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Questions for the Record from the Congressional Oversight Panel

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Timothy F. Geithner

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Congressional Oversight Panel Hearing on June 22, 2010
Questions for the Honorable Timothy F. Geithner
Secretary of the Treasury

<u>Questions for the Record from Elizabeth Warren, Chair, Congressional Oversight Panel</u>

1. From its first report on foreclosure mitigation in March 2009, the Panel has expressed serious concerns about the size and scope of HAMP and has raised questions about whether the relief afforded to homeowners would result in foreclosure avoidance or merely foreclosure delay. The data in the 15 months since then have confirmed that the program is clearly troubled. While Treasury has made numerous announcements, it has yet to demonstrate a track record of strong results. What is the status of the various initiatives and programmatic changes Treasury has announced in 2010? When will they be fully implemented?

A: We disagree with your conclusion that HAMP is "clearly troubled." While we continue to make improvements and additions to our housing programs, HAMP is an effective program that has provided immediate relief and helped hundreds of thousands of responsible American homeowners avoid foreclosure, stay in their homes, and get back on their feet. The Obama Administration took office in the middle of the most serious housing crisis in decades. Home prices had fallen for 30 straight months. Stresses in the financial system had reduced the supply of mortgage credit, limiting the ability of Americans to buy homes. And millions of responsible American families who were making their monthly payments—despite having lost jobs or income—had seen their property values fall, and were unable to sell or refinance at lower mortgage rates. The combination of falling home prices and economic contraction had dramatically increased the financial strains on many responsible homeowners.

At the time, there was no consensus among loan servicers about how to respond to responsible borrowers who were willing to continue making payments but were in need of some mortgage assistance. There were no accepted 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. Before HAMP, there was no program of any significant size or scope, public or private, to modify mortgages for affordability. As a result, the solutions offered by servicers often merely added unpaid interest and fees to the mortgage balance, resulting in higher—not lower—payments for homeowners.

During its first month in office, the Administration took aggressive action. It announced the Homeowner Affordability and Stability Plan, which provided numerous forms of relief, including: support for Fannie Mae and Freddie Mac to maintain broad availability of affordable mortgage credit; increased flexibility for Fannie Mae and Freddie Mac in refinancing mortgages to provide homeowners with lower monthly payments; tax credits to support development of affordable housing; and support to state and local housing finance agencies. HAMP was an important part of this comprehensive response. It was designed to offer responsible American homeowners reduced monthly mortgage payments that are sustainable over the long-term.

Through HAMP, 1.3 million homeowners have already received real payment relief (a median monthly payment reduction of $500) and nearly 400,000 have had their loans permanently modified.

Based on survey data from the eight largest servicers, homeowners unable to complete a HAMP modification are still receiving help, and in more than 85% of cases, have been able to avoid foreclosure. Preliminary results show that approximately one-half of homeowners not ultimately converting to a permanent modification have received some form of private-sector modification and the majority has avoided foreclosure through some alternative solution. These numbers help demonstrate that HAMP has changed the servicing industry in a way that is providing broader access to affordable modification options for homeowners both inside and outside of the HAMP program.

Within the past few months, we have announced details of key enhancements including incentives for principal reduction and unemployment forbearance. In conjunction with HUD, the Administration has announced a Federal Housing Administration (FHA) refinance option for underwater borrowers. We have also taken a number of steps to enhance HAMP, including prohibiting foreclosure referrals until a borrower has been fully evaluated for HAMP, simplifying required documentation and making critical improvements to complaint escalation and resolution processes. We are already beginning to see progress from these efforts and believe that HAMP is poised to meet the continuing demand.

These improvements and new programs include:

- Second Lien Modification Program (2MP) – Seven servicers, representing approximately 50 percent of all second liens, have enrolled to modify second liens in their portfolios when a corresponding first lien is modified under HAMP. Wells Fargo, Bank of America and JPMorgan Chase have all begun 2MP modifications in cases where they hold both the first and the second lien. The remaining participating servicers are scheduled to begin in late August 2010.

- Home Affordable Foreclosure Alternatives Program (HAFA) - Incentives for short sales and deeds in lieu of foreclosure, included in HAFA, became effective on April 5, 2010. We expect to begin reporting this activity in the fall.

