by CRA.[39] A 2008 study found that CRA-covered banks were less likely than other lenders to make risky, high-cost loans.[40]

Finally, a report issued by the Federal Reserve Board in 2000 concluded that mortgage loans satisfying the low- and moderate-income element of the CRA's lending test proved to be at least marginally profitable for most institutions, and that many institutions found that CRA lending performed no differently than other lending.[41] Similarly, the experience of community development financial institutions (CDFIs) serving low- and moderate-income communities, demonstrates that responsible loans in these communities can succeed. A recent report on the FY 2007 performance of community development financial institution ("CDFI") banks—over 71% of whose branches are operated in low- to moderate-income communities—found that the majority were profitable. Community development credit unions had a loan loss rate that was on a par with that of mainstream credit unions.[42]

Those who have studied the issue have concluded, as did, John Dugan, Comptroller of the Currency, that "CRA is not the culprit behind the subprime mortgage lending abuses, or the broader credit quality issues in the marketplace."[43]

H. Mortgage servicers engage in a range of predatory and illegal practices both in the foreclosure process and leading up to foreclosure.

For at least a decade, community-based organizations, housing counselors and advocates nationwide have documented a pattern of shoddy, abusive and illegal practices by mortgage servicers whose staff are trained for collection activities rather than loss mitigation, whose infrastructure cannot handle the volume and intensity of demand, and whose business records are a mess.[44]

The most egregious of these abuses include:

- Misapplication of borrower payments, which results in inappropriate and unauthorized late fees and other charges, as well as misuse of borrower funds improperly placed in "suspense" accounts to create income for servicers.
- Force-placing very expensive hazard insurance and charging the borrower's account when the borrower's hazard insurance has not lapsed, often driving an otherwise current borrower into delinquency and even foreclosure.
- Charging unlawful default- and delinquency-related fees for property monitoring and broker price opinions.
- Failing or refusing to provide payoff quotations to borrowers, preventing refinancing and short sales.
- Improperly managing borrower accounts for real estate tax and insurance escrows, including failure to timely disburse payments for insurance and taxes, causing cancellation and then improper force-placing of insurance as well as tax delinquencies and tax sales.
- Abuses in the default and delinquency process, including failing to properly send notices of default, prematurely initiating foreclosures during right to cure periods and immediately following transfer from another servicer and without proper notices to borrowers, initiating foreclosure when borrower is not in default or when borrower has cured the default by paying the required amount, and failing to adhere to loss mitigation requirements of investors.

These practices have become so ingrained in the servicing culture that they are now endemic in the industry. The harm to which borrowers have been subjected as a result of these abuses cannot be overstated. Numerous homeowners are burdened with unsupported and inflated mortgage balances and have been subjected to unnecessary defaults and wrongful foreclosures even when they are not delinquent. Countless families have been removed from their homes despite the absence of a valid claim that their mortgage was in arrears.

Perverse financial incentives in pooling and servicing contracts explain why servicers press forward with foreclosures when other solutions are more advantageous to both homeowner and investor. For example, servicers are entitled to charge and collect a variety of fees after the homeowner goes into default and can recover the full amount of those fees off the top of the foreclosure proceeds.[45] The problem of misaligned incentives is compounded by a lack of adequate resources, management, and quality control.

What's more, recent legal proceedings have uncovered the servicing industry's stunning disregard of basic due process requirements.[46] Numerous servicers have engaged in widespread fraud in pursuing foreclosures through the courts and, in non-judicial foreclosure states, through power of sale clauses. It is becoming more and more apparent that servicers falsify court documents not just to save time and money, but because they simply have not kept the accurate records of ownership, payments and escrow accounts that would enable them to proceed legally. The public is also now learning what foreclosure defense attorneys have asserted for years: the ownership of potentially millions of mortgages is in question due to "innovations" and short-cuts designed to speed the mortgage securitization process.[47]

As noted above, the illegal practices of servicers during the foreclosure process are not simply a technical problem. Due process when taking private property is a cornerstone of our legal system, and case after case reveals that this is not just a question of dotting the I's and crossing the T's, but of unnecessary and even wrongful foreclosures. The rules that the banks have broken in their rush to foreclose were put in place specifically to give people a fair chance to save their homes, and without them, homeowners are powerless to save their homes.

III. It is time for a comprehensive approach to foreclosure prevention that uses all the tools in the toolbox.

A. Congress can pass legislation that would meaningfully realign incentives among servicers, investors, and homeowners.

1. Mandate loss mitigation prior to foreclosure.

Congress has the power to require that all servicers, industry-wide, must engage in loss mitigation before foreclosing, and that the failure to do so is a defense to foreclosure. For many servicers, only a legal requirement will cause them to build the systemic safeguards necessary to ensure that such evaluations occur.

Almost two years ago now, Rep. Maxine Waters introduced legislation that would require loss mitigation.[48] This legislation also would have addressed many of the other shoddy servicing practices that have resulted in the problems we see today. We strongly suggest that this legislation be updated to reflect current understandings of the issues and be reintroduced in the 112th Congress.

2. In making changes that impact housing finance and mortgage origination going forward, consider the needs of first-time homebuyers and customers from low wealth backgrounds who have the ability to repay safe and sustainable loans.

The mortgage foreclosure crisis and resulting dramatic scaling back of mortgage lending has had grave consequences for those lower-income and minority households desiring to become homeowners. The consequences of predatory lending have effectively set the clock back to the mid-1990s, when underserved borrowers with less than perfect credit struggled to access any mortgage credit.

From the subprime boom years of the early 2000s, where irresponsible and unsustainable mortgage credit was all too easily available, the pendulum has swung to the other extreme, leading to overly tight lending standards. Fannie Mae, Freddie Mac, mortgage insurers and most lenders today have credit score floors of 620 and in some instances substantially higher. Most lenders are requiring substantial down payments, and now there are suggestions that FHA will soon be raising down payments and other upfront closing costs and establishing new credit score minimums.

Further evidence of the consequences of the tightening of credit eligibility comes from 2009 HMDA data. These data show that that mortgage application denial rates for minorities exceeded those for whites and that minorities were increasingly reliant on FHA and VA for access to any mortgage credit.[49] More than 80 percent of home-purchase loans and more than 50 percent of refinance loans to black borrowers were nonconventional. For Hispanic white borrowers in 2009, nearly three-fourths of their home-purchase loans and 30 percent of their refinance loans were nonconventional."[50] Moreover, many borrowers have suffered damage to their credit scores due to no wrongdoing of their own, which might nevertheless hinder their ability to qualify for mortgages or other forms of credit going forward. There are many examples: borrowers who experienced foreclosures from irresponsible loans with no meaningful underwriting, verification of income or other evaluation of the borrower's ability to repay. Similarly, the New York Times has reported that borrowers who have received loan modification programs but without ever missing or being late on mortgage payments can suffer credit score impairments, based only on the servicers use of outdated credit scoring designations.[51] In addition, many credit card companies have executed across the board reductions in credit balances without regard to the cardholder payment history, resulting in negative credit scoring consequences tens of thousands of cardholders.

For these reasons, we believe it would be a mistake to build barriers to first-time homeownership into the fundamental structure of the nation's housing finance system, either through the process of GSE reform, through the qualified residential mortgage definition, or in any other way.

3. Level the playing field in court by funding legal assistance for homeowners.

All banks and servicers are represented by attorneys, but most homeowners in default or foreclosure cannot afford an attorney. Housing counselors can help people with their mortgages, but only attorneys can contest foreclosures in court. Programs offering free legal assistance can play an integral role in foreclosure prevention, including:

- identifying violations of mortgage lending laws and laws related to the foreclosure process.
- Assisting with loan modification applications and the modification process.
- Advising homeowners on existing bankruptcy options.
- Helping homeowners seek alternatives to foreclosure.
- Defending tenants who are being forced out following foreclosure.
- Educating homeowners and tenants about the foreclosure process and legal rights.

Recognizing the importance of borrower representation, the Dodd-Frank Act authorized $35 million to establish a Foreclosure Legal Assistance Program through HUD that would direct funding to legal assistance programs in the 125 hardest hit metropolitan areas. Unfortunately, that money was never appropriated.

As the foreclosure crisis continues unabated, other funding for foreclosure legal assistance is drying up. State-administered Interest on Lawyer Trust Account (IOLTA) revenue, a major source of funding for legal aid programs, has declined dramatically percent due to interest rate decreases. State budget crises have forced the slashing of legislative appropriations that fund legal aid. Another major private source of funding for anti-foreclosure work, a grant program run by the Institute for Foreclosure Legal Assistance (IFLA), has already made the last grants it can make under current funding and will end in 2011.[52]

Without additional funding, the attorneys who have developed expertise in this area may well lose their jobs, and legal aid groups will not be able to keep pace with the spike in foreclosure-related needs. Already, legal aid programs turn away hundreds of cases.

One additional note: Congress also should clarify that foreclosure prevention funds allocated under TARP and being used in the HAMP and Hardest Hit Programs can be used for legal assistance when appropriate.[53] We know now that there are many types of servicing abuses that cannot be handled by a housing counselor alone. This change would not require any new allocations of funding, and Treasury Secretary Geithner supports it.

4. Ensure that homeowners receiving mortgage debt forgiveness or modifications do not find their new financial security undermined by a burdensome tax bill.

Even principal forgiveness or the most carefully structured loan modifications can be seriously undermined if struggling homeowners must treat the forgiven mortgage debt as taxable income. Solving this tax problem has been flagged as a priority by the IRS's Office of the National Taxpayer Advocate.[54]

When lenders forgive any mortgage debt, whether in the context of a short sale, a deed-in-lieu-of-foreclosure, foreclosure, or principal reduction in a loan modification, that amount of forgiven debt is considered income to the homeowner and tax must therefore be paid on it unless the homeowner qualifies for some kind of exclusion to that tax. In 2007, Congress passed the Mortgage Forgiveness Debt Relief Act of 2007 to prevent adverse tax consequences to homeowners in trouble. After passage of this bill, most policymakers considered the problem to have been solved.

Unfortunately, many homeowners are not covered by that legislation because they took cash out of their home during a refinancing to make home repairs, pay for the refinancing, or consolidate other debt.[55] Moreover, even those homeowners already fully covered by the Mortgage Forgiveness Debt Relief Act often fail to take advantage of this exclusion because it is complicated and they do not understand the need to do so to avoid owing additional taxes. [56]The National Taxpayer Advocate reports that in 2007, less than one percent of electronic filers eligible for the exclusion claimed it.[57] If the definition of qualified mortgage debt is expanded, the IRS can take steps through its tax forms to simplify the process for taxpayers claiming the mortgage debt exclusion.

Finally, while the sunset date on this legislation was already extended through 2012, it needs to be extended further, and preferably made permanent, since this particular part of the tax code was originally aimed at corporate deals (where the vast majority of the related tax revenues are generated) rather than at individual consumer debt issues.

5. Change the bankruptcy code to permit modifications of mortgages on principal residences.

Our country's well established system for handling problems related to consumer debt is bankruptcy court. The availability of this remedy is so crucial for both creditors and debtors that the Framers established it in the Constitution, and the first bankruptcy legislation passed in 1800. Today, bankruptcy judges restructure debt for corporations and individuals alike.

Shockingly, however, when it comes to the family home -- the primary asset for most people in our country -- these experienced judges are powerless: current law makes a mortgage on a primary residence the only debt that bankruptcy courts are not permitted to modify in Chapter 13 payment plans. Owners of vacation homes, commercial real estate and yachts can have their mortgage modified in bankruptcy court (and the peddlers of predatory mortgages such as New Century or over-leveraged investment banks like Lehman Bros. can have all their debt restructured) but an individual homeowner is left without remedy.

Addressing this legal anomaly would solve almost in one fell swoop a range of problems that have beset efforts to combat foreclosures. First and foremost, bankruptcy does not leave foreclosure prevention to the voluntary efforts of servicers. Instead, a trusted third party can examine documents, review accounting records, and ensure that both the mortgagor and mortgagee are putting all their cards on the table. Moreover, the homeowner is the one who controls when this remedy is sought, rather than the servicer.

Second, in bankruptcy, the judge can reduce the level of the mortgage to the current market value of the property. This stripdown (some call it cramdown), or principal reduction, can help put homeowners in a position to begin to accumulate equity on their home again, thereby shielding them against future income shocks and increasing their incentive to make regular mortgage payments.

Third, a bankruptcy judge has the power to deal with the full debt picture of the homeowner, including any junior liens on the family home and other consumer debt such as medical bills, credit cards, or student loans. Second liens have proven to be one of the most vexing problems facing many foreclosure prevention efforts, and high consumer debt can threaten the sustainability of any mortgage modification made in a vacuum.[58]

Fourth, bankruptcy addresses "moral hazard" objections, meaning the concern that people will want relief even when they don't need or deserve it. Filing a Chapter 13 claim is an onerous process that a person would rarely undertake lightly. Any relief from debt comes at a substantial cost to the homeowner -- including marring the homeowner's credit report for years to come and subjecting the homeowner's personal finances to strict court scrutiny.

Fifth, the availability of this remedy would in large part be the very reason why it would not need to be used very often. Once mortgages were being restructured regularly in bankruptcy court, a "template" would emerge as it has with other debts, and servicers would know what they could expect in court, making it much more likely that servicers would modify the mortgages themselves to avoid being under the control of the court. Similarly, the fact that a homeowner had the power to seek bankruptcy would serve as the now-missing stick to the financial incentive carrots provided by other foreclosure prevention programs.

Permitting judges to modify mortgages on principal residences, which carries *zero cost to the U.S. taxpayer*, could potentially help more than a million families stuck in bad loans keep their homes.[59] As foreclosures continue to worsen, more and more analysts and interested parties are realizing the many benefits this legislation could have.[60] Recently, the Federal Reserve Bank of Cleveland published an analysis of using bankruptcy courts to address the farm foreclosure crisis of the 1980s, concluding that using bankruptcy to address that crisis did not have a negative impact on availability or cost of credit.[61]

B. Federal agencies have significant authority that should be employed to help fight foreclosures.

There are a number of federal regulatory agencies with authority to help fight foreclosures. In a later section, we will provide extensive recommendations for improvements that Treasury can make to HAMP. In this section, we provide other suggestions.

1. The federal prudential banking regulators should focus on the servicing operations of their supervisees.

Federal supervisory banking regulators are currently conducting a review of the servicing operations of their supervisees, with a focus on the legality and propriety of accounting inaccuracies, inappropriate fees and charges, failure to comply with loss mitigation requirements, and other problems identified in this testimony. The methodology and results of these investigations should be made available to the public as soon and as extensively as possible.

To the extent that problems are found, the regulators should move to correct them quickly and thoroughly through an open and transparent process, and when necessary, referrals should be made to the appropriate enforcement authorities.

At the same time, the regulators should create national servicing standards that would govern mortgage servicers, including standards that require loss mitigation prior to foreclosure. One quick and effective place for those standards would be as part of the risk retention scheme created by Title IX of the Dodd-Frank Act. Because securitized loans have posed the most challenging set of obstacles to servicers, it makes sense to introduce strong standards that would apply to securitized loans related to loss mitigation, conflicts of interest, and servicer compensation.

2. HUD, VA, and other government housing programs should enforce their servicing rules, especially those related to mandatory loss mitigation.

FHA, VA, and other government-insured housing finance programs should ensure that their servicers are conducting the required loss mitigation reviews and following all relevant laws and guidelines. In a recent press conference, HUD Secretary Shaun Donovan admitted that an internal HUD investigation indicated that FHA servicers were not always conducting the loss mitigation reviews required by FHA. In addition to recommending that HUD terminate contracts with servicers that are not adhering to the provisions of those contracts, we recommend that HUD release public information concerning the loss mitigation track records of its servicers.

3. The Consumer Financial Protection Bureau should make regulating servicers one of its first priorities.

The Consumer Financial Protection Bureau (CFPB) is ideally positioned to provide consumers with a strong voice in the foreclosure fight -- a voice that has largely been absent in the regulatory structure and executive branch. The CFPB already has concurrent supervision authority with federal banking regulators over large banks to examine them for compliance and to assess risks to consumers and markets.[62] Right now, the nation's three largest banks (Bank of America, Wells Fargo, and JP Morgan Chase) account for approximately 50% of all mortgage servicing, so exercising this supervisory function with respect to the operations of these banks can begin immediately. Banks should be examined for compliance with all relevant laws and regulations as well as adherence to the provisions of contracts with investors and government agencies such as FHA and VA.

Moreover, as of July 2011, the CFPB will acquire rule-making authority to prevent abusive, unfair, deceptive and harmful acts and practices and to ensure fair and equal access to products and services that promote financial stability and asset-building on a market-wide basis. The CFPB can use this authority to create national servicing standards and to help address the foreclosure crisis. For an example of useful rules, the CFPB can look to what some states have already done.[63] It will also have strong enforcement tools, and the States will have concurrent authority to enforce the rules against violators in their jurisdictions. The CFPB should begin now to prepare to use its authority and tools to prevent predatory servicing practices.

Finally, apart from specific regulatory authority, as the voice of consumers in the regulatory structure, the CFPB can help to educate both policymakers and the public about this issue and thereby to help ensure that proposed solutions are as responsive to consumer interests as they are to bank interests.

4. Fannie Mae and Freddie Mac should serve as models to the industry.

Fannie Mae and Freddie Mac (the GSEs), now in conservatorship and supported by taxpayers, should serve as a model for how to prevent unnecessary foreclosures. While it has been a GSE priority to ensure that foreclosures proceed in a timely way, it is important that the desire to avoid delay does not prevent their servicers and attorneys from scrupulously adhering to all laws and guidelines, particularly those regarding loss mitigation reviews.

We call upon the FHFA to end the "dual track" practice of proceeding with foreclosures even when engaged in loss mitigation, to make its loan modification decisions more transparent, and to revisit its decision not to reduce principal on mortgage loans. Permitting modifications that produce both a positive net present value and a more sustainable loan modification will have a long-term, beneficial impact that needs to be weighed fairly against short-term profitability concerns.

5. The regulators involved in creating the Qualified Residential Mortgage safe harbor to "skin in the game" rules should not impose a hard down payment requirement on all borrowers.

We suggest that the Qualified Residential Mortgage safe harbor closely track the definition of the rebuttable presumption laid out in Sec. 1412 of Title XIV to the Dodd-Frank Act, which does not include a down payment requirement. This definition includes an extensive array of requirements that define responsible, well-underwritten loans. Keeping origination and securitization standards as identical as possible will simplify the securitization process, which will keep regulatory costs down and provide a more favorable environment for private investment.

In addition, we believe that requirements mandating specific loan-to-value ratios will unnecessarily disadvantage well-qualified borrowers who lack the wealth necessary for a large down payment, a particular concern for communities of color, low- and moderate-income families, and others traditionally underserved by mainstream lenders. Barring these families from access to responsible loans would reinforce an unfair, separate and unequal housing finance system that relegates underserved families to FHA or to higher cost, less desirable lending channels – or even excludes them entirely from homeownership they could otherwise sustain. Creditworthy borrowers should not be limited to FHA or to loans that do not meet QRM standards simply because they cannot make a large down payment. That is not good for homeowners or for the health of the overall market.

Moreover, disruptions in the housing market have stripped equity from homeowners everywhere, and home values have yet to stabilize. In this environment, mandating loan-to-value ratio requirements would impose unnecessary barriers to homeownership for all borrowers, including those traditionally well-served by the housing finance system.

C. The Treasury Department should continue to improve HAMP and its associated programs.

While HAMP's performance has been very disappointing, HAMP remains the principal federal response to the foreclosure problem and sets guidelines and standards that are very useful for any loan modification. If HAMP were to cease to exist, we would return to a time of no standards at all, when loan modifications were just as likely to raise a borrower's monthly payment as lower it.[64]

The vast majority of modifications continue to be made outside of HAMP. Servicers routinely ask borrowers to waive their right to a HAMP modification.[65] While we do not know all the reasons why this happens, some likely contributors are: (1) the design of the HAMP program does not fit the majority of borrowers; (2) servicers profit more from the proprietary modifications because the HAMP incentives are insufficient to overcome other financial incentives; (3) servicers do not want to fill out the detailed reports required by HAMP; or (4) servicers wish to avoid oversight. Whatever the reason, the lack of transparency about proprietary modifications makes it very difficult to compare them with HAMP modifications or to analyze their ultimate suitability for borrowers. Servicers should be required to release public, loan-level data for all modifications, not just HAMP modifications.

Similarly, the fact that servicers have violated HAMP guidelines and have resisted any kind of independent appeals process has resulted in the widespread negative experience that so many homeowners and their advocates have had with the program. For a whole range of reasons ranging from lack of capacity to conflicts of interest, mortgage servicers in many cases fail to provide many homeowners with a HAMP review that is timely, accurate, and adheres to HAMP guidelines. Stories abound of servicers who have had stunningly bad experiences when servicers ignore HAMP guidelines.

We make the following recommendations to refine HAMP's design and improve its performance.

1. Aggressively enforce HAMP guidelines through serious penalties and sanctions for noncompliance.

Over its year and a half of operations, Treasury has improved the HAMP program in a number of ways in response to concerns expressed by homeowners, advocates, and servicers. Unfortunately, servicers do not always comply with all the HAMP guidelines. Although we are told that errors are corrected when they are found during the Freddie Mac compliance process, the continuous flow of reports to the contrary from advocates and the press illustrates that many guidelines are being evaded or ignored.

