U.S. TREASURY DEPARTMENT OFFICE OF PUBLIC AFFAIRS

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CONTACT Jennifer Zuccarelli, (202) 622-8657

UNDER SECRETARY FOR DOMESTIC FINANCE ROBERT K. STEEL TESTIMONY BEFORE THE HOUSE COMMITTEE ON FINANCIAL SERVICES

WASHINGTON- Chairman Frank, Ranking Member Bachus, Members of the Committee, good morning. I very much appreciate the opportunity to appear before you today to present the Treasury Department's perspective on efforts to coordinate and enhance foreclosure prevention.

Let me begin by broadly examining the characteristics of foreclosures, in both good times and bad, to provide a better perspective on how to approach this issue, and then provide an update on the various actions we have taken to address the current situation.

As you know, we are experiencing a period of adjustment in the credit and mortgage markets. Fortunately, this market stress is occurring against a backdrop of healthy U.S. fundamentals and a strong global economy. Yet, the Administration recognizes the importance of housing to our economy, and as Secretary Paulson has said, the housing decline is the most significant current risk to our economy. In addition to the housing decline having a penalty on economic growth, a significant number of homeowners will experience strain due to resetting mortgage rates and home price depreciation.

The issues of foreclosure are complex and nuanced. In truth, thousands of homes end up in foreclosure every year, even when housing markets are strong. Between 2001 and 2005, for example, the U.S. rate of foreclosure starts averaged approximately 1.7 percent, meaning more than 650,000 homeowners began the foreclosure process each year. This baseline rate of foreclosure can result from events such as job loss, credit problems, a change in family circumstances, or other sources of economic instability. These foreclosures, although unfortunate, are largely unavoidable.

Over the course of the next 18 months, we expect the foreclosure rate to remain elevated above its historic level. A rising foreclosure rate during a housing downturn is not surprising, but largely because of lax underwriting in recent years, especially in the subprime market, a higher than usual number of homeowners will face delinquency during the next year and a half.

In total, over 2 million subprime mortgages are expected to reset in the next 18 months, but not all will end in foreclosure. Some homeowners will be able to afford their new payments without trouble and many others will qualify for refinanced, fixed-rate mortgages on their own. Others, however, have stretched too far beyond their means, and unfortunately, foreclosure is inevitable; in fact, many loans enter into foreclosure before ever reaching the reset date. A third group of homeowners facing resets fall somewhere in the middle. The challenge is for lenders to identify the homeowners in this middle group, who with a bit of assistance can stay in their homes.

On August 31st, President Bush announced an aggressive, comprehensive plan to help as many homeowners as possible stay in their primary residences. The President charged Secretary Jackson and Secretary Paulson to lead this effort and the focus of our hearing today is to discuss one part of this plan.

Whenever facing a challenging public policy issue, the first step is full understanding. We are appreciative of the interest Chairman Frank and this Committee have taken in understanding these current challenges. Hearings, such as this one, have contributed to our process of learning. The Department of Housing and Urban Development (HUD) and the Treasury Department have also been working closely with leading servicers, mortgage counselors, lenders, and investors to understand the causes of foreclosures and the best ways to help people keep their homes. We are continuing to learn but have reached two early conclusions:

- First, it is clear to everyone that the earlier we identify struggling borrowers, the more likely it is that servicers and lenders will be able to refinance or modify mortgages into something more sustainable for the long term. If we wait until borrowers miss several payments, their credit profiles will be tarnished and they will have far fewer refinancing options.

- Second, once identified the method and technique of contacting borrowers are quite important. When contacted by lenders, many borrowers mistakenly believe that the lenders' goal is to repossess their homes through foreclosure. Foreclosure is tough on families and bad for communities, but also very costly for lenders. In almost all cases lenders would rather find a way to help homeowners stay in their homes than foreclose. Yet according to most of the servicers and counselors with whom we have spoken, 50 percent of those who lose their homes to foreclosure never contacted their mortgage servicers or mortgage counselors for help. Frequently, borrowers are fearful of foreclosure and not aware that their lenders would prefer to work out a solution – such as a lowered interest rate or a payment plan.