- Home Affordable Unemployment Program (UP) – Mandatory forbearance for qualified unemployed borrowers becomes effective August 1, 2010.

- Principal Reduction Alternative (PRA) – We expect this to be effective by the fall - servicers will be required to evaluate every loan with a loan to value in excess of 115 percent to compare the NPV of a modification including principal reduction to the NPV of a standard HAMP modification. However, to encourage principal reduction approaches as quickly as possible, servicers are eligible for financial incentives for any principal reduction completed now as well.

2. The Panel's April 2010 report recommended that Treasury articulate clear goals and metrics by which the foreclosure mitigation programs could be judged.[1] SIGTARP and GAO have both made similar recommendations. To date, there has been no independent metric set out in advance by which success—or failure—of the foreclosure prevention program might be evaluated. Instead, Treasury has indicated that the program would help 3 to 4 million borrowers, which seems to mean only that this is the number of borrowers who will be offered a modification during the life of the program, not the number of borrowers actually receiving a modification or the number of borrowers experiencing long term success in a modification.

- **Why has Treasury refused to specify any metrics to evaluate the housing programs?**
- **Will Treasury identify any clear metrics for evaluating the success or failure of the housing programs, as recommended by COP, SIGTARP and GAO?**
- **What number of temporary modifications do you believe are necessary for the programs to be considered a success?**
- **What number of permanent modifications do you believe are necessary for the programs to be considered a success?**
- **What percentage of permanent modifications must still be in place at the end of five years for the programs to be considered a success?**
- **Treasury has modified the foreclosure program, but it has provided no metrics to determine whether those program changes are effective. Will Treasury identify any clear metrics for evaluating the success or failure of the changes that it has made to the housing programs?**

A: In February 2009, Treasury set a goal to "offer reduced monthly payments for up to three to four million at-risk homeowners," providing these homeowners with a second chance to modify their mortgages and "avoid foreclosure." This projection was based on the best available estimate at that time of the number of HAMP – eligible households that were likely to require assistance during the four-year duration of the program. As economic conditions have changed, Treasury has enhanced programs to address the impact of conditions such as increased unemployment and decreased home values on borrowers (e.g., unemployment forbearance, principal reduction). These enhancements are designed to ensure that the HAMP program can reach as many distressed borrowers as feasible.

Since the program began, the Administration has consistently strived to not only meet this baseline goal, but exceed it by translating this initial help into sustainable outcomes for borrowers that allow families to remain in their homes or avoid foreclosure through transitioning to other housing through efforts like the Home Affordable Foreclosure Alternatives program (HAFA). We believe that the most significant measures of success for the program are not just how many borrowers start trial modifications or even permanent modifications, but whether families are able to avoid foreclosures and how effective the program is in stabilizing neighborhoods and the housing market.

Additionally, transparency in the program's public reports suggest a number of other performance measures that go beyond whether a homeowner has received a permanent

[1] Congressional Oversight Panel, *April 2010 Oversight Report: Evaluating Progress on TARP Foreclosure Mitigation Programs*, at 95-97 (Apr. 14, 2010) (online at http://cop.senate.gov/documents/cop-041410-report.pdf).

modification. Since the first Servicer Performance Report in July 2009, these public reports have grown as more data becomes available and have become far more indicative of the effect HAMP has had galvanizing the mortgage industry and proliferating affordable solutions for homeowners.

The monthly reports state the number of trial offers, trials started, and permanent modifications completed each month since November 2009. The monthly reports also show servicer-specific progress – providing the percentage of delinquent loans against offers, trials, and permanent modifications. The report also provides information by servicer on the percentage of trial modifications converted to permanent modifications. These comparative performance metrics by servicer provide a good measurement of the program's progress. Treasury plans to continue reporting monthly these program performance metrics.
Lastly, with lessons learned from the past several months of full capacity operations, Treasury is increasing the number of performance metrics each month. For example, Treasury is now reporting data on servicer performance, including time to answer incoming borrower calls, time to process HAMP applications from homeowners, and time to resolve complaints raised by third parties (i.e., counselors, attorneys and government agencies).

3. Since the housing crisis began in 2007, the problem has evolved. New layers of borrowers have entered foreclosure, from subprime borrowers, to unemployed homeowners, to discouraged homeowners who see no reasonable possibility of paying off their homes. In the latter category, one-fourth of all mortgage holders now owe more money than their homes are worth and websites like youwalkaway.com clearly demonstrate that a number of families are considering that option. As the crisis continues to evolve after October 3, 2010, what authority will Treasury have to make changes to the foreclosure mitigation programs?

