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Insights

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Foreclosure Prevention:

Improving Contact with Borrowers

Abstract

The rapid growth in the subprime and nontraditional mortgage market, combined with a slowdown in the appreciation of home values, may lead to increased foreclosures over the next few years. Nearly $1.5 trillion of adjustable rate mortgages (ARMs) will be eligible to reset during 2007, and between $500 billion to $800 billion will actually reset with new interest rates.[1] Some analysts estimate that defaults from mortgage loans originated over the past few years using adjustable rates, introductory teaser rates, and payment options may lead to as many as 1.1 million foreclosures with losses approximating $112 billion, spread over the next six years or more.[2]

This Insights report reviews strategies that banks are using to prevent foreclosures to mitigate credit losses. The strategies presented in the report involve partnerships developed by banks, nonprofit organizations, state and local governments, and others who have a stake in keeping homeowners in their properties and maintaining the economic health of local communities. The information presented here was obtained from a variety of sources including financial institutions and nonprofit agencies.

I. What Is Foreclosure Prevention?

Over the past two decades, technological innovations in credit scoring, processing, and underwriting of mortgage loans helped fuel the growth of the prime and subprime mortgage markets. Additionally, the growth of the secondary mortgage market, the increased appetite of investors for mortgage backed securities (MBS), and the more recent period of low interest rates, all came together to create a housing boom that increased the nation's homeownership rate from 65 percent in 1995 to 69 percent in 2006.

However, as lenders tried to keep pace with the demand for MBSs, some originators, primarily in the subprime mortgage market, began to combine the underwriting of borrowers with weaker credit scores with other higher risk elements, such as higher loan-to-value ratios or incomplete

[1] *See* Doug Duncan, "A Return to Normal," Mortgage Banking, Vol. 67, Issue 4, January 2007.

[2] *See* Christopher L. Cagan, "Mortgage Payment Reset: The Issue and the Impact," First American Core Logic report, p. 2, March 19, 2007.

income documentation. The unintended consequence of the mortgage industry's ongoing effort to extend homeownership opportunities to less creditworthy consumers has been an increase in foreclosure rates.[3]

The rise in mortgage foreclosures, and especially the dramatic rise in subprime mortgage foreclosures, has the potential to undermine the significant homeownership gains made by lower-income and minority consumers during the 1990s. Additionally, foreclosed properties can become an eyesore and a location for criminal activity, which can depress area property values and contribute to negative perceptions of a neighborhood, increasing costs and reducing revenues for local communities.

Aside from the devastating impact of foreclosures on borrowers and communities, their increase also costs all participants in the mortgage industry. For investors and insurers of securities issues, foreclosures entail a reduction in cash flow and can lessen the market value of securities. Servicers incur significant expenses attempting to resolve problem loans. Further, income to servicers decreases as loans are removed from the pools backing securities issues.

To address the problems caused by a rising foreclosure rate, banks and others have developed programs to reduce the number of foreclosures. Many of these programs were developed as partnerships between banks acting as loan servicers and nonprofit organizations that provide financial counseling to homeowners.

II. Why Is Foreclosure Prevention of Interest to Banks?

Banks recognize that keeping homeowners in their homes is often the best way to mitigate credit losses, preserve customer relationships, maintain stable neighborhoods, and minimize the detrimental effects vacant properties can have on crime and property values.

Banks that originate and service mortgage loans are aware that prudent attempts to workout loans of homeowners who have defaulted on their contractual obligations are often in the best interests of both the lender and the borrower. Moreover, the federal financial institutions regulatory agencies have encouraged lenders to work proactively with these borrowers.[4] And in the case of servicemembers on active duty, servicers must adhere to the special considerations for the sale, foreclosure, or seizure of their property.[5]

When borrowers default on their home loans, some specific and measurable reasons exist for why banks should be interested in preventing foreclosure. These reasons include:

Reputation Risk

Banks face negative publicity over rising foreclosure rates in general and over individual cases when the bank may have made the loan or is currently servicing the loan. In addition, when a significant number of loans in an investment pool go into default, the secondary market can develop concerns about all loans originated by that institution. These defaults can negatively affect the institution's ability to sell new loans on the secondary market. In addition, investors rely on the Nationally Recognized Statistical Rating Organizations (NRSROs) to gauge the effectiveness of a servicing operation and the quality of loans.[6] A large number of foreclosures can affect negatively a bank's servicing rating assigned by a rating agency.

