



Improving Loan Servicing to Prevent Latino Foreclosures

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A Review of Mortgage Servicing Practices and Foreclosure Mitigation

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Submitted by:

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My name is Janis Bowdler, and I am Associate Director of the Wealth-Building Policy Project at the National Council of La Raza (NCLR). NCLR is the largest national Hispanic civil rights and advocacy organization in the United States, dedicated to improving opportunities for Hispanic Americans. I oversee our research and advocacy on issues related to increasing financial security and asset ownership for Hispanic families. While at NCLR, I have published on a number of issues important to the Latino community, including *Saving Homes, Saving Families: Hispanic Brokers Speak Out on Latino Homeownership* and *Jeopardizing Hispanic Homeownership: Predatory Practices in the Homebuying Market*. In addition, I have provided expert testimony before this committee on several occasions, as well as the U.S. Senate Committee on Banking, Housing, and Urban Affairs and the Board of Governors of the Federal Reserve. On behalf of NCLR, I would like to thank Chairman Frank and Ranking Member Bachus for inviting us to this hearing. Hispanic families are among the hardest-hit communities in this foreclosure crisis. By most indicators, conditions are projected to continue to decline. It is clear that a generation of Latino wealth and financial security is at stake. We hope to work with you to complete a comprehensive plan to address this issue.

For more than two decades, NCLR has actively engaged in relevant public policy issues such as preserving and strengthening the Community Reinvestment Act (CRA) and the Home Ownership and Equity Protection Act (HOEPA), supporting strong fair housing and fair lending laws, increasing access to financial services for low-income people, and promoting homeownership in the Latino community. For the last ten years, NCLR has been helping Latino families become homeowners by sponsoring housing counseling agencies. The NCLR Homeownership Network (NHN), a network of nearly 50 community-based counseling providers, works with more than 30,000 families annually. Our subsidiary, the Raza Development Fund (RDF), is the nation's largest Hispanic Community Development Financial Institution (CDFI). Since 1999, RDF has provided \$400 million in financing to locally-based development projects throughout the country. These relationships have increased NCLR's institutional knowledge of how Latinos interact with the mortgage market and how well the government regulates financial services markets.

As foreclosure rates continue to rise in all loan categories, it is clear that current efforts are falling short of their goal to keep willing and able families in their homes. According to figures released in July 2008 by the Mortgage Bankers Association, 16% of subprime loans were more than 90 days delinquent at the end of the March 2008—double the number one year earlier. Moreover, the figures continue to point to a bleak future. According to data released this month by HOPE NOW,¹ nearly 2 million loans are 60 days or more delinquent, a 43% increase from July 2007. While there are reports that loss mitigation activity by servicers this quarter is up from previous quarters, these loan modifications continue to lag far behind market demand.²

As the party contracted by loan holders to carry out loan maintenance activities on their behalf, loan servicers play a pivotal role in the mortgage market. NCLR is concerned that if aspects of the servicing industry business model are not changed, new initiatives designed to aid struggling

¹ HOPE NOW is an alliance of counselors, servicers, investors, and other mortgage market participants. Their quarterly data and press releases can be found at www.hopenow.com.

² State Foreclosure Prevention Working Group, *Analysis of Subprime Mortgage Servicing Performance*. Washington, DC, April 2008.

homeowners will be hampered. Improving the servicing system is the linchpin to a successful foreclosure prevention strategy. In my remarks today, I will give some background on the importance of reform in the servicing industry. I will also discuss the major barriers built into the mortgage servicing industry that stymie broad loss-mitigation efforts. Finally, I will close by offering a set of recommendations.

Background

Mounting foreclosures is one of the most pressing civil rights issues facing the nation. For decades many of us have worked together to build wealth in Latino and other underserved communities. Like all Americans, Latinos rely on homeownership to build wealth for their long-term financial well-being. Research predicts that one in 12 loans to Latinos will end in foreclosure.³ This threatens to leave millions of families without homes, access to credit, or a financial safety net. Since evidence suggests that Latino foreclosure rates have not yet peaked, systemic solutions are timely and urgently needed.

