



Statement of David G. Kittle, CMB

**Chairman-Elect,
Mortgage Bankers Association**

before the

Subcommittee on Housing and Community Opportunity

Committee on Financial Services

United States House of Representatives

Hearing on

**“H.R. 5679, the Foreclosure Prevention and
Sound Mortgage Servicing Act of 2008”**

April 16, 2008

Chairman Waters, Ranking Member Capito, members of the Subcommittee, I am David G. Kittle, CMB, President and Chief Executive Officer of Principle Wholesale Lending, Inc. in Louisville, Kentucky and Chairman-Elect of the Mortgage Bankers Association¹ (MBA). I appreciate the opportunity to appear before you on behalf of MBA to discuss H.R. 5679, the Foreclosure Prevention and Sound Mortgage Servicing Act of 2008.

H.R. 5679 seeks to specify and require certain loss mitigation procedures to reduce the level of foreclosures on home mortgages. MBA's members share your desire to avoid foreclosure whenever possible. Such a goal serves the interests not only of borrowers, but also of our members and of the communities in which they do business.

Avoiding Foreclosures

None of us wants a family to lose its home, and MBA members are devoting significant time and resources to finding ways to help borrowers keep their homes. The tools mortgage loan servicers use to avoid foreclosure include forbearance and repayment plans, loan modifications, refinances and partial claims.² Servicers also use short sales and deeds in lieu of foreclosure to avoid foreclosure when the borrower does not wish to or cannot retain the home.

It makes good economic sense for mortgage servicers to help borrowers who are in trouble. Borrowers who are not able to stay current on their loans are costly to the servicer. Servicers must forward principal and interest payments to investors as well as remit taxes and insurance payments, even if borrowers are not paying them. In addition, servicers must employ significant human resources to contact borrowers, assess the situation, work on repayment plans and other loss mitigation solutions, and if these efforts do not resolve the situation, initiate and manage the foreclosure process.

Informal forbearance and repayment plans are generally the first tool servicers use to help borrowers. Servicers allow mortgagors to miss up to three monthly payments, with the explicit understanding that the borrower will make up the payment(s) over a short period. If the situation is more involved than a short-term cash crunch due to temporary unemployment or illness, a servicer may turn to a special forbearance plan, which will typically combine a period of postponed or reduced payments followed by repayment of the arrearage over an extended period.

¹ The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 370,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,400 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

² A partial claim is a one-time advance of mortgage insurance benefits from FHA to the servicer in an amount necessary to bring a mortgage current. A borrower must sign a promissory note, and a lien will be placed on the property until the promissory note is paid in full. The promissory note is interest-free and is due when the first mortgage is paid off or when the property is sold. Some private mortgage insurers offer a similar option.

Loan modifications are the next level of loss mitigation. A loan modification is a change in the underlying loan document. It might extend the course of the loan, change the rate, change repayment terms or make other alterations. Loan modifications are one solution for borrowers who have an ability to repay a loan, and have the desire to keep their home, but may need some help in meeting this goal because they cannot meet the original terms of the loan. Servicers also use refinances to assist delinquent borrowers and borrowers who are at risk of defaulting on the loans in the future.

HOPE NOW alliance members³ have worked aggressively to make all of the available tools as efficient as possible. Lenders and servicers worked diligently with the American Securitization Forum (ASF) to create a framework⁴ to quickly modify certain loans securitized in the secondary market. This effort has received the backing of the U.S. Departments of the Treasury and Housing and Urban Development (HUD), many Members of Congress, the federal banking agencies and state and local officials.

The focus of the effort has been to identify categories of current borrowers with subprime hybrid adjustable rate mortgages (ARM) who can be streamlined into refinancings or modifications. The ASF-established framework is adding to existing efforts to assist distressed borrowers. The key is to find solutions that help borrowers, but do not violate the agreements with investors who now own the securities containing these loans.

Servicers, however, can only help borrowers who make themselves available for help. Lenders today are making major efforts to increase borrower response rates. They are employing third parties, sending attention-getting mail, making phone calls, going door to door and using other means to reach out to people. The industry is working hard to promote the HOPE Hotline (1-888-995-HOPE). We need borrowers who are in trouble to contact us. Borrowers must respond to servicers' notices and phone calls, or reach out to their servicer at the first sign of trouble. The longer the borrower waits to seek help, the less likely he or she will qualify for loss mitigation. The servicer can only do so much. At some point, the servicer has to assume a non-responsive homeowner does not intend to pay off the obligation and keep the home.