We recommend that Treasury develop a clear, impartial system of penalties and sanctions for failure to comply with HAMP guidelines. Some HAMP guidelines are more crucial than others (see, for example, the section below on foreclosure stops), and violation of those guidelines should result in stiffer penalties. In addition, Treasury should release full information on the compliance records of each servicer, along with the number of corrective actions that have been taken, and develop a system for logging and investigating complaints from advocates about noncompliance with HAMP guidelines.

2. Create an independent, formal appeals process for homeowners who believe their HAMP denial was incorrect or who cannot get an answer from their servicer.

When a borrower is rejected for a HAMP modification, that borrower should have access to an independent appeals process where someone who does not work for the servicer can review and evaluate the situation. The existing HAMP escalation procedures are inadequate. (Freddie Mac does conduct compliance reviews and will require a servicer to fix any errors it finds, but this process cannot be triggered by request of an individual homeowner.) Since HAMP changed its procedures in January 2010 to require that servicers send letters with reasons for denial, and even more so as HAMP implements the directive contained in the Dodd-Frank Act that servicers disclosure the inputs used to make those decisions, homeowners have increased access to information about their denial, but they still have no way to make a change if that information indicates their denial to be in error.

We recommend that the Treasury establish an Office of the Homeowner Advocate to serve an appeals and ombudsman role within the program, along the lines of the National Taxpayer Advocate. There is legislation currently pending that would establish such an office, although it is unlikely to pass during the 111th Congress (this idea did already succeed in a Senate floor vote with bipartisan support when it was offered as an amendment to another bill, the initial underlying legislation failed.[66] For states or localities that have foreclosure mediation programs, those programs could also be used to handle this type of appeal.

3. End the dual track of foreclosure and loss mitigation.

Prior to June 2010, servicers routinely pursued HAMP evaluations and foreclosures simultaneously. Homeowners trapped in those parallel tracks received a confusing mix of communications, including calls and letters concerning evaluation for a modification, and other formal notifications warning of an impending foreclosure sale. These mixed messages contributed to the failure of some borrowers to send in all their documentation, the early re-default of many trial modifications, and the difficulty servicers have reaching certain borrowers.

Although HAMP guidelines prohibited the actual foreclosure sale from taking place prior to a HAMP evaluation, sales were taking place anyway because the foreclosure proceedings are handled by outside law firms and communications between servicers and foreclosure attorneys regarding HAMP are extremely minimal.[67] Adding insult to injury, when continuing the foreclosure process during HAMP evaluation servicers' lawyers were billing thousands of dollars in attorneys fees that the homeowners were then expected to pay.

With Supplemental Directive 10-02, Treasury directed that for all new applicants, servicers were supposed to complete the HAMP review prior to referring the case to foreclosure. Furthermore, if an applicant was already in foreclosure, services were to stop additional steps toward a foreclosure once that borrower was in a verified trial modification.

Not surprisingly, despite Supp. Dir. 10-02, advocates are still routinely seeing homeowners placed into the foreclosure process even when they have not yet had their HAMP review. In some cases, this is because the homeowner did not qualify for the "foreclosure stop"; in other cases, servicers simply are not complying with the guidelines; in still other cases, the rules are ambiguous. For example, while servicers may not refer a case to a foreclosure attorney before the review, in a non-judicial state, it may not be clear that the foreclosure cannot actually be filed.

Foreclosures and foreclosure sales prior to HAMP evaluation are perhaps the biggest reason for the public's loss of confidence in the program. We recommend that when a borrower applies for HAMP,[68] the servicer should stop all foreclosure referrals, filings, or any actions to advance any goal other than HAMP review. As noted in Recommendation #1 above, when a servicer is found to proceed with a foreclosure prior to evaluation, strict penalties should ensue swiftly.

4. To ensure that loan modifications are sustainable, require servicers to reduce principal whenever the alternative waterfall yields a positive NPV or at least to disclose the positive NPV to investors, require servicers to reduce principal on second liens proportional to any reduction of principal undertaken with respect to the first lien, and require servicers to reduce principal appropriately when the underlying mortgage exhibits predatory characteristics.

Millions of Americans now owe more on their mortgages than their homes are worth. While the overall number of mortgages underwater is estimated to be more than one in four,[69] this ratio is far higher for homeowners who are having trouble affording their mortgage, and the average HAMP borrower owes $1.14 for ever $1.00 the house is worth.[70] Homeowners who are underwater have no cushion to absorb future financial shocks, and they have fewer incentives to sacrifice to stay in the home or to make ongoing investments in maintenance.[71] For these homeowners, even the reduction of monthly payments to an affordable level does not fully solve the problem. As a result, a homeowner's equity position has emerged as a key predictor of loan modification redefault.[72]

Many stakeholders believe that principal reduction is ultimately the only way to help the housing market reach equilibrium and begin to recover.[73] However, even as loan modification activity has ramped up in the overall market, principal reduction has remained relatively rare. One context in which it occurs is in portfolio loans with no second liens, which suggests that banks understand the usefulness of principal reduction but that for securitized loans, there is a conflict of interest between the banks that own the second liens (and who also own the servicers) and the investors who do not want to agree to a write-down on the first lien unless the second lienholder does the same.

In recognition of these realities, HAMP has initiated two programs: the "alternative waterfall" principal reduction program, and 2MP, the second lien program. Unfortunately, although HAMP offers generous financial incentives to cover the write-down, HAMP does not *require* servicers to engage in principal reduction even when it's in the best interests of the investor.[74]

Since the alternative waterfall program just began this month, we do not yet know how it will work. It is likely that the only way principal reduction is ever going to happen on a widespread basis is if it is required. Similarly, although 2MP has existed for over a year and although all four major banks have signed up, that program has modified only a few thousand second liens.[75] For this reason, HAMP should either require the write-downs or require the servicers to disclose the results of the positive NPV calculations to the investor.

Finally, HAMP should provide a commensurate reduction in principal for loans that exhibit predatory characteristics, such as 2/28s, 3/27s, and non-traditional loans such as interest-only or negatively amortizing loans not underwritten to the fully indexed rate or fully amortizing payment.

5. Increase the mandatory forbearance period for unemployed homeowners to twelve months and reinstitute the counting of unemployment benefits as income.

Another attempted improvement to HAMP this year was the establishment of a forbearance program for homeowners who lose their job (UP). Under UP, unemployed homeowners get at least three months (more if the servicer chooses) of reduced payments that will end when the homeowner becomes reemployed.

Unfortunately, this program does not adequately address the issue of unemployed homeowners. First, servicers were already doing a lot of three-month forbearances on their own. The problem is that most homeowners need longer than three months, as the average length of unemployment during this downturn is well over six months.[76] Second, when UP was announced, the HAMP guidelines changed so that unemployment income was no longer counted as "income" for a HAMP modification, even if it was guaranteed for at least nine months. Many families have sufficient income in addition to unemployment benefits to qualify for HAMP, and generally they would be better served by a HAMP modification than by a temporary forbearance.

Finally, HAMP should clarify the relationship between UP, HHF, and the new HUD Emergency Home Loan Program.

6. Mandate automatic conversions of successful trial modifications and reimburse homeowners who pay their trial modifications but are not converted for any interest and fees paid during that period.

First, for borrowers who entered into verified income trial modifications, servicer delays in converting trial modifications to permanent modifications are simply unacceptable. They increase costs to homeowners and create significant periods of uncertainty. There is no reason why trial modifications should not automatically convert to permanent modifications if the borrower makes three timely trial modification payments.

Second, homeowners who have received a stated income trial modification in good faith, have made all their trial payments in a timely way, but have been denied a permanent modification should not end up financially worse off than they were before the trial modification. Currently, however, they often do end up worse off. Throughout the entire period, which is usually longer than three months since servicers are so backed up, these borrowers who are doing everything that is asked of them continue to be reported to credit bureaus as delinquent on their mortgage. Moreover, since the trial modification payments are by definition less than the full contract payment under the mortgage and the terms of the mortgage are not altered during the trial modification, homeowners finish a trial modification owing more on their homes than when they started. We have seen servicers use these arrears, accumulated during the trial modification, as the basis for initiating an immediate foreclosure against a homeowner, post-trial modification.

Homeowners who pay their trial modification payments but are not converted should be given an opportunity to pay back the arrears through regular monthly installments rather than a lump sum payment. Furthermore, the borrower should have the choice to have the arrears capitalized into the loan and the term extended so that their participation in HAMP does not result in an increase in monthly payments (if the PSA prevents a term extension, the amortization period should be extended). Finally, many homeowners end up facing foreclosure solely on the basis of the arrears accumulated during a trial modification. Such foreclosures should be prohibited.

7. Require servicers to provide the homeowner with the relevant written documentation anytime a modification is denied to investor restrictions.

Servicers are required to provide a HAMP modification whenever the NPV is positive, unless the Pooling and Servicing Agreement with the investor prohibits such a modification and the servicer has sought a change in policy from the investor and the investor has not agreed. When a servicer believes a PSA prevents an NPV-positive modification, the servicer is supposed to contact the trustee and any other parties authorized under the terms of the PSA to attempt to obtain a waiver. However, it appears that many servicers are using "investor turndowns" as a reason not to do a modification in violation of HAMP rules, in most cases because the contract does not actually prohibit the modification and in some instances because the servicer has not requested a change in policy from the investor.

Recognizing this problem, the Treasury Department changed its policy last November to require servicers to provide basic information related to investor denials.[77] While this is a small step in the right direction, it is crucial that servicers provide the borrower with this information directly, in hard copy form, as he or she is in the best position to act quickly if there is a problem but may be unable to access online databases. To minimize paperwork burden on servicers, we suggest that the servicer provide the borrower or the borrower's representative a photocopy of the limiting language in the PSA along with information on how to electronic access to a complete and unaltered copy of the PSA, and a copy of all correspondence with the lender and investors attempting to obtain authority to perform a modification,

8. Permit homeowners who experience additional hardships to be eligible for additional HAMP modifications.

Even after a homeowner is paying the monthly payments due under a HAMP loan modification, life events may still occur that would once again disrupt these payments, such as job loss, disability, or the death of a spouse. These subsequent, unpredictable events, outside the control of the homeowner, should not result in foreclosure if a further loan modification would save investors money and preserve homeownership.

Foreclosing on homes where homeowners have suffered an involuntary drop in income without evaluating the feasibility of a further HAMP modification is punitive to homeowners already suffering a loss and does not serve the interests of investors. Some servicers provide some modifications upon re-default as part of their loss mitigation program; this approach should be standard and should include continued eligibility for HAMP modifications rather than only specific servicer or investor programs.

9. Mandate an additional 30 days after HAMP denial for the borrower to apply for assistance through a state Hardest Hit Program and then re-evaluate for HAMP if the application is approved.

Under Supplemental Directive 10-07, servicers may, but do not have to, provide borrowers with an additional 30 days after denial for the borrower to apply for HHF and see if the HHF program will get them to a HAMP-positive result. This additional time period should be mandatory. Allowing servicer discretion will lead to inconsistency in the program operation and denial of borrowers who could qualify for HAMP, and is at odds with HAMP's apparent intention that servicers not be allowed to condition HAMP application on HHF application.

Since borrowers can't know in advance if HHF funding will make the difference between HAMP denial or acceptance and won't know if the servicer will give them a chance to apply for HHF funding if they are denied for HAMP, borrowers will have to apply for

HHF funds, even if HAMP alone would do the trick. This will result in the use of HHF funds to subsidize HAMP and diminish the impact of the additional HHF funds.

10. Clarify existing guidelines to streamline the process and carry out the intention of the program

These additional issues require some measure of clarification or minor tweaking to prevent abuses and problems:

- **All servicers should accept the standard HAMP application and corrected 4506-T forms.** Borrowers report that servicers reject HAMP applications if borrowers submit a standard application form (RMA) instead of the servicer's form, or return with corrections a 4506-T form completed by the servicer. Servicers need additional guidance that submission of standard tax and HAMP forms by borrowers is adequate for purposes of HAMP review and that servicers may not deny review because a borrower has corrected misinformation on a servicer form.

- **Equity in a home should not preclude a HAMP modification.** Servicers routinely reject borrowers for HAMP who are in default because they have "too much equity," apparently relying on old guidelines to assess the availability of refinancing. Explicit guidance should be provided to servicers to disregard the amount of equity in a home when evaluating a borrower's HAMP eligibility, aside from its role in the NPV test.

- **Non-borrower surviving spouses and those awarded the home in a divorce decree should be eligible for a HAMP modification.** In Sup. Dir. 09-01 and in FAQ 2200, HAMP appears to permit non-borrower surviving spouses or those who receive the property in a divorce decree although they are not borrowers to obtain a loan modification. Servicers, however, continue to insist that an estate be opened before dealing with the surviving spouse and often initiate foreclosure proceedings instead of reviewing the surviving spouse for a HAMP loan modification. Treasury should state directly that non-borrowers permitted under the Garn-St Germain Act to assume the note are to be treated as eligible borrowers for HAMP, provided they meet the other qualifications.

- **Wholly owned subsidiaries should be covered under the servicer contracts.** Many large servicers operate multiple companies and divisions, often with similar names, yet there is no easy way for homeowners to identify if these divisions are participating. For example, the only Wells Fargo entity listed on the "Contact Your Mortgage Servicer" page of the Making Home Affordable website is the national bank, but most mortgage customers of Wells Fargo will deal with Wells Fargo Home Mortgage, Wells Fargo Financial, or America's Servicing. Advocates continue to report confusion as to coverage, with subsidiaries frequently denying that they are covered by a contract signed by the parent.

- **Servicers should not be able to rescind permanent HAMP modifications.** Although HAMP trial modification contracts indicate that a homeowner can obtain a permanent modification by making three trial modification payments, servicers have been withdrawing trial modification offers, and, worse, cancelling existing permanent modifications, citing investor restrictions and other issues that should have been identified prior to these agreements. While servicers and others have sought to describe these cancellations as clerical errors, they are breaches of contract that epitomize the one-sided dynamic of HAMP modifications.

- **Servicers should pre-sign permanent modification documents.** After a borrower successfully completes a trial modification, the servicer is required to send permanent modification papers to the homeowner. Often, these papers are not pre-signed and such finalizing can often take months. Permanent modifications would increase and the timeline would be shortened if servicers were required to send pre-signed permanent modification agreements to the homeowner. Further efficiency would be derived from the establishment of a timeline for the sending and returning of permanent modification documents.

D. States also should act to prevent servicing abuses and save homes.

1. State legislatures should mandate loss mitigation prior to foreclosure.

States are also in a strong position to prevent unnecessary foreclosures. Although mandatory loss mitigation standards exist in many parts of the market now, lack of enforcement has diminished their impact, and they are not industry-wide. By exercising their control over the foreclosure process, states can require that servicers assess whether foreclosure is in the financial interest of the investor before proceeding to foreclosure. A mandatory loss mitigation standard will function as a low-cost, high-impact foreclosure prevention tool that ensures foreclosure is a last resort.[78]

While states ideally would require servicers to perform a loss mitigation analysis prior to filing for foreclosure, existing laws have incorporated elements of a mandatory loss mitigation standard at other stages of the foreclosure process. Currently, loss mitigation components exist in state foreclosure laws, either implicitly or explicitly, in the following four places: (1) as a pre-condition to foreclosure filing; (2) as part of a foreclosure mediation program; (3) as a pre-condition to foreclosure sale; and (4) as the basis for a challenge post-foreclosure sale.

This range of approaches demonstrates the extent to which a loss mitigation standard can be adapted to any foreclosure process. Because not all foreclosures are preventable, the implementation of this standard will not limit the right of creditors to foreclose on a property where appropriate, but would ensure that the foreclosure sale is a last resort after all other foreclosure prevention strategies have been considered.

States can further promote transparency and accountability by combining a mandatory loss mitigation standard with basic disclosures of the inputs used in the NPV calculation and the results of the calculation, which can be contested by appeal.

To be most effective, a flexible mandatory loss mitigation standard should be combined with:

- a requirement that the foreclosing party provide homeowners with a loss mitigation application in tandem with any pre-foreclosure notice or pre-foreclosure communication;
- a requirement that the foreclosing party submit an affidavit disclosing the specific basis for the denial of a loan modification, including the inputs and outputs of any loss mitigation calculations;
- a defense to foreclosure (or equivalent right in non-judicial foreclosure states) based on failure of the foreclosing party to engage in a good faith review of foreclosure alternatives; and
- public enforcement mechanisms to safeguard against systemic abuses.
- using existing or planned mediation programs as an appeal process when an adverse loss mitigation determination is made.[79]

Finally, state authority to regulate and license mortgage servicers provides yet another avenue through which States can promote servicer accountability and incorporate mandatory loss mitigation. For example, New York recently enacted a strong set of rules that will go a long way toward ending predatory servicing practices and ensuring that homeowners do not lose their homes due to servicer failures.[80] These rules are easily replicable and provide a very useful set of tools for enforcement authorities and advocates.

2. States should exercise their supervisory and enforcement authority over servicers doing business in their jurisdiction.

Where state banking agencies have examination and enforcement authority over servicers operating in their jurisdiction, they, too, should focus on the legality, propriety, and accuracy of accounting, inappropriate or unnecessary fees and charges, failure to comply with loss mitigation requirements, and other problems identified in this testimony.

The recently announced investigation by the state attorneys general is one of the most promising developments to date in the fight against foreclosures. We recommend that in addition to any monetary damages, states seek injunctive relief to help promote sustainable loan modifications and eliminate shoddy and illegal business and legal practices.

Conclusion

Today's foreclosure crisis is arguably the most significant obstacle to national economic recovery, so the stakes are high. Even under a best-case scenario, the current crisis will continue and fester if interventions remain on the current narrow course. To make a real difference in preventing foreclosures and reducing associated losses, we need a multi-pronged strategy that strengthens the way current foreclosure prevention programs are implemented and also invests in new approaches.

As policymakers take actions aimed at reviving the ailing housing market, we hope they also will be mindful of the policy failures that enabled the situation. Economic cycles and housing bubbles may always be with us, but the experience of recent years vividly shows the value of sensible lending rules and basic consumer protections, even during economic booms, to prevent another disaster in the future. Government can play a crucial role in supporting a healthy housing market by exercising its oversight function to guard against inappropriate risk-taking and abusive practices and to ensure a level playing field for market competition.

We appreciate the chance to testify today and look forward to continuing to work with Congress on these crucial issues.

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[1] Laurie Goodman, Roger Ashworth, Brian Landy, and Lidan Yang, "The Housing Crisis—Sizing the Problem, Proposing Solutions," Amherst Mortgage Insight (Oct. 1, 2010) [hereinafter "Amherst Study," on file with CRL.

[2] MBA National Delinquency Survey, August 2010 [hereinafter "MBA National Delinquency Survey"]. The combined percentage of loans in foreclosure or at least one payment past due was 13.7 percent on a non-seasonally adjusted basis.

[3] This is for Q4 2010 and can be found at Zillow's Real Estate Market Reports at zillow.com. Another source is the First American Core Logic Negative Equity Report, which has reported similar statistics and whose Q4 2010 report should be out in a few weeks.

[4] Rod Dubitsky, Larry Yang, Stevan Stevanovic and Thomas Suehr, *Foreclosure Update: over 8 million foreclosures expected*, Credit Suisse (Dec. 4, 2008) (projecting 10 million foreclosures by 2012 depending on current unemployment rates); Jan Hatzius and Michael A. Marschoun, *Home Prices and Credit Losses: Projections and Policy Options*, Goldman Sachs Global Economics Paper (Jan. 13, 2009) (projecting 13 million foreclosures by 2014) at 16.

[5] Debbie Gruenstein Bocian, Wei Li, and Keith S. Ernst, "Foreclosures by Race and Ethnicity: The Demographics of a Crisis," Center for Responsible Lending (June 18, 2010), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/foreclosures-by-race-and-ethnicity.pdf.

[6] For methodology, *see* Center for Responsible Lending, "Soaring Spillover: Accelerating Foreclosures to Cost Neighbors $502 Billion in 2009 Alone; 69.5 Million Homes Lose $7,200 on Average; Over Next Four Years, 91.5 Million Families to Lose $1.9 Trillion in Home Value; $20,300 on Average" (May 2009), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/soaring-spillover-3-09.pdf.

[7] Center for Responsible Lending, *Continued Decay and Shaky Repairs: The State of Subprime Loans Today* (Jan. 8, 2009), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/continued_decay_and_shaky_repairs.pdf.

[8] G. Thomas Kingsley, Robin Smith, & David Price, *The Impact of Foreclosures on Families and Communities*, The Urban Institute (May 2009), at 21, Fig. 3.

[9] D. Pelletiere, "Renters in Foreclosure: Defining the Problem, Identifying Solutions," National Low-Income Housing Coalition (Jan. 2010), *available at* http://dsl-router.nlihc.org/doc/renters-in-foreclosure.pdf.