Responding to early warning signs, NCLR engaged in a number of efforts to better understand how to prevent foreclosures among Hispanic and immigrant households. Three years ago, NCLR seeded a pilot program to introduce foreclosure prevention counseling to NHN agencies. Today, the majority of our grantees operate bilingual foreclosure prevention programs and many receive foreclosure prevention training through a partnership with the National Consumer Law Center. In addition, NCLR recently launched the Home Rescue Campaign to help community-based organizations address the rising rates of foreclosures. The campaign features funding for foreclosure prevention counseling, a Home Rescue Fair pilot program, and a tool kit on foreclosure prevention for community-based organizations. These efforts are complimented and supported by sophisticated partnerships with mortgage servicers and other industry stakeholders.

Furthermore, NCLR has hosted three major convenings this year to identify the gaps in services available to families facing foreclosure, the needs of community-based organizations serving those families, and the experiences of Latino and immigrant families facing foreclosure. The first, “Effective Community-Based Responses to Foreclosure” (January 2008), focused on local efforts while the other two had a national focus: “Building Wealth in a Troubled Economy: A Symposium on Latino Wealth-Building Opportunities” (June 2008) and “Foreclosures and the Mortgage Mess: How to Save Latino Homeownership” (July 2008). At each of these events, community leaders expressed a strong concern that our national financial system lacked balance for many middle- and low-income and underserved families. In particular, participants expressed their frustration at what seemed to be plenty of help provided to Wall Street while their community-level efforts struggled to meet the ever-increasing demands of their constituents in foreclosure.

Through the services of NHN counselors and our Home Rescue Fairs, NCLR has helped thousands of families successfully avoid foreclosure. Through our research and convenings, NCLR has invested heavily in uncovering the root causes of foreclosure among Latino and immigrant households. It is through this unique vantage point that we have been able to

³ Ellen Schloemer, Wei Li, Keith Ernst, and Kathleen Keest, *Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners* (Washington, DC: Center for Responsible Lending, December 2006).

document major systemic barriers built into the servicing system that prevent it from appropriately serving troubled borrowers.

Systemic Barriers in the Mortgage Servicing System

While many in Congress and the media have been quick to blame greedy home loan borrowers for the mortgage crisis, NCLR has long pointed to systemic flaws in the mortgage market that put borrowers at serious risk of foreclosure.⁴ Thus, as we have advocated, the solution must also be systemic in nature, such as through anti-predatory lending legislation and incentives for better product design. Similarly, certain characteristics of the mortgage servicing industry make it inherently difficult to reach the broad goal most of us share: to help working families keep their homes.

Loan servicers are vendors contracted by the owner of a loan to perform account management duties, such as processing payments and handling customer service. This includes managing loans that go into default and seeing the case through loan workouts, short sales, or foreclosure. In today's market, this relationship can become complex. In some instances, though it is increasingly rare, the original lender owns and services the loan itself. If this is the case, the lender and servicer are the same company and can exercise broad discretion when conducting loss mitigation activities. However, the majority of home loans are packaged and sold on the secondary market into loan pools, and single or multiple entities can own all or shares of a loan pool. A trustee packages the loans and contracts a servicer to work on behalf of the trust and loan pool owners, known as the investors.⁵ The contract, which can vary by loan pool, gives the servicer guidelines on how to manage the loans. Despite the variability, servicers generally have the discretion necessary to conduct loss mitigation activities as necessary. If a case falls outside the authority granted to the servicer, the servicer must seek permission from the investors before approving a loan modification or other workout.

Several studies show that actual completed loan modifications fall well below market demand. Despite having the authority to do so, servicers are not executing enough loan modifications to combat rising foreclosure rates.⁶ Yet the prominent solutions offered to the foreclosure crisis rely on the voluntary cooperation and initiative of the industry (investors and servicers). Unless we work together to craft sustainable, structural change in the mortgage servicing business model, other initiatives to address the foreclosure crisis, such as Insurance of Homeownership Retention Mortgages (included in H.R. 3221), will fall short or their benefits will fail to reach all intended recipients.

⁴ Latino and immigrant borrowers are more likely to have hard-to-serve characteristics, such as multiple sources of income or thin credit files, than other market segments. However, they are not necessarily less creditworthy. With automated loan processes, lenders had an incentive to push these borrowers into loans that were high-risk simply because it was a faster and more profitable process.