It is also important to note the options for helping borrowers who purchased homes as investments are limited. During the housing boom of the last several years, there were many speculators and investors looking to profit from price appreciation. The strength of our economy relies on the willingness of people to take risks, but risk means one does not always win. During this time, a majority of these properties were purchased to try to capitalize on appreciating home values or to use rents as a source of investment income, or some combination of both. With the downturn in the housing market, a number of these investors are walking away from their properties and defaulting on their loans. In the third quarter of 2007, 18 percent of foreclosure actions started were on

³ See <http://www.hopenow.com/members/members.html> for a list of members.

⁴ See <http://www.americansecuritization.com/uploadedFiles/FinalASFStatementonStreamlinedServicingProcedures.pdf>

non-owner occupied properties. Foreclosure starts for the same period for non-owner occupied properties in Arizona, Florida, Nevada and Ohio were at 22 percent.

HOPE NOW helps all borrowers, not just subprime ARM borrowers eligible for fast track refinance or modifications. The ASF framework for a streamlined, scalable solution for current borrowers facing a reset allows servicers to give more detailed attention to at-risk, hard-to-reach borrowers. Servicers will be able to work closely with homeowners, directly or through credit counselors, to explore options to avoid foreclosure. The scalable outreach and modification effort in no way precludes ongoing work out solutions for the highest risk delinquent borrowers. By having this framework in place, mortgage company personnel and other resources are able to focus on the cases that require the most attention.

Why Mortgages Have Lower Rates than Credit Cards

While considerable effort is being made by lenders, borrowers and public officials to avoid foreclosure, we all recognize that there will be cases where this goal cannot be achieved. Ultimately, the mortgage contracts rest on two pillars: the promise of the borrower to pay and the ability of the lender to rely, in the last resort, on the house that is pledged as security for the loan. It is the pledging of the house as security that makes mortgage credit considerably less expensive than unsecured consumer debt. The rate of interest on mortgage loans is significantly lower than the rate on unsecured consumer loans. If Congress deprives borrowers, by legislation, of the ability to reliably pledge their homes as security for mortgage loans, it is probable that the rates borrowers pay for mortgage credit will approach the rates paid for unsecured credit.

In evaluating any legislation designed to reduce mortgage foreclosures, we would submit that Congress should ensure that the legislation:

- (i) enhances the likelihood that borrowers experiencing economic difficulties will be able to remain in their homes;
- (ii) does not unfairly deprive investors of the value of their investments in mortgage instruments; and
- (iii) preserves for all consumers the benefits of reasonably priced mortgage credit by maintaining the essential elements of the mortgage contract, particularly the ability to reliably pledge a house as security for the loan.

Provisions of H.R. 5679 that Should be Removed or Modified

In reviewing H.R. 5679, there are elements of the bill that fail one or more of the above three criteria.

- A. *Backdoor Moratorium on Foreclosures*: The bill would authorize borrowers' counsel to use "qualified written requests" and other procedural demands to block foreclosure indefinitely, imposing a backdoor moratorium on foreclosures.
- B. *Rewriting Mortgage Terms*: The bill's prescriptive loss mitigation provisions could require lenders not only to restructure mortgages, but to write down mortgage debt. The effects of these provisions will be (i) to deprive the holders of existing

loans of the ability to exercise their rights and remedies under the mortgage contract, and (ii) to increase the cost of mortgage credit to future borrowers.

- C. *First Mortgages Subsidizing Second Mortgages and Unsecured Debt:* By mandating debt-to-income ratios on first loans, the bill would appear to require holders of first liens to subordinate their economic interests to the interests of junior lien holders and unsecured creditors, which may be the source of the borrower's inability to stay current on the first mortgage payments.
- D. *Eliminating Flexibility Needed to Work Out Loans:* By prescribing detailed procedures and the order in which lenders are to proceed in mitigating losses, the bill would deprive lenders the flexibility required to negotiate effectively with borrowers to achieve a manageable debt payment schedule.
- E. *Paperwork Burden:* The bill would impose expensive and time-consuming paperwork requirements on lenders without any corresponding benefit to borrowers.

What follows is a more thorough explanation of each of these points.

A. Backdoor Moratorium on Foreclosures

The right created under H.R. 5679 for borrowers to file extensive "qualified written requests" for information regarding the status of their loans coupled with a prohibition on proceeding with foreclosure until a response to the "qualified written request" has been delivered will empower borrowers' attorneys to impose an effective foreclosure moratorium. Subsection (c) of the bill requires mortgage loan servicers to provide "at all times" responses to "qualified written requests." The bill also mandates that "no foreclosure proceeding may be initiated or continued against the borrower or the principal residence of the borrower during any period in which a qualified written request under this subsection is pending."

