Embargoed until
April 16, 2008, at 10:00 am

Statement of

Scott M. Polakoff
Senior Deputy Director and Chief Operating Officer
Office of Thrift Supervision

regarding

Turmoil in U.S. Credit Markets: Examining Proposals to Mitigate Foreclosures and Restore Liquidity to the Mortgage Markets

before the

Committee on Banking, Housing, and Urban Affairs
United States Senate

April 16, 2008

Office of Thrift Supervision
Department of the Treasury

1700 G Street, N.W.
Washington, DC 20552
202-906-6288

Statement required by 12 U.S.C. 250: The views expressed herein are those of the Office of Thrift Supervision and do not necessarily represent those of the President.

STATEMENT OF SCOTT M. POLAKOFF
SENIOR DEPUTY DIRECTOR AND CHIEF OPERATING OFFICER
OFFICE OF THRIFT SUPERVISION
ON EXAMINING PROPOSALS TO MITIGATE FORECLOSURES
AND RESTORE LIQUIDITY TO THE MORTGAGE MARKETS
BEFORE THE
SENATE BANKING COMMITTEE

April 16, 2008

I. Introduction

Good morning, Chairman Dodd, Ranking Member Shelby and members of the Committee. Thank you for inviting me to testify on behalf of the Office of Thrift Supervision (OTS) on proposals to mitigate and prevent further home foreclosures in America and to restore liquidity in our mortgage markets. In particular, I appreciate the opportunity to discuss the OTS Foreclosure Prevention Proposal (OTS Plan) and to comment on your bill, Mr. Chairman, the HOPE for Homeowners Act (HOPE Act).

I want to commend you, Mr. Chairman, for your diligence and leadership on this important subject. I also want to thank you for the cooperative approach and exchange of ideas that my staff has had with your staff and others as we work toward this essential common goal.

In my testimony today, I will focus exclusively on the two subjects at hand – foreclosure prevention and restoring market liquidity to the housing markets. You are well aware of the issues that brought us together today, including the profound changes in the underlying housing market and the impact of the housing downturn on homeowners, financial institutions, and the broader economy. The bulk of my testimony focuses on the HOPE Act and the OTS Plan. Both seek to preserve homeownership and limit preventable foreclosures through the use of FHA loan programs.

The OTS's continuing work in developing and fine-tuning the OTS Plan has included extensive conversations with mortgage market participants and stakeholders, and allowed us to identify and study the issues involved. In this process, we have gained key insights into the incentives that drive the behavior of various players in the mortgage market. These incentives present both obstacles and opportunities that must be considered in fashioning an appropriate strategy for avoiding further foreclosures while restoring liquidity to the mortgage markets. Perhaps the most difficult challenge is the fact that these two objectives – foreclosure prevention and mortgage market liquidity – exhibit policy elements that may tend to run counter to each other (i.e., solutions that require debt forgiveness by investors may discourage investors' future investments in mortgage securitizations). While both are important policy objectives, the various competing concerns and interests present in minimizing foreclosures and promoting foreclosure prevention highlight important long-term policy implications to long-term liquidity and stability in the mortgage markets.

II. Foreclosure Prevention and Existing Loss Mitigation Efforts

A. Overview of Affected Parties/Participants

In exploring foreclosure prevention solutions, it is important to understand the interests of the various participants when a mortgage loan is made and, in many cases, subsequently securitized.

The first group of affected participants is the borrowers. Even within this group there is not a single borrower profile. This, of course, complicates appropriate responses and solutions aimed at assisting borrowers on a blanket or wide-scale basis. Generally, distressed borrowers can be sub-grouped into three broad classes:

- Borrowers not able to sustain the financial demands of homeownership;
- Borrowers who can be helped, and who were put into their current situation because they were victims of predatory lending, poor loan advice, or poor judgment on their own part; and
- Borrowers who can be helped, and were put into their current situation because of a change in their personal circumstances and now require payment flexibility to get back on their feet.

