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Good morning Chairwoman Maloney, and members of the Subcommittee. My name is Larry B. Litton, Jr., and I am the President and Chief Executive Officer of Litton Loan Servicing. I appreciate the opportunity to bring the perspective of the servicing agent to this important discussion of "The Role of the Secondary Market in Subprime Mortgage Lending." Litton was founded in 1988 by my father, Larry Litton, Sr., in the midst of a similar real estate and mortgage default crisis that was concentrated in Texas in the late 1980s. My father's vision was to create a new kind of mortgage servicing company that focused substantial efforts on providing high levels of customer care with an emphasis on curing delinquent loans. Over the years we've developed a host of flexible options that we offer to consumers who have experienced financial hardships. Our vision was that investors would find value in our ability to cure loans, and this vision led to the growth of our business.

In 1996, Litton was acquired by Credit-Based Asset Servicing and Securitization (C-BASS). C-BASS is an investor in closed mortgage loans, and an active issuer and purchaser of mortgage-backed securities. Because C-BASS holds the credit risk on a significant percentage of the loans serviced by Litton, Litton's main focus is protecting C-BASS's core investment, not functioning as a "fee-for-service" company. Litton's key interest is in reducing losses rather than keeping costs down or generating revenue through fees. This structure ensures that the interests of the consumer, servicer, and investor remain aligned.

Today, Litton services 400,000 loans totaling $60 Billion in principal balance. We are regarded as an industry leader in servicing subprime and Alt-A loans. I believe that in general, the entire mortgage industry is committed to finding ways to enable families to maintain homeownership. The development of the subprime secondary market, the expansion of subprime product innovations, and the growth of mortgage securitization have all increased the availability of home loans to all borrowers, boosting the country's homeownership rate to its highest levels ever during the last 30 years. Responsible, fair, and appropriate extension of credit is key to providing the opportunity to every American to own a home, and even as we face a widespread foreclosure and delinquency crisis, it is important that we preserve access to credit for all borrowers, and provide second chances where appropriate to borrowers who may have had a credit problem in the past.

Mortgage servicers are accountable to two key constituents – consumers and investors. We are in a unique position, and interact at the crossroads where the capital and secondary markets intersect with consumer's interests. The interests of investors and consumers are both aligned to help the borrower keep his or her house. Foreclosures lead to credit losses for investors – the average foreclosure costs investors fifty cents on the dollar. When foreclosures occur, investors lose, consumers lose, and communities lose. It is worth noting that in 2006, Litton saved over 70,000 homeowners from foreclosure and we estimate that in 2007 we will help keep over 95,000 customers in their homes.

Let's discuss solutions. Rising mortgage payments, reduced credit availability, and the decline in home prices have created financial hardship for a growing number of homeowners. Litton employs a number of proactive strategies to assist borrowers facing financial difficulties, while managing to meet our responsibilities under the law and our contracts with our investors.

Some of our strategies include early and active contact with borrowers facing pending rate and payment resets, delinquency or default: modification of existing loans to provide long-term affordability; broadening relationships with third party organizations to assist in communication efforts with borrowers; making available credit counseling services, and implementing alternatives to foreclosure when that option is unavoidable.

We strongly believe that providing loan modification options to consumers is the number one tool we have available to deal with the impending issue of ARM resets. Litton has made use of modifications for years, and over the last few years, we have modified in excess of 10,000 loans with great success. These modifications provide payment relief for the consumer by restructuring loan terms based on the consumer's demonstrated willingness and ability to pay. When done properly, modifications (through payment deferrals, extensions of maturity date, waiving or capping arrearage, and interest rate reductions) provide the consumer with payment relief while reducing credit losses to the investors. The goal of any loan modification program should be to provide borrowers with the opportunity to make good on their financial obligation, and to create long-term affordability.

Others in the industry are employing "extension" strategies which may look like a modification but aren't. These extensions defer dollars owed without fundamentally changing the terms of loan, and they generally do not have a payment relief feature. Over time, investors could actually see increased losses associated with these extensions due to potentially high re-default levels. In fact, there is a precedent – several years ago, the manufactured housing industry used extensions as a way to cure delinquent loans. The net effect was that losses were merely deferred, and investors and homeowners were both big losers.