[10] The "Helping Families Save Their Home Act of 2000," signed into law by President Obama in May 2009, provided that month-to-month tenants must receive 90 days' notice before having to move out and that tenants with leases may stay until the end of their lease (unless the owner plans to occupy the property, in which case tenants still must receive 90 days notice).

[11] Also, many tenants are not aware of their right to stay in their homes, and when they receive a notice from a bank lawyer naming their landlord and seeking eviction, they leave regardless of their legal rights. *See, e.g.,* Testimony of Deborah Cuevas Hill, The Legal Aid Society of the District of Columbia, before the Committee on Public Services and Consumer Affairs, Council of the District of Columbia (May 28, 2009), *available at* http://www.legalaiddc.org/issues/documents/TestimonyreTOPALegilsation.pdf.

[12] "Meeting Multifamily Finance Housing Needs During and After the Crisis: A Policy Brief," Joint Center for Housing Studies, Harvard University (Jan. 2009), *available at* http://www.jchs.harvard.edu/publications/finance/multifamily_housing_finance_needs.pdf.

[13] *Id.*

[14] Based on MBA Delinquency Survey for 2010 Q3, adjusted to reflect MBA's estimated 88% market coverage.

[15] See Hope Now December Data Report, *available at* http://www.hopenow.com/industry-data.php.

[16] *Supra* note 3.

[17] It is popular, although incorrect, to blame the Community Reinvestment Act (CRA) and Fannie Mae and Freddie Mac (the GSEs) for the foreclosure crisis. For a complete discussion of why CRA and the GSEs did not cause the crisis, *see* Testimony of Eric Stein, Center for Responsible Lending, before the Senate Committee on Banking (Oct. 16, 2008), *available at* http://www.responsiblelending.org/mortgage-lending/policy-legislation/congress/senate-testimony-10-16-08-hearing-stein-final.pdf.

[18] These were loans with the following characteristics: debt-to-income ratios lower than 41%; fixed rate or loans with at least a 7 year fixed period; a term of 30 years or less; no balloon payments; no interest-only or negative amortization loans; full income documentation; and either an LTV under 80% or, if LTV above 80%, with mortgage insurance.

[19] Vertical Capital Solutions, Historical Performance of Qualified vs. Non-Qualified Mortgage Loans (February 2010) (on file with CRL).

[20] Rick Brooks and Ruth Simon, *Subprime Debacle Traps Even Very Credit-Worthy: As Housing Boomed, Industry Pushed Loans To a Broader Market*, Wall Street Journal at A1 (Dec. 3, 2007).

[21] Letter from Coalition for Fair & Affordable Lending to Ben S. Bernanke, Sheila C. Bair, John C. Dugan, John M. Reich, JoAnn Johnson, and Neil Milner (Jan. 25, 2007) at 3.

[22] *See e.g.,* Yuliya Demyanyk, "Ten Myths About Subprime Mortgages," Economic Commentary, Federal Reserve Bank of Cleveland (May 2009) *available at* http://www.clevelandfed.org/research/commentary/2009/0509.pdf; Karen Weaver, "The Sub-Prime Mortgage Crisis: A Synopsis," Deutsch Bank (2008) *available at* http://www.globalsecuritisation.com/08_GBP/GBP_GSSF08_022_031_DB_US_SubPrm.pdf (concluding that subprime mortgages "could only perform in an environment of continued easy credit and rising home prices).

[23] Lei Ding, Roberto G. Quercia, Janneke Ratcliff, and Wei Li, "Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Propensity Score Models," Center for Community Capital, University of North Carolina at Chapel Hill (Sept. 13, 2008), *available at* http://www.ccc.unc.edu/abstracts/091308_Risky.php.

[24] Center for Responsible Lending, *Steered Wrong: Brokers, Borrowers and Subprime Loans* (April 8, 2008), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/steered-wrong-brokers-borrowers-and-subprime-loans.pdf.

[25] *Id.*

[26] R.B. Avery, G.B. Canner, and R.E. Cook, Summer 2005. "New Information Reported under HMDA and Its Application in Fair Lending Enforcement," Federal Reserve Bulletin (available at http://www.federalreserve.gov/pubs/bulletin/2005/summer05_hmda.pdf); R.B. Avery, K.P. Brevoort, and G.B. Canner, September 2006. "Higher-Priced Home Lending and the 2005 HMDA Data," Federal Reserve Bulletin (available at http://www.federalreserve.gov/pubs/bulletin/2006/hmda/bull06hmda.pdf); R.B. Avery, K.P. Brevoort, and G.B. Canner, December 2007. "The 2006 HMDA Data" Federal Reserve Bulletin (available at http://www.federalreserve.gov/pubs/bulletin/2007/pdf/hmda06final.pdf); R.B. Avery, K.P. Brevoort, G.B. Canner, December 2008. "The 2007 HMDA Data", Federal Reserve Bulletin (available at http://www.federalreserve.gov/pubs/bulletin/2008/pdf/hmda07final.pdf); R.B. Avery, K.P. Brevoort, G.B. Canner, September 2009, "The 2008 HMDA Data", forthcoming in Federal Reserve Bulletin (available at http://www.federalreserve.gov/pubs/bulletin/2009/pdf/hmda08draft2.pdf). *See also* Debbie Gruenstein Bocian, Keith Ernst and Wei Lee, "Race, Ethnicity and Subprime Loan Pricing." Journal of Economics and Business, Vol. 60, Issues 1-2, January-February 2008, at 110-124; Debbie Gruenstein Bocian and Richard Zhai, "Borrowers in High Minority Areas More Likely to Receive Prepayment Penalties on Subprime Loans,"January 2005, available at http://www.responsiblelending.org/mediacenter/press-releases/archives/rr004-PPP_Minority_Neighborhoods-0105.pdf

[27] *Supra* note 2, at 3.

[28] *Supra* note 5.

[29] According to the 2007 Survey of Consumer Finance, the median net worth for white, non-Hispanic families in 2007 was $171,200, compared to $28,300 for families of color. *See* Table 4 of the Survey of Consumer Finance (Tables based on Internal Data, Estimates in Nominal Dollars), *available at* http://www.federalreserve.gov/PUBS/oss/oss2/2007/scf2007home.html.

[30] Similarly, the "cure" rate – the rate at which homeowners who are behind on their mortgages catch up rather than default – has plummeted to an astonishing 6.6 percent. *See* Fitch Ratings, Delinquency Cure Rates Worsening for U.S. Prime RMBS (Aug. 24, 2009).

[31] Laurie Goodman, Roger Ashworth, Brian Landy, Ke Yin, *Negative Equity Trumps Unemployment in Predicting Defaults*, Amherst Mortgage Insight, Amherst Securities Group (Nov. 23, 2009).

[32] See Freddie Mac Seller/Servicer Guide, available at http://www.freddiemac.com/sell/guide/#; Fannie Mae Single Family Selling Guide, *available at*

http://www.allregs.com/efnma/index.asp?dv=0&id=a&ii=0&im=0&io=fnma&ip=/&iq=0&iv=0&iw=0&iy=0&iz=0&fc=0&fk=_&fm=0&fs=0&fv=0&sd=/&sm=1&sp=fnma&sq=_&st=_&sv=0&sx=/&sy=0&sz=0&t=0&tc=fnma&tp=/&td=0&ti=0&tm=0&to=fnma&tw=0&tv=0&tq=0&tx=/.

[33] *Inside the GSEs*, January 3, 2007, p. 4. These securities are divided into tranches, with the AAA tranches being the least risky, and for this reason the easiest to sell to investors. Fannie Mae and Freddie Mac purchased only AAA tranches. The harder securities to sell are those from the subordinate tranches. These were made palatable to investors through the creation of collateralized debt obligations, which repackaged BBB tranches into, in part, a new set of AAA tranches, which help to further market the securities; to my knowledge the GSEs did not invest in CDOs. It was the ability to fund the riskiest portion of subprime mortgage loans that made possible the explosive growth of subprime lending. See Pershing Square Capital Management, L.P., "Who's Holding the Bag," presentation, May 2007, available at http://www.designs.valueinvestorinsight.com/bonus/pdf/IraSohnFinal.pdf.

[34] See David Goldstein and Kevin G. Hall, "Private sector loans, not Fannie or Freddie, triggered crisis," McClatchy Newspapers (Oct. 11, 2008) ("Between 2004 and 2006, when subprime lending was exploding, Fannie and Freddie went from holding a high of 48 percent of the subprime loans that were sold into the secondary market to holding about 24 percent, according to data from Inside Mortgage Finance, a specialty publication. One reason is that Fannie and Freddie were subject to tougher standards than many of the unregulated players in the private sector who weakened lending standards, most of whom have gone bankrupt or are now in deep trouble. During those same explosive three years, private investment banks—not Fannie and Freddie—dominated the mortgage loans that were packaged and sold into the secondary mortgage market. In 2005 and 2006, the private sector securitized almost two thirds of all U.S. mortgages, supplanting Fannie and Freddie, according to a number of specialty publications that track this data.") available at http://www.mcclatchydc.com/251/story/53802.html.

[35] Fannie Mae, Investor presentation, "Fannie Mae 2008 Q2 10-Q Investor Summary," (Aug. 6, 2008), p.36, available at: http://www.fanniemae.com/media/pdf/webcast/080808transcript.pdf. By the middle of 2008, Alt-A loans accounted for roughly 10% of Fannie Mae and Freddie Mac's risk exposure, but 50% of their combined losses. Federal National Mortgage Association, United States Securities and Exchange Commission Form 10-Q, for the quarterly period ended June 30, 2008, p.6, available at http://www.fanniemae.com/ir/pdf/earnings/2008/q22008.pdf; Federal Home Loan Mortgage Corporation, United States Securities and Exchange Commission Form 10-Q, for the quarterly period ended June 30, 2008, p.71, available at http://www.freddiemac.com/investors.

[36] Kevin Park, "Fannie, Freddie and the Foreclosure Crisis," University of North Carolina Center for Community Capital (Sept. 2010), available at http://www.ccc.unc.edu/documents/FannieFreddieForeclosure.pdf at 4.

[37] Staff Analysis of the Relationship between the CRA and the Subprime Crisis, Nov. 21, 2008, Board of Governors of the Federal Reserve, Division of Research and Statistics (available at http://www.federalreserve.gov/newsevents/speech/20081203_analysis.pdf).

[38] For further discussions of how CRA has aided rather than harmed communities, *see* Janet L. Yellen, Opening Remarks to the 2008 National Interagency Community Reinvestment Conference, San Francisco, California (March 31, 2008) (noting that studies have shown that the CRA has increased the volume of responsible lending to low- and moderate-income households); Ann F. Jaedicke, Testimony Before the Committee on Financial Services, US House of Representatives (February 13, 2008) ("over half of subprime mortgages of the last several years—and the ones with the most questionable underwriting standards—were originated through mortgage brokers for securitization by nonbanks, including major investment banks"); Michael S. Barr, *Credit Where It Counts: Maintaining a Strong Community Reinvestment Act,* Brookings Institution Research Brief (May 2005) ("encouraged by the law, banks and thrifts have developed expertise in serving low-income communities.").

[39] Federal Register Vol. 75, No. 47 (Mar. 11, 2010) at 11652 ("As a general rule, mortgage backed securities and municipal bonds are not qualified investments because they do not have as their primary purpose community development, as defined in the CRA regulations.")

[40] See Traiger & Hinckley LLP, The Community Reinvestment Act: A Welcome Anomaly in the Foreclosure Crisis: Indications that the CRA Deterred Irresponsible Lending in the 15 Most Populous U.S. Metropolitan Areas, Jan. 8, 2008, *available at* http://www.traigerlaw.com/publications/traiger_hinckley_llp_cra_foreclosure_study_1-7-08.pdf.

[41] Board of Governors of the Federal Reserve System, "The Performance and Profitability of CRA-Related Lending, A report submitted to Congress pursuant to Section 713 of the Gramm-Leach-Bliley Act of 1999." (July, 17, 2000) at 45-46, www.federalreserve.gov/boarddocs/surveys/craloansurvey/cratext.pdf; see also "CRA Special Lending Programs," Avery, Bostic and Canner, Federal Reserve Bulletin (Nov. 2000) at 723, www.federalreserve.gov/pubs/bulletin/2000/1100lead.pdf (Ninety-three percent of responding CRA-covered institutions so reported).

[42] The CDFI Data Project, Fiscal Year 2007, Seventh Edition, "Providing Capital, Building Communities, Creating Impact" http://www.opportunityfinance.net/industry/industry_sub1.aspx?id=248.

[43] Press release issued on November 19, 2008, quoting Mr. Dugan in a speech to the Enterprise Annual Network Conference.

[44] *See e.g. In re Ocwen Loan Servicing, LLC Mortg. Servicing Litigation,* 491 F.3d 638 (7th Cir. 2007) (allegations by a class of homeowners that Ocwen systematically charged late fees for payments that were sent on time); *Federal Trade Commission (FTC) Settlement* (2003) resulted in $40 million for consumers harmed by illegal loan servicing practices, *available at* http://www.ftc.gov/fairbanks (FTC alleged, among other things, that Fairbanks illegally charged homeowners for "forced placed insurance" and violated the Fair Debt Collection Practices Act); and *FTC Settlement with Countrywide, available at* http://www.ftc.gov/countrywide (Countrywide agreed to pay $108 million dollars to homeowners in response to the FTC's allegations that Countrywide charged illegal fees to homeowners during Chapter 13 bankruptcy proceedings).

[45] For a thorough discussion of the servicing incentive structure, see Testimony of Diane Thompson before the Senate Banking Committee (Nov. 16, 2010), *available at* http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Testimony&Hearing_ID=df8cb685-c1bf-4eea-941d-cf9d5173873a&Witness_ID=d9df823a-05d7-400f-b45a-104a412e2202 ; *see also* Diane Thompson, "Why Servicers Foreclose When They Should Modify and Other Puzzles of Servicer Behavior," National Consumer Law Center (Oct. 2009), *available at* http://www.nclc.org/images/pdf/foreclosure_mortgage/mortgage_servicing/servicer-report1009.pdf.

[46] The Center for Responsible Lending is serving as co-counsel in several cases relating to these issues, including a Maine class action filed against GMAC Mortgage, *Bradbury et al v. GMAC Mortgage, LLC* (Civil Action, Docket CV-2010-494, U.S. Dist. ME). In a related individual case, US Bank v. James (Civil Action, Docket CV-2009-0084, U.S. Dist. ME, Doc. 196 1/31/11), the court recently awarded sanctions against GMAC to a homeowner required to defend against a motion for summary judgment supported by a falsely sworn affidavit (robo-signing) ruling, "Stephan's actions in this case strike at the heart of any court's procedures, are egregious under the circumstances, and must be deemed worthy of sanctions."

[47] Testimony of Adam Levitan before the Senate Banking Committee (Nov. 16, 2010), *available at* http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Testimony&Hearing_ID=df8cb685-c1bf-4eea-941d-cf9d5173873a&Witness_ID=2ada1da6-e7cc-4eca-99a4-03584d3748af; *see also In re Agard,* Docket No. 810-77338-reg (EDNY Bnkr. Slip Op. at 31, 2/10/11)("naming MERS a 'nominee,' and/or 'mortgagee of record' did not bestow authority upon MERS to assign the Mortgage.").

[48] In the Senate, Senator Jack Reed also introduced legislation in the 111th that would mandate loss mitigation (S. 1431).

[49] 2009 HMDA data.

[50] The Federal Reserve, "The 2009 HMDA Data: The Mortgage Market in a Time of Low Interest Rates and Economic Distress," Dec. 2010.

[51] http://bucks.blogs.nytimes.com/2010/01/05/how-loan-modifications-impact-credit-scores/?hp.

[52] With a well developed system for making, tracking, and evaluating grants for foreclosure legal assistance, IFLA would be well positioned to assist HUD in administering this funding. IFLA is funded through the Center for Responsible Lending and administered by the National Association of Consumer Attorneys.

[53] Surprisingly, the Treasury Department has concluded that HHF funds can be used for housing counselors but not for attorneys. While an interpretation of EESA that denies its use for either purpose may be colorable, there is no credible reason for funding one but not the other.

[54] National Taxpayer Advocate, *2008 Annual Report to Congress*, at 341, 391-96.

[55] The legislation defined "qualified mortgage debt" to include only that debt that was used to purchase a home or make major home improvements. In calculating the tax, any unqualified debt is first subtracted in its entirety from the amount of forgiven debt (not on a pro rata basis). In many cases, the amount of unqualified debt will equal or exceed the amount of debt forgiven, leaving the homeowner to pay tax on the entire forgiven debt – and even in those cases where the amount forgiven exceeds the amount of unqualified debt, the homeowner will still owe tax.

[56] To take advantage of the mortgage debt exclusion, a homeowner now has to file a long-form 1040 (not a 1040EZ) along with a Form 982. Unfortunately, most lower and middle income taxpayers are not accustomed to using these forms, and taxpayers filing long-form 1040s are not eligible to use the various tax clinics offered by the IRS and others for lower-income taxpayers.

[57] *Supra* Note 55 at 394.

[58] As Lewis Ranieri, founder of Hyperion Equity Funds and generally considered "the father of the securitized mortgage market," has recently noted, such relief is the only way to break through the problem posed by second mortgages. Lewis S. Ranieri, "Revolution in Mortgage Finance," the 9th annual John T. Dunlop Lecture at Harvard Graduate School of Design, Oct. 1, 2008, *available at* http://www.jchs.harvard.edu/events/dunlop_lecture_ranieri_2008.mov (last visited Feb. 24, 2010).

[59] Mark Zandi, "Homeownership Vesting Plan," Moody's Economy.com (Dec. 2008), *available at* http://www.dismal.com/mark-zandi/documents/Homeownership_Vesting_Plan.pdf.

[60] Blackrock, the world's largest asset manager, supports using bankruptcy courts to address the need for principal reduction. Bloomberg News, *BlackRock Cramdown Plan,* American Banker (Jan. 22, 2010), *available at* http://www.americanbanker.com/syndication/blackrock-cramdown-plan-1006339-1.html. In April 2010, Bank of America joined Citi in support of this measure as well, so two of the four largest banks now support it. Barbara Desoer, President, Bank of America Home Loans, Hearing Before the Committee on Financial Services, U.S. House of Representatives, 111th Congress, Second Session, April 13, 2010, transcript *available at* http://financialservices.house.gov/Media/file/hearings/111/Printed%20Hearings/111-120.pdf. Citi reaffirmed its support at this same hearing.

[61] Thomas J. Fitzpatrick IV and James B. Thomson, "Stripdowns and Bankruptcy: Lessons from Agricultural Bankruptcy Reform" (8/3/10), *available at* http://www.clevelandfed.org/research/commentary/2010/2010-9.cfm.

[62] Pub. L. No. 111-203, Title X, §§ 1025(e); 1029A. Six of the top ten servicers, as ranked by Mortgage Servicing News, appear to be subject to the OCC's primary supervision.

[63] NY and NC in particular.

[64] For a comparison of modification parameters pre- and post-HAMP, see OCC/OTS Mortgage Metrics reports *available at* http://www.ots.treas.gov/?p=Mortgage%20Metrics%20Report. See also State Foreclosure Prevention Working Group reports *available at* http://www.csbs.org/regulatory/Pages/SFPWG.aspx.

[65] According to attorneys who are part of the Institute for Foreclosure Legal Assistance network, servicers often promise borrowers a speedier resolution if they choose a proprietary modification.

[66] The Office of the Homeowner Advocate would have been established by S. 3793, the Job Creation and Tax Cuts Act of 2010, introduced by Senator Max Baucus (D-MT); "Franken Homeowner Advocate Amendment Passes" (June 15, 2010), *available at* http://senatus.wordpress.com/2010/06/15/franken-homeowner-advocate-amendment-passes.

[67] One Pennsylvania bankruptcy judge has recently provided troubling details of how "communications" between servicers and their outside law firms take place almost entirely through automated systems without any human interaction. *In re Taylor*, 407 B.R. 618 (E.D. Pa. 2009). That judge concluded, "The thoughtless mechanical employment of computer-driven models and communications to inexpensively traverse the path to foreclosure offends the integrity of our American bankruptcy system."

[68] As of April 2010, all applications must now be fully documented.

[69] *Supra* note 3.

[70] "Factors Affecting the Implementation of the Home Affordable Modification Program", SIGTARP (March 25, 2010), *available at* http://www.sigtarp.gov/reports/audit/2010/Factors_Affecting_Implementation_of_the_Home_Affordable_Modification_Program.pdf

[71] Although many decry the phenomenon of "walkaways," when people voluntarily default on their mortgages, there are actually far fewer such walkaways than economic theory might predict. *See, e.g.*, Roger Lowenstein, *Walk Away from your Mortgage!*, New York Times (Jan. 10, 2010) (noting that it would be economically rational for more people to walk away from their mortgages). However, it is clear that at some level, the disincentive of being underwater will have an impact on the homeowner's success in continuing with the mortgage.

[72] Andrew Haughwout, Ebiere Okah, and Joseph Tracy, *Second Chances: Subprime Mortgage Modification and Re-Default*, Federal Reserve Bank of New York Staff Report (Dec. 2009).

[73] *See, e.g.*, Amherst Study *supra* note 1; Shawn Tully, *Lewie Ranieri Wants to Fix the Mortgage Mess*, Fortune Magazine (Dec. 9, 2009); "Analysis of Mortgage Servicing Performance, Data Report No. 4, Jan. 2010, State Foreclosure Prevention Working Group, at 3.