A: Under the Dodd-Frank Wall Street Reform and Consumer Protection Act, Treasury's authority to initiate new programs under the Emergency Economic Stabilization Act of 2008 (EESA) has expired. In addition, after October 3, 2010, Treasury will no longer be authorized to obligate new funds under existing programs, but will still have some limited flexibility to modify existing programs, subject to restrictions set forth in its contracts with servicers and the apportionment in place as of October 3, 2010.

Similarly, for the Housing Finance Agency Innovation Fund for the Hardest-Hit Housing Markets ("HFA Hardest-Hit Fund"), the states are permitted to introduce new programs within their individual state allocations, provided, of course, that any such new programs meet the terms of the contracts with the related state and the other requirements of EESA.

4. The Panel held a hearing in March with Citigroup CEO Vikram Pandit and Assistant Secretary for Financial Stability Herb Allison. In a question for the record of that hearing, the Panel asked Assistant Secretary Allison about "the unique challenges and potential remedies for unwinding a foreign financial institution with significant U.S. operations or a U.S. financial institution with significant overseas operations". In his response, Assistant Secretary Allison noted the ongoing work of the G-20 leaders and the Financial Stability Board they established to "promote the implementation of effective regulatory, supervisory, and other financial sector policies".

In the aftermath of TARP and other rescue efforts in the United States, how do we assure that very large multinational financial institutions do not exploit the implicit guarantee that this experience has served to confirm by moving their operations to more lenient countries?

A: Domestically, the Dodd-Frank Wall Street Reform and Consumer Protection Act gives the federal government the authority to shut down and break apart large non-bank financial firms whose imminent failure might threaten the broader system. Modeled on the FDIC resolution process, this resolution authority closes a gap that severely limited the federal government's options during the crisis. Internationally, we are working to achieve high-quality standards and a level playing field. The Administration has taken a leadership role in the G-20 to bring all global institutions and markets within a more transparent regulatory system. G-20 Leaders have committed to act together to raise capital standards, to implement strong international compensation standards aimed at ending practices that lead to excessive risk-taking, to improve the over-the-counter derivatives market and to create more powerful tools to hold large global firms accountable for the risks they take. Standards for large global financial firms should be commensurate with the cost of their failure. Now we are working to reach agreement internationally on reducing leverage and raising capital requirements, improving both the quantity and quality of capital. While new measures must be phased in over time so as not to interfere with the flow of credit, establishing those rules now can be an important source of certainty and confidence.

4a: How can we prevent very large financial institutions from taking advantage of the weakest regulatory environments to take excessive risks?

A: The United States has played a leadership role in driving an ambitious reform agenda internationally. G-20 Leaders have committed to take action at the national and international level to raise standards together so that our national authorities implement global standards consistently in a way that ensures a level playing field and avoids fragmentation of markets, protectionism, and regulatory arbitrage. Internationally, we have developed and begun implementing sweeping reforms to tackle the root causes of the crisis and transform the system for global financial regulation. Substantial progress has been made in strengthening prudential oversight, improving risk management, strengthening transparency, promoting market integrity, establishing supervisory colleges, and reinforcing international cooperation. We have enhanced and expanded the scope of regulation and oversight, with tougher regulation of over-the-counter (OTC) derivatives, securitization markets, credit rating agencies, and hedge funds. We continue to work together in the G-20 and the Financial Stability Board to reach consensus on achieving more rigorous global financial regulation and supervisory procedures. For example, at the Toronto Summit in June, G-20 Leaders reaffirmed their support for a strengthened capital regime, underscoring that banks should hold enough capital to absorb losses of the magnitude arising in the recent financial crisis. Given the depth of the recent recession, there is a high bar for bank capital. The Basel Committee on Banking Supervision is working hard to reach an agreement on improved capital standards in time for the Seoul Summit in November.

4b: What can you tell us about the progress that the international organizations are making in establishing a coordinated process for unwinding multinational banks that are facing insolvency?

