TESTIMONY OF INGRID BECKLES

VICE PRESIDENT
SERVICING AND ASSET MANAGEMENT
FREDDIE MAC

before the

SUBCOMMITTEE ON HOUSING AND ECONOMIC OPPORTUNITY
COMMITTEE ON FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES

THE FORECLOSURE PREVENTION AND SOUND MORTGAGE
SERVICING ACT OF 2008
APRIL 16, 2008

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Before the Subcommittee on Housing and Economic Opportunity
Committee on Financial Services
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Chairwoman Waters, Ranking Member Capito, members of the subcommittee:

Good morning, and thank you for the opportunity to address the Subcommittee today. My name is Ingrid Beckles, and I am Vice President of Servicing and Asset Management at Freddie Mac. In this capacity, I oversee the servicing of Freddie Mac's single-family mortgages, which includes management of mortgage delinquencies, foreclosure actions, and the disposition of foreclosed properties. In my testimony, I'd like to briefly describe how Freddie Mac approaches mortgage delinquencies and foreclosure prevention, and offer some thoughts on how our experience might inform the Subcommittee's work on H.R. 5679, "The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008."

Freddie Mac's Role In the Mortgage Market

Freddie Mac is a government-sponsored enterprise, or GSE, created by Congress to bring liquidity, stability and affordability to the nation's residential mortgage markets. We do this by providing the primary market with a reliable secondary market for mortgages in all economic conditions. We are a shareholder-owned corporation, capitalized entirely by private-sector money.

Historically, Freddie Mac's guarantee and securitization activities have concentrated on the "prime" conventional conforming segment of the mortgage market, not the subprime mortgages that are at the center of the current crisis. At year-end 2007, we guaranteed more than $1.7 trillion of mortgage-backed securities, representing approximately 12 million mortgages.

Freddie Mac's mortgages continue to perform very well relative to other market sectors, despite the turmoil in the market. At year-end 2007, for mortgages we guarantee only about one mortgage out of 150 was seriously delinquent (90 days plus) or in foreclosure, compared to about one out of seven subprime mortgages, according to statistics from the Mortgage Banker's Association. Our serious delinquency rate is less than two-thirds of one percent (65 basis points). It is actually lower than it was five years ago, but also represents a 55 percent increase over the 2006 rate of 42 basis points. We expect that the rate will rise further in 2008. So while to date we may have experienced comparatively low delinquencies, Freddie Mac is not immune from the worsening conditions in the overall housing market.

We pool the mortgages we buy into mortgage-backed securities called Participation Certificates (PCs), which give the holder an undivided interest in the cash flows from the underlying mortgages. The guarantee we provide ensures investors that they will receive timely payment of principal and interest from these mortgages. Because we continue to own the underlying mortgages, however, we can proactively assist troubled borrowers. In the private-label subprime market, by contrast, ownership of the underlying mortgages

is diffused through the securitization structure, and servicing is governed by the terms of the Pooling and Servicing Agreement (PSA) entered into at the time the securities were issued. These contractual arrangements, as well as technical tax and accounting issues, make foreclosure prevention efforts for mortgages in subprime securities more challenging.

Freddie Mac's Delinquency Management Practices

Helping Delinquent Borrowers

At Freddie Mac, our interest in a mortgage, the home securing the mortgage, and the family whose home the mortgage finances starts when we purchase the mortgage. When a borrower becomes delinquent, our focus intensifies. We start from the proposition that foreclosure is not in anyone's interest – not the investor, the lender, and certainly not the homeowner. This is also the proposition underlying H.R. 5679. We are constantly reviewing our systems and processes for dealing with delinquent mortgages, and experimenting with new ones, all with the aim of keeping families in their homes, even when house prices are falling as they currently are some markets.

We know from experience that the earlier the servicer and borrower start to work out a delinquency, the more likely the borrower is to avoid foreclosure. We want every workout to be sustainable over the long term. For that reason, we emphasize early and frequent intervention with delinquent borrowers, as early as the first missed payment. We try to work out every delinquent mortgage, not just principal residences, because any foreclosure damages neighborhoods where other homeowners live, as well as causing losses to investors.

In 2007, we worked out three and a half times as many mortgages as we had to foreclose upon. Under our Seller/Servicer Guide, our basic contract with our servicers, we require, not just recommend, that our servicers work with borrowers to try to resolve troubled loans short of foreclosure. As a result, with the help of our servicers we entered into about 50,000 workouts – nearly 1,000 a week – that helped families stay in their homes. This level of workouts is an exceptionally high proportion of our seriously delinquent mortgages, which stood at about 79,500 at the end of 2007. By contrast, we foreclosed on only about 14,000 homes.