[74] Most Pooling and Servicing Agreements require the servicer to act in the best interest of the investors as a whole, but those obligations have been honored mainly in the breach.

[75] See SIGTARP Jan. 2011 Quarterly Report to Congress, p. 45, *available at* http://www.sigtarp.gov/reports/congress/2011/January2011_Quarterly_Report_to_Congress.pdf.

[76] http://www.businessinsider.com/average-duration-of-unemployment-in-july-2010-8.

[77] HAMP Supplemental Directive 10-15, *available at* https://www.hmpadmin.com/portal/programs/docs/hamp_servicer/sd1015.pdf.

[78] U.S. Department of Housing and Urban Development, Mortgagee Letter 2010-04, Loss Mitigation for Imminent Default (January 22, 2010), *available at* http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/10-04ml.pdf (Loss Mitigation is critical to both borrowers and FHA because it works to fulfill the goal of helping borrowers retain homeownership while protecting the FHA Insurance Fund from unnecessary losses. By establishing early contact with the borrower to discuss the reason for the default and the available reinstatement options, the servicer increases the likelihood that the default will be cured and the borrower will be able to retain homeownership.)

[79] *E.g.*, Maryland HB 472 (2010), *available at* http://mlis.state.md.us/2010rs/bills/hb/hb0472f.pdf (Maryland homeowners deemed ineligible for relief from their lender then have the option to participate in the court-administered foreclosure mediation program.).

[80] *See, e.g.*, NYS Banking Department, Part 419 of the Superintendent's Regulations, at 419.11 (effective October 1, 2010), *available at* http://www.banking.state.ny.us/legal/adptregu.htm (Servicers shall make reasonable and good faith efforts consistent with usual and customary industry standards and paragraph (b) of this section to engage in appropriate loss mitigation options, including loan modifications, to avoid foreclosure.).

The Housing Market and Economic Recovery

Douglas Holtz-Eakin
President, American Action Forum*

February 16, 2011

Introduction

Chairman Biggert, Ranking Member Frank and members of the Committee, I am pleased to have the opportunity to appear today to discuss stops toward a greater involvement of the private sector in housing finance. In this short statement, let me make two major points:

- Adoption of appropriate housing finance policies will aid the pace of economic growth and job creation by stabilizing household balance sheets and clarifying single-family and multi-family investment incentives; and

- There are good, pro-growth reasons to re-think the policy tradition of providing support to residential housing through tax and regulatory subsidies to debt-financed owner-occupied housing.

Let me discuss these in turn.

The Framework for Macroeconomic Recovery

According to the National Bureau of Economic Research the recession began in December 2007. Their data show that there were 142.002 million jobs in December of 2007 – the average of payroll and household survey data. In June 2009, NBER's date for the end of the recession, the same method showed 135.257 million jobs, for a total job loss of 6.745 million attributed to the recession. These numbers are quite close to those using the Bureau of Labor Statistics non-farm payroll, which showed a loss of 6.803 million.

* The opinions expressed herein are mine alone and do not represent the position of the American Action Forum. I am grateful to Cameron Smith, Michael Ramlet, and Matt Thoman for assistance.

There are glimmers of promise. Since December 2009, 1.1 million jobs have been added, bringing the U.S. to 130.712 million jobs. However at the same time, there are 14.5 million unemployed persons in the economy and many more discouraged workers. The peak in the size of the labor force was 155 million in October 2008, and is now estimated at slightly below 154 million.

For these reasons, the current unemployment rate of 9.0 percent likely understates the real duress. Using the BLS alternative unemployment rate (U-6), one finds that unemployed, underutilized and discouraged workers are 16.7 percent of the total. As evidence of the difficulties, the number of long-term unemployed (27 weeks or more) is currently 6.4 million and accounts for 44.3 percent of all unemployed persons.

These data reflect the fact that the U.S. has suffered a deep recession and is growing slowly. Over the course of the past several years, Administrations and Congresses have engaged in a number of counter-cyclical fiscal measures ("stimulus"): checks to households (the Economic Stimulus Act of 2008), the gargantuan stimulus bill in 2009 (American Recovery and Reinvestment Act), "cash for clunkers" (the Car Allowance Rebate System), and tax credits for homebuyers (the Federal Housing Tax Credit). As this Committee is well aware there is an ongoing debate regarding the effectiveness of these measures in mitigating the natural course of the business cycle downturn.

Regardless of the ultimate resolution of that debate, I believe it would be a mistake for policymakers to evaluate future policy from that perspective. The U.S. economy *is* growing, albeit slowly, not declining. Gross Domestic Product (GDP) has been rising since the third quarter of 2009, and employment is up from its trough in December 2009. There is substantial and widespread evidence of an ongoing economic expansion. Accordingly, this is not the time for counter-cyclical "stimulus".

The pace of expansion remains solid and unspectacular. In many ways this is not surprising. As documented in Rogoff and Reinhart (2009), economic expansions in the aftermath of severe financial crises tend to be more modest and drawn out than recovery from a conventional recession.[1] Nevertheless, at this juncture it is imperative that policy be focused on generating the maximum possible pace of economic growth. More rapid growth is essential to the labor market futures of the millions of Americans without work. More rapid growth is essential to minimizing the difficulty of slowing the explosion of federal debt to a sustainable pace. More rapid growth will generate the resources needed to meet our obligation to provide a standard of living to the next generation that exceeds the one this generation inherited.

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[1] See *This Time Is Different: Eight Centuries of Financial Folly*, by Carmen M. Reinhart and Kenneth Rogoff, 2009.

Drivers of Economic Growth

Policies focused on more rapid economic growth are the most important priority at this time. In light of this, it is useful to reflect on the four basic sources of growth in final demand for GDP: households, businesses, governments, and international partners.

Households are caught in a double bind of badly damaged balances sheets and weak income growth. As is well known, the collapse of the U.S. housing bubble left many households in mortgage distress, and more broadly diminished the net worth of the household sector. In addition, the financial crisis itself destroyed additional household wealth, with the result that household net worth is now $9 trillion below where it stood in 2007. The expansion thus far has yielded modest income growth.

It would be unrealistic, or even unwise, to expect households to be a robust source of final demand growth. Instead, the best course for households would be to repair their damaged balance sheets as quickly as possible. Policies that support the ability of households to do so while otherwise maintaining their consumption patterns will be the most beneficial. There is little that one-time "stimulus" in the form of tax cuts or transfers contribute to these goals.

Similarly, federal and sub-federal governments face enormous budgetary difficulties, largely due to long-term pension, health, and other spending promises coupled with recent programmatic expansions. Consider the federal budget. Over the next ten years, according to the Congressional Budget Office's (CBO's) analysis of the President's Budgetary Proposals for Fiscal Year 2011, the deficit will never fall below $700 billion. Ten years from now, in 2020, the deficit will be 5.6 percent of GDP, roughly $1.3 trillion, of which over $900 billion will be devoted to servicing debt on previous borrowing.

The budget outlook is not the result of a shortfall of revenues. The CBO projects that over the next decade the economy will fully recover and revenues in 2020 will be 19.6 percent of GDP – over $300 billion more than the historic norm of 18 percent. Instead, the problem is spending. Federal outlays in 2020 are expected to be 25.2 percent of GDP – about $1.2 trillion higher than the 20 percent that has been business as usual in the postwar era.

As a result of the spending binge, in 2020 public debt will have more than doubled from its 2008 level to 90 percent of GDP and will continue its upward trajectory. Traditionally, a debt-to-GDP ratio of 90 percent or more is associated with the risk of a sovereign debt crisis. Indeed, there are warning signs even before the debt rises to those levels.

The President released his budgetary proposals for Fiscal Year 2012 this past Monday. While CBO has yet to have the opportunity to provide a non-partisan look at their implications, my reading of the budget is that **[will complete here]**

The fiscal future outlined above represents a direct impediment to job creation and growth. The United States is courting downgrade as a sovereign borrower and a commensurate increase in borrowing costs. In a world characterized by financial market volatility stemming from Ireland, Greece, Portugal, and other locations this raises the possibility that the United States could find itself facing a financial crisis. Any sharp rise in interest rates would have dramatically negative economic impacts; even worse an actual liquidity panic would replicate (or worse) the experience of the fall of 2008.

Some suggest that we can stave off such a crisis by raising additional revenue. Ultimately, this approach is likely to fail as the potential spending plans exceed any reasonable ability for the U.S. to finance via higher taxes. No tax regime since World War II has come close to raising 25% of GDP, during a period that has seen an incredible variety of tax rates.

In short, the failure to control future spending raises the prospect of higher interest rates, higher taxes, or both. This constitutes a serious impediment to confidence The federal government needs to reduce spending growth, and control its debt. No sensible growth strategy can be built around greater federal spending, or greater government spending more generally.

With households and governments repairing balance sheets this leaves private-sector investment spending and net exports at the heart of badly-needed pro-growth policies. Policies to encourage more international trade are important and should be explored vigorously. The United States has been on the sidelines of international trade agreements for far too long. Pro-trade polices should be a bipartisan approach to raising growth and increasing jobs.

The Role of Housing Policy

This framework suggests two channels by which housing finance policy will affect the pace of economic growth: housing valuations and new construction incentives. Housing valuations are a central part of household asset holdings. Until housing valuations stabilize, households will continue to be under stress and restrict their spending. The most important objective at the moment is to clear excess housing inventory. To date, no federal housing policy has been successful in speeding this process; indeed most observers would argue that they have slowed this process. In sum, getting federal policy out of the way would be the best way to speed progress from this front.

Housing valuations also depend crucially on purchasers' expectations of future federal housing policies ranging from tax-deductibility of mortgage interest, to subsidies for energy-efficient investments to guarantees for the securitization of conforming mortgages. I will discuss my thoughts on housing policy below. Regardless, one lesson is that the sooner that policy is settled the better it will be for stabilizing housing valuations and removing the drag from the housing market from job creation and growth.

Similar considerations apply to the second channel by which housing affects macroeconomic growth: the construction of residential single- and multi-family homes. Incentives to build depend in the same way on the expectations for low-income tax credits and other federal policies. Resolving policy uncertainty will speed the ability of the construction sector to make decisions on demographic and economic fundamentals.

A Framework for Policy Towards Housing and Housing Finance

Housing is one of the most heavily regulated economic activities. However, the dominant federal policy interventions are those that provide subsidies to the debt-finance of the purchase of owner-occupied housing. The tax deduction for mortgage interest costs takes precisely this form. Similarly, taxpayer financed guarantees for mortgages through the Federal Housing Administration and the Government Sponsored Enterprises are subsidies to debt-financed homeownership.

It is evident from the recent housing bubble and current market conditions that this approach has not served market participants well. Thus, it is useful for the committee to step back and answer key questions regarding the policy framework toward U.S. housing:

- Should the federal government subsidize housing?
- If subsidies are appropriate, should they apply equally to rental housing and owner-occupied housing? Or, is it a policy objective to promote homeownership over rental occupancy?
- If subsidies are appropriate, should they be provided directly to owners and renters – i.e., through the purchasers of housing services? Or, is it more desirable to subsidize builders and sellers of apartments and houses in order to improve their affordability?
- Should subsidies depend on the mixture of debt and equity finance?
- Will subsidies be transparently displayed on the federal budget and controlled by Congress? Or, will the federal government continue to provide virtually open-ended mortgage subsidies through the tax code and off-the-books finance subsides via the GSEs?

Conclusion

Thank you for the chance to offer this brief written statement. I would be happy to elaborate in areas that you find interesting and look forward to answering your questions.

Support & Guidance For Homeowners

Statement of Faith Schwartz

Executive Director, HOPE NOW Alliance

Before the

Financial Services Committee

Subcommittee on Insurance, Housing and Community Opportunity

Hearing on

"Government Barriers to the Housing Recovery"

February 16, 2011

Introduction

Chairwoman Biggert and Members of the Subcommittee, thank you for the opportunity to testify before you today. I am Faith Schwartz, Executive Director of the HOPE NOW Alliance. I have served in a leadership capacity at HOPE NOW since 2007, in which I have worked closely with mortgage servicers, non-profit housing counseling partners, government agencies and regulators to help homeowners avoid foreclosure. I also co-founded HOPE LoanPort™, a separate non-profit entity, of which I am a board member and a senior advisor. HOPE LoanPort™ is a web-based utility to improve communication among homeowners, housing counselors and servicers. HOPE Loan Port makes it possible for homeowners working with counselors to securely submit all required data and documentation necessary to enable loan servicers to make a decision on loan modifications or other workouts in a timely manner.

The comments I plan to make today are my own and reflect my breadth of experience on housing related issues. Additionally, these comments do not necessarily represent the views of all HOPE NOW members.

Today I will review a brief history of HOPE NOW, the state of foreclosure prevention efforts and what has changed in course of government and non-government interventions to prevent foreclosures. There have been new programs and tools intended to increase foreclosure prevention efforts introduced over the past three years. I will attempt to highlight some of them and the progress that has been made in assisting homeowners avoid foreclosure. Some of these efforts have also contributed to longer timelines associated with the foreclosure process. This information should assist you as you think about the important issue of bringing private capital back to the market. Loan servicing is a critical component of this process as we move forward in the areas of consumer and investor confidence.

Foreclosure Prevention: 2007 to present

Today there are nearly three million Americans at least 60 days or more delinquent on their mortgage, and millions more who are still feeling the repercussions of a significant slide in housing prices. Studies and experience has shown that one of two homeowners going to foreclosure never contact their loan servicer in order to find out if an alternative to foreclosure is available. Some may desire to move on and others may not realize there are many effective tools that may assist them to avoid foreclosure.

HOPE NOW

Established in 2007, HOPE NOW is a voluntary, private sector, industry-led alliance of mortgage servicers, non-profit HUD-approved housing counselors and other mortgage market participants focused on finding viable alternatives to foreclosure. HOPE NOW's primary focus is a nationwide outreach program that includes 1) over five million letters to non-contact borrowers, 2) regional homeownership preservation outreach events offering struggling homeowners face to face meetings with their mortgage servicer or a counselor, 3) support for the national Homeowner's HOPE™ Hotline, 888-995-HOPE™, 4) Directing homeowners to free resources through our website at www.HOPENOW.com and 5) Directing borrowers to free resources such as HOPE LoanPort™, the new web-based portal for submitting loan modification applications.

In addition, HOPE NOW also collects data on almost 40 million first lien loans, from all participating servicers, on loan workout solutions; and has publically reported these results on a monthly basis since 2007.

Summary of 2010 data results: In 2010, mortgage servicers completed 1.76 million permanent loan modifications for homeowners. 1.24 million were completed through proprietary programs and 512,000 permanent HAMP modifications. This compares to just over 1 million foreclosure sales in 2010. Since HOPE NOW began reporting data in the third quarter of 2007, the industry has completed over 3.5 million proprietary modifications and roughly 580,000 HAMP modifications - for a total of more than 4 million permanent loan modifications for American homeowners.

HOPE NOW Outreach

The HOPE NOW outreach events are broad partnerships that include Making Home Affordable, NeighborWorks® America, Federal Reserve Banks, The GSEs, local task forces and hundreds of volunteers who care deeply about their communities The homeowner outreach events were first initiated by the industry in early 2008 and since then they have been expanded to include these vital partners.

HOPE NOW has hosted over 100 in-person outreach events across the country since 2008. These events have enabled more than 85,000 families to meet with servicers and counselors to work face-to-face on foreclosure prevention solutions. It is important to note the significant personnel and resource dedication that mortgage servicers, counselors and partners have made to HOPE NOW events and other outreach events. Outreach events are held throughout the year and there are many individuals that work seven days a week to work with distressed homeowners who want to stay in their home.

Here are some of the comments from homeowners who have attended HOPE NOW events over the past three years:

"I'm really glad I took the time to come here today to talk to Bank of America. I worked with a wonderful person on-site and I am happy to say that we were pre-qualified for a Home Affordable Modification today." – Leslie, Mechanicsville, VA

"It was important for me to sit face to face with someone and go over my situation. I recently started a new job so I wanted to make sure all of the documents for my trial modification were in order. It turns out that the bank just needs my hardship letter to complete the application, but I feel good about my prospects for getting a loan modification. I'm really glad I took the time to come to this event." –Judi, Las Vegas, NV

"We were ready to walk away from our home if we weren't able to reach a solution today. I spent all day here, but it ended far better than I had anticipated – and was well worth the trip. I was able to reach an agreement with Wells Fargo that reduced my loan by almost $500 a month. I am taking away nothing but positives from this event and I now have some peace of mind." – Bob, Mesa, AZ

What have we learned? Since initiating the homeowner outreach events, we have been tracking participating homeowner satisfaction in order to gauge our success and adjust the outreach model accordingly.

From the beginning, nearly two-thirds of all borrowers in attendance say they would recommend the outreach events and over half rate the workshops experience as excellent. Surprisingly, we continue to find that for 35-40% of participating homeowners, these events are the first meaningful contact they have had with their loan servicers. We have also seen a change in the circumstances of at-risk homeowners over the last two years. Now up to 30% of borrowers who attend are unemployed. Unemployment significantly affects the type of aid available and highlights the obvious challenges we face in this housing crisis.

To improve the ability of servicers to provide decisions to borrowers at the events, we have put document scanners onsite and made other technology improvements. Borrowers now routinely bring better documentation to the in-person events which helps produce a more accurate discussion of their situation and possible solutions. Please review the addendum to see the latest survey data from our Las Vegas event in January 2011.

Free counseling to borrowers: Objective third party counseling for homeowners is also a vital part of the effort. HOPE NOW supports the Homeowner's HOPE™ Hotline, 888-995-HOPE™, which is managed by the non-profit Homeownership Preservation Foundation, and operates 24 hours a day, 7 days a week in several languages. The hotline connects homeowners to counselors at reputable HUD-certified non-profit agencies around the country. There have been more than 4 million consumer calls into the hotline since inception and it serves as the nation's "go-to" hotline for homeowners at risk.

The US Government uses this hotline for their Making Home Affordable program and noted in its December 2010 report that 1.8 million calls have been fielded by the hotline to date, and more than 900,000 borrowers have received housing counseling assistance.

We urge investors, GSEs, lenders and the government to continue support and maintain this vital hotline and its network of qualified housing counselors who continue to support at- risk homeowners through the housing crisis.

HOPE LoanPort™

HOPE LoanPort™ (HLP) is a much needed addition to improve efficiency and effectiveness of communications among borrowers, counselors, investors and mortgage servicers. HLP is an independent non-profit entity that was developed through cooperative work by members of the HOPE NOW Alliance. A group of companies and housing counselors worked with HOPE NOW, and our vendor IndiSoft, to create a web tool that met the needs of all parties working to avoid foreclosures. HLP was created to help address the frustration among borrowers, policymakers, counselors and servicers in the document submission process.

- HOPE LoanPort™'s web-based system allows a uniform intake of an application for a loss mitigation solution though HAMP, all Federal programs as well as proprietary home retention programs. It allows for all stakeholders to see the same information, in a secure manner, and delivers a completed loan package to the servicer for action. The system is fully operational, and is being used by 13 major mortgage servicers, representing approximately 80% of the loan market, as well as almost 500 housing counseling offices in 46 states, the District of Columbia and Puerto Rico - comprised of more than 2,100 counselors who are using this portal.

- Much of the activity on the portal has occurred in the forth quarter of 2010.
- Of the 13,255 cases created by counselors, 8,561 cases were submitted to the loan servicer (completed applications with completed required documentation for any loan workout).
- It takes an average of 49 days for a loan servicer to approve a loan modification, which includes an average of 17 days for a counselor to submit the full package and 32 days for the servicer to make a final decision on a fully complete application.
- Nearly 700 servicing users (data from 12 active users at year end Dec, 2010) are managing the process and pipelines. This means that for every 3 counselors active on the portal; there is one servicer counselor.
- HOPE LoanPort™ has the endorsement of HUD, as well as four state housing finance agencies and one state Department of Banking.
- One of the nation's largest mortgage insurers is an active partner.

This web-based portal increases accountability, stability and security for submitted information and increases borrower confidence that that their information will be reviewed and will not be lost. They can continue to work with third party housing counselors to make sure they understand the requirements and options in an effort to avoid foreclosure. Servicer and counselor steering teams, working together have made the decisions on how best to create and improve the HOPE LoanPort™ system.

This portal was designed by a core group of non-profits including NeighborWorks® America and HomeFree-USA, and six industry servicers who shared in this unique and important mission. For more information please visit www.hopeloanportal.org.

Impact of HOPE LoanPort™: HOPE LoanPort™ provides a method for housing counselors to efficiently transmit a homeowner's completed application to partner mortgage servicers to enable the servicers to make a decision on a completed application.
HOPE LoanPort™ is free to HUD-Approved housing counseling agencies and National Foreclosure Mitigation Counseling Program (NFMC) recipients. The portal has established a standardized modification application and communication process that ensures mortgage servicers and counselors receive a complete application and homeowners receive regular updates on the status of their application. This system has improved accountability, transparency and simplified a complicated system of loss mitigation that has been hampered by reliance on inefficiencies in faxes, mailed packages, phone calls and missing documents. The data collected through the system will enable mortgage servicers and insurers to work with non-profit counselors and borrowers to clear up any backlog or missing documents. This non-profit portal is funded by servicers and investors and has not received any Government funding.