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[3] Remarks by Chairman Ben S. Bernanke at the Federal Reserve Bank of Chicago's 43rd Annual Conference on Bank Structure and Competition, Chicago, Illinois, May 17, 2007.

[4] OCC Bulletin 2007-14, Interagency Statement on Working with Mortgage Borrowers.

[5] *See* 50 USC App. 501-596.

[6] *See* 17 CFR 240.3b-10 for the definition of Nationally Recognized Statistical Rating Organizations.

Costs to Bank-Owned Portfolio

For loans that are held in a bank's portfolio, direct losses can result from foreclosures. These losses are affected by the property's condition, local market conditions, fees, and advances related to the length of time it took to foreclose on the property. General estimates of the losses to lenders on a foreclosure range from 20 to 60 cents on the dollar.

Costs of Servicing

Most mortgage loans are sold to secondary market investors, shifting much of the risk of foreclosure to the servicers and investors and costing banks that service loans. As a delinquency progresses, servicers often make advances for taxes, insurance, property preservation, inspections, and legal costs. Servicers must also make advances on principal and interest to investors, regardless of whether the servicer has received a payment from the borrower. Many, but not all, of these advances are reimbursed once the property is liquidated, but the servicer still faces the cost of funds for advancing fees, expenses, and debt service payments.

In addition, servicing a foreclosure requires the servicer to use additional staff resources. One bank reported that servicing a loan in foreclosure is at least three times as costly as servicing a current loan.

Major Investors Paying Incentives for Workouts

The income from these workout incentive payments can be substantial and offset some of the costs associated with servicing operations. The availability of such incentives is determined by the performance of an investor's loans and the relationships among the various parties involved (servicer, investor, etc.).

Property Values

Vacant and abandoned properties are vulnerable to vandalism, deterioration, and criminal activities. A large number of foreclosures can increase the supply of homes on the market, negatively affect neighborhood values, and drive down sale prices.

Community Reinvestment Act (CRA) Credit

Two primary activities are useful in preventing foreclosures and each may receive positive CRA consideration. First, banks can provide financial counseling to low- or moderate-income homeowners, either directly or through a nonprofit agency, to help keep them in their homes.[7] Second, banks may provide refinancing of higher variable rate mortgages into lower fixed-rate mortgages for low- or moderate-income borrowers.[8] Examiners will consider such a program as responsive in helping to meet the credit needs of its community.

III. How Does Foreclosure Prevention Work?

Effective foreclosure prevention relies on increasing the amount of contact between servicers and delinquent borrowers. All of the banks interviewed for this report described increasing

[7] *See* Questions and Answers Regarding Community Reinvestment, 71 Fed. Reg. 12424, 12432 (Mar. 10, 2006) (Q&A § __.12 (i)-3).

[8] *See* Questions and Answers Regarding Community Reinvestment, 66 Fed. Reg. 36620, 36631 (Jul. 12, 2001) (Q&A § __.22 (a)-1).

the contact rate as the key to success of their foreclosure prevention initiatives. As a result, the strategies banks have developed all focus on methods of increasing their ability to make contact with borrowers who are either behind on payments or alerting them earlier of impending loan rate resets.

Mortgage servicers have found that traditional collection methods are no longer producing satisfactory results. The old method was to flood borrowers with letters and telephone calls, hoping that the borrower would contact the servicer, but knowing that only a small percentage would do so.[9] All of the banks interviewed have found that delinquent borrowers often do not respond to mail notifications from the servicer, and those that have answering machines and caller ID on their telephones screen calls from lenders. Furthermore, cell phones have replaced landline telephones in popularity. In fact, servicers are finding it difficult to obtain a telephone number for borrowers who use cell phones exclusively.