Borrowers' attorneys will have the opportunity to delay foreclosure indefinitely by issuing "qualified written requests" after default. The bill provides no restrictions on these requests. Without limiting the number, timing, content or delivery of "qualified written requests," the law effectively denies mortgagees the opportunity to exercise their right to foreclosure.

This *de facto* foreclosure moratorium will not benefit borrowers. In fact, a delay to foreclosure may unintentionally harm the borrower's ability to recover from defaulting on their loan. Through experience with borrowers who have defaulted, mortgage loan servicers have learned that the longer the borrower remains delinquent, the less likely he or she will be able to cure the delinquency and avoid foreclosure. An efficient foreclosure process actually benefits the borrower by stopping debt from continuing to accrue, and giving the borrower a reasonably clean break from a mortgage loan he or she cannot afford.

A law that indefinitely delays foreclosure through procedural hurdles will deprive the lender of necessary discretion and encourage borrowers to remain in delinquency or become delinquent hoping to use delay as a tactic to negotiate more favorable terms. Thus, what the bill intends as a procedural “safeguard” will, in fact, create a procedural barrier to resolving the status of the property.

Currently, the delinquency and foreclosure process provides adequate time for borrowers and lenders to work out a reasonable debt repayment schedule before borrowers lose their homes. Cases are generally not referred to a foreclosure attorney until the loan is 90-120 days past due. The foreclosure attorney must prepare the petition for foreclosure and file it with the appropriate court or begin the statutorily prescribed notices that pre-condition non-judicial foreclosure. In most cases, foreclosure is not a quick process. In New York, for example, it takes approximately 13 months from the petition filing date to reach foreclosure sale (i.e., an average of 19 months from due date of last paid installment to foreclosure sale). In Pennsylvania, it takes approximately 10 months. Foreclosure timelines are shorter in non-judicial states and those processes have been developed and vetted by the state legislatures over many decades.

It is important to stress that servicers continue to solicit borrowers for loss mitigation even when the loan is “in foreclosure.” In today’s market, trends indicate that about half of all people who enter foreclosure are able to avoid losing the home in a foreclosure sale (there are no reliable data to produce exact numbers). In fact, servicers will execute a viable loss mitigation arrangement up to the foreclosure sale date, provided state law does not require the servicer to restart the foreclosure action all over again for stopping or postponing the sale. Some states also offer redemption periods that allow a borrower to tender payment to the servicer after the foreclosure sale is complete and get the property back. Diligent borrowers have sufficient time to prevent a foreclosure if they qualify for loss mitigation.

H.R. 5679, by creating a new right to make virtually an unlimited number of “qualified written requests” regarding loan status and staying the foreclosure process until responses are received, sets up a procedural barrier to foreclosure that could turn into a backdoor moratorium on foreclosures. While foreclosure is not a desired outcome for the borrower or the lender, if legislation eliminates the possibility of foreclosure in any reasonable period, the incentive for a borrower to participate in work out negotiations is significantly diminished. Given the fact that lenders are already having difficulty persuading borrowers to contact them and to enter into negotiations regarding work outs, indefinitely postponing foreclosure is unlikely to facilitate resolution of the problems associated with delinquent loans. The only certain impact will be to call into question the right of the lender to realize on its security interest in the property, thus undermining a core element of the mortgage lending paradigm.

B. Rewriting Mortgage Terms

H.R. 5679’s provision for delay of foreclosure through “qualified written requests” and the mandatory loss mitigation activities required under the bill seem designed to force

mortgage loan servicers to rewrite the terms of the mortgage loan contract. The proposed addition of Section 6A to RESPA mandates that mortgage servicers “shall engage in reasonable loss mitigation activities that provide for -- (1) the long-term affordability of the loan; and (2) the maximum retention of home equity.”

The bill then provides a list of priority and secondary loss mitigation activities. While the bill’s mandate to engage in specific loss mitigation activities is ambiguous, these provisions, coupled with the “affordability” and “maximum equity” standards, can be read as a statutory redefinition of essential loan terms. Procedural barriers to the timely exercise of property rights can effectively eliminate those rights as a matter of law, and we fear that this could be the ultimate impact of H.R. 5679 on mortgage contracts. This being the case, (i) current holders of mortgage loans will be deprived of their legal rights, and (ii) because lenders will not be able to rely upon the security interests created under mortgage contracts in the future, the price of mortgage credit can be expected to rise.

