Testimony of JPMorgan Chase & Co.

Committee on Financial Services

U.S. House of Representatives

November 12th, 2008

Chairman Frank, Ranking Member Bachus and Members of the Financial Services Committee, we appreciate the opportunity to appear before you today on this most important topic of helping homeowners. We recognize that no one benefits in a foreclosure.

My name is Molly Sheehan and I work as a senior housing policy advisor in the Home Lending Division of JPMorgan Chase & Co. Chase is one of the largest residential mortgage servicers in the United States, serving over 10.3 million customers on the platforms of Chase, WaMu and EMC, with mortgage and home equity loans of approximately $1.5 trillion in every state of the country. We are proud to be part of one of this country's pre-eminent financial institutions with a heritage of over 200 years.

Here is a snapshot of our servicing portfolio of $1.5 trillion:

- Chase owns $332 billion in mortgages and home-equity loans: $176 billion (12% of total serviced) is first-lien mortgage loans and $156 billion is home equity (10% of total serviced).
- Chase services or sub-services $1.17 trillion (78% of total serviced) in first-lien mortgage loans owned by investors.
- Non-prime loans total $123 billion (8%): $27 billion of it owned by Chase and $97 billion owned by investors.
- Pay-Option ARMs total $128 billion (8.5%): $51 billion owned by Chase and $77 billion owned by investors.

As you know, two weeks ago we announced several significant enhancements and we would like to share those with you.

Expanded Foreclosure Prevention Initiatives

While Chase has helped many families already, we feel it is our responsibility to provide additional help to homeowners during these challenging times. We will work with families who want to save their homes but are struggling to make their payments.

That's why we announced on October 31st that we are undertaking multiple new initiatives designed to keep more families in their homes.

We will open regional counseling centers, hire additional loan counselors, introduce new financing alternatives, proactively reach out to borrowers to offer pre-qualified modifications, and commence a new process to independently review each loan before moving it into the foreclosure process. We expect to implement these changes within the next 90 days.

While implementing these enhancements, we will stop any additional portfolio loans from entering the foreclosure process. This will give potentially eligible homeowners an opportunity to take advantage of the enhancements, and applies to owner-occupied properties with mortgages owned by Chase, WaMu or EMC, or with investor approval. Chase has worked diligently and will continue to work diligently with investors to get their approval to bring these enhancements to loans we service on behalf of others so our efforts can have the broadest possible impact. We also will advise homeowners in the foreclosure process to continue to work with their assigned counselors, who will have access to the expanded toolkit.

The enhanced program is expected to help an additional 400,000 families – with $70 billion in loans – in the next two years. Since early 2007, Chase, WaMu and EMC have helped about 250,000 families avoid foreclosure, primarily by modifying their loans or payments. The enhanced programs apply only to owner-occupied properties.

We inherited pay-option ARMs when we acquired WaMu's mortgage portfolio in September and EMC's portfolio earlier this year as part of the Bear Stearns acquisition. After reviewing the alternatives that were being offered to customers, we decided to add more modification choices. All the offers will eliminate negative amortization and are expected to be more affordable for borrowers in the long term.

As a result of these enhancements for Chase, WaMu and EMC customers, Chase will:

- Systematically review its entire mortgage portfolio to determine proactively which homeowners are most likely to require help – and try to provide it before they are unable to make payments.

- Proactively reach out to homeowners to offer pre-qualified modifications such as interest-rate reductions and/or principal forbearance. The pre-qualified offers will streamline the modification process and help homeowners understand that Chase is offering a specific option to make their monthly payment more affordable.

- Establish 24 new regional counseling centers to provide face-to-face help in areas with high delinquency rates, building on the success of one- and two-day Hope Now reach-out days. We will partner with our community counselors to reach more borrowers.

- Add 300 more loan counselors – bringing the total to more than 2,500 – so that delinquent homeowners can work with the same counselor throughout the process, improving follow-through and success rates. Chase will add more counselors as needed.

- Create a separate and independent review process within Chase to examine each mortgage before it is sent into the foreclosure process -- and to validate that the homeowner was offered appropriate modifications. Chase will staff the new function with approximately 150 people.

- Not add any more Chase-owned loans into the foreclosure process while enhancements are being implemented.

- Disclose and explain in plain and simple terms the refinancing or modification alternatives for each kind of loan. Chase also will use in-language communications, including local publications, to more effectively reach homeowners.

- Expand the range of financing alternatives offered to modify pay-option ARMs to an affordable monthly payment, including 30-year, fixed-rate loans, interest rate reductions, principal deferral, and interest-only payments for 10 years. All the alternatives eliminate negative amortization.

- Offer a substantial discount on or donate 500 homes to community groups or through non-profit or government programs designed to stabilize communities.

- Use more flexible eligibility criteria on origination dates, loan-to-value ratios, rate floors and step-up features.

The enhancements reflect Chase's commitment to continue to seek additional ways to help homeowners.

Expanded Offers For ARM Customers

Chase offers two programs for unsolicited rate modifications for short-term hybrid ARMs (with initial fixed terms of only two or three years). These programs are specifically designed to avoid delinquency and reward current borrowers who have demonstrated a willingness and ability to pay but may be subject to future payment shock.

➢ In late 2007, we began a blanket loan modification program for Chase-owned loans. It works very simply for homeowners: We unilaterally lock in the initial interest rate for the life of the loan on all short-term ARMs that are due to reset in the coming quarter. This saves each homeowner hundreds of dollars a month. We also have done similar blanket modification programs for investors at their request. Fewer than 10% of these modified loans end up in re-default. We are currently reviewing the EMC and WaMu portfolios to see if this program should be expanded.