Borrower's Reasons for Avoiding Lender Contact

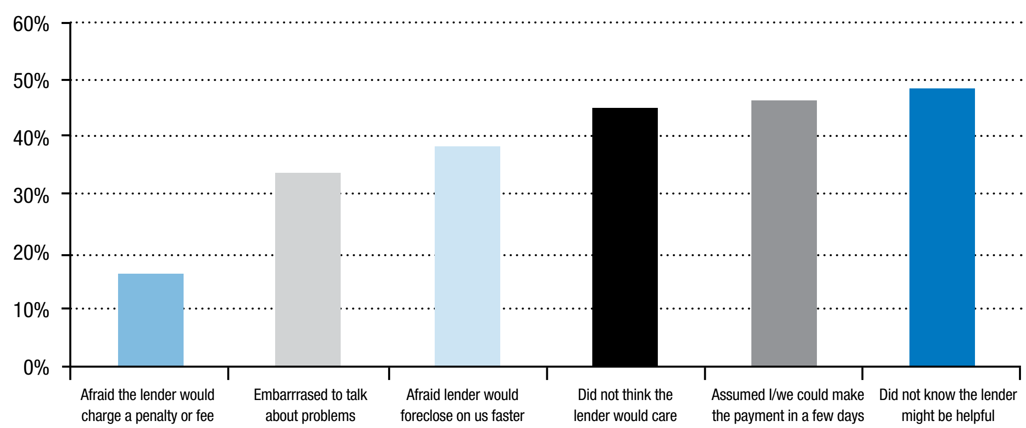

Chart provided by J. Michael Collins, PolicyLab Consulting.[10]

Servicers still use the letter and the telephone as the main means of contacting borrowers whose payments are late, but have adapted these measures by training their loss mitigation staff to convey a number of positive messages early in the call. Many servicers use software that can propose a workout solution with a payment schedule based on such factors as the borrower's income and other expenses. The software also incorporates any investors' requirements into the servicing agreement. These software packages also script the call for the servicing staff.

Default Intermediation

There are three main models for reaching borrowers who are late on payments:

- Direct servicer contact.
- Direct contact by counseling agencies.
- National toll-free number for borrowers to call.

[9] *See* http://www.freddiemac.com/service/msp/pdf/foreclosure_avoidance_dec2005.pdf.

[10] Home Ownership Preservation Initiative, Partnership Lessons & Results, Neighborhood Housing Services of Chicago, July 17, 2006, p. 25. www.nhschicago.org/downloads/82HOPI3YearReport_Jul17-06.pdf

Direct Servicer Contact

Banks are trying a number of direct contact strategies to improve their contact rate. Five of the most common options are:

Behavior scoring

Banks are using scoring models to help them determine which late paying borrowers are priority contacts. These models provide a score that identifies the risk of a borrower going further into delinquency. The models incorporate borrower-specific factors, such as payment patterns and credit scores, combined with economic data, such as local unemployment rate and trends in real estate values. The main purposes of these scoring models are: (1) to streamline collection calls by risk-ranking delinquent accounts to identify loans most likely to benefit from early intervention to avoid foreclosure and (2) to identify loans most likely to create a loss without an intervention.[11]

Non-standard call times

After reviewing behavior scores to determine which borrowers should receive more phone calls, banks are calling on weekends and on weekday evenings to contact borrowers when they are home.[12]

Customer friendly contact

Following are three general messages that servicers use to help engage the borrower on the phone and in letters:

- The loan servicer does not want to take your house.
- The loan servicer on the phone is not judgmental.
- The loan servicer would like to help you stay in your home.

Options that do not require conversations

Banks have developed additional resources for borrowers who do not want to talk to the servicer on the phone. One bank provides a Web site with information about payment and other options. The Web site also outlines information borrowers must provide to the bank to take advantage of one of the workout options. Another bank servicer incorporates a payment plan option in a letter to the borrower. A third bank has developed a DVD, which identifies foreclosure prevention methods, and is mailed to delinquent borrowers who have not contacted the servicer.

