Judiciary Subcommittee on Regulatory Reform, Commercial and Antitrust Law
Oversight Hearing on "Consumers Shortchanged? Oversight of the Justice Department's Mortgage Lending Settlements"
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Thank you for inviting me to testify today. My primary research focus for the past eight years has been the mortgage market, the foreclosure crisis and the regulation of credit more generally. I am currently serving as the co-reporter for the Uniform Law Commission's project on a model Foreclosure Procedures Act. In that capacity I have also conducted substantial research on mortgage servicing, foreclosure litigation and mediation and loss mitigation programs.

Let me begin by setting the record straight concerning the claim that the 2013-2014 federal-state task force settlements with Citigroup, J.P. Morgan and Bank of America compel the banks to fund activist groups, and to divert large sums from consumer relief for that purpose. That claim does not square with the facts.

First, it is entirely up to the banks which legal aid agencies and housing counselors to fund. The banks may choose from hundreds of housing counselors and legal aid agencies, including many faith-based organizations and nonpartisan community development groups whose political orientations range from left to centrist to nonpartisan to right. If a bank sees a particular nonprofit agency as too controversial, because of the work that agency does with its other funding, the bank can simply leave the group off of its donation list. Second, less than one percent of the consumer relief dollars in these settlements is earmarked for housing counselors and legal aid. There is simply no significant diversion of money from the billions in required consumer relief. Third, as I will explain in more detail, the nonprofit legal aid and housing counseling agencies are all subject to auditing and oversight that prevents misuse of public and private funds for political activity of any kind.

I would like to focus my testimony on three more substantive points concerning the consumer relief provisions of the three federal-state task force settlements with Citigroup, Bank of America and J.P.Morgan.

First, the settlement agreement provisions to incentivize banks to write down mortgage principal for underwater homeowners are critical to homeownership preservation and full housing market recovery. Second, housing counseling and legal services provided by a full range of nonprofit organizations are highly effective to enable homeowners to access consumer relief in the settlements, to increase successful mortgage workouts, and to prevent further losses for mortgage investors; indeed, I would urge the banks to spend substantially more than the required minimum on these services. Third, government and private funding for legal services and housing counselors always comes with necessary oversight, auditing and reporting to prevent misuse of funds.

1) The settlement incentives to encourage principal reduction for underwater homeowners will save homes, preserve neighborhoods, prevent further investor losses and aid the housing market recovery.

Although the foreclosure crisis is finally abating, we still have an inventory of roughly 2 million homes in foreclosure. The percentage of mortgages in foreclosure stands at 2.39%,[1] still far exceeding the foreclosure rate at the peak of the Great Depression in 1933.[2] One in six homeowners is still underwater, a historically unusual and precarious situation where middle class Americans are paying down home debt that is more than their homes are worth[3]. Historically low interest rates are reducing payment strain on homeowners, but the persistence of serious negative equity remains an obstacle to full recovery, for households and for the housing market.

We now know, seven years into the foreclosure crisis, that well-designed loan modifications work very well for homeowners and for investors, and that there are still not enough well-designed loan modifications. The most recent Office of the Comptroller of the Currency mortgage metrics report reveals that redefaults on modified loans have dropped from more than 50% in 2008 to less than 20% now, and less than 15% for HAMP modifications with significant payment reductions.[4] We also know that modifications with principal reduction perform much better than those where the bank adds delinquent payments to the total balance. So if our objective is to work through the remaining inventory of homes in foreclosure or serious default with minimal losses to homeowners and investors, principal reductions will be an important tool.

We also know that the banks have performed poorly in resolving defaulted mortgages. Some servicers have much higher rates of successful mortgage modifications than others, and the large bank servicers consistently have the worst performance.[5] The enforcement actions and settlements by the Federal Reserve,