A: We have advocated reforms to make the global financial system safer for failure. Our objective is to ensure that taxpayers will no longer bear the costs of financial crises. Our regulatory reform legislation expands the FDIC model for winding down failing banks to include authority for dealing with other types of financial institutions, and will ensure that the financial industry – and not taxpayers – bears the costs of responding to a financial crisis. In Toronto, in late June, G-20 Leaders committed to implementing national resolution authorities based on the Basel Committee's work. That work has identified improvement of national resolution systems, better cross-border management mechanisms and convergence of national laws as the most effective way forward. Leaders also called on the Financial Stability Board to consider and develop concrete policy recommendations to effectively address problems associated with, and resolve, systemically important financial institutions in time for the Seoul Summit. G-20 Leaders also have supported firm-level rapid resolution plans to enable firms to facilitate resolution. Firm-specific crisis management groups are being established as well.

5. At the Panel's March hearing on Citigroup, both Citigroup CEO Vikram Pandit and Assistant Secretary for Financial Stability Herb Allison testified that the firm was not on the brink of failure in November 2008, despite the fact that Treasury provided it with $20 billion in capital on top of the $25 billion it provided in October 2008.

- **While these decisions were made by the prior administration, do you have a view on Citigroup's financial position in November 2008?**
- **If it was not on the brink of failure, why was it necessary for the government to provide Citigroup with an additional $20 billion in capital and a guarantee on a portion of potential losses on a $301 billion pool of assets? If it was on the brink of failure, why was bankruptcy (and/or its banking equivalent) not an option?**

A: By way of clarification, at the Panel's March hearing on Citigroup, in response to a question as to whether Citigroup was a failing institution on November 21, 2008, Assistant Secretary Allison testified as follows: *"I think that Citi, and a number of other banks -- many banks -- were on the brink of failure had the system not been underpinned by actions of the government - including the Federal Reserve, as well as the U.S. Treasury."*

Although the October 2008 announcement of the initial investments under the Capital Purchase Program (CPP) was well received, the outlook for the U.S. economy and Citigroup continued to deteriorate in subsequent weeks. For example, the credit default swap (CDS) spread on 10 year senior Citigroup debt fell from 354 basis points on October 13, 2008 - the day before the announcement of Treasury's CPP investment - to 161 basis points the following day. The spread was back up to 378 basis points on November 21, 2008 - the last trading day before the announcement of assistance to Citigroup under what became known as the Targeted Investment Program (TIP) and the Asset Guarantee Program (AGP). At the same time, broader measures of risk throughout the financial system were also highly unstable. The VIX Volatility Index fell from 70 on October 10, to 55 on October 14, but was back up to 73 on November 21. Due to the deterioration in confidence, there was concern that, without government assistance, Citigroup would not be able to obtain sufficient funding in the market over the following days.

During the week of November 17, 2008, as the outlook for the U.S. economy and the market's perception of Citigroup continued to deteriorate, representatives of the Federal Reserve, the FDIC, Treasury and Citigroup participated in meetings and conference calls to discuss Citigroup's financial position, as well as the logistics of a coordinated government response.

As the Federal Reserve observed in recommending a systemic risk determination regarding Citigroup's insured depositary institution subsidiaries, a failure to act to reestablish confidence in Citigroup by providing additional liquidity and an asset guarantee program would have had a significant adverse effect on U.S. and global financial markets. A further deterioration of Citigroup would have led investors to doubt the ability and willingness of U.S. policymakers to support U.S. banking institutions and financial markets, notwithstanding Treasury's prior CPP investments. As a result, funding markets would likely have frozen, and other large U.S. banking organizations would have been extremely vulnerable to a loss of confidence by wholesale suppliers of funds. Investors would have been concerned about direct exposures of other financial firms to Citigroup, and might have begun to doubt the financial strength of other large U.S. financial institutions that might have been seen as similarly situated, likely weakening overall confidence in U.S. commercial banks.

More generally, given Citigroup's substantial international presence, global liquidity pressures would likely have increased and confidence in U.S. assets more broadly could have declined. Moreover, in the event that Citigroup would have been unable to obtain sufficient funding in the market in that period, losses on Citigroup paper could have led some money market mutual funds to "break the buck." All of these effects would likely have caused investors to raise sharply their assessment of the risks of investing in U.S. banking organizations, making it much less likely that such institutions would be able to raise capital and other funding despite the efforts of Treasury under the CPP.