Door knockers

Some servicers hire staff to go door-to-door to contact late-paying borrowers. These individuals are trained to explain repayment options to borrowers and provide a brochure explaining these options. The "door knockers" carry cell phones so they can contact the loss mitigation and collections departments at the bank when they have reached a delinquent borrower. This method can result in the door knocker putting the borrower in direct contact with the servicer's loss mitigation staff. They generally attempt to make contact with the borrower well before the loan is 90 days delinquent.

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[11] Amy Crews Cutts and Richard K. Green, Innovative Servicing Technology, Freddie Mac Working Paper 04-03, July 2004, p. 14.

[12] *See* 15 USC 1692a *et seq.* Servicers making direct contact with delinquent borrowers and any counseling agencies acting on behalf of servicers should consider the applicability of the requirements of the Fair Debt Collection Practices Act.

Direct Contact by Counseling Agencies

In addition to the servicers' requirements to notify eligible borrowers of the availability of homeownership counseling by the servicer or a HUD-approved nonprofit counseling agency, many servicers have begun to partner with these counseling agencies.[13] Some servicers have realized that counseling agencies are more trusted by borrowers and that borrowers may be more likely to respond to a call or letter from a counseling agency. These servicers have found that by partnering with a counseling agency, their contact rates with delinquent borrowers have increased. These partnerships capitalize on the desire of both banks and counseling agencies to have borrowers stay in their homes if they can afford their mortgage payments.

Some servicers have contracted with nonprofit housing counseling agencies to make an initial contact with borrowers who are late on payments.[14] Under this scenario, a servicer provides a pre-selected counseling agency with a list of borrowers to contact. The counselor is trained to make a friendly call to the borrower, emphasizing his or her ability to work with the borrower and help the borrower work out a solution with the lender. The borrower has the option of sharing financial information with the counselor.

This strategy begins with a letter from the counseling agency to the borrower, providing a toll-free number and a Web site. The letter states that if the counseling agency does not hear from the borrower, the agency will contact the borrower by telephone. When contact is made, the counselor can collect documentation and information needed to evaluate loss mitigation options, with permission from the borrower. If no feasible plan can be developed, the counselor helps develop a detailed plan for selling the property. Overall, some servicers have concluded that the fees paid to counseling agencies are considerably lower in comparison with the costs of foreclosure.

National Toll-Free Number for Borrowers

Several reputable national nonprofit organizations have partnered with mortgage servicers to provide no cost telephone counseling to delinquent borrowers. NeighborWorks America has partnered with the Homeownership Preservation Foundation to establish a 24 hours a day, seven days a week, toll-free hotline for homeowners to discuss their delinquency problems with a housing counselor.[15] Calls flow into a national call center staffed by English- and Spanish-speaking counselors. Callers are prioritized immediately. Depending on the nature of the problem, counseling can be provided as part of the initial call or through a series of follow-up calls or in-person visits to a local housing counseling service to which the borrower is referred. If a workout can be arranged with the lender, counselors can also provide budgeting assistance and other financial education to help ensure that these borrowers can meet the terms of their workout agreements. In about 25 percent of the counseling sessions, the homeowner is recommended for loan workout, and the counselor helps the homeowner work with the servicer on a loan modification.[16] A further discussion of these partnerships can be found in Section V of this report.

Nationwide lenders who also service loans for others have established their own toll-free numbers to encourage borrowers to contact them. Borrowers who have defaulted on their home loans are advised of these phone numbers by letter or phone call from the servicer or the nonprofit partner.

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[13] *See* 12 USC 1701x, which was recently augmented with special disclosures for servicemembers.

[14] *See* 15 USC 1692a *et seq.*

[15] *See* "Innovative Partnership to Prevent Foreclosures," Office of the Comptroller of the Currency, *Community Developments*, Spring 2006, at http://www.occ.gov/CDD/spring06b/cd/innovativepartnerships.htm.