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[1] Mortgage Bankers Association of America, National Delinquency Survey 3rd Quarter 2014, http://www.mba.org/NewsandMedia/PressCenter/89895.htm.
[2] David C. Wheelock, The Federal Response to Home Mortgage Distress: Lessons from the Great Depression, 90 *Federal Reserve Bank of St. Louis Review* 133, 139 (May/June 2008) (noting that foreclosure rate would have been far higher but for state moratoria and New Deal programs).
[3] Zillow Negative Equity Report, 3rd Quarter 2014, http://www.zillow.com/research/negative-equity-2014-q3-8532/.
[4] Office of the Comptroller of the Currency, Mortgage Metrics Report 3rd Quarter 2014, http://www.occ.gov/publications/publications-by-type/other-publications-reports/index-mortgage-metrics.html.
[5] Sumit Agarwal, et. al., Policy Intervention in Debt Renegotiation: Evidence from the Home Affordable Modification Program (Federal Reserve Bank of Chicago 2013) http://ssrn.com/abstract=2369419; Alan M. White, Deleveraging the American

FDIC and other regulators attest to this systemic failure.[6] It is therefore completely appropriate for the federal-state task force settlement to create strong incentives for better foreclosure prevention and loss mitigation by the major bank servicers as the foreclosure crisis continues to wind down.

Congress could help banks, homeowners and mortgage investors by extending the Mortgage Forgiveness Debt Relief Act, which expired at the end of 2014. A homeowner whose bank agrees to make their home loan affordable shouldn't be confronted with an unaffordable federal income tax bill. If Congress extends this tax relief measure, the banks could then put the consumer relief dollars in the settlements to better use.

2) Legal aid and housing counseling are very effective at reducing foreclosure losses for homeowners and investors.

Empirical research consistently shows that housing counseling and legal representation are effective in preventing preventable foreclosures.[7] The reasons counselors and legal aid lawyers are helpful are fairly obvious. Servicers have done a poor job of communicating with homeowners and restructuring their loans. Homeowners facing foreclosure are sometimes reluctant to engage with their servicer, have difficulty organizing paperwork to respond to bank requests, and aren't familiar with the different alternatives to foreclosure and who is eligible for

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Homeowner: The Failure of 2008 Voluntary Mortgage Contract Modifications, 41 *Conn. L. Rev*. 493 (2009).

[6] *See* Federal Reserve Board April 2011 press release regarding enforcement actions against 10 banking organizations, http://federalreserve.gov/newsevents/press/enforcement/ 20110413a.htm; Justice Department press release on 2012 national mortgage settlement, http://www.justice.gov/ust/eo/public_affairs/consumer_info/nms/.

[7] Kenneth Temkin, et. al.,National Foreclosure Mitigation Counseling Program Evaluation, Final Report (September 2014) http://www.neighborworks.org/Documents/HomeandFinance_Docs/Foreclosure_Docs/ForeclosureCounseling(NFMC)_Docs/2014_NFMC_UrbanInstituteReport.aspx; J. Michael Collins & Maximilian D. Schmeiser, The Effects of Foreclosure Counseling for Distressed Homeowners, 32 *J. Policy Anal. & Mgt.* 83 (2012); Neil Mayer, et. al., Has Foreclosure Counseling Helped Troubled Homeowners? Evidence from the Evaluation of the National Foreclosure Mitigation Counseling Program (2012), http://www.urban.org/UploadedPDF/412492-Has-Foreclosure-Counseling-Helped-Troubled-Homeowners.pdf; Ding, Lei, Robert G. Quercia, and Janneke Ratcliffe, Post-purchase Counseling and Default Resolutions among Low- and Moderate-Income Borrowers, 30 *Journal of Real Estate Research* 315-344 (2007); Maggie Barron & Melanca Clark, Foreclosures: A Crisis in Legal Representation, http://www.brennancenter.org/page/-/Justice/Foreclosure %20Report/ForeclosuresReport.pdf.

them. Banks repeatedly lose homeowner paperwork and make frustrating and duplicative requests.

Counselors and legal aid lawyers have expertise in the variety of loss mitigation programs and the paperwork needed to apply, and they serve a vital function by persistently following up with both homeowners and servicers to bring workout requests to a conclusion. Counselors and lawyers know about the various federal and state legal settlements, and know how to connect homeowners with these new consumer relief programs.

Successful outcomes facilitated by lawyers and housing counselors include not only loan modifications and repayment plans, but also negotiated short sales and deeds in lieu of foreclosure. All of these outcomes are better for both the homeowners and mortgage investors. Every successful resolution arranged by a housing counselor, even a short sale, mitigates foreclosure losses to investors, including of course the GSEs.