I must emphasize that the current wave of defaults we are seeing today has little to do with ARM resets. This initial default wave is a result of early payment defaults associated with the 2005 and 2006 originations and we believe it is merely the tip of the iceberg. These early payment defaults are generally the result of lax underwriting standards, improper documentation, or borrower fraud. The real impact of ARM resets will be seen in increasing defaults later this year and into 2008 as many borrowers experience payment increases associated with the upcoming rate increases on their ARM loans.

To get in front of the next wave, servicers need more flexibility to modify loans that are current, but are at risk of going into default. Too often, servicers trying to act in the best interest of both the homeowner and the bondholder are hamstrung by legal, accounting, and tax rules that prevent us from working with borrowers as thoroughly as we need to. In particular, I would highlight to the committee the accounting issues related to modifying loans in structured transactions, particularly FASB 140. Current understanding of accounting rules force servicers to be overly conservative when exploring options to help borrowers facing financial difficulties. Unless a loan in a structured transaction is in default, or imminent default as determined by the servicer, it cannot be modified. A servicer who attempts to modify a loan that is "current" cannot do so without facing significant accounting implications. This is a problem when borrowers are making payments on teaser rates, but will not be able to afford the rate reset on an ARM loan. Given that more than half of the loans originated in 2006 were ultimately sold to investors as mortgage-backed securities, the need for flexibility for servicers to attempt to maximize the value of the underlying loans in a securitization is more important than ever.

We do not advocate an across-the-board, "modify everybody" approach. This would be devastating to those investors who have purchased mortgage-backed securities and would cause a dramatic reduction in credit provided to the housing market. The fact is that most consumers have the ability to pay, and are in fact, making payments, and most will continue to be able to do so, even in the face of resetting rates. It is important to remember that as Americans, we believe that personal responsibility is an important part of the social contract, and repayment of debt is an important piece of that contract. All citizens have a responsibility to pay debts they owe. However, lives and communities are harmed by foreclosures. Consumers who cannot pay deserve a fair review of their loans and their ability to pay, simply because foreclosure is almost never the best answer. We believe that modifications have to be made one loan at a time, as each borrower, his loan, and his financial circumstances are different.

I would fear any holistic strategy aimed at blindly “fixing” every subprime loan. Such a strategy would lead to an accelerated flight of capital out of the mortgage markets, and that in turn would hurt homeownership opportunities for those that need help the most. Litton and C-BASS do not originate loans; however, we do believe that regulation of mortgage brokers, who have no fiduciary obligation to either the borrower or the lender, would go a long way to help reduce predatory lending, misrepresentation of loan terms to trusting borrowers, and/or misrepresentation of borrower financial ability to lenders.

Another issue that we believe should be seriously considered is requiring subprime borrowers to establish an escrow account. Historically, escrow accounts have not been required for these borrowers when they enter into a loan agreement. For borrowers struggling to remain current in their mortgage payments, the burden of a once a year tax and insurance payment can cause additional difficulty. We believe that going forward, escrow accounts should be required in order to ensure that the borrower remains able to afford the payments for the life of the loan.

The idea of a foreclosure moratorium is a bad idea for the industry, and the economy as a whole. Moratoriums and bailouts tend to encourage bad behavior, and may provide an incentive for borrowers to default on their loan obligations without penalty. Unfortunately, servicers are not always successful in their attempts to avoid foreclosure, and foreclosures are a necessary process in order for investors and lenders to recover the money they are owed. A moratorium forces us to believe that all borrowers facing financial difficulties are exactly the same, when in reality each loan, each borrower’s financial situation, even each community is different. Servicers need to be able to evaluate each individual situation, the circumstances currently facing the borrower, and the borrower’s willingness and ability to repay the debt. Denying investors the ability to recover invested capital will accelerate a flight of capital out of these markets. Rather than a full moratorium, we would suggest encouraging servicers to adopt a two-week delay – which we have already implemented at Litton - in the process for every borrower referred to foreclosure. This solution achieves the same goal of a moratorium by slowing the process down without significantly driving expenses up, which in turn keeps losses down. That two-week period gives the servicer additional time to communicate available options to the borrower, while giving the borrower additional time to explore their options as well as find help available through neighborhood and national advocacy groups.