From our review, it became clear to us that while many market participants are working hard on their own trying to reach and help homeowners, they are not having as much success as they or we would like. In addition, the mortgage market today has developed into a system based on securitization. Securization has brought many benefits but also leads to greater complexity in finding solutions for homeowners. The breadth of disaggregation in the mortgage market presents a practical problem that does not lend itself to easy solutions.

Hope Now Alliance

Many of the servicers, lenders, investors and counselors with whom we have met realized that if they coordinated their efforts behind a unified strategy, they would be more effective in reaching and helping homeowners. The Treasury Department and HUD facilitated discussions and encouraged them to work together. On October 10th, they announced the formation of a non-partisan initiative called the Hope Now Alliance. To date, the Hope Now Alliance consists of four counseling organizations, seventeen mortgage servicers and lenders (comprising 60 percent of the U.S. market for mortgage servicing), three investor groups (including the American Securitization Forum, which represents over 370 members), and ten trade associations. We applaud these industry leaders for coming together.

Since their launch a few weeks ago, the Alliance has been meeting regularly and working hard to develop and implement an aggressive plan to help homeowners. Let me describe the details of their strategy and why we believe such elements are critically important.

Communication
Earlier this week, the Alliance announced a new, national direct mail campaign to contact at-risk borrowers, encouraging them to call for help. Servicers have been mailing letters to their at-risk customers but have had limited success. The role of counselors is crucial to helping challenged

homeowners, and no where is that more apparent than in communication. We have heard anecdotally that servicers achieve only a modest success rate with their letters, because borrowers in trouble do not want to hear from their lenders. In contrast, independent counselors have reported a significantly higher 25 to 30 percent success rate when sending similar letters to borrowers. The Alliance expects this new letter campaign, which will come from the Hope Now Alliance itself, rather than from servicers, to increase their effectiveness in reaching at-risk borrowers. This is going to be an on-going campaign that servicers will tailor and adjust as they learn from the response. The more attention we can bring to this unified campaign, the more likely it is that borrowers will pay attention to this important information and call for help. The Alliance will begin mailing these letters on November 19th, and will send over 200,000 letters by the end of this month.

Let me take a minute to emphasize the importance of these letters and to ask for your help. When you are home in your districts over the weekend or for the holidays, please tell your constituents about this mail campaign. Tell them it is OK to contact Hope Now for assistance. This organization is ready to lend a hand, but we need your help in making their message known.

Process

The Alliance is also working hard to develop strong working relationships between servicers and counselors. Some servicers already have dedicated teams and contacts for counselors to call. Other servicers do not have dedicated resources to work with counselors, and, as a result, counselors can spend hours trying to find the right person to contact. We have learned that some counselors are more effective than others at efficiently working with borrowers to collect the required information and pass that on to servicers. Servicers and counselors who joined the Alliance have agreed to adopt a standard process model that will strengthen and speed work flow, productivity, and communications between them. Improving the way servicers and counselors work together will make them all more effective at helping homeowners once they have been contacted.

Counseling

The Alliance is working to expand the capacity of an existing national counseling network to receive, assess, counsel, refer and connect borrowers to servicers. Most borrowers feel more comfortable speaking with independent, not-for-profit counselors than with their lenders. While there are already many conscientious HUD-certified mortgage counselors, their efforts could be enhanced through a uniform message. Similarly, servicers want to be able to point their borrowers to quality counselors who have adopted best practices, and this national network will serve that function. They are working to ramp up capacity now, but it will take some time before it is fully operational.

Investors

The American Securitization Forum (ASF), which represents securitization issuers, investors, and other secondary market participants, has joined the Alliance and announced that counseling fees can be reimbursed from securitization transactions in appropriate circumstances. This is extremely important. Historically, counseling was funded by the government and independent foundations. Now the securitization issuers and investor community have recognized the important role counseling plays in avoiding foreclosure and is willing to fund quality counseling. Having ASF as an active member of this Alliance is important because it can help manage the complexity resulting from the securitization model by making sure investors are doing their part.