[16] In approximately 17 percent of cases, homeowners cannot be helped through a workout. In these cases, the goal is for the homeowner to preserve the equity by selling the home. *See* Testimony of John H. Dalton on behalf of the Housing Policy Council of the Financial Services Roundtable before the U.S. House Financial Services Committee, April 17, 2007.

Options for Borrowers and Servicers

Once the servicer has made contact with the delinquent borrower, either directly or through a counseling agency, there are a variety of options to be discussed. These options are divided into two major groups: retention workout options and non-retention options. Retention workout options allow a borrower to retain possession of the home. Alternatively, non-retention options result in the borrower relinquishing the home, but avoiding the expense and stigma of foreclosure process.

Retention Workout Options

Retention options allow a borrower to retain possession of the home. There are several workout options that loan servicers, borrowers, and nonprofits can utilize in their best efforts to keep the borrower in the home.[17] The earlier these conversations occur, the greater is the likelihood of a successful outcome.

Early Contact Discussion of Alternatives. For loans with upward adjusting payments (such as hybrid ARMs and payment-option ARMs), some servicers have begun contacting borrowers prior to the scheduled payment increase to advise them of the new payment amount. If the borrower cannot afford the new payment and is reasonably likely to default, the servicer may be able to modify the loan to create longer-term affordability. In some cases, servicers acting on behalf of lenders are offering to refinance ARMs into lower cost, fixed rate loans.

Repayment Plan. The servicer increases the regular monthly payment until the delinquency is repaid. Typically, the payment period extends over a two- to six-month period.

Loan Modification. A loan is modified in a written agreement between a borrower and servicer that permanently changes one or more of its original terms. The loan modification may include an interest rate concession, reducing the principal balance outstanding, extending the term of the loan, establishing escrows for taxes and insurance, or adding the delinquent interest amount to the unpaid principal balance.

Forebearance. Forebearance is an agreement to allow a reduced or suspended payment for a specific period of time, usually not to exceed three months. The borrower still owes the unpaid amount, which may be worked out later with a loan modification.

Non-retention Options

There are some situations in which the borrower will be unable to retain the home, and foreclosure is inevitable. In these cases, quick action is needed to reduce the financial hardship on the borrower and to limit any losses to the lender. All parties involved must look seriously at the borrower's financial profile and be willing to admit when leaving the home is the best alternative.

Sale of the House: Borrowers are encouraged to sell their house and pay off the mortgage in full. Servicers can assist in the marketing and sale of the home.

Short Sale: A servicer agrees on behalf of an investor to accept the proceeds of a pre-foreclosure sale in satisfaction of the loan, even though the proceeds may be less than the amount owed on the mortgage.

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[17] Certain accounting and tax issues may limit a servicer's ability to offer these options (see page 11).

Deed in Lieu of Foreclosure: A workout in which a borrower voluntarily conveys clear property title to the servicer in exchange for a discharge of the debt. This is generally used when the home has been listed for sale for a period of time with no activity.

Developing Options

Some banks that hold mortgage loans in their portfolios have determined that offering fixed-rate loans to refinance a higher rate ARM may save some borrowers from foreclosure. Recent announcements from the government-sponsored enterprises (GSEs), specifically Fannie Mae and Freddie Mac, have indicated a willingness to purchase some of these refinanced loans once program guidelines have been established. This is a significant option for loan servicers to monitor in the near future.[18]

Separately, at least two states are considering a bond sale to establish a pool of funds to refinance higher rate and ARM loans in danger of foreclosure into new fixed rate loans. And certain states have rescue funds that will refinance loans from areas hit by job losses from industrial dislocations. Loan servicers should be aware of options available in various states.

Differences Between Prime and Subprime Servicing

Servicers have found significant differences between servicing prime and subprime loans. Overall, servicing subprime loans is more expensive because it requires frequent calls to borrowers who may also be receiving calls from other collectors. Servicers report that subprime borrowers also are more likely to send in partial payments that require additional resources to process. Since more contact is needed, the number of cases that one employee can handle is lower.