This bill’s provisions that adjust a security interest in real property raise issues under the takings clause of the Constitution. The government may acquire property for public use or benefit, but it must provide just compensation to the owner. In this bill, Congress would alter the terms of mortgage loan holders’ security interest in real property, for the apparent public purpose of encouraging continued homeownership. A security interest vests a real property right protected by the Fifth Amendment of the Constitution. Under takings clause jurisprudence, a lender must receive just compensation if its preexisting property rights are to be extinguished.⁵ Federal Courts of Appeal have also consistently held that an indefinite delay on the right to foreclose constitutes a taking.⁶ Since this bill does not explicitly limit its effects to future loans, if Congress does enact the provisions of H.R. 5679 referenced above, it should include authorization for an appropriation to compensate lenders for any taking of their preexisting property rights that may result.

Given that mortgages often back securities that are widely held by institutional investors, including pension funds, university endowments and insurance companies, whose interests will be negatively affected if Congress enacts a mandate to write down principal and interest on home mortgage loans, there are strong public policy reasons supporting the constitutional mandate to provide just compensation.

The effectiveness of the mortgage market rests on the ability of the loan holder to recoup money lent based on the terms of the mortgage contract. If Congress, by statute, alters mortgage loan terms for existing and future mortgages, calling into question the ability of the loan holder to realize on its security interest in real estate, then the mortgage market as it exists today can be expected to change dramatically. One result may be a return to an era when borrowers with riskier credit profiles were shut out of the mortgage loan market altogether because lenders are unable to offer

⁵ See *Lingle v. Chevron U.S.A. Inc.*, 544 U.S. 528, 538-39 (2005)(holding that to determine whether a taking has taken place particular weight will be given to the extent the law interferes with investment backed expectations)

⁶ See e.g. *Simon v. Cebreck*, 53 F.3d 17, 24 (3d Cir. 1995); *Donna Independent School District v. Balli*, 21 F.3d 100, 101 (5th Cir. 1994); *Matagorda County v. Russell Law*, 19 F.3d 215, 225 (5th Cir. 1994).

affordable mortgage loans. Even borrowers with good credit histories will likely have to pay more for credit, because they will be unable to effectively pledge their homes as security for their loans.

Further, any provision that *mandates* an adjustment to the terms governing the amount of principal or interest paid over the course of the loan is unacceptable. The bill includes as a priority loss mitigation activity: “Waiver, modification or variation of any material term of the loan . . . that change the interest rate, forgive the payment of principal or interest, or extend the final maturity date of the loan.” MBA believes that while adjustments may be made to certain mortgage loan terms, providing by statute that borrowers may avoid their financial responsibility creates a moral hazard that would have serious repercussions throughout the consumer credit markets.

C. First Lien Mortgages Subsidizing Second Mortgages and Unsecured Debt

Through the bill's affordability provisions, first lien holders may, in effect, subsidize secondary creditors by providing for the borrower's junior debt in loss mitigation activities. Subsection (d)(3) of the bill requires “each mortgagee or servicer with respect to a senior lien shall reasonably take into account the obligations of the borrower or mortgagor under subordinate liens,” and “any other secured or unsecured obligations.” Under this provision, when making the debt-to-income calculations, a mortgage loan servicer will have to provide lower monthly payments for a borrower who has larger debts to junior lien holders, and even unsecured creditors. This would essentially reverse the priority position of the lien holders. Junior lien holders and unsecured creditors would have no incentive to adjust the terms of their credit agreement when the first lien holder faces a statutory obligation to provide loss mitigation activities, including principal write-downs that ensure “the long-term affordability of the loan and maximum retention of home equity.”

If enacted, this provision could also have the perverse effect of rewarding the most financially irresponsible borrowers. Since a first lien holder must provide for unsecured debt in rewriting loan terms, some borrowers may take advantage of this provision to increase credit card and other unsecured debt, knowing higher unsecured debt will cause further favorable adjustments in the payment terms of their first mortgage loan.

D. Eliminating Flexibility Needed to Work Out Loans

The bill prescribes in statutory terms a specific listing of activities a lender must take with respect to delinquent loans and prescribes the order in which they must be taken. It is extraordinary to use statutory language like this to micromanage the loan administration process.

