Industry Experts Dissect Foreclosure Crisis and Servicer Performance

By: Jann Swanson | Thu, Nov 4 2010, 4:08 PM

The **Congressional Oversight Panel (COP)** recently conducted a hearing focused on the current status of the foreclosure crisis and the recent revelations that inappropriate processes have been used to prosecute those foreclosures.

COP was created by Congress under the Troubled Asset Relief Program (TARP) to "review the current state of financial markets and the regulatory system." The panel consists of Senator Ted Kaufman (D-DE), chairman; Richard H. Neiman Superintendent of Banks for the State of New York; Damon Silvers, associate general counsel for the AFL-CIO; J. Mark McWatters, attorney and CPA who specializes in tax law and mergers and acquisitions; Dr. Kenneth R. Troske, Director of the Center for Business and Economic Research, Chair of the Economics Department and William B. Sturgill Professor of Economics at the University of Kentucky.

Kaufman said he hoped to define more concrete goals for success in foreclosure prevention and to hear evidence that the foreclosure picture had improved dramatically since the Panel had last looked at the issue. "Yet all evidence appears to be to the contrary." He cited reports that banks and servicers may have rushed the process; reports which he said were already undermining investor and homeowner confidence in the mortgage market. Yet, if the reports are true, "it is conceivable that the problems are even worse; that banks have failed to follow the legal steps necessary to ensure clear title" which could lead the financial industry to suffer "staggering losses."

Phyllis Caldwell, chief of the Treasury Department's Homeownership Preservation Office, outlined the problems initially facing the administration and servicers. She said there was **no consensus about how to respond to responsible borrowers in need of assistance and no timeframes for servicer decisions**. "Servicers were paralyzed by the need to seek approval from investors on an individual, mortgage-by-mortgage basis. And, perhaps most critically, there was no affordability standard for monthly mortgage payments." In the absence of a framework the solutions offered by servicers "often achieved nothing other than adding unpaid interest and fees to the mortgage balance, resulting higher - not lower - payments for homeowners. Millions of responsible American families simply lost their homes."

Julia Gordon, Senior Policy Counsel, Center for Responsible Lending, however, blasted the response to the crisis saying, "Things did not need to be this bad." **She faulted both the Bush and Obama Administrations for failing to act quickly and forcefully to limit the breadth and depth of the crisis**. "Instead, seemingly hamstrung by concerns about bank capitalization levels and 'moral hazard', the government put forth a series of initiatives that relied on voluntary actions from servicers in return for targeted monetary incentives."

She called HAMP's performance "disappointing," and said **it would have met with greater success if government had implemented measures such as changes to the bankruptcy code and providing borrowers with an alternative to servicers which put their own interests first**. "Instead, the system is still entirely at the mercy of those servicers, who frequently have not acted in the best interests of either investors or homeowners, and who have demonstrated a complete disregard for the legal requirements of the foreclosure process." The servicing industry has even now, she claimed, failed to develop the capacity and quality control to ensure the integrity of the process.

Guy Cecala, CEO and Publisher of Inside Mortgage Finance addressed why proprietary servicers modifications have outpaced those done under the Home Affordable Modification Program (HAMP) by 3 to 1 since HAMP began; a gap, he said, that has increased significantly over the past several months. First, the **proprietary servicers have more flexibility than allowed under HAMP's tough government mandated underwriting and documentation requirements**. The only criterion for proprietary servicers is whether a modification is in the best interests of the investor.

Second, Cecala said, the **HAMP modifications are much more aggressive in terms of payment reductions while proprietary modifications tend to restructure the loan to bring it current**. However, there is some indication that the HAMP method may have a more positive impact on re-default rates. While modifications with little or no pay reductions have default rates of 50 percent or more, big reductions such as found under HAMP have rates as low as 25-30 percent. Further muddying the equivalencies; unemployment has emerged as a leading cause of re-defaults in recent months and that impacts modifications regardless of payment reductions.

Katherine Porter, professor, University of Iowa College of Law spoke to the current flap over documentation of loan transfers and of the process followed during the foreclosure process. She said that the implications of problems with asset transfer are serious. **If the trust does not have the loan, homeowners may have been making payments to the wrong party. If the trust does not have the note or mortgage, it may not have standing to foreclose or legal authority to negotiate a loan modification."** Where the documentation of transfers is being done retroactively there are issues of honesty and questions about validation if an entity in the securitization chain is defunct. Such transfer may also violate the terms of the trust or may cause the trust to lose its REMIC status and favorable tax treatment.

These problems also have the potential to expose the banks to investor lawsuits.

Porter said it is important to know if the problems are sporadic or endemic but, regardless of the scope, lenders have an obligation to address it and the assertion by one party that the other is clearly liable, i.e. has not paid its mortgage, does not give the first party sufficient standing to foreclose.

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