Prime loan servicers will generally call a borrower who has missed a payment 15 to 20 days after the payment was due, if that borrower typically makes payments on time. Subprime loan servicers will call as soon as one to two days after a payment was due, and may sometimes call before a payment is due. In addition, servicers have found that approximately 80 percent of 90-day past due subprime loans roll into foreclosure, so they have to be proactive and aggressive about reaching borrowers. This additional contact creates a higher cost and requires more staff to make the additional calls.

IV. What Are the Key Risks and Regulatory Considerations Presented by Alternatives to Foreclosure?

Banks must consider a number of risks and regulatory issues as part of their foreclosure prevention programs. Most often mentioned issues relate to privacy and the need to obtain third-party authorizations from borrowers.[19] These third-party authorizations would permit the servicer to engage a local nonprofit counseling agency to reach out directly to delinquent borrowers, as the borrowers are more likely to open mail and answer telephone calls from a nonprofit counseling agency. The suggestion has been made that a disclosure explicitly authorizing the servicer to provide information on a borrower to a nonprofit counseling agency if the borrower is in danger of default should be made part of standard mortgage closing documentation.

Foreclosure procedures vary by state. Some states mandate judicial foreclosures, which are processed through the courts, and others allow non-judicial foreclosures, which are processed

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[18] *See* testimony by Daniel H. Mudd, President and CEO, Fannie Mae, and Richard F. Syron, Chairman and CEO, Freddie Mac, before the U.S. House Committee on Financial Services, Washington, DC, April 17, 2007.

[19] *See* 15 USC 1692a *et seq*. Servicers working with counseling agencies to contact delinquent borrowers should consider the applicability of the requirements of the Fair Debt Collection Practices Act. Lenders should also be aware of their responsibilities regarding agents working on their behalf (see OCC Bulletin 2001-47, Third-party Relationships).

without court intervention. Judicial foreclosures take much longer to process, allowing more time for the development of a workout plan, yet providing an incentive for borrowers to remain in their homes without making payments for a significant period of time.

Declining housing prices in some areas create additional risks to lenders, servicers, and investors. Declining values present a scenario in which the servicer has little or no built-in equity margin to serve as a cushion while negotiating a workout with a delinquent borrower. Also, the borrower has no real incentive to agree to the workout plan if the property is worth less now than when it was originally purchased.

There are safety and soundness issues that banks also address as part of offering foreclosure prevention programs. For example, if the lender is capitalizing principal and interest payments, it could cause a need for expanded loan loss coverage.

The federal bank, thrift, and credit union regulatory agencies are encouraging financial institutions to work with homeowners who are unable to make mortgage payments. Prudent workout arrangements that are consistent with safe and sound lending practices are generally in the long-term best interest of both the financial institution and the borrower. Institutions will not face regulatory penalties if they pursue reasonable workout arrangements with borrowers.[20]

V. Who Is in the Foreclosure Prevention Business Today?

Foreclosure prevention in the mortgage servicing business has become a major focus of the loss mitigation function.[21] And while loss mitigation is still the bottom line for all parties involved, much of the mortgage servicing industry has come to recognize that a more customer-friendly approach to the problem of contacting delinquent borrowers will most likely generate better results.

Loan Servicers

In many mortgage operations, loan servicers remain in their historic roles as those primarily responsible to contact delinquent borrowers. Alternatively, foreclosure prevention programs today at many large/national loan servicers are beginning to rely more on partnerships with interested third parties.

Nonprofit Counseling Agencies

A number of nonprofit housing counseling agencies are now working with servicers to develop foreclosure prevention programs.[22] They are: the National Training and Information Center (NTIC), the Association of Community Organizations for Reform Now (ACORN), the National Community Reinvestment Coalition (NCRC), the Neighborhood Assistance Corporation of America (NACA), and NeighborWorks America.