What has changed from 2007 through 2011?

Subprime Crisis: When the crisis began in 2007, most of the early foreclosure prevention efforts focused on repayment plans, and some modifications, which entailed capitalizing missed payments (arrearages) and re-setting the mortgage. The HOPE NOW data indicates that in July 2007, there were 17,000 modifications completed. The primary focus was in the subprime products; the hybrid ARMs and option ARMs which were defaulting in record numbers, many prior to the ARM reset. In 2007, The Treasury Department and the Department of Housing (HUD) reached out to industry and asked them to increase and expand collaboration with non-profits to reach more borrowers and help them avoid foreclosures wherever possible. Through HOPE NOW, more servicers set up toll-free numbers for housing counselors; HOPE NOW servicers produced servicing guidelines to improve the loss mitigation process, and worked with third parties to reach homeowners who were not responding to contact from servicers. The housing crisis deepened with the recession and we saw more widespread defaults happening across loan portfolios – economic problems spread defaults to borrowers with prime, fixed-rate loans. Servicers continued to be proactive working with housing counselors and third parties, while hiring and expanding activity around foreclosure prevention efforts.

In 2007, there were few government resources focused directly on foreclosure prevention. Mortgage servicers and others worked individually and then pulled together through HOPE NOW to meet the challenge, progress was made but the growth of the housing crisis outweighed the response. Since 2008, the Government has taken on a broader role to address the crisis.

I. New Government programs - 2008-2010

Government programs have fallen into the following categories:

- Refinance
- Unemployment Assistance
- Modification
- Short sale and deed in lieu
- Mediation (at the state level)

Some of these programs are more successful than others and it is difficult to measure the full impact of the programs. However, a combination of factors has led to record long foreclosure timelines as measured in 2010.

The average loan in delinquency that went to foreclosure in 2010 exceeded 500 plus days, up from 300 days in 2008, according to an LPS report in early 2011.

a) **FHA HOPE for Homeowners** was an attempt to assist homeowners who might qualify to refinance to an FHA-insured loan with the participation of servicers and investors willing to write-down the existing loan. It also required the homeowner to share possible future appreciation of the property with the government. There were few loans produced through the program in part because of its complexity. Originators and servicers have not been easy to match up with regard to refinancing higher risk loans and expanding short payoffs.

b) **Home Affordable Refinance Program (HARP) is the refinance portion of the MHA program** offered by the Fannie Mae and Freddie Mac. It is a first lien refinance program targeted to loans at 80% LTV up to 125% LTV. Essentially, it targeted borrowers who were current on their loan, but at-risk to become delinquent. From April 2009 through November 2010, FHFA reports 539,597 homeowners refinanced into this program. This is creative and an opportunity to continue reaching borrowers who could not otherwise refinance and may become future foreclosure candidates.

c) **Making Home Affordable: HAFA** – A short sale and deed in lieu program that focuses on a detailed process for the complicated nature of a "short sale" and deed in lieu product. The effort has key timelines, document and process requirements that need to be followed and extends the timeline for loans for up to 120 days. It includes forgiveness of the deficiency when a borrower sells a property short of value and it offers clarity, accountability and clear expectations of what is required for realtors, servicers, and other stakeholders. Junior lien holders often require more dollars than HAFA supports. Recent adjustments to the program offered by Treasury suggest that this program may be used more in the future because of adjustments made to the requirements to prove hardship or stick to 31% DTI thresholds.

d) **Making Home Affordable: HAMP** – This is the loan modification program which was rolled out to respond to the growing stress in the housing market. The crisis was deepening. By intervening with a loan modification that was subsidized by the government, it was a change from the previous attempts to modify loans, and was an important step toward creating market standards.

- Standards: Despite criticism for falling short of projected numbers for permanent modifications, HAMP helped create standards that improved methods and transparency on how to achieve affordable and sustainable loan modifications.

- Increasing Homeowner Awareness: When the United States Government offers a potential solution to the loan modification process, the public listens. The awareness created by the HAMP program helped engage millions of at- risk homeowners in efforts to preserve their home and avoid foreclosure. The existence of the HAMP program helps attract borrowers to seek help. It is still a very valuable way for borrowers to get in the system, even if they do not qualify for a HAMP modification.

- First line of defense for homeowners: The HAMP program structure requires participating servicers to first review the borrower for HAMP eligibility prior to placing them into alternative modifications. Even if they do not ultimately qualify, borrowers are first assessed for eligibility for HAMP and then must be considered for other loan modifications or other workouts.

- *Safe Harbor*: HAMP created an industry "safe harbor" for modifying loans. Due to conflicting investor contracts, prior to HAMP it was difficult to identify a consistent "industry standard". HAMP helped create these standards and common practices The creation of tools to use in an evaluation "waterfall" and use of a Net Present Value test has transcended HAMP and is a model for servicers to use for proprietary modifications. This may transcend HAMP for other modifications as the process and NPV test provide an "industry standard".

- Structure created: Through Making Home Affordable, government HAMP modifications introduced clear guidance for the HAMP waterfall, including guidance for working with unemployed or underemployed borrowers- one of the most difficult situations. The protocols on structuring an affordable payment for borrowers include:

  a. Forbearance (3-6 months) for unemployed borrowers;
  b. 31% housing DTI split by investors and government dollars from 38%;

c. Use of lower interest rate to 2%, extended terms to 40 years, and principal deferral and/or principal write-down;
d. If ineligible, servicers must review for proprietary solutions (GSE, other), and if ineligible for that option;
e. Servicers must consider HAFA (Home Affordable Foreclosure Alternatives short sale and deed in lieu) or proprietary programs;
f. In many instances, foreclosure prevention will then state mediation requirement to review all solutions outside of foreclosure; and
g. Foreclosure sale as the final option.

Challenges and added complexity: While HAMP did help create standards, it also has detailed and complex HAMP/HAFA documentation requirements to ensure there is no fraud in using taxpayer funds. Specific HAMP requirements were rolled out gradually and changed several times. Initially, servicers spent many months re-tooling systems to accommodate HAMP. This was slow to get off the ground and existing efforts to modify loans slowed down so that the loans would not require a second modification for loans that fit the HAMP eligibility.

- Servicers must devote significant time, personnel and technology resources to implement every change or even slight modification in HAMP requirements.

- Those initial revisions helped slow the conversion from HAMP trial modifications to permanent modifications and there became a significant "in process" modification segment of loans that were in limbo. For those who were getting a lower payment (often $500 per month) this was a relief versus a final foreclosure action. For others, it may have exacerbated a situation where the failed trial modification led to overdue payments and arrearages that were difficult to make up.

- Confusion and expanded timelines were the result of this early execution of HAMP/HAFA and we still have some of that "in process" pipeline being worked through. As a note, there have been over 20 directives from HAMP and though we see that slowing down in 2011, the early implementation was delayed due to many adjustments of the programs over time.

Average foreclosure timelines in 2008, 2009 and 2010 are as follows (according to data from LPS):

- January 2008 – 300 days
- January 2009 – 350 days
- January 2010 – 450 days
- September 2010 – 500 days

e) ***Treasury: Hardest Hit Funds*** - Treasury has also expanded foreclosure prevention programs by creating a Hardest Hit Fund. The Hardest Hit Fund distributed $7.5 billion dollars to 18 States and the District of Columbia and directed them to set up their own programs to assist unemployed and other at-risk homeowners in the hardest-hit housing markets. When a borrower is unemployed, it is difficult to qualify for a loan modification due to lack of income. State housing finance agencies develop the waterfall for approving borrowers for various means of assistance, including unemployment assistance, principle write down, and combined funds that may compliment a HAMP modification.

This deployment of dollars should be helpful to assist some homeowners in particularly distressed States where there are few other solutions. However, the states, Treasury, counselors and state housing finance agencies must continue to work with industry to achieve some uniformity to ensure servicers can implement the many variations of programs in the different states. To help share information and increase the ability to execute on these programs, HOPE NOW has played a role in convening the stakeholders to discuss implementation issues. As a reminder, loan servicers need uniform standards and guidelines wherever possible for efficient execution. Each time a program is introduced, the more aligned it is with similar programs in various states with uniform automation, the more successful that new program will be.

*f) **Other government involvement, state mediation programs*** - Mediation is a recent development and there are now approximately 26 states that offer some kind of opt-in or opt-out mediation for homeowners. The physical presence of a third party is valuable for this final attempt to bring parties together to prevent a foreclosure. When appropriate mediation is a viable option, however, there is not enough data on mediation programs to make a clear judgment around the best mediation process. For instance, an author for the *Sun Sentinel* newspaper recently reported that Broward County, Florida examined 326 cases via mediation in December 2010 and 17% resulted in written settlements that avoided foreclosure. It is important we study mediation efforts going forward and wisely use our limited funds and human capital to make these most effective nationwide, and maximize assistance to qualified homeowners.

There is a movement among the other 24 states to incorporate mediation as another means to prevent foreclosures. In doing so, we believe certain risk parameters must first be addressed. By nature, mediation hearings delay the foreclosure process. And the intent is to ensure the borrower understands the options available to prevent foreclosure. We know from experience, sometimes borrowers in financial distress do not answer phones, open mail and respond to more formal meeting requests such as State mandated mediation.

Recommendation to encourage uniformity in mediation efforts:
In an attempt to increase productivity and measure outcomes, consideration of the following may be helpful:

- Establish a uniform set of documentation and transfer of required information prior to the mediation.
- Limit on the numbers of meetings required for face to face transactions to a reasonable number.
- Ensure that mediators have proper training and/or knowledge of the mortgage industry, as loan workout solutions are complex,
- Develop definitions, quantitative standards and metrics that measure success.

HOPE NOW stands ready to supports all efforts to bring homeowners into the system to review options to avoid foreclosure. However, we believe that mediation can streamlined with more effective processes so that all parties participating have aligned expectations.

II. Proprietary Solutions/Modifications

The deterioration of the housing market and high unemployment has changed the nature of the loss mitigation effort. We now see much higher numbers of defaulted loans in the prime sector. Negative equity and unemployment have changed the face of foreclosure and the nature of the foreclosure mitigation efforts needed.

The latest 2010 data estimate is as follows:

- 2010 foreclosure starts: 2.6 million foreclosure starts (2 million prime and 600,000 subprime).
- 2010 foreclosure sales: 1.07 million.
- 2010 permanent loan modifications: 1.76 million.
  - 1.24 million proprietary loan modifications
  - 512K permanent HAMP modifications
- December 2009 delinquencies over 60 days past due: 4.1 million
- December 2010 delinquencies over 60 days past due: 2.9 million.

The quality and uniformity of proprietary modifications has improved from earlier years of freezing existing rates or capitalizing arrearage and recasting the loan. According to HOPE NOW's 2010 data estimates:

- 84% of all proprietary modifications, from June 2010 through December 2010, had an initial set rate duration of five years or greater.
- 81% percent of proprietary modifications in 2010 had a lower principal and interest payment.
  - 59% of these modifications, from June 2010 through December 2010, reduced principal and interest payments by 10% or more.
  - 80% of all proprietary modifications, on average, are performing after 6 months seasoning and are less than 90 days past due. This data looks back over an 18 month period.

Considering all retention plans, workout plans, and permanent modifications, HOPE NOW servicers, and the housing industry, have assisted nearly 12.2 million families since July 2007. While some forms of support are short term (due to short term hardships) and others longer term and permanent solutions, the tools used across the industry have had a meaningful impact on foreclosure prevention for millions of families.

Impact of proprietary loan modifications: The proprietary modifications have been a work in progress pre-HAMP and post-HAMP roll out. The face of proprietary modifications has changed due to some standards set by HAMP and the changing nature of the problem with unemployment and significant increase in defaults on prime loans.

If a borrower is qualified and there is more flexibility with the modification terms (such as documentation or DTI adjustments) then the borrower may be moved swiftly into a proprietary modification (in lieu of foreclosure).

As a reminder, proprietary modifications follow only after a loan is ineligible for a HAMP modification.

Proprietary modifications make up the majority of the total loan modification solutions being offered, providing sustainable, affordable and permanent solutions for borrowers seeking to avoid foreclosure. Additionally, there are no government funds or incentives used for proprietary modifications.

Summary and recommendation: Private Capital returning to mortgage markets

The Administration released a series of options on GSE reform which outlined three proposals that described a range of government involvement in housing. Federal regulators and State agencies are also working on various enhanced mortgage standards, including the QRM standard from Dodd Frank which identifies capital requirements for various mortgage products for new originations, securitization and mortgage servicing. All of these proposals provide new templates for investors on how the mortgage market will function moving forward.

During the past three years the mortgage industry and capital markets have faced high levels of volatility and uncertainty. Increasing foreclosures and delinquencies, record levels of homeowners at risk, who need assistance to navigate the myriad of options to avoid foreclosure, and significant Federal and State Government intervention are a few of the biggest risks facing participants. Resources to reach borrowers at risk and help them stay in their home have never been greater or more effective. However, homeowners and investors have paid a significant price. Homeowners and communities have been severely impacted, especially in the hardest hit states. Investors have experienced tremendous losses and risk models did not predict with any confidence the severity of the housing crisis or potential losses to investors.

To create a climate in which investors return to the private markets will require transparency, reliability and market integrity. Investors need confidence in both industry and government in order to participate in a meaningful market recovery. A few issues that are directly related to servicing are as follows:

1) **Standards and uniformity**: Whether it is State or Federal programs, uniformity across the servicing sector will be important to set expectations and reach performance benchmarks. The average time to foreclose on a property is difficult to predict and mortgage rates will be impacted by uncertainty. The more uncertainty, the higher the rates for homeowners. As foreclosure timelines continue to increase, pricing for mortgages will increase.

   Per LPS data, average foreclosure timelines in 2008, 2009 and 2010:

   - January 2008 – 300 days

- January 2009 – 350 days
- January 2010 – 450 days
- September 2010 – 500 days

One example of "uniform standards" that would benefit the homeowner, the market and participants is to have mediation standards that have a common set of expectations for all parties. This will have an impact on shortening timelines if expectations are identified early but hopefully improve outcomes for borrowers who have an additional option to stay in their home and avoid foreclosure. Use of an automated system to share required information among multiple parties is an example of a more efficient and timely way to communicate prior to the mediation meeting.

2) **Representations and Warranties**: Identifications of key roles and responsibilities for servicers, investors and homeowners remains an important distinction. Terms of contracts must be enforceable. Accountability and transparency will follow better contracts which provide needed clarity. Vague contracts, such as some private label securitization agreements lead to interpretations that may differ among parties.

3) **Duration, prepayment risk**: Some mortgages are bought out of pools after 90 or 120 days past due. Others are left in a pool for two years until they are foreclosed upon, leaving vastly different options for investors. Some require advances all the way through, others do not. The volatility of resulting investor cash flow projections are priced into loan rates. Certainty and uniformity help improve pricing options for mortgages.

4) **Credit risk:** Clearly, the return of private capital will require better clarity and data on borrower credit risk -- including risk layering of mortgages. The cost of servicing is directly related to higher default and foreclosure risk (higher touch and feel application). The price of loss mitigation needs to be assessed to ensure proper fee structures are imbedded in contracts to appropriately pay for the costs of increased servicing.

5) **Federal / State Regulatory, Legislative risk and Enforcement risk:** External risks such as enhanced regulation or new legislation should be taken into account. While this has always been the case, the stepped up involvement including activity by 50 state Attorney's General, banking regulators, the Federal Reserve, and others, will be important an important component to pricing the risk of lending and servicing in the marketplace.

6) **Servicing performance/model:** Capacity issues have plagued the performance of servicers, large and small, across the market. Capacity is severely impacted by high volume consumer inquiries for assistance from overlapping programs. Rolling out new programs without similar uniform processes (Federal and State Governments, GSE investors) adds friction to the system. Appropriately, some of the government programs have been used to increase consumer protection by providing more options to avoid foreclosures. That said, efforts should be made to ensure strong coordination and program alignment. Simplicity where possible should replace complex procedures and processes for homeowners and servicers with clear protections in place to preserve consumer protection for homeowners.

7) **Government guarantee:** Investors will differentiate on loans guaranteed by the government versus those of private industry. It is important for the government to act, when possible, with one voice and more uniform processes, for loss mitigation to assist with improved execution.

Addendum:

Data Snapshot:

"Year to Date" Snapshot

Industry Extrapolations and HAMP Metrics (January 2010 - December 2010)

	Q1-2010	Q2-2010	Q3-2010	Q4-2010	Oct-2010	Nov-2010	Dec-10	Year to Date Total or Average
Total Completed Modifications	469,381	499,103	444,787	342,384	124,600	112,022	105,763	**1,755,656**
HAMP Permanent Modifications[1]	163,863	167,220	97,877	83,752	23,750	29,972	30,030	**512,712**
Proprietary Modifications Completed[2]	305,518	331,883	346,910	258,632	100,850	82,050	75,733	**1,242,944**

Proprietary Modifications Completed

Reduced P&I Modifications	234,796	262,958	294,190	215,339	84,692	68,761	61,886	**1,007,283**
% of Proprietary Modifications	77%	79%	85%	83%	84%	84%	82%	**81%**
Fixed Rate Modifications[3] (initial fixed period of 5 years or more)	N/A	N/A	284,815	234,676	90,785	73,722	70,169	**609,057**
% of Proprietary Modifications	N/A	N/A	82%	91%	90%	90%	93%	**84%**
Reduced P&I Modifications[3] (10% or greater)	N/A	N/A	185,015	176,002	70,581	56,287	49,134	**426,371**
% of Proprietary Modifications	N/A	N/A	53%	68%	70%	69%	65%	**59%**

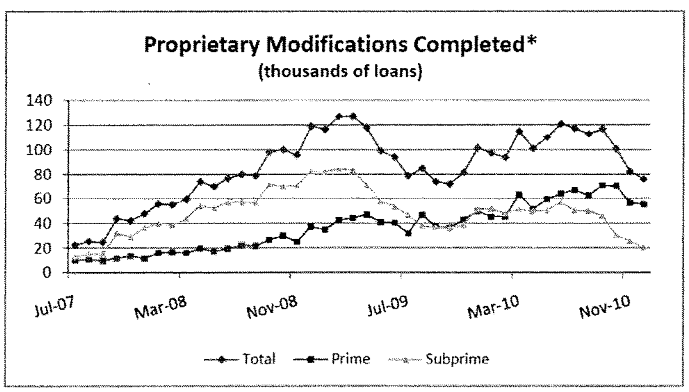
Foreclosure Starts	684,874	566,012	709,119	658,401	205,125	221,095	232,181	**2,618,406**
Foreclosure Sales	288,526	286,712	313,949	180,680	69,197	55,137	56,346	**1,069,867**
60+ Days Delinquency[4]	3,944,479	3,605,377	3,202,259	3,028,199	3,130,875	3,079,238	2,874,485	**3,445,079**

[1]Source - Making Home Affordable. Estimated.

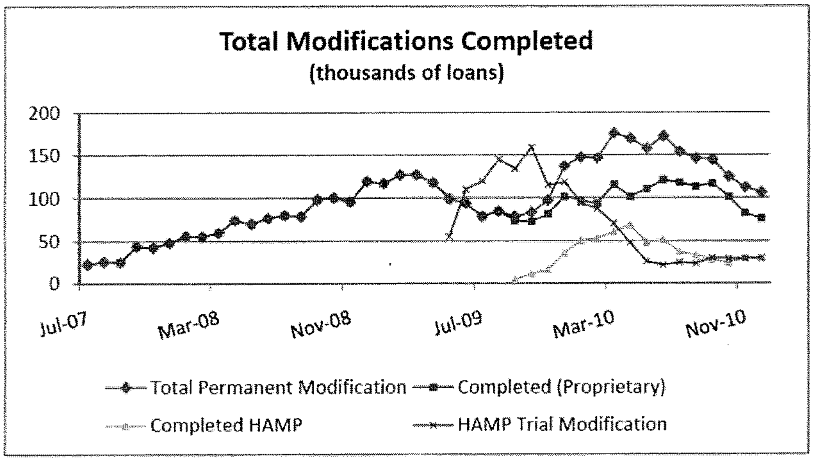
[2]Extrapolated. Modifications Completed was revised in December 2009 to include Current Modifications and specifically exclude HAMP.

[3]Year to Date Total for this field begins in June 2010.

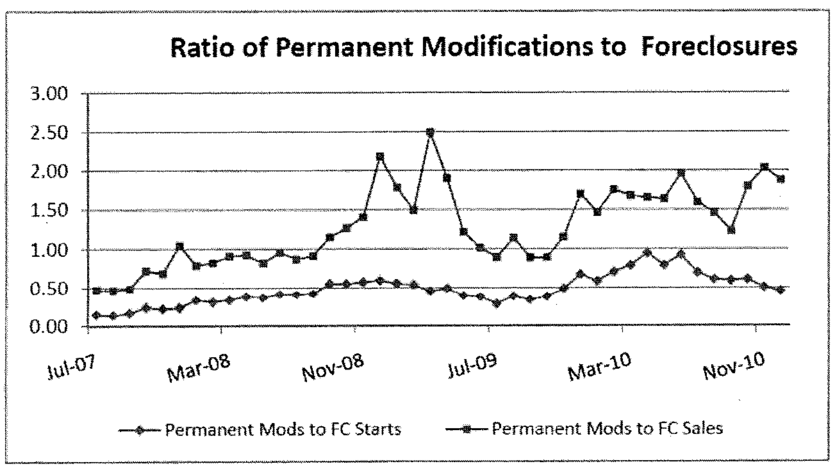
[4]Monthly average.