These workouts fall into three categories:

- Forbearances, under which mortgage payments are reduced or suspended for a defined period of time. Forbearances may be used to give troubled borrowers time to arrange other foreclosure alternatives, or to provide temporary relief to victims of natural disasters like Hurricane Katrina. In the wake of Gulf

hurricanes, we entered into more than 24,000 forbearance agreements in 2005 and 2006, but that number fell to 3,100 in 2007;

- Repayment plans, that allow borrowers to make up past due amounts over a period of months and return to compliance with the original terms of their mortgage. We entered into nearly 39,000 repayment plans in 2007; and

- Modifications, which typically involve changing the terms of the original mortgage in a way that allows the borrower to return his mortgage to good standing. Modifications may involve capitalizing any delinquency into the total mortgage amount, extending the term of the mortgage, and/or reducing the interest rate. When we modify an ARM, we generally convert it into a fixed-rate mortgage. We entered into more than 8,000 loan modifications in 2007, and expect 2008 volume to be even higher.

In every case, we want borrowers to be able to sustain the workout based on the circumstances at the time the family enters into it. When we do a loan modification, for example, we not only assess the borrowers' current income and other debts, but also whether the family's other living expenses, like food and fuel, are such that the modified loan will be sustainable. Reliance on outdated and less comprehensive information might simply set the borrower up for another failure. We also want to be sure that the family has sufficient cushion – about 20 percent of net disposable income – to cover unanticipated expenses that might otherwise force them back into default.

Since any workout must be sustained based on the borrowers' *present* financial situation, we do not support H.R. 5679's requirement that the affordability assessment be based on income information furnished by the borrower at the time of origination (unless the borrower volunteers current information). Our approach, which uses current information, has given us a very low re-default rate; our overall success rate is about 80 percent.

Unfortunately, some families experience circumstances in which they will not be able to keep their homes. In some of these cases, we may be able to help families avoid some of the short- and long-term effects of foreclosure through deeds-in-lieu of foreclosure or short sales, in which the borrower, working with the servicer, sells the home and pays a part of the outstanding loan, accrued interest and other expenses from the sale proceeds. H.R. 5679 aptly terms these "secondary loss mitigation activities." We engaged in more than 2,000 such transactions in 2007.

In the final analysis, most borrowers try to pay their mortgage as originally agreed, even if home values have fallen or personal circumstances make it harder than anticipated. Homeownership is a long-term investment. Freddie Mac and it servicers work diligently to accommodate borrowers in financial distress who have the capacity and desire to avoid

foreclosure. Foreclosures remain an important tool to protect investors' rights and recirculate properties that the borrower can no longer afford or does not desire to keep.

<u>Working with our Servicers</u>

My staff and I work with our servicers every day to ensure that together we can do the best job possible for delinquent borrowers. In our Seller/Servicer Guide, we spell out our loss mitigation expectations for our servicers. We measure our servicers' performance under the Guide against monthly performance benchmarks, which include minimizing credit losses and helping delinquent borrowers avoid foreclosure. If a servicer is performing poorly, we work with them to improve so that they may in turn better serve borrowers and their communities. If poor performance persists, we may limit the type of loans the servicer can service, or in extreme cases terminate its right to service Freddie Mac mortgages.

We have found, however, that while mandates provide clarity, the best way to encourage effective delinquency management is to combine carrots with any sticks. We therefore reinforce "good" behavior by providing financial incentives to servicers who help families avoid foreclosure – through per loan fees for completing repayment plans, modifications and foreclosure alternatives. These fees are in addition to the fees we pay servicers on each of our mortgages. We absorb these fees, rather than pass them on to families who are already in financial trouble, because we believe they are cost-effective in the long run. In 2007, we paid about $12 million in various incentive fees to our servicers.

Freddie Mac backs up these efforts by heavily investing in a variety of technology tools to assist servicers in prioritizing resources for resolving delinquencies, analyzing workout options and tracking workouts.

- EarlyIndicator® is a tool developed by Freddie Mac and widely utilized in the servicing industry. It scores the likelihood that a delinquent mortgage will cure or evolve into a more serious default. This score permits the servicers to prioritize staff resources and outbound contact, and provide special attention to the borrowers who are most likely to require help.

- Workout Prospector® is a tool available to servicers to analyze the optimal workout option based on a borrower's individual circumstances. The tool uses data regarding the loan, including borrower income/expenses and property value, and helps the servicer choose the best foreclosure alternative, such as loan modification, short sale, or deed-in-lieu of foreclosure.

- Workout Manager® enables servicers to analyze their entire portfolios of pending and completed workouts online. Workout Manager's intended users are a servicer's managers who need portfolio workout information on a daily basis. By using Workout Manager, a servicer has the daily workout information, which can be accessed to help the servicer spot problems sooner and increase the probability of successful completion of a workout. Essentially, this tool enhances the likelihood of workouts by applying portfolio technology to create workout processes that are efficient, effective and consistent.

Other Initiatives

We also have initiatives that focus specifically on at-risk borrowers. For example, we know that low- and moderate-income families are at higher risk of foreclosure, largely because they are more likely to live paycheck to paycheck than more affluent families, and may lack adequate reserves to get through tough times. We reinstated our requirement of pre-purchase counseling for some high-risk borrowers, and developed an intervention that linked delinquent borrowers who had financed their homes with certain "affordable" Freddie Mac mortgage products with housing counselors. We found that the counselors became a trusted intermediary between the borrower and the servicer until the borrower developed the confidence that the servicer could help. Through this initiative, nearly 8700 borrowers have avoided foreclosure. Our experience underscores the wisdom of H.R. 5679's incorporation of housing counselors into the loss mitigation process.