Another obstacle facing servicers comes from the Rating Agencies. Servicer ratings and required language in the Pooling and Servicing Agreements related to Mortgage-Backed Securities transactions restrict some servicers more than others when it comes to ability to modify loans. It is in the best interest of consumers if all servicers have the flexibility to modify loans, when warranted. A level playing field is in the best interest of consumers – because when a servicer's options are restricted, more foreclosures are the ultimate result.

With respect to mortgage-backed securities, it is unlikely that any participant in the process would want to encourage the origination of loans where there is little to no expectation of payment. The success of mortgage-backed securities is dependent on the expectation that homeowners would generally want to find a way to make their monthly payments, and keep their loans current. These payments are what ultimately form the cash flow paid to bondholders and it is generally in everyone's best interest that foreclosure be avoided as often as possible. Everyone loses – the borrower, the investor, and the servicer – when foreclosure is the only option. Every participant in the process is interested in reducing defaults and lowering delinquencies.

In any discussion of a legislative solution to the subprime crisis, it is important to note that securitization has allowed homebuyers an unprecedented access to credit, increasing homeownership rates throughout the United States. Securitization allows this increase in lending to be achieved without an excessive concentration of risk in any one area of the economy. Short and long-term market disruptions can be absorbed without major impact to the larger economy. Any potential legislative responses to the current concerns regarding increasing delinquency rates should be evaluated carefully to ensure that they are not overly restrictive to those entities working diligently to help borrowers keep their homes, nor overly restrictive to consumers who need access to fair and appropriate mortgage credit in order to purchase or refinance their homes, or to the investors who bought the mortgage-backed securities in good faith.

Finally, it is important to understand that variations in local economies create pockets where some communities are hit harder by the current subprime crisis. It is in these areas that Litton believes that community organizations can deliver help and solutions more rapidly and more effectively than government involvement. Legal restrictions in the way servicers are required to communicate with borrowers can create problems that may only be solved through the intervention of local, grassroots advocacy organizations. Borrowers facing financial difficulties – and the possibility of losing their homes – are more often than not confused, frightened, and unaware that there are options available to them. Because servicers are required to inform customers that any communication is an “attempt to collect their debt,” customers who need help most are often reluctant to contact their servicer directly for fear that an admission of financial hardship is a fast track to foreclosure. Litton conducts aggressive outreach to borrowers in communities experiencing high delinquencies, however, in many cases, customers are more comfortable speaking to their neighborhood organization than directly to us. We are in favor of not only providing funding and support to these types of organizations, but in creating relationships between the organizations and the servicers to assist in efforts to reach homeowners who want to make a sincere effort to save their homes. We don’t care how borrowers get in contact with us – as long as they do. We can’t help borrowers until we can communicate with them. We also believe that these relationships are a two-way street. Consumer groups need to behave responsibly and recognize that not all corporate entities are “bad,” and not all consumers need, or deserve, a loan modification.

In summary, Litton is in favor of the following initiatives to address the issues in the subprime market: servicers engaging in early and frequent contact with borrowers who, in their estimation, face a high likelihood of default based on their loan product; servicers actively engaging in appropriate loan modifications if the borrower's financial situation warrants such a modification and there is a willingness on the borrower's end to satisfy their debt, and the modification is appropriate in that it creates long-term affordability; requiring escrow for tax and insurance payments, and giving servicers more flexibility under current accounting standards, to modify loans within securitizations before they default. Litton is opposed to a nationwide foreclosure moratorium, and would prefer a recommended two-week delay before any foreclosure action proceeds in order to allow borrowers more time to explore the options available to them. Litton is also a strong believer in working with third-party and community organizations in order to provide counseling and communication channels to reach out to borrowers who may be too scared to contact their lender or servicer directly. Support of these types of relationships at the federal, state, and local level would go a long way to mitigating the impending increase in delinquencies and foreclosures.

I would like to thank the Chairwoman and the members of the Subcommittee for the opportunity to share Litton's perspectives on the subprime mortgage market and I would be happy to answer any questions you may have.