The worsening of the financial turmoil that would likely have resulted would have further undermined business and household confidence. In addition, with the liquidity of banking organizations further reduced and their funding costs increased, banking organizations would likely have become even less willing to lend to businesses and households. Beyond the much greater severity of the financial crisis that would have ensued, these effects would have contributed to weaker economic performance, higher unemployment, and reduced wealth, in each case materially.

As a result of these conversations, and, in consultation with the Federal Reserve and the FDIC, Treasury concluded that given the state of the U.S. markets, the economy, and the size, importance and inter-connectedness of Citigroup, additional action was necessary to promote financial stability, and that failure to act would have severe repercussions on global financial markets and the economy.

Regarding your question about the bankruptcy option, it is important to note that the actions taken to combat the financial crisis were, in part, the result of a fundamental failure of the structure of financial regulation. Regulators did not have the tools to break apart or wind down a failing financial firm without putting the entire financial system at risk. The FDIC's resolution authority was limited to insured depository institutions and did not include their holding companies. To its credit, Congress did not wait for the next crisis before enacting the common sense reforms we needed. Congress passed, and President Obama signed, the Wall Street Reform and Consumer Protection Act of 2010, which eliminates "Too Big to Fail" by providing the ability to shut down and break apart a failing financial firm in a safe, orderly way – with the FDIC as receiver – without putting the rest of the financial system at risk, and without asking the taxpayers to pay a dime. And in mitigating the risk to U.S. financial stability the same mechanism will also significantly mitigate the contagion risk associated with the failed firm's cross-border contractual obligations.

6. One of the recommendations in the Panel's March report on GMAC (now Ally Financial) was that "Treasury should consider whether it is in the taxpayers' interest to consider promoting a merger with GM", because combining GM and Ally Financial's auto finance arm would likely create more value than the government could realize if these two entities remained separate.[2] It was recently reported that GM is now considering teaming with one or more major financial institutions to compete with Ally Financial's auto finance business.[3] While Treasury has stressed that it is not interested in taking an active role in the management of either company, have you considered the implications of merging GM and the auto finance arm of Ally Financial? If so, please comment on the merits or demerits of this approach. If not, please explain why not.

A: It would be inappropriate for Treasury to speculate publicly regarding any particular transaction involving GM or Ally. Treasury has previously articulated the principles it will follow in managing its investments. A merger would first require a determination by the boards of directors of each company that it is in the interest of each company and all its stockholders, not just Treasury. Each board operates independently and is not directed by Treasury.

Treasury is committed to maximizing taxpayer returns on its investments. To that end, Treasury will continue to monitor and evaluate the performance of GM and Ally with a view toward determining the appropriate method and timing for divesting Treasury's interests in each company. Treasury has previously announced guidance with respect to its role in the exploration of a possible initial public offering by GM, and Treasury will continue to entertain a range of strategic alternatives to exit its stake in Ally as soon as practicable, including both a public or private sale of Treasury's interest.

6a. What is Treasury's view with respect to reports that GM is considering an alliance with other providers of auto finance? What impact could this competition have on Ally's ability to repay the government?

A: In July 2010, GM announced that it entered into a definitive agreement to acquire AmeriCredit. In line with the principles that guide the government's role as a shareholder,

[2] Congressional Oversight Panel, *March 2010 Oversight Report: The Unique Treatment of GMAC Under TARP*, at 121 (Mar. 10, 2010) (online at http://cop.senate.gov/documents/cop-031110-report.pdf).
[3] David Welch, *GM Said to Decide Against Credit Unit, May Team Up With Banks*, Bloomberg Businessweek (July 9, 2010) (online at http://www.businessweek.com/news/2010-07-09/gm-said-to-decide-against-credit-unit-may-team-up-with-banks.html).

Treasury was not involved in this decision. GM is not required to seek Treasury's approval for its investments, but Treasury was notified of the decision.

Treasury is committed to maximizing taxpayer's returns on its investments in both GM and Ally. However, consistent with our principles of not interfering in the day-to-day operations of either GM or Ally, decisions with regards to acquisitions, business alliances or customer relationships will be decided by the companies' management and boards of directors.