➢ In early 2008, we kicked off the American Securitization Forum Fast Track loan modifications for non-prime, short-term hybrid ARMs that we service. The American Securitization Forum developed a systematic, highly streamlined process that quickly freezes the loan's current interest rate for five years, protecting the borrower from rate and payment increases. WaMu and EMC also use the American Securitization Forum Fast Track procedures.

Chase also provides loan modifications for customers who can not sustain their current payment due to affordability. As a general rule, an analysis is completed to determine an affordable payment level for the customer that will result in a reasonable housing ratio (principal, interest, taxes and insurance and condo or association fees as a percentage of income) while producing a more positive result for the investor than foreclosure. Income is subject to verification. WaMu and EMC presently use a net present value (NPV) and affordability model to determine the optimal modification for the borrower and investor. Chase is reviewing that model to determine which approach yields the most consistent and efficient process across all the portfolios.

Chase has had a proactive outreach program for resetting ARM customers since the first quarter of 2007, with no restriction based on origination date. The outreach is done for all ARM customers with contacts occurring 120 days and 60 days before reset. Under WaMu's Program for pay-option ARMs, starting in January 2008, customer contact begins for all pay-option ARM customers up to 180 days before reset to explore workout and refinance options. EMC has a similar program of outreach that it started in the fourth quarter of 2007, beginning outreach up to 270 days before reset.

Also, as we announced, we will proactively reach out to homeowners to offer pre-qualified modifications such as interest-rate reductions and/or principal forbearance. The pre-qualified offers will streamline the modification process and help homeowners understand that Chase is offering a specific option to make their monthly payment more affordable.

New Offers for Pay-Option ARM Customers

As mentioned, Chase did not originate, own or service pay-option ARMs, but has acquired portfolios of both owned and serviced pay-option ARMs through WaMu and EMC. Chase has reviewed the existing programs and expanded them.

In January of 2008, WaMu began a proactive program for its owned pay-option ARM portfolio. A month ago, WaMu kicked off a more aggressive campaign with more refined targeting and offers for borrowers due to recast in the next 180 days. The offers – and the frequency of follow-up mailings -- depend on whether the consumer is coming up on a scheduled recast or a forced recast. Under the WaMu and EMC programs, the first offer is a refinance into an Agency or FHA loan, including FHASecure. Borrowers can also be referred directly to loss mitigation counselors at their request.

Under the expanded initiatives we announced two weeks ago, our second offer for pay-option ARMs will be a modification to a 30-year fixed-rate fully amortizing loan that eliminates the possibility of negative amortization. It also allows the deferral of principal to bring the amortizing balance as low as 95% of the home's current value, with a loan at a market interest rate. The initial interest rate can be reduced as low as 2% to achieve affordability, and the rate would step up to a market rate over five years with adjustments no sooner than after years two and four to eliminate payment shock. This program is designed for owner occupants who want to stay in their home.

Under the WaMu and EMC programs, the third offer is a 10-year/interest-only ARM at a rate discounted to a floor of 3.5% and no modification fees. If a below-market rate is required, the rate will step up to a market rate over five years with adjustments no sooner than after years two and four to eliminate payment shock. Negative amortization is eliminated. Principal deferral also can be used to bring the amortizing balance as low as 95% of the home's current value. This program is also limited to owner occupants.

Once operational at Chase, the FHA Hope for Homeowners Program will provide an additional option for these borrowers.

For these loan modification programs, we will determine affordability based on a housing ratio (principal, interest, taxes, insurance and condo or association fees) that generally does not exceed a range of 31% to 40% of income. Borrowers, with housing ratios between 40% and a hard cap of 50% may be eligible if they demonstrate documented compensating factors, which can include the amount by which the monthly payment has been reduced and payment history during the trial modification period. Chase uses these ratios today in current modification programs and the relatively low level of recidivism validates their reasonableness. Where necessary, principal forbearance will be used to achieve an affordable housing ratio, as long as the result is still NPV positive. There is no interest charged on the principal forbearance, but a required payment upon sale or refinance allows the owner of the loan to share in any potential future appreciation.

Once borrowers provide preliminary income information, they begin making a reduced payment. But the final modification will be subject to 1) the borrower making up to three consecutive payments at the modified amount, 2) Chase receiving and validating income information and 3) Chase confirming the current collateral value. No modification fees will be charged and delinquency fees will be waived.

As announced, we anticipate being able to roll out the program over the next three months and, during the implementation, we will not commence foreclosure proceedings for potentially eligible borrowers for loans owned by Chase and seek investor consent, where required, for serviced loans. Chase has worked diligently and will continue to work diligently with investors to get their approval to bring these enhancements to loans we service on behalf of others so our efforts can have the broadest possible impact.

The Committee has asked what conditions servicers could impose that would make a universal approach to loan modifications acceptable to investors. It is not the servicer's role to impose conditions on investors; instead our role is to fulfill our contractual obligations by working to achieve the best possible results for our investors while creating affordable payments for the borrowers. That is what we intend to do with our new program.

The Committee has also asked what policy or operational changes the servicing industry could implement to make loan modifications more feasible under current pooling and servicing agreements. At Chase, we are designing our just-announced process to consistently achieve a result that is positive to the investors on a net present value basis. Once we tangibly demonstrate the methodology and the process, we believe we will receive the consents necessary to roll out the program more broadly. We also believe that the efforts of many servicers, the sharing of best practices and the leadership of the FDIC is helping the industry to converge on a new industry standard for loan modifications. To the extent the investor community joins in accepting this emerging standard, there will be greater certainty for the servicing industry.

We are pleased to provide this information to you and we will be happy to meet with you and respond to additional questions you may have or ideas you would like to share. In turn, as we continue to improve or programs and efficiency, we would be happy to keep you advised. We especially appreciate your leadership and that of Committee members in keeping a focus on this important issue of keeping families in their homes.