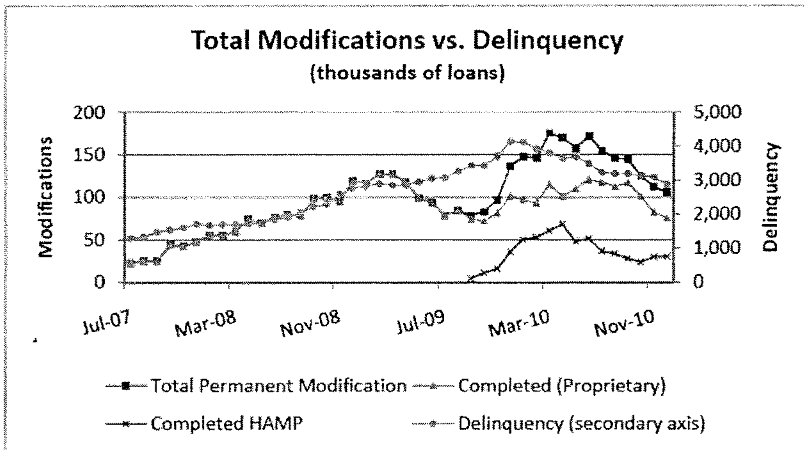


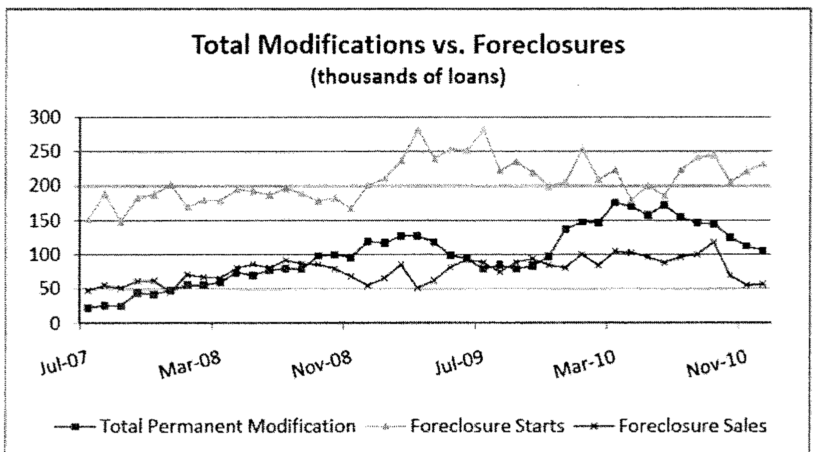
*Non-HAMP



Source: Making Home Affordable and HOPE NOW
Total Permanent Modifications is the sum of Completed HAMP and Completed (Proprietary). HOPE NOW has collected data on Completed (Proprietary) Modifications since 2007. Data for HAMP Trial Modifications began in May 2009 while data for Completed HAMP loans began in September 2009.







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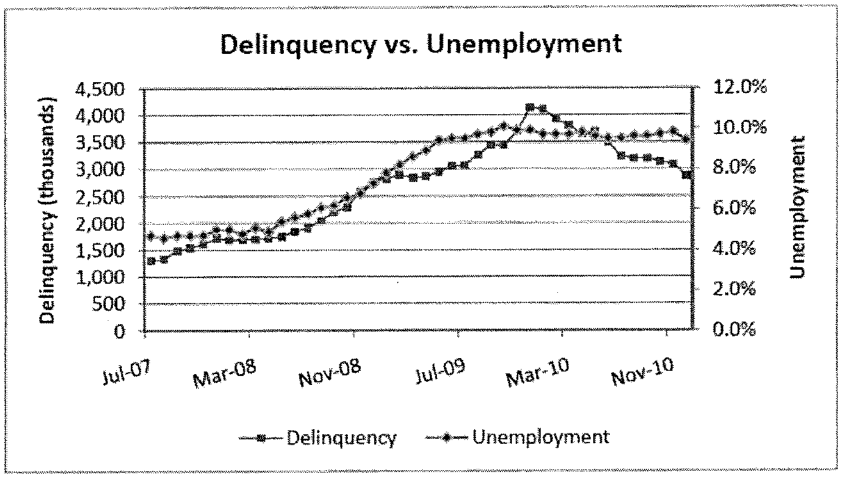
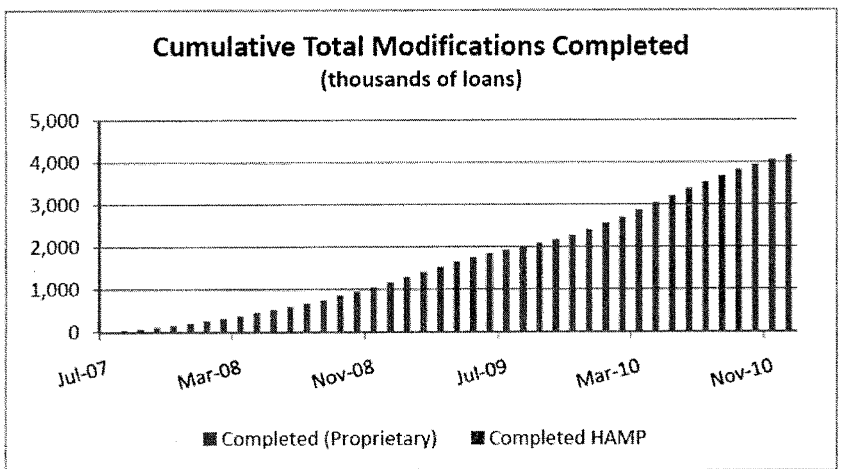


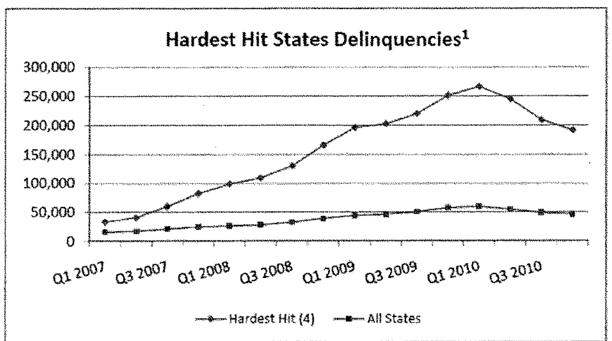


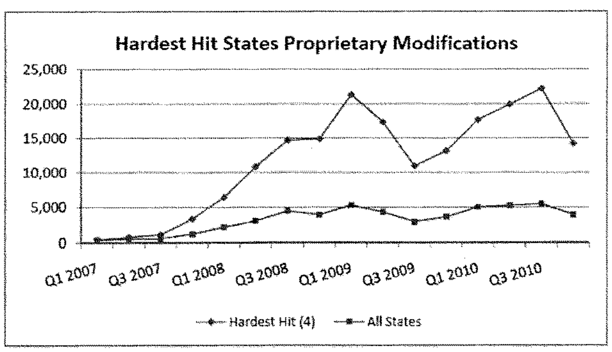
Source: Making Home Affordable and HOPE NOW
HOPE NOW has collected data on Completed (Proprietary) Modifications since 2007. Data for Completed HAMP loans began in September 2009.

	2007	2008	2009	2010
Delinquency				
Hardest Hit (4)	54,128	126,104	217,343	228,048
All States	19,753	31,597	49,618	52,443
Foreclosure Starts				
Hardest Hit (4)	81,661	182,087	220,734	172,923
All States	23,160	35,170	43,359	38,941
Foreclosure Sales				
Hardest Hit (4)	23,692	78,458	81,610	83,298
All States	8,464	14,800	14,670	15,930
Modifications				
Hardest Hit (4)	5,640	46,810	62,687	73,986
All States	2,668	13,651	16,193	19,705

[1]Delinquency data is shown as a monthly average.
Hardest Hit States: California, Florida, Nevada, Arizona
State Data is not extrapolated.

Source: HOPE NOW





Source: HOPE NOW --- Hardest Hit States: California, Florida, Nevada, Arizona

HOPE NOW is the industry-created alliance of mortgage servicers, investors, counselors, and other mortgage market participants, brought together by the Financial Services Roundtable, Housing Policy Council and Mortgage Bankers Association, that has developed and is implementing a coordinated plan to help as many homeowners as possible prevent foreclosure and stay in their homes. For more information go to www.HopeNow.com or call the free Homeowner's HOPE™ Hotline at (888) 995-HOPE™.

The following companies are members of the HOPE NOW Alliance:

Counselors
Affordable Housing Centers of America
Catholic Charities USA ®
Citizens' Housing and Planning Association, Inc.
Consumer Credit Counseling Service of Atlanta ™
HomeFree - USA ©
Homeownership Preservation Foundation ™
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Bank of America
Bayview Financial
Carrington Mortgage Services, LLC
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First Horizon Home Loans and First Tennessee Home Loans
GMAC Mortgage
HSBC Finance-Beneficial
HSBC Finance-HFC
HSBC Mortgage Corporation
HSBC Mortgage Services
IBM Lender Business Process Services
JP Morgan Chase
Litton Loan Servicing
LoanCare Servicing Center
MetLife Home Loans
NationPoint
Nationstar Mortgage, LLC
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OneWest Bank
PMI Mortgage Insurance Co.
PNC Mortgage
Quicken Loans
Residential Credit Solutions
RoundPoint Mortgage Servicing Corporation
Saxon Mortgage Services / Morgan Stanley
Select Portfolio Servicing, Inc.
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SunTrust Mortgage, Inc.
Vericrest Financial Inc.
Wells Fargo and Company

Trade Associations
American Bankers Association
Mortgage Bankers Association ® (MBA)
The Financial Services Roundtable ®
The Housing Policy Council
Investors
Fannie Mae
Freddie Mac
Mortgage Insurance Companies
Genworth Mortgage Insurance Corporation
Radian Guaranty, Inc.
PMI Mortgage Insurance Co.
State Farm Insurance

Mortgage Market Participants
MERS

HOPENOW Support & Guidance For Homeowners

What is HOPE NOW?

HOPE NOW is an alliance of counselors, mortgage lenders/servicers, investors, and other mortgage market participants to prevent foreclosures through outreach to delinquent borrowers, counseling, and loan workouts based on the borrower's ability to repay. The goal is to prevent foreclosures by connecting troubled borrowers with counselors and/or their mortgage servicer

- **Reaching Homeowners in Need:**
  - Homeownership Forums: HOPE NOW is conducting a multi-state tour of homeownership workshop where homeowners have the opportunity to talk to their lender and/or a HUD certified housing counselor about their mortgage. In 2009, HOPE NOW held thirty-one events across the country, reaching over 31,000 homeowners, providing piece of mind and a roadmap to mortgage relief. HOPE NOW conducted 44 outreach events in 2010, reaching nearly 30,000 borrowers.
  - Web Based Resources: The HOPE NOW website can be a valuable resource for homeowners looking to avoid foreclosure. Information on government resources ranging from modification programs to unemployment benefits can be found, along with a comprehensive list of all HUD approved non-profit counseling agencies by state. Also, homeowners can take a Home Affordable self-assessment which will give them a clearer idea of whether or not they would qualify for the Making Home Affordable Program.
  - Web Help for Homeowners and Counselors: Partnership with HOPE LoanPort, a separate non-profit entity that has created a web-based portal for streamlined submission of loan modification applications and faster decision making by mortgage servicers. Currently, twelve major mortgage servicers, along with 1,700 housing counselors from 428 organizations across the country, are using HOPE LoanPort. The total cases submitted to participating servicers in 2010 were more than 6,000.

- **Counseling Homeowners in Need:**
  - 888-995-HOPE: Free counseling for homeowners is available at the Homeownership Preservation Foundation's Homeowner's HOPE™ Hotline, 888-995-HOPE. When a homeowner calls the Hotline, they are connected to one of 450 counselors from one of ten non-profit counseling agencies who are all HUD-approved who receives, assesses, counsels, refers, and connects the borrower to their servicer. In 2010 the Hotline received more than 1 million calls from distressed homeowners.
  - In-person counseling: NeighborWorks® America and other HUD-approved agencies provide face-to-face counseling to borrowers in need. As the outreach efforts are promoted, local groups are encouraged to attend and play a major role in the triage of distressed families. Local servicers are a welcomed relief and help families understand what systems are free and readily accessible.
  - Free Counseling: All HUD-approved counseling is free for homeowners and HOPE NOW urges borrowers to seek assistance from qualified experts. There are unscrupulous parties who entice homeowners to pay for foreclosure prevention help.

- **Survey Data Reporting:**
  - Since July 2007, more than 4.16 million homeowners have saved their homes via permanent loan modifications. This included both proprietary loan modifications and all permanent modifications completed under the Home Affordable Modification Program (HAMP). In 2010 servicers completed 1.76 million permanent loan modifications.
  - Information for Policy Makers: Testimony provided for Congress, on several occasions, regarding the unprecedented collaborative efforts of the mortgage industry, government and non-profit community to preserve homeownership in the United States.

HOPE LoanPort™, powered by RxOffice ® and developed by the HOPE NOW Alliance, is a new web-based tool that streamlines loan modification applications on behalf of homeowners at-risk of foreclosure, allowing housing counselors to efficiently transmit completed applications to mortgage companies. HOPE LoanPort™ is designed to improve the quality of both the application by gathering the required information and documentation and transmitting it to partner mortgage servicers application.

HOPE LoanPort

How does an at-risk homeowner use HOPE LoanPort™?

- Contacts a participating US Department of Housing & Urban Development (HUD) approved non-profit counselor(s) in the HOPE LoanPort™ network.
- Counselor gathers all information and documentation from homeowner and completes application through HOPE LoanPort™.
- Complete application is sent electronically to the homeowner's mortgage servicer. Documents and information cannot be lost.
- Applications are updated with current status every 10 business days through HOPE LoanPort™ by all partners.

What are the benefits of HOPE LoanPort™?

- Secure electronic submission of completed modification applications.
- Standardization of required application data elements and supporting documents.
- Electronic verification that the mortgage servicer has received the fully completed modification package.
- Messaging of application statuses between counselor and mortgage servicer.
- Migration away from faxes, redundant telephone calls, and lost documents.
- Integrates seamlessly with counselor and servicing systems.

Who is using HOPE LoanPort™?

- Open to HUD-Approved housing counseling agencies and National Foreclosure Mitigation Counseling Program (NFMC) recipients.
- Approximately 500 counseling organizations, 2,100 counselors in 46 states and the District of Columbia, as well as Puerto Rico are active on HOPE Loan Port™.
- Thirteen (13) mortgage servicers are currently using HOPE LoanPort™: American Home Mortgage Servicing, Inc., Bank of America, Bayview Loan Servicing, JP Morgan Chase, Citi Mortgage, GMAC, Met Life® Home Loans, Ocwen Loan Servicing, OneWest Bank, PNC Mortgage, Saxon Mortgage Services, SunTrust Mortgage, Inc. and Wells Fargo Home Mortgage.
- Supported by state housing finance agencies in four states: Arizona, Nevada, Ohio & Maryland, as well the North Carolina Department of Banking.

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Written Testimony of David H. Stevens
Assistant Secretary of Housing – Federal Housing Administration Commissioner
U.S. Department of Housing and Urban Development

"Are There Government Barriers to the Housing Market Recovery?"

Hearing before the House Financial Services Committee's Subcommittee on Insurance, Housing, and Community Opportunity
Wednesday, February 16, 2011

Chairwoman Biggert, Ranking Member Gutierrez, and Members of the Subcommittee, thank you for the opportunity to testify today on behalf of the Obama Administration's efforts to encourage the return of private capital to the housing market, particularly as that effort relates to the Federal Housing Administration. We are committed to ensuring that government will continue to facilitate, and not be a barrier to, recovery of the housing market.

Today, I want to discuss three major elements that inform and underpin those efforts: the current state of the housing market and FHA's role in it, the reforms we've already put in place to protect the taxpayer and facilitate the return of a robust private mortgage market, and the role that this Administration envisions going forward for a reformed and strengthened FHA within a 21st century housing finance system.

Administration Efforts to Stabilize the Housing Market

Madam Chairwoman, this Administration quickly took several steps to confront the economic crisis as soon as taking office two years ago, including steps to stabilize a housing market that was declining rapidly with seemingly no bottom.

House prices were in freefall -- having fallen every month for 30 straight months before President Obama took office. Home equity had been slashed in half—losing $6 trillion total—which wiped out wealth for many families. And we were losing an average of 753,000 jobs a month and were in the middle of 22 straight months of job losses.

With the market collapsing and private capital in retreat, the Administration had no choice but to take action.

Federal Reserve and Treasury Department mortgage-backed securities purchase programs helped keep mortgage interest rates at record lows. To ensure mortgages were available at those low rates, the Administration also provided critical support for Fannie Mae and Freddie Mac, while the FHA and Ginnie Mae stepped in to play a larger role in the home purchase market and enabled a robust refinancing market to emerge. As reported in the Obama Administration's January Housing Scorecard[1], since April 2009, nearly 13 million homeowners have been able to refinance their mortgages to benefit from lower interest rates, saving them an average of $140 per month or $17.6 billion annually.

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[1] The Obama Administration Housing Scorecard is posted monthly at http://portal.hud.gov/hudportal/HUD?src=/initiatives/Housing_Scorecard

And collectively, the FHA's loss mitigation policies and the Administration's Home Affordable Modification Program (HAMP) set an example for mortgage modification efforts that the private market took too long to adopt but has finally begun to incorporate into their servicing practices. More than 4.1 million distressed borrowers have received mortgage assistance since April 2009—including HAMP modifications, FHA loss mitigation activities, and voluntary private efforts as part of the HOPE NOW alliance—more than twice the number of foreclosures completed during that time. Monthly foreclosure starts are down more than 30,000 per month from this same time one year ago. While the sharp decline may be partially attributed to servicer process reviews in light of foreclosure processing deficiencies (which I will address later in this testimony), and this number may trend upwards as servicers revise and resubmit foreclosure paperwork in coming months, we are seeing encouraging signs that fewer families are entering delinquency in the first place. Our combined efforts to take action in the housing market have stopped the 30-month slide in home prices. And most importantly, the Administration's broader economic policies have produced 13 straight months of job growth in the private sector.

The Importance of a Robust and Responsible Private Mortgage Market

A critical component to further recovery of the broader economy, and to reducing the financial risk to taxpayers, includes this Administration's affirmative steps to facilitate the return of private capital to the housing finance system in a responsible way.

One such step includes reforming FHA's mortgage insurance premium structure to levels that are more reflective of market pricing and will rebuild FHA's capital reserves, which I will discuss later in my testimony. I would like to take this opportunity to thank Congress for enabling this reform through bipartisan passage of H.R. 5981 in the 111th Congress. FHA immediately took steps to implement reform after President Obama signed this bill on August 11, 2010. FHA lowered its upfront mortgage insurance premium once while increasing its annual mortgage insurance premium on three occasions, including the most recent change announced on February 14th. With this reformed revenue structure and improved risk mitigation efforts, FHA is projected to generate approximately $9.8 billion in receipts for the U.S. Treasury in FY 2011, a significant increase compared to the $565 million of receipts generated in FY 2009, prior to the reforms implemented by this Administration. While materially strengthening our balance sheet, we have ensured that FHA-insured loans remain affordable for first-time and lower-income homebuyers – for example, the annual premium increase announced on February 14th will translate to average increased housing costs of only $30 more per month from newly insured loans – and the monthly fee on existing FHA-insured homeowners remains unchanged. This increased revenue will enable FHA to further strengthen its capital reserves at a robust pace while continuing to responsibly insure new home purchases and refinances that contribute to stabilizing the housing market. Additionally, these changes have already begun to create market conditions that facilitate greater competition in the private mortgage market and the return of private capital to the housing sector. But we want to make sure that the health of the capital markets is not restored on the backs of low and moderate income families, so we will be looking for reforms that balance the impacts to these borrowers as we consider further FHA reforms.

The return of private capital is particularly important given that today, Fannie Mae, Freddie Mac, FHA and Ginnie Mae collectively insure or guarantee more than nine out of every ten new mortgages.

FHA's current share of the housing market

During the height of the boom of private involvement in the housing market in 2006, FHA-insured mortgages constituted less than 4 percent of the number of new home purchases. This was a significant decrease from FHA's historically traditional share of approximately 10-15 percent and an indication that the private sector was aggressively extending credit. All too painfully, we learned that was this extension was often irresponsible. As poorly underwritten subprime loans and other products that were securitized into private label securities (PLS) began to default at an alarming rate, their defaults led to losses throughout the private market and private capital vanished from the housing sector at an unprecedented pace – in 2006, more than $1 *trillion* of mortgages were securitized into PLS; in 2008, that figure was less than $60 *billion*[2].