<u>Questions for the Record from Richard Neiman, Member, Congressional Oversight Panel</u>

1. At our hearing, I appreciated you stating that Treasury would work to provide more information to the public about the terms of the non-HAMP modifications received by homeowners who are removed from the HAMP program. The panel would be grateful for your indication of what type of information can be provided and whether such information can be made available by the publication of the Panel's July monthly report on July 14, 2010. It is important that this disclosure provide sufficient information for the public to be able to assess whether these non-HAMP modifications are actually making homeowners better off.

Data on proprietary, or "non-HAMP," modifications is already collected for two separate publications: by HOPE NOW for its monthly Industry Extrapolations and Metrics report; and by the Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS) for their quarterly Mortgage Metrics report.

The HOPE NOW report contains summary data that shows workout plans and proprietary modifications by month, broken down by prime and subprime and by owner occupancy. The OCC-OTS report has more detailed statistics on the types of proprietary modifications, categorized by risk category, by investor and product type, and by the change in monthly principal and interest payments achieved through modification. Additionally, the report shows the performance of those modifications over time, including re-default rates by investor type and by the change in monthly payments.

The OCC-OTS report helps to elucidate the change that HAMP has brought to the quality of loan modifications offered to distressed homeowners. Nearly half of mortgage modifications done in the quarter just prior to HAMP left mortgage payments either unchanged or higher than they were before modification. After HAMP began, the number of modifications that did not reduce payments fell dramatically and now comprises just 12.6 percent of all modifications.

The Making Home Affordable monthly public reports will continue to report on the number of homeowners who receive non-HAMP modifications after applying for HAMP.

2. Your directness in stating that the inability to verify income through collected documentation was the main driver for HAMP participants in trial modifications to ultimately be removed from the program was appreciated. Was the problem primarily that the homeowners' documentation revealed that they had more income than they initially stated or less? Or did the servicers perhaps fail to fully review documentation

from homeowners? What steps has Treasury taken to ensure that servicers have fully reviewed all borrower documentation and that documents submitted are not lost?

A: As I noted during the hearing, we made a choice last summer to allow homeowners to receive a trial modification based on stated income in order to provide immediate assistance to an unprecedented number of struggling homeowners. Because of that decision, we have thus far provided over one million homeowners an opportunity to reduce their mortgage payments and avoid foreclosure. However, we found that servicers were having trouble converting a large number of these homeowners because they found significant discrepancies between stated and verified incomes – discrepancies that often could not be easily reconciled because they had implications for homeowner eligibility in the program.

As we worked with servicers to deliver modification decisions during the conversion campaign we found that both over- and under-statements of income were occurring. However, as the recent MHA Public Report shows, one of the major reasons for trial cancellations was that homeowners' verified debt-to-income was less than 31 percent. In these cases, homeowners began a trial modification with a lower stated income that qualified them at the 31 percent threshold. Once that income was determined to be higher based on full documentation, many homeowners were then found to have monthly payments lower than 31 percent of their gross monthly incomes.

The strongest assurance that servicers are appropriately reviewing all documentation prior to cancellation is the work of our compliance activities. The Compliance Agent for HAMP is Freddie Mac, which has established a separate, independent division to conduct the compliance activities: MHA-C. MHA Compliance is designed to ensure that servicers are meeting their obligations under the HAMP Servicer Participation Agreement (SPA) and Program guidance, and utilizes a variety of compliance activities to assess servicers from different perspectives or "touch points." Two of these activities specifically serve to evaluate the design and effectiveness of the processes servicers use to manage documentation and validate borrower income.

Loan file reviews of a servicer's non-performing loan portfolio are performed to assess completeness of relevant documentation and appropriate loan modification decision making. This includes reviews of loans which have successfully converted to a permanent modification to ensure they meet the HAMP guidelines, as well as loans that have not been offered HAMP modifications to ensure that the exclusion was appropriate ("Second Look"). In both cases, one of the objectives of the review is to ensure that servicer loan files contain appropriate documentation, including documentation submitted by the borrower. Servicer calculation of borrower income is assessed to ensure that the borrower was properly evaluated against the HAMP housing debt to income threshold.

Second Look results from January and February show that an average of 11.4 percent of loans that were not offered a HAMP modification did not meet the debt to income threshold. The Compliance Agent disagreed with an average of 3.9 percent of these decisions, which is consistent with the overall percentage of disagreements for all reasons loans are not offered a HAMP modification.