Consumer education is a critical component of our strategies – borrowers need to know that there are alternatives to foreclosure and that they should work with their mortgage servicer to see what alternatives might work in their circumstances. Falling behind on your mortgage is frightening and embarrassing, and in more than half of Freddie Mac's foreclosures servicers report they were unable to make contact with the borrower. Families have to understand that help is available before they can benefit from it. A 2007 Roper survey of delinquent borrowers we commissioned found that most – 86 percent – knew that their lender had tried to contact them, but more than half – 57 percent – were unaware of the availability of foreclosure alternatives. That is the bad news. The good news is that public awareness had increased from a previous survey in 2005. So consumer education is a keystone.

H.R. 5679

This hearing is about H.R. 5679, "The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008." Chairwoman Waters has explained that the bill reflects her frustration that subprime mortgage servicers are not moving quickly enough to offer delinquent borrowers sustainable alternatives to foreclosure. The bill would therefore

create a legal duty on servicers to make "reasonable" efforts to keep delinquent borrowers in their homes before foreclosing.

We do not believe that it is necessary to create an affirmative statutory duty that imposes particular loss mitigation activities on the entire mortgage market. Such a measure would add unneeded costs and complexity to delinquency management. Moreover, no matter what standard – FHA, VA, Freddie Mac, Fannie Mae, or some private mortgage investor – is picked, that standard and the practices underlying it may not be equally effective for all borrowers and in any event can always be improved upon. In the long run, a federal standard could chill innovation, discourage some investors from getting into the mortgage market, and ultimately raise costs for all borrowers.

If Congress decides legislation is needed, we recommend that it focus on the arena in which the problems arose – the servicing practices in the private-label mortgage securities market. The servicing practices in the prime market served by the GSEs and the government-insured market served by FHA and VA are not the problem, and should be not be covered by the bill. We also have some concerns with some of the bill's particulars. We have discussed these with Subcommittee staff, and we are pleased to continue those discussions.

We are pleased that H.R. 5679 recognizes that servicers need to be compensated for engaging in loss mitigation activities. I described how we use monetary incentives to reinforce our contractual loss mitigation requirements. But subprime servicing was never set up to deal with anything like the current level of delinquencies, and the servicing compensation structure reflects that. My understanding is that while the trusts reimburse servicers for foreclosures costs, they are not typically paid for working out a loan. This compensation arrangement is not sustainable if servicers are to help borrowers avoid foreclosure. H.R. 5679 would allow servicers to charge borrowers a "reasonable fee" for working out a loan, but we think this just adds to the burden on an already financially-strapped family and lowers the borrowers' chance of success. To fix this, one writer suggested that the FHA pay subprime servicers a fee for each workout, on the theory that this would be cheaper for the government than other interventions.[1]

Another idea is to protect subprime servicers from legal liability if they work out securitized mortgages. For example, under most PSAs, servicers have authority to work out loans, but must always act in the best interests of the trust. Some servicers have therefore expressed concern that working out loans would open them up to lawsuits from the investors. In addition, accounting rules may prevent servicers from taking action before borrowers become seriously delinquent. Senator Dodd has proposed creating a

[1] Steven Rattner, "Fixing the Housing Crunch," Washington Post A 17 (March 27, 2008).

"safe harbor" to protect against these eventualities – and we think it is certainly something to consider.

Conclusion

At Freddie Mac, we spend a lot of time thinking about how to address the turmoil in the mortgage markets. Like almost everybody else, we have concluded that there is no silver bullet, and that, unfortunately, things are going to get worse before they get better. For the moment, the combination of lack of borrower capacity and falling house prices demonstrates that there are no easy solutions to this problem.

Nevertheless, let me suggest some things that can be done to mitigate its effects:

- We agree that subprime servicing practices should focus on keeping families in their homes on a sustainable basis. Loan modifications, repayment plans and other foreclosure prevention initiatives are important, but we must recognize that that not all borrowers can afford the house they are now living in, and may have to transition to less expensive homes or rental housing.

- Help some borrowers refinance into mortgage products like Freddie Mac's SafeStep mortgages and FHASecure. It may be appropriate to consider other approaches that take house price declines into account. But unless the borrower has the capacity to afford the monthly payments, a refinance simply sets up both the lender and the borrower for a repeat of the earlier failure.

- Support, with the participation of the public and private sectors, community stabilization efforts of local and national non-profits and state and local governments hard-hit by the crisis. For this reason, we should not limit our interventions to principal residences. Any foreclosure has a negative impact on the whole community, lowering everyone's property values, evicting tenants, and cutting the supply of affordable rental housing.

I wish I could be more optimistic, but the housing crisis is going to be painful and take time to resolve. At Freddie Mac, we are committed to working with Congress, the Administration, our customers and other industry participants to find and implement effective solutions to this very difficult problem.

Thank you for the opportunity to address the Subcommittee. I will be pleased to answer any questions.