Metrics

Today, the industry does not have a thorough, standardized set of metrics with which to evaluate servicers' loss-mitigation performance or to evaluate counselors' effectiveness. The Alliance is developing standard measures which policymakers, homeowners and investors need in order to monitor performance. These performance measurements could include data, such as the number of loans in default, outcomes for these loans, and success rates for modifications and refinances. Developing these metrics will allow us to identify categories of borrowers who can be helped, determine successful treatments, and measure the rate of successful outcomes.

Technology

The servicers have agreed to work toward cross-industry technology solutions to more effectively connect servicers and counselors together in order to better serve the homeowner. Some major servicers use sophisticated software to analyze borrower situations and determine if work-outs or modifications are appropriate. The Alliance is taking this software and making it web-enabled so other servicers and counselors can access it. This should speed the loan modification process: if a counselor can access this software tool, enter the data from the borrower, and pass that along to the servicer in an automated system, then the servicer will have more confidence in the data and the recommended solution and can approve modifications in a more expeditious manner. This element will likely take the most time, but the Alliance is working closely with a major information technology services firm to develop and launch the tool.

Looking forward

The efforts of this private sector alliance alone will not prevent all foreclosures. But it is a good start and a critical first step. As we work with them, we will all learn and improve the means of reaching and helping homeowners to prevent foreclosures.

By better identifying those borrowers in need, we hope to see more loan modifications and refinancing. For many families, this will be the only viable solution. Given today's situation, the current process requires a more committed approach.

Just as the lenders, servicers and counselors have come together to develop metrics and standards that will measure the most effective ways to make counseling accessible to troubled borrowers, we have also encouraged them to come together in a similar way to develop an efficient methodology for offering suitable mortgage solutions such as loan modifications, refinancings, or other flexibility as appropriate.

We are optimistic about the effectiveness of our current initiatives. Yet given the size, nature and implications of current challenges for homeowners, we should continue to work to find additional solutions without compromising our shared ambition to not bail out lenders or speculators or those who committed fraud.

Other complementary efforts have already been initiated. For example, we applaud the guidance that the federal regulators have given to banks which hold mortgages on their balance sheets to be more flexible in seeking economic solutions in modifying existing mortgages for distressed homeowners. The same is true with respect to the guidance that regulators issued to servicers where the record of loan modification has proven to be more difficult and disappointing for many of the reasons identified above in addition to the challenges associated with securitization.

We should focus on results and not on prescribing a single approach. Preserving homeownership is the goal, and we must recognize that many different avenues can get us there.

Borrowers, too, have responsibility. Mortgage providers must offer clear, transparent and understandable information on the mortgage products they sell. And homebuyers have a responsibility to use that information and understand their mortgages. Buying a home today is a complex process, but that in no way excuses homebuyers from their obligation for due diligence.

Policy Initiatives

The Administration has requested that Congress also do their part by focusing on three initiatives. First, Congress should pass Federal Housing Administration (FHA) modernization to make affordable FHA loans more widely available. Second, to facilitate mortgage workouts, the President has asked Congress to temporarily eliminate taxes on mortgage debt forgiven on a primary residence. And third, Congress should enact comprehensive government sponsored enterprise (GSE) reform.

FHA modernization is moving through Congress, and we are hopeful that it will reach the President's desk soon. The tax relief proposal has cleared the House of Representatives and is awaiting further action in the Senate. In large part due to this Committee's hard work, GSE reform has cleared the House of Representatives, and now awaits action in the Senate. Congress should enact these bills as quickly as possible.

Conclusion

Mr. Chairman, in conclusion, let me thank you for holding this hearing. Under the President's leadership, the Administration is working diligently to help mitigate the impact of rising foreclosures on homeowners and the economy. We appreciate having the opportunity to present the Treasury Department's perspectives on these important issues and pledge to keep you apprised of the progress with Hope Now and our other initiatives and programs. Thank you and I look forward to your questions.

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