FHA's temporarily elevated market share of more than one-third of new home purchases is the result of our efforts to fulfill our mission to be a countercyclical facilitator of responsible capital liquidity in the housing sector at times in which the fully private sector exits the market abruptly. I would like to remind the Committee that FHA does not lend directly to homeowners, but instead insures lenders against losses that may result in the event of a borrower default, under the condition that lenders are required to abide by extensive documentation and underwriting guidelines to originate sustainable mortgages, and they are required to provide numerous loss mitigation opportunities to help borrowers avoid default or foreclosure. By facilitating the availability of this vital liquidity through a variety of approved community banks, credit unions, and national lenders, FHA has helped over 2 million families buy a home since President Obama took office – 80 percent of whom were first-time buyers. FHA has also helped nearly 1.5 million existing homeowners refinance into stable, affordable products, with monthly savings exceeding $100 in most cases.

FHA's countercyclical role in the multifamily (apartment) market is equally important. In 2008, FHA supported the development of about 49,000 rental homes. Now, however, conditions are very different, reflecting the sharp decline in fully private financing and most notably commercial mortgage-backed securities. In 2010 alone, FHA supported the development or refinancing of more than 150,000 rental units with a total dollar volume of nearly $11 billion – almost four times the level of two years earlier, and now almost 25 percent of the multifamily market. And I'd like to thank Congress for passing legislation last summer – H.R. 5872, the General and Special Risk Insurance Funds Availability Act of 2010 – to increase FHA's commitment authority for our multifamily and healthcare facilities insurance programs, a key step that helped make this increased support possible to help facilitate the production and refinancing of multifamily properties that are critical for a more balanced housing sector. In response to this unprecedented demand, as in our single-family programs, FHA simultaneously implemented the most significant reforms to FHA's multifamily programs to strengthen underwriting guidelines and minimize financial risk to taxpayers while providing this critical support.

Towards a New System of Housing Finance

Ultimately, however, we do not want FHA to have such a substantial share of the market – and we are very aware of the risks this elevated role poses. While the FHA's countercyclical role has

[2] Source: Inside Mortgage Finance, HMDA, and Mortgage Bankers Association

been essential to providing liquidity to the housing market to prevent further disruptions in the broader economy, the Obama Administration believes that meeting the diverse housing homeownership and rental needs of the country requires a strong, safe, and healthy market for private capital.

FHA Reforms to Date

That is one reason the FHA has already taken significant steps to facilitate the return of private capital, making the most sweeping combination of reforms to credit policy, risk management, lender enforcement, and consumer protection in FHA history. These reforms have strengthened our financial condition and minimized risk to taxpayers, while allowing us to continue fulfilling our mission of providing responsible access to homeownership for first-time homebuyers and in underserved markets.

In addition to the reformed mortgage insurance structure that I described earlier, FHA implemented a "two-step" credit score policy for FHA purchase borrowers. Purchase borrowers with credit scores below 580 are now required to contribute a minimum down payment of 10 percent. Only those with stronger credit scores are eligible for FHA-insured mortgages with the minimum 3.5 percent down payment.

The goal of these reforms is to balance the need to provide access to our mortgage markets with the need to protect taxpayers from financial risk. That's also why in October of 2009, we hired the first Chief Risk Officer in the organization's 75 year history -- and last July, we received Congressional approval to formally establish this position and create a permanent risk management office within FHA, for which the Risk Officer is now Deputy Assistant Secretary. With this new office and additional staffing, we're expanding FHA's capacity to assess financial and operational risk, perform more sophisticated data analysis, and respond to market developments.

Further, we've strengthened credit and risk controls – toughening requirements on our Streamlined Refinance program, making several improvements to the appraisal process and to condominium policies, and implementing the two-step credit score policy discussed above. We are very grateful for the support that Congress has provided with our efforts to reduce fraud and risk. Through the $20 million Combating Mortgage Fraud funds that Congress granted HUD in FY2010, we have already begun to implement several risk management and systems modernization reforms to incorporate modern risk and fraud tools and counterparty data consolidation.

Additionally, FHA introduced policy changes and improved lender oversight and enforcement to increase the quality of FHA insured loans. In April 2010, we published Final Rule (FR5356-F-02) "Federal Housing Administration: Continuation of FHA Reform – Strengthening Risk Management Through Responsible FHA-Approved Lenders." This rule eliminated FHA approval for loan correspondents and increased net worth requirements for lenders, thereby strengthening FHA's counterparty risk management capabilities.

The Need for FHA Reform Legislation

Of course, the job is far from over. As important as the new premium authority established by Congress is, Secretary Donovan and I remain committed to comprehensive FHA reform legislation that enhances FHA's lender enforcement capabilities and risk management efforts critical to our ability to monitor lender performance and ensure compliance. And we hope Congress will pass comprehensive FHA legislation as quickly as possible.

Indeed, last year the House of Representatives passed an FHA reform bill, H.R. 5072, and shortly after a Senate companion, S. 3704, was introduced. In addition to provisions strengthening FHA's lender enforcement ability, the bill also includes technical clarifications that will allow for third party loan originators to close FHA insured loans in their name. This third party originator provision is particularly important to ensuring that several hundred community banks are able to continue originating FHA loans.

Additionally, HUD is seeking Congressional authority to extend FHA's ability to hold all lenders to the same standard and permit FHA to recoup losses through required indemnification for loans that were improperly originated and for which the error may have impacted the original loan decision, or in which fraud or misrepresentation were involved.

We also hope to work with Congress to give FHA additional flexibility to respond to stress in the housing market and to manage its risk more effectively. This will mean giving FHA flexibility to adjust fees and programmatic parameters more nimbly than it can today. FHA should also have the technology and talent needed to run a world-class financial institution.

Results from FHA Reforms to Date

As you know from the Secretary's Annual Report to Congress on the Financial Status of the FHA Mutual Mortgage Insurance (MMI) Fund at the end of FY 2009, the secondary reserves held in FHA's Capital Reserve Account to support single-family loan guarantees had fallen below the required two percent level by the end of FY09 – to 0.53 percent of the total insurance-in-force. Combined with reserves held in the Financing Account, the MMI Fund held more than $31 billion. These combined funds are set aside specifically to cover losses over the next 30 years and, while they have been sufficient to avoid the need for taxpayer assistance, they were lower than required by Congress and, frankly, below what is considered to be acceptable by this recently confirmed management team. Even prior to the release of the actuarial review, we took several steps to strengthen the Fund, as I have described earlier in this testimony as well as at several previous hearings before this Committee.

Just more than a year later, I am pleased to inform you that tangible, measureable progress has been accomplished and continues to be underway to improve the financial condition of the Fund, hold lenders more accountable, and reduce risk to taxpayers.

Summary of FY 2010 Actuarial Review[3]

Total capital resources (combined Capital Reserve Account and Financing Account) in FY 2010 increased by $1.5 billion to $33.3 billion. While the overall capital ratio held steady at 0.5% reflecting that more conservative economic forecasts and model changes offset the benefits of improved borrower credit profiles and increased premium income. On a standalone basis, had capital resources not been shifted from the forward loan accounts to HECM accounts to cover

[3] HUD's Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund FY 2010 can be found at http://www.hud.gov/offices/hsg/rmra/oe/rpts/actr/2010actr_subltr.pdf

HECM budget reestimates, the capital ratio of single-family forward loans (96% of the portfolio) would have increased from 0.42% in FY 2009 to 0.79% in FY 2010, demonstrating significant improvement in loan quality and underlying reserves. Without any additional policy actions, and incorporating the more conservative economic forecasts, the capital ratio for the entire MMI Fund was projected by the independent actuaries to be 1.99% in 2014 and then exceed the 2% statutory requirement in 2015. Furthermore, we have implemented a wide range of additional policy actions that are expected to strengthen the Fund even more quickly than forecasted.

- The quality of loans made in 2009 and 2010—the years FHA has done the most significant volume—is much improved. FY 2010 is the highest quality FHA book-of-business on record.

- Credit score distribution continues to be significantly improved. The average credit score on current insurance endorsements has risen to nearly 700. And for the second straight quarter, average credit scores are equal across refinance and purchase books of business.

- Loan performance, as measured by early period delinquency and seasonally adjusted serious delinquency rates, continues to show significant improvement. FHA's seasonally adjusted 90+ day delinquency rate in December 2010 was 5.8% compared to 7.45% in December 2009. Furthermore, FHA loans continue to perform significantly better than all product types except fixed prime loans. According to the Mortgage Bankers Association's Q3 2010 National Delinquency Survey, FHA's 90+ day delinquency rate was 5.03%, compared to 2.22% for prime fixed, 7.72% for prime ARMs, 11.46% for fixed-rate subprime, and 18.39% for subprime ARMs.

It is clear that FHA is in a stronger position today than we were the year before. While we are not yet completely out of the woods—and while loans insured before 2009 are responsible for 70 percent of the single family loan losses we continue to expect—based on the evidence we're seeing, FHA is weathering the economic storm. And we're doing so, Madam Chairwoman, while simultaneously reducing financial risk to taxpayers and helping to create a firm foundation for the recovery of the housing finance system. Perhaps no element is more crucial to that system's recovery than facilitating a more responsible return of private capital – and FHA is already taking significant action to help capital return to the market.

Paving the Way for a Robust and Responsible Private Mortgage Market

However, these steps are only the beginning to ensuring the return of a robust and more responsible private mortgage market. That is one reason why the Administration is working to produce a more balanced, comprehensive national housing policy that supports homeownership and rental housing alike, providing people with the options they need to make good choices for their families.

Toward that end, Madam Chairwoman, the Obama Administration delivered a report to Congress last week, *Reforming America's Housing Finance Market*[4], which provides a path forward for reforming our nation's housing finance system. I'd like to outline briefly the changes and

[4] Report can be found at http://portal.hud.gov/hudportal/documents/huddoc?id=housingfinmarketreform.pdf

options this report suggests for consideration by Congress and stakeholders, including consumers and industry participants.

Long-Term Options for the Housing Finance System

Given this hearing's focus on facilitating the return of private capital to the market in the near term, a detailed discussion of the structure of a reformed housing finance system in the years and decades to come is beyond the appropriate scope of my testimony. My colleagues at this table and the Administration as a whole remain committed to continued dialogue with this committee, all Members of Congress and housing stakeholders as we take the steps necessary to restructure the U.S. housing finance system. I will however outline the three options presented by the Administration for consideration as we work towards this goal. The purpose of the options is to be sensitive to the critical importance that housing plays in America and the need to be thoughtful and deliberative in order to allow all to participate as we move forward.

One common thread in each of these options is the FHA – which this Administration believes must be part of the solution when it comes to facilitating the return of private capital and a more balanced national housing policy.

The first option would limit the government's role in insuring or guaranteeing mortgages to FHA and other programs targeted to creditworthy lower- and moderate-income borrowers, leaving the vast majority of the mortgage market to the private sector. The second option would complement the FHA's role with a backstop mechanism designed to help ensure access to credit during a housing crisis. And the third option would include, alongside the FHA, limited government reinsurance for the securities of a targeted range of mortgages that would be designed to increase liquidity and access and respond to future crises.

Whatever path we choose, one thing that is clear is that abruptly and prematurely withdrawing today's levels of support for housing finance would be irresponsible – and could threaten access to credit for American families looking to buy a home or refinance their mortgage. It could cause home prices to decline substantially, reducing the value of what is often the largest asset that most families will ever own. And it could do severe damage to the housing market, which remains one of the largest sectors of our economy.

Steps to Shrink Government's Oversized Footprint in Housing Finance

I'll begin by describing ways the Administration is proposing to shrink government's oversized footprint in housing finance through the FHA.

Returning FHA to its traditional role as targeted lender of affordable mortgages.

We want to return FHA to its traditional role as a targeted lender of affordable mortgages. Indeed, before the crisis, the FHA was largely a targeted provider of mortgage credit access for underserved low- and moderate-income Americans and first-time homeowners – and the Administration proposes to return the FHA to its pre-crisis role. As Fannie Mae and Freddie Mac's market presence shrinks, the Administration will coordinate similar reforms at FHA to ensure that the private market–not FHA—picks up that new market share.

To accomplish this objective, we recommend decreasing the maximum loan size that can qualify for FHA insurance – first by allowing the present increase in those limits to expire as scheduled on October 1, 2011, and revert to the limits established under HERA.

As we work with the Federal Housing Finance Agency (FHFA) to pursue increased pricing for guarantees at Fannie Mae and Freddie Mac, we will also increase the price of FHA mortgage insurance. We have already acted on this front, raising premiums three times since the beginning of this Administration, including the 25 bps increase in the annual mortgage insurance premium that was announced on February 14, 2011 as part of the President's FY 2012 Budget and that I discussed earlier in my testimony. This will continue the ongoing effort to strengthen the capital reserves of FHA, and put it in a better position to gradually shrink its market share. Going forward we will coordinate reforms of Fannie Mae and Freddie Mac with changes at FHA to help ensure the private market, not FHA, fills the market opportunities created by reform.

Additional Near-Term Steps to Encourage the Return of Responsible Private Capital

In the housing finance reform white paper, the Administration also details several near-term steps that we have begun to take and will accelerate to encourage the return of responsible private capital to the housing sector.

The first step is to withdraw the government's support for the housing market gradually and in a manner that encourages the "crowding-in" of private capital accompanied with strengthened capital standards, consumer protections, and reduced risk to the financial system. We will shrink the government's oversized footprint in housing finance and help bring back private capital to the mortgage market. Central to this effort is winding down Fannie Mae and Freddie Mac at a deliberate pace that doesn't pose further risk to taxpayers, jeopardize recovery in the housing market, or constrain families' access to mortgage credit. But Madam Chairwoman, make no mistake – this Administration believes that the current level of government support for housing finance is unsustainable and unacceptable for the permanent state of this market because it exposes taxpayers to far too much risk.

Secondly, we will pursue housing finance reforms with care so as not to harm our economic recovery, but we will do so in a fair and equitable way so that all Americans have access to a choice of affordable housing. The Obama Administration believes we have an imperative to fundamentally reform our nation's broken housing finance market. But we also have a responsibility to the American people to make sure that, as we move forward with our reform efforts, we do no harm to the housing market or our nation's economy.

Third, we will fix fundamental flaws that occurred at every link in the housing finance chain, which were deeply scarring to homeowners and eroded private investor confidence in the entire system, which directly led to the need for the government to take unprecedented action to prevent further losses for all taxpayers. These flaws allowed too much risk to build up in the market. And the resulting damage inflicted severe harm on homeowners, lenders, investors, and our nation's broader economy. That blow to confidence is an important reason why the housing market remains fragile and will take time to fully heal.

We have a responsibility to continue our work fixing the fundamental flaws in the mortgage market to help restore confidence among homeowners, lenders, and investors. That process is already underway as we continue to fundamentally transform the mortgage market through the Dodd-Frank Wall Street Reform and Consumer Protection Act, including through HUD's role as a member of the interagency group working to define the types of loans deemed Qualified Residential Mortgages. But we need to build on that progress and make additional reforms to strengthen underwriting and capital standards, help fix our broken servicing and foreclosure processes, and make sure consumers have the information they need to make the choices that are best for them when buying a mortgage.

This crisis has also taught us that appropriate consumer protection requires immediate action to institute long overdue reforms to mortgage servicing compensation structures, servicing standards, and foreclosure processing procedures.

HUD is working with the FHFA to explore alternative servicing compensation structures to align industry incentives and better protect homeowners. A compensation structure that corrects for the current structure's shortcomings could help ensure servicers are appropriately incentivized to invest the time and effort to work with troubled borrowers to avoid default or foreclosure. HUD is also working with other federal agencies and regulators to fully investigate the issues that recent foreclosure revelations have raised, including working with the Financial Fraud Enforcement Task Force, the Office of the Comptroller of the Currency, the Federal Housing Finance Agency, and the Federal Reserve Bank.

In May, FHA launched an in-depth review of several of its largest servicers, looking in particular at whether their foreclosure prevention efforts fully comply with the FHA's rules and regulations. FHA is ensuring these servicers address the issues of concern identified through its reviews. This includes extensive consultation with servicers' senior management and assigned work groups; customized training and planning assistance; ongoing evaluations of servicers' progress in correcting deficiencies and improving compliance; and potential, fines, penalties, and claim reimbursements imposed by FHA on servicers.

Fourth, Madam Chairwoman, we will seek to find common ground on the tools we must use to help bring back private capital to the market. There will be reasonable debate about the appropriate pace of the transition, but there is broad agreement that we need to move forward to exit the government's current oversized role in housing finance on a responsible timeline. Much of our immediate efforts will be focused on the challenge of working towards that shared objective. It's our hope that this will serve as a foundation for longer term reforms as we work to build a housing finance market where the private sector, not the government, is the primary source of mortgage credit and bears the primary risk for losses.

Finally, this Administration believes that the government must help ensure that all Americans have access to quality housing that they can afford.

A System with Transparent and Targeted Support for Access and Affordability

The Administration believes that we must continue to take the necessary steps to ensure that Americans have access to an adequate range of affordable housing options. This does not mean all Americans should become homeowners. Instead, we should make sure that all Americans who have the credit history, financial capacity and desire to own a home have the opportunity to take that step. At the same time, we should ensure that there are a range of affordable options for the 100 million Americans who rent, whether they do so by choice or necessity.

The report recommends focusing initially on four primary areas of reform:

- A reformed and strengthened FHA.
- A commitment to affordable rental housing.
- Measures to ensure that capital is available to credit-worthy borrowers in all communities, including rural areas, economically distressed regions, and low-income communities.
- A consistent, flexible and transparent funding source to support targeted access and affordability initiatives.

A Reformed and Strengthened FHA

As I have mentioned, housing finance reform depends on a reformed, strengthened FHA – a process which this Administration has begun, but which must continue to reduce the government's role in the market.

As such, the Administration will make sure that credit-worthy borrowers who have incomes up to the median level for their area have access to FHA mortgages, in a way that does not allow the FHA to expand during normal economic times to a share of the market that is unhealthy or unsustainable. While FHA has already changed policy to require that borrowers with lower FICO scores make larger down payments, FHA will consider other options, such as lowering the maximum loan-to-value ratio for qualifying mortgages more broadly. In considering how to apply such options, FHA will continue to balance the need to manage prudently the risk to FHA and the borrower with its efforts to ensure access to affordable loans for lower- and middle-income Americans. And similar to the Administration's process for broader reform of the U.S. housing finance system, FHA will seek comment on the appropriate pace of change.

However, as we consider changes in such areas as down payments and LTV ratios, we continue to believe that it is essential to avoid permanently locking in such changes. Rather, we will work with Congress, as we did in last year's premium increase legislation, to give FHA more flexibility to respond to market conditions and manage its risk more effectively.

A Commitment to Affordable Rental Housing.

Reducing government's role in the single family market requires a commitment to affordable rental housing – which is a critical component of a comprehensive balanced national housing policy. A housing policy that supports sustainable homeownership as well as the increased need for rental housing would ensure three desirable outcomes for families, and for the housing market as a whole.

It would ensure that people who are in a financial position to own a home have access to the capital they need to do so.

It would guarantee that families are not set up to fail with mortgages that enable them to buy homes they simply cannot afford.

And it would make financing available to those who will build the rental housing that we need to provide choices for the growing number of families for whom homeownership may not be the best option.

As such, exploring ways to provide greater support for rental housing is also essential to shrinking government's role in the market. One option would be to expand FHA's capacity to support lending to the multifamily market. Utilizing existing multifamily expertise so that FHA and other entities continue the industry's current best practices and retain valuable human capital would help achieve this objective.

We will also consider a range of reforms, such as risk-sharing with private lenders to reduce the risk to FHA and the taxpayer, and developing programs dedicated to hard to reach property segments, including the smaller properties that contain one-third of all rental apartments.

But with half of all renters spending more than a third of their income on housing—and a quarter spending more than half—this Administration believes there should be a range of affordable options for the millions of Americans who rent.

The Challenge Ahead

And so, Madam Chairwoman, it is clear that we must work together to chart a path forward.

During my tenure as FHA Commissioner I've seen firsthand that one of the leading barriers to private sector involvement in the market isn't government at all – but a "trust deficit" faced by the industry in its relationship with the American people.

As long as consumers, particularly the younger generation, associate the housing industry with exploding ARMs, predatory loans, and foreclosures, restoring a healthy balance in American housing policy will be a struggle.

But Madam Chairwoman, given that I had spent my entire career in the private sector before coming to the FHA, I also know that government cannot do it alone.

Whether it is through gradually shrinking the government's role in the market without disrupting our economic recovery, strengthening the mortgage market to rebuild confidence, or removing barriers to the return of capital, this Administration is not only committed to restoring a healthy balance in the housing market – it is committed to working with Congress to find the common ground we need to build a 21st century system of housing finance rooted in a strong, healthy market for private capital.

FHA's role in restoring this balance will be critical, and we look forward to working closely with Congress to ensure that we build a system that works better for borrowers, lenders, investors and the broader American economy.

Madam Chairwoman, thank you again for this opportunity to testify. I would be glad to respond to any questions.

Written Testimony of Ted Tozer
President, Ginnie Mae
U.S. Department of Housing and Urban Development

"Are There Government Barriers to the Housing Market Recovery?"