The bill's rigid loss mitigation prescriptions do not accord to the realities of the mortgage marketplace. For instance, not all borrowers want to stay in their homes. Some have decided to stop making mortgage payments because to do so no longer suits their economic interests.⁷ For these individuals, loss mitigation would clearly be

⁷ See, for example, Said, Carolyn: “More in Foreclosure Choose to Walk Away,” *San Francisco Chronicle*: March 16, 2008 (<http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2008/03/16/MNFFVI036.DTL>)

unproductive. Focusing efforts on these borrowers would prevent mortgage loan servicers from giving full attention to borrowers who would benefit from loss mitigation activities.

For those borrowers that can use loss mitigation to keep their homes, the current goal within the mortgage loan servicing industry is to determine the appropriate loss mitigation activity as quickly as possible. Obviously, the faster the servicer can adjust terms of a loan, the greater the chance the borrower has to avoid foreclosure. The list of required loss mitigation activities that a mortgage loan servicer must employ in this bill would make a fast turnaround impossible.

This bill does not allow mortgage loan servicers the flexibility to include a merit test, which is essential to making loss mitigation economically feasible. Some borrowers have misused their credit by running up credit card or other debt. Some borrowers vandalize their property after becoming delinquent on their mortgage payments. Other borrowers stop making payments after unsuccessful home improvement projects. Recently borrowers with sufficient income to pay their mortgages are demanding principal write-downs simply because they now owe more on their mortgages than their homes are worth due to recent price declines in some markets. Federal policy should not encourage this behavior. By allowing these borrowers to remain in their homes, and in effect mandating modifications to their mortgages, this bill would increase mortgage and insurance costs, further drive down property values and absorb the servicer's limited capital resources to make modifications. Mortgage loan servicers need the flexibility to separate those borrowers who are deserving of loss mitigation and those who would abuse the opportunity to retain one's home that loss mitigation provides.

The duty to refer borrowers to a HUD-certified housing counselor raises another concern about industry flexibility. Subsection (i) in the bill requires the mortgage servicer to "forward to a housing counseling agency approved by the Secretary the contact information of the borrower." While housing counseling may be beneficial in some instances, mortgage loan servicers would like to have more flexibility in determining whether counseling would be productive. After all, mortgage loan servicers have the most information about the borrower and his or her property. As noted above, some borrowers are not interested in keeping their home. Other borrowers may be able to negotiate a beneficial loss mitigation activity without any counseling. Still others may be uncomfortable with an unfamiliar "counselor" knowing that they are delinquent in their mortgage payments. The bill also conflicts with existing privacy laws that restrict servicers' ability to share this information with third parties without the borrower's consent. There is no provision in the bill that addresses this conflict.

E. Paperwork Burden

Mortgage servicers could not feasibly comply with the bill's "qualified written request" provision. Subsection (4) of the bill requires mortgage loan servicers to "have available" for the borrower: (i) information regarding whether the account is current, (ii) the current balance due on the mortgage loan, (iii) full payment history, (iv) the initial terms of the loan, (v) a copy of the original note and security instrument, (vi) identification of the

owner of the mortgage note and any investors, (vii) any documents that limit or explain loss mitigation activities, and (viii) “any other information requested by the borrower that is reasonably related to loss mitigation activities.” This “availability” would require an extraordinary amount of paperwork for each loan at a significant cost to the mortgage servicer. The current mortgage servicing computer software may not include all of this information, and this provision would be a compliance nightmare for loans made before the effective date of the bill. Further, we do not believe this mass production of documents would benefit borrowers. Most borrowers would be flooded with information that would not assist them in resolving their delinquency or achieving a payment schedule that will allow them to keep their home.

Conclusion

While we share the goal of preventing foreclosures, MBA must oppose H.R. 5679 because of the harm it will cause to the mortgage market and borrowers. H.R. 5679 will increase rates, reduce availability of credit and dampen investor interest in mortgage instruments. Affordable mortgage loans depend on the security interest in the pledged home and the certainty that loan terms are enforceable. Combined with additional regulatory burdens placed on mortgage servicers through paperwork and unnecessary bureaucracy, H.R. 5679 would strike a significant financial blow to the industry. With investor appetite for U.S. mortgages waning, it is ill advised to pass legislation that will further disrupt the mortgage market.

We urge Representatives to consider carefully the long-term implications of H.R. 5679, not just the perceived benefits the bill would provide to some homeowners whose loans are delinquent. We believe that even the intended beneficiaries are unlikely to be advantaged by this legislation, and investors in mortgage assets are likely to be significantly disadvantaged as their investments become illiquid because of uncertainties the legislation would introduce. We are convinced that, upon review, Congress will agree that this bill is not a prudent solution to current challenges.

Thank you for the opportunity to share our thoughts with the Subcommittee. I look forward to answering your questions.