This point bears emphasizing. The average investor loss on a single foreclosure home sale is roughly $100,000.[8] Money spent on housing counseling pays off, both for moderate-income homeowners who can renegotiate their mortgage, or at least negotiate a graceful exit, and for investors, who save tens of thousands of dollars on each foreclosure sale that is prevented.

3) Housing counselors and legal aid agencies are subject to rigorous oversight to prevent misuse of funds, such as for political activity

The Citigroup and Bank of America settlements require minimum contributions of $15 million and $30 million, respectively, for state legal aid funders, and $10 million and $20 million, respectively, for HUD-approved counseling agencies to provide foreclosure prevention services. Apart from minimum distributions in the participating states, there are no restrictions on how the banks may achieve these targets. In particular, the language of the settlement agreements leaves to Citigroup and Bank of America the decision of which housing counselors are to receive donations. For legal aid, the donations are to be directed to state interest on lawyer trust account (IOLTA) programs, the vast majority of which are administered by nonpartisan state bar associations or affiliated nonprofits.[9]

HUD-approved housing counselors include

> -nonprofit consumer credit counseling agencies first established with support from banks to help consumers manage credit card debt, like Consumer Credit Counseling Services of Northeastern Pennsylvania

[8] Alan M. White, Deleveraging the American Homeowner, 41 *Conn. L. Rev*. 1107, 1119 (2009).
[9] For a directory of state IOLTA programs, *see* www.iolta.org.

-faith-based organizations that work on getting low- and moderate-income families into affordable housing and helping them avoid evictions and foreclosures, like Metro-Interfaith Housing Management in Binghampton, New York, Neighborhood Christian Legal Clinic in Indianapolis, and Council of Jewish Organizations of Flatbush in Brooklyn, New York,

- state housing finance agencies, and

-local community development organizations dedicated to housing and small business development in their communities.[10]

Interestingly, the settlement documents give the banks credit only for money going to the housing counselors, and not for state or national intermediaries like Neighborworks to distribute the funds and monitor their use. Presumably the banks will decide whether to contract with intermediaries or find another way to administer the distribution of funds.

HUD-approved counseling agencies receive federal, and in some cases, state funding support. They are therefore subject to detailed reporting and auditing requirements, designed to insure that funds are used for approved activities only. For example, in my state of New York, the Center for New York City Neighborhoods and the Empire Justice Center in Albany administer funds from the 2012 national mortgage settlement. Each housing counseling agency and legal aid provider must sign a detailed contract with the Office of the Attorney General to receive funds. The contracts make clear what activities are permitted, and prohibit lobbying or other misuse of funds. The contracts require housing counselor grantees to submit bimonthly reports with numerous data points, including the number of homeowners served and the foreclosure avoidance outcomes achieved.

Individual housing counselors must be trained and certified in accordance with the National Industry Standards for Homeownership Education and Counseling.[11] The National Industry Standards Committee developed these standards. Citigroup, Bank of America and Chase are all members of the NISC.

Housing counseling agencies typically receive funding from many sources, they must engage in detailed cost accounting, and they must submit activity reports to both government and foundation funders. There is no reason to believe the banks will not use similar contract oversight in complying with the settlements.

Legal aid agencies uniformly require their attorneys to keep time records and allocate every hour of every day to federal, state, local government funding or

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[10] A full list of HUD-approved housing counseling agencies is available at http://www.hud.gov/offices/hsg/sfh/hcc/hcs.cfm.

[11] http://www.homeownershipstandards.org/Home/Home.aspx

private grant sources, with detailed activity descriptions. The reports are audited by the federal Legal Services Corporation and state funders, and staff at these programs are keenly aware that they are accountable for any unauthorized use of funding, including for any prohibited political activity.

IOLTA-funded legal aid providers and HUD-approved counseling agencies count among them nonprofits with a wide variety of missions, religious and ideological viewpoints. It is preposterous to characterize a broad program of funding to these agencies as funneling money to left-wing activists, right-wing activists, religious zealots, or any other disfavored political group. What all these counseling agencies have in common is a commitment to putting American families into decent and affordable homes and keeping them there. The campaign of misinformation regarding the required bank support for legal aid and homeowner counseling does a serious disservice to these agencies, and to America's struggling homeowners.