NeighborWorks America has more than 240 affiliated community-based organizations that provide counseling services to at-risk homeowners. NeighborWorks operates the National Center for Foreclosure Solutions, which, in partnership with the Homeownership Preservation Foundation, has established a national toll-free number to channel borrowers to community-based nonprofits to facilitate workouts with lenders.

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[20] *See* OCC Bulletin 2007-14, Interagency Statement on Working with Mortgage Borrowers.

[21] National banks and their operating subsidiaries originated less than 10 percent of all subprime loans originated (or produced) in 2006.

[22] *See* "National Community Organizations' Foreclosure Prevention Initiatives," *Community Developments,* Office of the Comptroller of the Currency, Spring 2006, p. 9. Available at http://www.occ.gov/CDD/spring06b/cd/nationalcommunityorg.htm.

The National Foundation for Credit Counseling has a network of local affiliated credit counseling agencies that are available to partner with loan servicers. Other community-based organizations are involved in these initiatives and are listed on HUD's Website (http://www.hud.gov/offices/hsg/sfh/hcc/hcs.cfm).

Government

The detrimental effects of numerous foreclosures in any residential neighborhood are well documented. As a result, some local governments have combined forces with nonprofits and loan servicers to develop outreach programs to delinquent borrowers. For example, Chicago's Homeownership Preservation Initiative (HOPI) links delinquent borrowers with nonprofit credit counseling agencies through a 3-1-1 non-emergency hotline.[23]

Government Sponsored Enterprises (GSEs)

The major secondary market investors, who are the largest purchasers of mortgages in the United States, recognize the benefits of foreclosure prevention programs and are directing their delegated servicers to incorporate them into their operations.

Federal Housing Administration (FHA)

The Federal Housing Administration, a major insurer of mortgages made to subprime borrowers, requires that all delinquent borrowers of FHA-insured loans be referred to nonprofit credit counseling agencies.

VI. How Does the Cost/Pricing Structure Operate?

The business rationale underlying foreclosure prevention is that restoring a delinquent borrower to a current status on his or her loan is preferable to the potential losses inherent to foreclosure.[24] Although none of the banks interviewed could provide a cost on a per-loan basis for their foreclosure prevention programs, one study estimated that lenders lose $58,759 per loan.[25]

Despite the general lack of precise data on the costs of foreclosure prevention, the banks interviewed for this report provided some metrics by which they measure the success of these programs. Some of the standard measures being used by servicers include the number of completed workout cases, the approval ratio by individual staff members, and whether the loans are performing 12 months after their workout.[26] Servicers are beginning to analyze the data they collect from their loss mitigation activities, including analysis performed on each bucket of delinquencies (60-day, 90-day, and 120-day).

[23] For best practices from local programs, see *Preserving Homeownership: Analyzing the Elements of Leading Foreclosure Prevention Programs,* NeighborWorks America, Center for Foreclosure Solutions, May 30, 2007.

[24] One study using data on loans owned by Freddie Mac that entered into 60-, 90-, or 120-day delinquency found that 90 percent of loans that start repay plans will cure within 18 months compared with 73 percent for loans that are 90-days delinquent or just 61 percent of loans that are 120-days or more delinquent. The study also found that of loans that get to 120-days delinquent status, 28 percent will fail, but just 4 percent of loans in repay plans will end in home loss for the borrower. *See* footnote 11.

[25] Craig Focardi, "Servicing Default Management: An Overview of the Process and Underlying Technology," *TowerGroup Research Note,* No. 033-13C, November 15, 2002.

[26] *See* Joseph R. Mason, and Joshua Rosner, "How Resilient Are Mortgage Backed Securities to Collateralized Debt Obligation Market Disruptions?" Hudson Institute, February 2007.

The success rates among servicers varied according to the workout options they reported. Some found that "promise to pay" and repayment plans had a higher success rate than loan modifications, while others found the reverse to be true.