Hearing before the U.S. House Financial Services Committee's Subcommittee on Insurance, Housing and Community Opportunity
Wednesday, February 16, 2011

Chairwoman Biggert, Ranking Member Gutierrez and distinguished members of the Subcommittee, thank you for inviting me to testify on President Obama's plan to spur private capital back into the U.S. housing finance market. My name is Ted Tozer and I am the President of Ginnie Mae. I have served in this position since February of 2010.

Prior to joining Ginnie Mae, I served as Senior Vice President of Capital Markets at the National City Mortgage Company. For more than two decades, my responsibilities included pipeline hedging, pricing, loan sales, loan delivery and credit guideline exceptions. My combined experience at National City and now Ginnie Mae gives me a keen perspective on private mortgage market business needs and government expectations.

Today I will discuss Ginnie Mae's unique business model; the value our securities bring to investors, lenders and consumers and our conservative approach to risk management. I will also spend some time today highlighting efforts we've taken to reduce government support of the housing market, while doing so at a pace that does not undermine the burgeoning economic recovery, and our plans to continue that effort going forward.

Background
I would like to begin my testimony by providing background on Ginnie Mae and its evolving role and function in U.S. housing finance. Ginnie Mae serves as a financing arm for HUD and other government insured or guaranteed mortgage products. We are a self-sustaining, wholly-owned government corporation, charged with supporting the secondary market for insured or guaranteed government loans.

In 1968, Congress created Ginnie Mae by partitioning Fannie Mae into two entities: the Government National Mortgage Association and the Federal National Mortgage Association.

In 1970, Ginnie Mae created and issued the first mortgage-backed security (MBS) in U.S. history. And since its inception, our corporation has issued more than $3.7 trillion in MBS, helping millions of families realize the dream of affordable housing. We have provided liquidity and stability to the U.S. housing market through all economic environments for more than 40 years.

The steep decline of the housing market in recent years placed tremendous stress on lenders, including Ginnie Mae's Issuers, and led to the retreat of investors from the market. As it has before in troubled times, Ginnie Mae has stepped into the market space previously dominated by others to ensure that core customers – Issuers, homeowners and investors – are well served. That is our historic role – to provide counter-cyclical support in times of crisis. In doing so, Ginnie Mae demonstrates its leadership in providing capital and liquidity, and supports the Administration's efforts to stabilize the housing markets.

Paving the Way for a Robust Private Mortgage Market

Since the onset of the housing crisis, Ginnie Mae has taken an active role in working with other government agencies involved in stabilizing the credit and housing markets. This includes ongoing discussions with other components of HUD including the Federal Housing Administration (FHA), as well as with agencies such as the Department of Veterans Affairs, the Department of Agriculture, the Treasury Department, the National Economic Council (NEC), and regulatory bodies, notably the Federal Housing Finance Agency (FHFA), the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency. In particular, Ginnie Mae worked closely with FDIC to manage the orderly transition of Ginnie Mae portfolios of depositories placed in FDIC receivership. Additionally, Ginnie Mae collaborates with the Treasury Department, NEC and FDIC, and within HUD, on policies to address the financial crisis in the housing market.

More than ever, Ginnie Mae is focused on offering programs that meet the needs of our stakeholders and provide sufficient flexibility to respond to market changes. Over the past several years, Ginnie Mae has made significant upgrades to its technology infrastructure to streamline business processes and to allow its customers to more efficiently address the demands from the surge in volume. Together with expanded enterprise-wide risk management practices, which I will address later, these efforts have strengthened Ginnie Mae programs and increased operational efficiencies. Our practices may also serve as a model – especially in the areas of disclosure and risk management – for the changes that are needed to build a better functioning private label securities (PLS) market.

Business Model

Ginnie Mae works with qualified private mortgage lenders to pool their government-insured or guaranteed mortgage loans and issue Ginnie Mae MBS. Lenders service and manage the MBS portfolio and the underlying loans. Many of these institutions are aggregators, meaning they purchase loans from other lenders and consolidate them into pools of mortgages eligible for a Ginnie Mae MBS. Only loans insured or guaranteed by FHA, VA, USDA's office of Rural Development and HUD's Office of Public and Indian Housing (PIH) can serve as collateral for Ginnie Mae securities.

Lenders pay a guaranty fee to securitize these government-backed products. For this fee, Ginnie Mae assures the timely payment of principal and interest on MBS to investors. Our guaranty makes our MBS highly liquid and attractive to domestic and foreign investors. In time of crisis, when Ginnie Mae MBS volumes rise, lenders obtain a better price for government-insured mortgage loans when sold as part of a Ginnie Mae security. Although the securities are commonly referred to as "Ginnie Mae's," we are not the Issuer. Private lenders issue the securities. I will discuss more about this aspect of our business model later as it has risk implications. Our MBS allows lenders to recycle the funds obtained by selling Ginnie Mae securities to originate more mortgage loans for single-family and multifamily properties across the country. This ongoing cycle helps to lower financing costs and thus supports accessible and affordable housing.

Protecting Taxpayers from Risk
Ginnie Mae's business model mitigates the added taxpayers' exposure to risk associated with secondary market transactions. We do not originate or invest in mortgage loans or MBS directly so we have no active retained investment portfolio. Additionally, we do not take on borrower credit risk or rely on credit derivative products to hedge. And because we have no need to finance whole loans or MBS portfolios, we don't carry significant long-term debt on balance sheet.

Furthermore, Ginnie Mae is insulated by several layers of protection before it faces any risk associated with the mortgage collateral underlying the securities. The credit risk on loans in Ginnie Mae securities resides with the Issuer of the security and the respective government insuring agency. When speaking about the Ginnie Mae program, I will often use the term Issuer to refer to the lenders who participate our program; we often use the term Issuer and lender interchangeably. Ginnie Mae's exposure to risk is limited to the ability and capacity of Issuers to fulfill their obligation to pay investors. Our Issuers are expected to pass through principal and interest payments to investors even when borrowers are delinquent.

In fact, under our program guidelines, Issuers are expected to finance the repurchase of loans out of an MBS in order to foreclose or modify. For example, in the case of a home foreclosure, these institutions continue to make payments to investors until loans are repurchased from the security and the Ginnie Mae guaranty is removed. Generally the Issuer makes payments throughout the foreclosure process. When that process is completed, the Issuer submits a claim to the insuring agency for reimbursement of the payment advances it has made. If the insuring agency does not fully reimburse the Issuer, the Issuer assumes the short fall as a loss.

In rare circumstances, Issuers fail to make the required principal and interest payments. When that happens, Ginnie Mae can seize the portfolio without compensating the Issuer. Failure to make all required payments is considered a default in the Ginnie Mae program.

Ultimately, before Ginnie Mae's guaranty is at risk, three levels of protection must be exhausted: 1) homeowner equity; 2) the insurance provided by the government agency that insured the loans; and 3) the corporate resources of the lender that issued the security. We are in the fourth and last loss position. Only catastrophic circumstances will cause Ginnie Mae to face losses on its guaranty. Again, Ginnie Mae only steps in when all of an Issuer's corporate resources are exhausted, usually accompanied by bankruptcy. Furthermore, when we do step in, our losses are limited to either the cost of transferring the portfolio or to any decline in the servicing value of the portfolio. It is important to note that we are the only entity involved in housing today that is modeled in this manner.

Issuer Monitoring
Issuer approval and ongoing monitoring processes are an important component of our enterprise risk management efforts. We aggressively manage Issuers and their servicing portfolios to mitigate potential losses. Our MBS staff manages potential servicing value deterioration by

requiring Issuers to either repurchase excessive amounts of seriously delinquent loans or take other actions that mitigate Ginnie Mae's losses should a default occur. Also, we require the repurchase of defective loans.

To assure continued accountability for our efforts, Ginnie Mae has had a Chief Risk Officer in place for nearly 3 years. Our CRO monitors the corporation's aggregate risk and compliance with risk policies, develops and maintains corporate-wide procedures for risk management, and provides independent evaluation and oversight of all risk management activities.

Similar to the FHA, Ginnie Mae has implemented industry-leading policies that shore up our risk management and may provide a model for building confidence in private label securitization. We have implemented policies that increase accountability among our Issuer base and disclose more information to investors on the loans that back our securities. This includes increased net worth, capital and liquid asset requirements for all Issuers across our single-family, multifamily and home equity conversion mortgage (HECM) business lines. Imposing these requirements reflects Ginnie Mae's commitment to prudent risk management. By requiring Issuers to retain more capital and liquidity to absorb potential losses and advance delinquent payments to investors, we hold them accountable. Our capital and liquidity requirements can be looked at as a different, but very effective form, of "skin in the game".

Corporate Organization and Performance
Ginnie Mae's conservative, well-managed business model and strong risk position is managed by an equally solid staff of 77 employees. I could not be more proud of the performance of our staff during these tough times.

We have two major business units: MBS and Capital Markets. These divisions are responsible for the production and marketing of mortgage-backed and multiclass securities.

Our activities receive no appropriations from general tax revenue. Ginnie Mae's operations are self-financed through the fees we charge to Issuers, which eliminates the need to use taxpayer funds.

Net Revenues
For more than 20 years, Ginnie Mae has generated profits. In Fiscal Year 2010, Ginnie Mae's net income was $541 million. Total revenues were $1.01 billion; total expenses were $92.5 million; and gains were $352 million. We earned $541 million in profit despite increasing our loss reserves by more than $700 million to $1 billion. And in FY 2009, our performance was just as strong; we earned $510 million. To bring all of this in perspective, over the last two years, through the worst sustained housing decline since the Great Depression, we *earned* profits each year on behalf of the U.S. taxpayer. And, yes, we are also well-positioned to deal with any future market volatility, with more than $14.6 billion in retained earnings. Ginnie Mae's sustained profitability and strong capital position demonstrates that its operations pose no financial risk to the federal government and taxpayers.

To put our increasingly important role in perspective, at the close of FY 2008, Ginnie Mae's portfolio stood at $577 billion. In June 2010, the portfolio reached $1 *trillion*, and it currently stands at $1.1 trillion. This trillion dollar portfolio has financed more than 7.2 million single-family homes and 1.1 million rental housing units; in FY 2010 alone, we financed nearly 1.9 million households.

Indeed our growth has provided benefits to taxpayers and the economy as it has allowed lenders to continue the business of making loans to prospective homeowners. In 2006, Ginnie Mae's market share was four percent. In FY 2010, Ginnie Mae's market share was approximately 30 percent. Despite this incredible spike in volume, the delinquency rate of the Ginnie Mae portfolio is among the lowest in the industry.

The present outstanding MBS balance is the largest since the inception of the organization. Our growth is a direct result of the current economic downturn, but these levels are neither desired nor sustainable.

The Current State of Ginnie Mae
The extraordinary growth in volume is challenging for our organization; we approved 43 new Issuers last year. Prior to the present economic crisis, we approved five or six new Issuers per year. The staff at Ginnie Mae has managed the tremendous volume increases and its expanded role by asking more of themselves. This, as well, is unsustainable. This is why the President's 2012 budget proposes to authorize a significant increase in Ginnie Mae salary and administrative expenses – still to be funded from fee income alone. Increased salary resources will allow Ginnie Mae to bring more functions in-house and reduce our reliance on outside contractors. I believe this the right direction, and given Ginnie Mae's continued profitability and strong risk management practices, it is time to use our fee resources to ensure we run as efficiently and effectively as possible.

Restoring Trust and Integrity in the Broader Housing Market
The challenges in housing finance have an impact not just on the mortgage industry, but on the national and global economies as well. Falling home values, high rates of mortgage delinquencies and foreclosure and the loss of millions of jobs strain families and communities. The economic problems in the United States extend beyond our shores and have led to the erosion of global investors' confidence in all but the most secure investments.

These factors have perpetuated credit constraints for consumers and businesses alike and are further hampering recovery. Uncertainty and volatility in the economy and the aftermath of the unnecessary risk-taking has limited investor appetites for any MBS other than those insured or guaranteed by the U.S. Government or the GSEs. This has resulted in a lack of private capital and corresponding financing, which is reflected in the low rate of issuance of private label securities over the past three years.

Towards a New System of Housing Finance
We *must* revive the PLS market. Going forward, the Administration is committed to ensuring that private capital markets – subject to strong oversight and standards for investor protection – should be the primary source of mortgage credit and bear the burden of losses. It is crucial that

this transition away from government's oversized role is measured and doesn't upset a still fragile housing market. The task before us will not be easy as the MBS market has long relied on government involvement. Much is needed in the way of change if we are to create an environment attractive to private capital. Ginnie Mae stands ready to help with these efforts.

A Path Forward

The Administration believes the securitization market should continue to play a key role in housing finance. That market, however, requires meaningful reform so private investors can confidently participate in the housing market and provide an alternative funding source for mortgages outside of the traditional government-supported institutions.

Increasing Transparency, Standardization, and Accountability in the Securitization Chain

As I mentioned, we are the financing arm of HUD and other government insuring agencies, so the levels of MBS we guarantee are directly related to the levels of mortgage loans other government agencies insure. Commissioner Stevens has outlined plans to reduce FHA's imprint in the market, and our MBS volume will decrease accordingly.

Along with FHA, Ginnie Mae has implemented industry-leading policies that shore up our risk management and may provide a model for building confidence in the private label securitization process. For example, as previously discussed, Ginnie Mae implemented increased net worth, capital and liquid asset requirements for all Issuers across our single-family, multifamily and home equity conversion mortgage (HECM) business lines. Imposing these requirements reflects Ginnie Mae's commitment to prudently manage risk, while requiring Issuers to retain more capital and liquidity to absorb potential losses and advance delinquent payments to investors. Our capital and liquidity requirements can be looked at as a different, but very effective form of "skin in the game."

Ginnie Mae MBS consistently trades with tighter spreads to Treasury than those of the GSEs and significantly better than private label securities. This directly contributes to government-insured borrowers obtaining the lowest interest rates possible for consumers during a crisis. For example, a review of a mortgage calculator from a major lender revealed that a 30-Year Fixed Rate FHA-insured mortgage is approximately 25 basis points less than a 30-Year Fixed Rate mortgage on a $160,000 conventional loan. Transparency and full disclosure are critical elements in attaining the best execution. The Administration believes increased disclosure on underlying mortgage collateral is key to increasing standardization and accountability in the securitization chain. Our efforts to expand loan disclosures in our securities have been well received in the market.

Under my direction, Ginnie Mae began releasing the number and dollar value of modified loans, FHA short-refinance loans, and HECM Saver loans contained in our pools. The new disclosure initiatives are designed to spur more efficient pricing of our securities. As part of our continuing efforts to strengthen transparency and disclosure, Ginnie Mae also began releasing monthly disclosure files on outstanding MBS approximately two weeks earlier each month.

And during FY 2010, we announced two important operational changes that will allow small lenders to more easily and efficiently do business with Ginnie Mae; this will help to ease liquidity strains. To reduce interest costs associated with carrying loans until they can be securitized and settled, Ginnie Mae implemented program changes to allow daily issuance of multiple-Issuer pools. These changes should allow Issuers to use warehouse lending lines more efficiently. And we also recently allowed Issuers to securitize single loans in multiple-Issuer pools.

And I insisted that Ginnie Mae work with Fannie Mae and Freddie Mac to implement a Uniform Loan Delivery Data set. Use of the data set will *standardize* the definitions of the data elements lenders are required to provide when issuing securities. This means loan delivery information will be standardized across the industry, further increasing transparency.

Improving Mortgage Servicing and Foreclosure Processing
An important matter to help stem the tide of foreclosures is establishing national standards for mortgage servicing. The Administration supports several immediate and near-term reforms to correct problems in mortgage servicing and foreclosure processing. One immediate step is to reform servicing compensation to align with industry incentives. We are working with the FHFA to explore alternative servicing compensation structures. A more efficient servicing compensation model could provide for better servicing of non-performing loans and could help address some of the nation's foreclosure problems. Given the positive impact a resolution to this issue could have on the mortgage industry, we are excited to join FHFA in addressing this matter. I have significant experience in loan servicing compensation and capital markets and I look forward to contributing leadership towards this initiative.

Winding Down Fannie Mae and Freddie Mac
Clearly, the current market in which Fannie Mae, Freddie Mac and Ginnie Mae guarantee 95 percent of all securities is unsustainable. It exposes taxpayers to too much risk. For investors, uncertainty about the future of the GSEs impacts decision making. It is difficult to plan production and identify appropriate secondary market outlets when pending legislation looms. Also, as long as the GSEs offer a secondary market outlet for mortgage loans with below market pricing based on a government-supported cost of capital, PLS transactions will be disadvantaged. The Administration proposal to increase GSE guarantee fees, increase the capital ahead of their guarantees and wind down their investment portfolios will end uncertainty and create space for greater private sector investment. Having participated in developing the Administration's recently released White Paper on GSE reform, I believe the options laid out form the foundation for a thoughtful discussion moving forward.

Restoring Trust and Integrity in the PLS Markets
The current private label securitization process works with limited oversight. A neutral party is needed to ensure accountability and transparency. The role of bond trustees may need to be expanded. Bond trustees are currently responsible only for distributing monthly principal and interest payments to investors. We should consider whether bond trustees need the ability to make sure loans are serviced properly, have the authority to require repurchase of defective loans by Issuers and give guidance to servicers on loan level loss mitigation issues. Additionally, providing authority to bond trustees through private label securities contracts to require Issuers to cover some or all catastrophic loss could help restore confidence in our securities markets. Bond

trustees are an obvious choice for this expanded role, but there may be other options; the point I want to make is that a strong well capitalized entity is needed to assume some of these responsibilities.

Addressing Fannie Mae and Freddie Mac alone will not give rise to a housing finance market that meets the needs of investors. Nor will it guarantee that private markets can effectively play a more dominant role in the mortgage market. We must work together to map our way forward by looking at some of the recommendations provided above.

In recent years, fundamental flaws occurred at almost every link in the mortgage process. We are now all well aware of the advantages and disadvantages of securitization. When securitization is managed appropriately, it is a very efficient conduit for capital. However, when insufficient attention is paid to the quality of the collateral or the end product is so complex that no one understands the risk, the consequences can be disastrous. Significant reform is needed to help address the flaws that led to the crisis and to rebuild trust and integrity in the mortgage market. This is especially true for the securities markets. Many investors in private label securities believe that investing in today's market often requires them to take excessive and unpredictable risk. Restoring their faith in the markets will require greater transparency, standardization and accountability in the securitization process. As someone who has worked in the capital markets for more than 30 years, I welcome the opportunity to work with Congress to develop a solution that meets the needs of homeowners, investors, and taxpayers. Thank you for giving me the opportunity to testify today, and I look forward to answering any questions you may have.

Questions Submitted by Representative Westmoreland
Hearing: "Are There Government Barriers to the Housing Market Recovery?"
February 16, 2011

Question for David Stevens, Assistant Secretary for Housing and Commissioner of the Federal Housing Administration, U.S. Department of Housing and Urban Development (HUD)

As you are aware, Chairman Bachus and Ranking Member Frank sent a letter to HUD Secretary Donovan on July 22, 2010 clarifying the legislature's intent with respect to the S.A.F.E. Act, specifically that it is permissible for States to "consider a de minimis standard for registration and licensing requirements under the Act." Many Americans from middle-income households, those in which annual household income is $30,000 to $100,000, depend on the delivery of financial services products – such as mortgages – from providers that use a model that enables services to be delivered at a lower cost than banks. In HUD's response, Peter Kovar, Assistant Secretary for Congressional and Intergovernmental Relations, expressed that only the federal banking regulators were authorized to create an exemption to the S.A.F.E. Act licensing requirements for entities in their jurisdiction that originate a de minimis number of mortgages annually.

Importantly, however, it has come to my attention that HUD has, in fact, endorsed S.A.F.E Act exemptions for loans originated by attorneys, family members, and owner financing. HUD also advised a state regulator last summer that it would be appropriate to temporarily exempt from licensure under the S.A.F.E. Act HUD-certified housing counselors, non-profit lenders, and certain mobile home park operators. In the preamble to its proposed rule, HUD also proposed a temporary exemption from licensure of persons that only perform loan modifications in connection with the federal government's Making Home Affordable program. While I take no position on the need for these exemptions, I feel it imperative for HUD to seriously consider a similar waiver for States that are setting licensing requirements for a de minimis standard.

- Will HUD observe Chairman Bachus' and Ranking Member Frank's intent on this issue and allow states to issue a de minimis exemption for originators of five or fewer mortgages?

- Does the draft final rule currently being considered by OMB include language that allows states to adopt a de minimis standard for registration and licensing requirements under the Act?

- If not, then will changes be made to this standard based on comments before the S.A.F.E Act rules are made final?

HUD Response: HUD's draft final rule is currently under review by the Office of Management and Budget, pursuant to Executive Order 12866. Under the terms of the Executive Order, and in order to ensure a thorough and deliberative regulatory review process, HUD is not permitted to communicate with persons who are not employed by the executive branch regarding the substance of the regulatory action that is under OMB review. (Please see section 6(b)(4)(A) of Executive Order 12866.) HUD issued guidance on states' implementation of the SAFE Act prior to HUD's submission of its draft final rule to OMB, and that guidance remains available at http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/rmra/safe/sfea

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