⁵ Despite the fact that investors are often referred to as a collective group, they are actually quite fragmented. Various companies, investment firms, banks, and pension funds make up the collective "investors."

⁶ California Reinvestment Coalition, *The Continuing Chasm Between Words and Deeds III* (San Francisco, CA: California Reinvestment Coalition, April 2008); State Foreclosure Prevention Working Group, *Analysis*. See also statements by Sheila Bair, Chairman, Federal Deposit Insurance Corporation, before the Committee on Financial Services, U.S. House of Representatives, April 9, 2008.

There are four major structural barriers in the servicing system:

- **Servicers work for the investor.** As vendors, the mortgage servicers' primary duty and obligation is to maintain the mortgage account for the loan investor or mortgage trust holder. The servicer also collects fees, most of which become a profitable source of revenue for the servicer. Servicers are not obligated to conduct loss mitigation activities or to grant loan modifications to qualified borrowers; in fact, incentives exist for them to avoid these activities. Processing a loan modification requires complex paperwork, while short sales and foreclosures are easier to process and earn servicers higher fees. NHN counselors routinely report having to send workout packages completed on behalf of their clients multiple times. This concern is echoed by the State Foreclosure Prevention Working Group and others. While industry stakeholders have claimed an increasing openness to loan modification, the on-the-ground reality is that few are being completed. One example of this conflict of interest can be seen in the constant battle over second mortgages. Often, borrowers with two different mortgages find that their loans are serviced and/or owned by two different entities. When a borrower has trouble paying its loans, it is often the second lien holder/servicer that will refuse to negotiate a loan workout, even when it means increasing the likelihood of default on both loans.
- **The business model focuses on the short term.** Most servicing guidelines and call centers are designed around the more "traditional" causes of foreclosure, such as major life events, medical emergencies, or unemployment. In these cases, many families only need a few months to get back on their feet; their challenges can be addressed through a variety of short term solutions or "workouts," such as repayment and forbearance plans. However, most would agree that the majority of families defaulting during the last year and into the near future face a different set of issues—many are working, their loans are permanently unaffordable, and their homes are losing value. Yet despite widespread acknowledgement of these conditions, most resolutions that are being approved by servicers are short-term. According to the HOPE NOW Alliance, many of the "workouts" approved in 2007, for example, were for short-term forbearances of 3-6 months. This only delays the inevitable for most families, as their situations will not change dramatically within this timeframe. Most at-risk borrowers need permanent loan modifications, and many will need a reduction in principal, to create a long-term sustainable situation.
- **The mortgage servicing industry lacks capacity.** Despite efforts to increase staff support, there are strong indicators that servicers are still struggling to meet the growing demand for loss mitigation services. It is not uncommon for NHN counselors to wait between three and six months to receive a response from servicers after submitting a loan modification request or a workout package. A report by the State Foreclosure Prevention Working Group shows that two-thirds of loan modifications started were not completed within the following month. The Working Group revealed that borrowers, often about 50% of them, never speak to their servicer/lender before the foreclosure. However, we are concerned with mounting reports of dropped calls and unreturned messages by servicers. These delays can have real consequences. For one client of Dalton Whitfield Community Development Corporation, it meant foreclosure. This family had a

temporary reduction of income and had accrued late payments and several high legal fees. The housing counselor requested a loan modification that would include all the fees in the family's monthly mortgage payments over the life of the loan. It took four months for the servicer to respond to the request, during which the fees continued to accrue. When the servicer finally responded, it counter-offered with an unaffordable repayment plan. By the time an acceptable loan modification could be negotiated, the family had lost its home in a sheriff auction. NCLR is aware of the many initiatives industry leaders are setting in motion to address this issue. However, far too often we are seeing the system break down due to overload.