VII. What Barriers Have Constrained the Growth of Foreclosure Prevention?

Many roadblocks have hampered efforts by banks to increase the effect of their foreclosure prevention programs. The greatest obstacle is the inability to contact delinquent borrowers. When these borrowers do not open their mail or answer phone calls from their servicer, they remain unaware of the workout options available to them. Further, some borrowers erroneously assume that it is "too late" to contact the lender after foreclosure proceedings have begun. The Housing Policy Council of the Financial Services Roundtable reported that an estimated 50 percent of borrowers whose homes go into foreclosure never talk to their servicer.[27]

A second obstacle occurs when borrowers who are having problems making payments do not seek help from reputable credit counseling agencies. Not only can these agencies provide objective financial counseling about whether it makes sense to try to retain the home, they can also act as an intermediary with the mortgage lender.

A third obstacle is that some mortgage backed securities' pooling and servicing agreements (PSAs) contain restrictions on actions a servicer may take in conjunction with loan workouts, for example, placing limitations on the percentage of loans in a securitized pool that may be modified.[28] Similarly, modifications of loans in these pools may present certain accounting and tax issues.[29]

A fourth and final barrier may be the disclosures that a servicer who is a debt collector under the Fair Debt Collections Practices Act, must use in all correspondence to delinquent borrowers, both written and verbal. The language used in this disclosure may have the unintended consequence of creating a situation in which delinquent borrowers may not be forthright in revealing their current financial condition. Under the Fair Debt Collections Practices Act, servicers acting as debt collectors must use the following language, *"This is an attempt to collect a debt and any information obtained will be used for that purpose."* Borrowers already fearful that speaking with loan servicers may hasten an unwanted event can be further intimidated by this language, which was intended to protect the consumer.[30]

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[27] *See* Testimony of John H. Dalton on behalf of the Housing Policy Council of the Financial Services Roundtable before the U.S. House Financial Services Committee, April 17, 2007. p. 8.

[28] *See* "The Day After Tomorrow: Payment Shock and Loan Modifications," Credit Suisse Fixed Income Research, April 5, 2007.

[29] *See* "Servicing Seriously Delinquent Subprime RMBS," Deutsche Bank Global Markets Research, March 26, 2007 for a discussion of tax treatment for Real Estate Mortgage Investment Conduits. *See* written testimony of Larry B. Litton, Jr. of Litton Loan Serving, for example, before the U.S. House Financial Services Committee accessible at: http://www.house.gov/apps/list/hearing/financialsvcs_dem/litton_testimony.pdf.

[30] *See* 15 USC 1692e (11) (Fair Debt Collection Practices Act).

VIII. Conclusion

Banks recognize that keeping homeowners in their homes is the best way to mitigate credit losses, preserve customer relationships, and maintain stable neighborhoods. Unfortunately, not all borrowers can avoid the loss of their property. In many instances, however, foreclosure prevention works best when borrowers and loan servicers communicate to determine their options and the best course of action.

For a variety of reasons, borrowers often avoid having this communication with their loan servicers. Because the number of delinquent mortgages is rising, loan servicers are looking at new techniques to improve their contacts with delinquent borrowers to enhance the chances for homeowners to remain in their homes and to reduce losses.

Best practices include: training servicing personnel in customer friendly outreach and on how nonprofit counseling agencies can assist them in this activity; providing servicer training for counseling agencies on acceptable options and outcomes related to delinquent borrowers; and, paying incentives to staff members based on the number of successful workouts they complete.

Resource Guide

OCC Community Developments Newsletter on Foreclosure Prevention
http://www.occ.gov/cdd/spring06b/cd/index.html

Interagency Statement on Working With Mortgage Borrowers
http://www.occ.gov/ftp/bulletin/2007-14.html

NeighborWorks America Center for Foreclosure Solutions
http://www.nw.org/network/neighborworksProgs/foreclosuresolutions/default.asp

HUD Certified Counseling Agencies
http://www.hud.gov/offices/hsg/sfh/hcc/hcs.cfm

Homeownership Preservation Foundation
http://www.hpfonline.org/

Servicemembers Civil Relief Act
http://www.occ.treas.gov/Consumer/servicemember.htm

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