Implementation on-site reviews cover the servicer's overall execution of the HAMP program. Areas covered include, among other things, solicitation, eligibility, underwriting, document management, payment processing, reporting, complaint management and response, and governance. During these reviews, servicer controls over document intake, scanning, and management are assessed. Additionally, controls over the calculation of borrower income and housing debt are assessed, and specific loan files are reviewed to ensure the servicer has appropriate documentation and conducted an appropriate HAMP evaluation process.

The results of our compliance activities with respect to document management and servicer calculation of borrower income indicate that where errors have occurred, they were equally likely to relate to over- or under-reporting of income. Where servicers have been found to require improvements in either area, Treasury has taken actions that range from re-evaluating individual loans to changing servicer processes and implementing additional procedures and tools to address the issue noted.

3. You were also direct in stating that mortgage servicers have done a terrible job as HAMP program participants. Given this assertion, which many share, how can we really trust the servicers' position that homeowners should be removed from the program? Some homeowners indeed may not have submitted documentation that backs up their stated income, but isn't it just as likely that servicers are not adequately reviewing the documentation that they are receiving?

A: Because of the substantial implementation burdens associated with ramping up such an unprecedented foreclosure mitigation program, servicers did experience issues with the transmission and storage of borrower documents. Due to borrower complaints of lost documents, and to ensure that all borrowers were properly evaluated, Treasury began the Mortgage Modification Conversion Campaign in December 2009. This campaign prevented servicers from cancelling any trial modification during the conversion period. The campaign also required servicers to confirm borrower status and communicate to the borrower any missing documentation needed to convert to permanent modification.

That cancellations have only recently increased demonstrates how the conversion campaign pushed servicers to exhaust efforts to reach out to borrowers who lacked appropriate documentation before making a final determination of ineligibility. From the program's inception through February 2010, just 89,000 trial modifications had been cancelled. Between March and June, an additional 432,000 were cancelled, many of which had been in trials for over six months. Survey data show that the most common causes of trial cancellations were incomplete documentation, missed trial payments, and ineligibility due to verified income being below the 31 percent debt-to-income affordability requirement.

In addition to this concentrated effort to ensure proper evaluation for borrowers, MHA Compliance has performed a series of Second Look evaluations, in which they sample servicers' portfolios to make sure borrowers were appropriately evaluated for HAMP. As reported in the May 2010 MHA Public Report, these exhaustive reviews found that MHA Compliance disagreed with the servicer actions in only 3.9 percent of cases.

4. Given the servicers' performance, isn't it very important that Treasury have a website completely up and running by now that homeowners can log into in order to determine if their servicer has received their documentation submission? Such a website is now more critical than ever as homeowners can now be denied access to the program until documentation is submitted and confirmed. At a minimum, the website would reveal which servicers are sufficiently organized to handle documentation allowing the site to be used, much like the monthly HAMP reports, to publicly shame and pressure servicers into remaining up to date on informing homeowners of the status of their documentation.

A: The recently-enacted Wall Street Reform and Consumer Protection Act requires Treasury to maintain a website that includes a net present value calculator and make a reasonable effort to include on such website a method for homeowners to apply for a mortgage modification under HAMP. Treasury is currently evaluating the feasibility of a web-based application method.

5. Freddie Mac's audit of servicer compliance reported in the June HAMP report shows a high degree of agreement with servicer decisions but only with respect to whether servicers are complying with their solicitation requirements to encourage homeowners to apply. In truth, the audit of whether homeowners were appropriately denied acceptance into the program or into a permanent modification is the critical issue now. When do you expect to have results of this compliance review? And will that review be limited to simply a review of the homeowner's file, or will it be more comprehensive to include contacting borrowers for at least a random sample? Finally, has there been, or is there planned, an audit of the HAMP escalation process within the servicer itself? High volumes of complaints seem to indicate that the escalation process is not successfully resolving the documentation issues that are a driver of cancellations.

A: The information reported in the June report represents one of a number of different types of compliance activities (described in the report Appendix and in prior submissions to the Panel).