- **Loss mitigation efforts are not transparent.** Borrowers and housing counselors are often told that their loan modifications cannot be approved due to rules or guidelines set forth by the investor. However, when asked, servicers generally will not release information on the investor or loan holder. This prevents the borrower/counselor from verifying the information given to them by the servicer. This is a critical step in negotiating a loan modification. Our conversations with both investors and servicers reveal confusion and a lack of clarity on common servicing guidelines. For example, one investor has a rule that a loan cannot be modified unless it is in danger of "imminent default." In this case, imminent default could mean a foreseeable loan reset that the borrower knows it will not be able to afford. However, servicers point to this same guideline as the reason they cannot work on a loan until the borrower is more than 60 days delinquent. In fact, this reading of the rule has led some call center agents to advise borrowers to go delinquent on their loan so they can be assisted.

Furthermore, NCLR is concerned that as demand for loan modifications continues to rise, the impact of the barriers described above will be exasperated and result in a decline in the quality of the loan modifications. The system is already overburdened and overwhelmed with miscommunication and confusion. In fact, the State Foreclosure Working Group found that seven out of ten seriously delinquent borrowers have not even started the loan modification process. With the industry already focused on short-term solutions, we are concerned that the bottleneck in demand will create fertile ground for abuse. According to Moody's Investors Service, 42% of loans that were modified in the first half of 2007 were 90 days delinquent or more as of March 31, 2008. This is a sign that a significant number of those modifications were not made to be affordable over the long term. Should such a trend continue or grow, it will only intensify the foreclosure crisis. Moreover, as borrowers grow increasingly frustrated with their servicers, they are more likely to turn to predatory foreclosure rescue scams for help, unaware of the dangers. Foreclosure rescue scams target vulnerable, struggling borrowers with promises of saving their homes. Some scam borrowers for cash, while others walk away with the deeds to their homes.

NCLR's Recommendations

NCLR has supported a number of policies, best practices, and legislative proposals aimed at reducing foreclosures for all homeowners. Given the magnitude of the crisis we are facing, many tools are needed to address the problem. With that said, changes to the servicing industry are critical to ensuring the successful delivery of any foreclosure prevention strategies.

- **Create a duty for servicers to provide loss mitigation services to struggling borrowers.** In the current scenario, borrowers are at the mercy of their servicers, who work for the investor. To give the relationship balance, servicers must be given an incentive to provide loss mitigation services to delinquent borrowers before proceeding with a foreclosure action. Such a duty is included in the “Foreclosure Prevention and Sound Mortgage Servicing Act of 2008” (H.R. 5679).
- **Require that loan modifications are sustainable over the long term.** Most at-risk borrowers are in their current predicament because the original lender did not issue a loan that was sustainable over the long term. Servicers must use caution to ensure the same mistake does not happen again. NCLR calls for the use of rescue products, loan modifications, principal reductions, and other tools to modify the loan in a way that will remain affordable for the borrower over the long term. H.R. 5679 would require that servicers engage in an affordability analysis before granting a modification.
- **Require servicers to disclose the investor upon request.** Borrowers have a right to know who owns their loans and to verify their rules and guidelines regarding loan servicing. Disclosing the investor will shed more light on the negotiation process and borrowers and counselors will be better informed of their rights and opportunities.
- **Prohibit foreclosure during loss mitigation.** Due to the bottleneck of cases in the loss mitigation system, too many borrowers are slipping through the cracks. Servicers and investors should be prohibited from moving forward on a foreclosure while the case makes its way through the company’s own loss mitigation system. Practically speaking, this means the servicer would be prohibited from moving a case to its internal legal department once a borrower submits a loan workout package to the loss mitigation department. This will improve the borrower’s chances of understanding all its workout options before excess legal fees pile up or foreclosure proceedings begin.

Moreover, NCLR renews its support for large-scale, automated, streamlined loan modifications. As we have described throughout our testimony, without a broad, industry-wide plan to address the growing number of homeowners in need of loss mitigation services, our foreclosure prevention initiatives will fall short.

When NCLR joined other members of the Leadership Conference on Civil Rights Fair Housing Task Force in calling on the industry to institute a six-month moratorium on foreclosures for families with the riskiest subprime loans, we were assured that such action would not be necessary. Servicers and lenders assured Congress, borrowers, and advocates that the market would correct itself. Now valuable time has been lost and servicers and other industry stakeholders are struggling to make up for it. If foreclosures go unchecked, not only will wealth be lost, but large segments of our neighborhoods will lose their ability to send their children to college and plan for retirement.

I will be happy to answer any questions you may have. Thank you.