From its inception, the focus of Treasury's compliance reviews of servicers is ensuring that borrowers are properly evaluated for a HAMP modification using HAMP criteria. MHA Compliance's "Second Look" review process – which is a review of loans that have not been offered HAMP modifications to ensure that the exclusion or denial was appropriate –has for each servicer taken into consideration borrower complaints and has included in its statistical sample population individual loans that were denied and canceled. The evaluations in second look consider all aspects of servicers' requirements under HAMP related to eligibility, and not only the solicitation requirements. This data was included in the cited report. The second look loan file review is conducted at the related servicer, and we do not at this time intend to reach out to individual borrowers.

The information included in the report is evaluated and discussed on an ongoing basis. At this time, we plan on continuing to report results of second look reviews on a quarterly basis.

The Homeownership Preservation Office will be issuing guidelines to servicers in late summer regarding their internal complaint and escalation processes. MHA Compliance will adjust its compliance activities after publication of its guidance to ensure that servicers are following the new requirements.

6. In your view, what misaligned incentives do servicers have in making HAMP modifications?

A: Servicers are fully incented to modify mortgage loans that they hold on their own portfolios, because they bear the risk of nonperformance. However, loans held in portfolio are a small percentage of the total mortgage loans outstanding. When servicing mortgages owned by other investors, current servicing compensation - negotiated in an era of low delinquency and few modifications - offers little incentive to engage in staff- and system-intensive loss mitigation activities. HAMP addresses this problem by providing compensation both for the initial effort involved in underwriting and documenting a modification and through pay-for-success incentives, which make servicers' relationship to HAMP modified loans a valuable asset as long as the borrower remains current.

Some observers of the HAMP program have suggested that servicers may have a disincentive to reduce principal on a mortgage loan because their servicing fees are typically based on a percentage of the outstanding principal amount of that loan. However, because servicers usually can only pay themselves servicing fees for loans that are current, servicers would therefore rather modify a loan (which may include reducing principal) in order to preserve some portion of the servicing fee, rather than have the loan go into default or foreclosure, in which case they would receive no servicing fees. Therefore the servicer has an incentive to modify a loan rather than see it default. In addition, because many servicers have a fiduciary relationship to pools of multiple investors, a decision not to reduce principal is likely influenced more by the servicers' inability to determine that principal reduction is in the best interest of all investors than by a reduction in servicing income.

7. What is Treasury's position on homeowners being hit with large balloon fees due immediately after a trial modification is cancelled in order to repay the benefit temporarily gained during the trial? Further, are servicers allowed to be charging late fees for the time homeowners are in a trial period, as some reports indicate?

A: During a trial period plan the servicer temporarily agrees to accept a reduced payment equal to 31 percent of the borrower's gross monthly income in order to test the borrower's willingness and ability to support this payment on a permanent basis. The trial plan notice provided to the borrower explains that during the trial period the scheduled loan terms do not change. The borrower still owes the full amount of principal and interest and late fees still accrue, though they must be waived if the loan is permanently modified under HAMP.

Treasury is concerned about reports that servicers may be asking borrowers who are not offered permanent modifications to repay the difference between the scheduled and trial plan payments as a lump sum. This is certainly not consistent with the intent of the program, which is to avoid foreclosure. Subject to further research, Treasury will consider future policy guidance to address this practice.

8. Without a Homeowner Advocate's Office to help homeowners with complaints and servicer issues, Treasury has been asking homeowners to rely on hotline numbers to resolve

their problems. What has been the outcome of these calls? How many homeowners have been helped? How many of these calls resulted in judgment that the servicer was in error?

A: Treasury is devoting considerable attention to ongoing improvements at the Homeowner's HOPE™ Hotline and the HAMP Solution Center (HSC). These call centers are the mechanisms for borrowers and their advocates to escalate their HAMP cases.

Recent data, which is being tallied and formatted for public release on a quarterly basis, has shown that 93 percent of all cases demonstrate no servicer error identified by the HOPE Hotline or HSC call center agent. Treasury is also actively engaged in strengthening both its servicer response validation techniques and also its quality control processes to ensure that servicer errors are properly identified and documented.

To date, over 1.3 million borrowers have called the HOPE Hotline seeking assistance. Data available currently in the MHA Public Report includes:

- Number of callers
- Outcome of calls
- Time it takes servicers to resolve homeowner problems that have been reported by third parties such as housing counselors, attorneys, and congressional and other government offices.
- Servicer handling of calls from homeowners (speed to answer, hang-up rates)
- Servicer share of homeowner complaints to the Homeowner's HOPE Hotline borrower call center.