The next group of participants in the process is lenders. Within this group, there are generally two sub-groups: portfolio lenders and lenders who originated for sale into the secondary market. It is relatively straightforward to understand the interests of a portfolio lender that retains the credit risk associated with originating a mortgage. In contrast, lenders that originated for sale and expected to transfer credit risk may not have been as prudent in underwriting and assessing the ability of borrowers to repay.

Next are the investors in the securitization. A typical securitization has a number of different investor types with differing risk profiles, return expectations, and interests in the securitization. For example, investors in the highest rated tranches have agreed to take a lesser return and assume a lower risk profile in exchange for a more stable and predictable income stream. The typical securitization will have mezzanine tranches held by investors who have a more elevated risk profile than the AAA (highest rated) investors, but who also expect a certain return on their investment in the securitization. Finally, there are the residual owners or investors, who bought into the deal with the understanding that they had the potential for significantly higher returns if the mortgage loans performed as expected, but would take the first losses if the loans did not perform as expected.

The interests of the securitizer are also unique. The securitizer will attempt to maintain liquidity in the capital markets for the loans and ensure that the loans are sold at the highest possible value. To accomplish these goals, the proceeds from the sale of the loans will be used to fund future loans, thus potentially providing a stable source of funds in mortgage finance. Of course, the performance of the loans is essential to maintaining regular access to the capital markets for funding and maximizing value. As a result, there is a built-in incentive for the securitizer to insist on proper underwriting. It is primarily the failure of this mechanism that has contributed to the challenges confronting mortgage securitizations today.

Finally, perhaps the most complicated and complex interest in a securitization is that of the servicer, whose goal is to make sure the mortgage loans perform and payments are made to the mortgage trust based on the timetable established in the securitization. In effect, the servicer is the bill collector for the securitization. In this regard, the role of the servicer is critical to the success and continued viability of a securitization. For the same reason, the servicer also figures prominently in any efforts to prevent foreclosures of mortgage loans held by the trust, including loan modification and loss mitigation efforts to keep borrowers in their homes. Providing proper financial incentives and/or aligning the interests of the servicer with the other parties in a securitization is, we believe, key to the success of any foreclosure prevention or loss mitigation program.

B. Loan Modifications and Workouts

Loan modification is an important tool in preventing foreclosures; however, as with any foreclosure prevention approach, it may be appropriate for certain situations but not others. The OTS has consistently encouraged the institutions we regulate to work constructively with borrowers whose mortgage loans are in default or for which default is reasonably foreseeable. We continue to stress that prudent workout arrangements, conducted in accordance with safe and sound lending practices, are generally in the long-term best interest of both borrowers and lending institutions.

Many mortgages are held in securitization trusts that have outside servicers to manage the cashflows arising from the underlying mortgages. Many Pooling and Servicing Agreements have been structured under the assumption that loan modifications are rare and would be pursued on a case-by-case basis. Generally, delinquent loans can be modified under this approach if the borrower demonstrates a willingness and ability to repay the loan under modified terms and such a modification maximizes proceeds to the securitization trust. We recognize, however, that a loan-by-loan evaluation is time consuming and will be aided by an articulation of clear guidelines regarding acceptable procedures for structuring write-downs.

There have been a number of initiatives to develop and implement a streamlined loan modification plan, such as that articulated in the American Securitization Forum's December 2007 statement of principles and the efforts of the HOPE NOW alliance. While these efforts have been successful, with HOPE NOW participants reporting over one million loan workouts during the last six months of 2007, issues and obstacles to implementing blanket loan modifications remain a challenge. Reaching borrowers is a challenge with any foreclosure prevention proposal and other issues, such as the potential tax consequences arising under the real estate mortgage investment conduit (REMIC) federal tax rules, present additional obstacles. Another challenge is providing servicers with as much guidance and flexibility as practical to conduct meaningful reviews to identify borrowers in need of assistance. Ultimately, it is important to identify the goals of a foreclosure prevention program and then structure it accordingly.

In our view, structuring a viable loan modification program involves three primary goals that should be recognized and incorporated into any plan. First, and most fundamental, the program should preserve and sustain homeownership. Second, of course, the program should protect homeowners from avoidable foreclosures due to interest rate resets or unexpected life events. Finally, it is extremely important that the program be structured to preserve and maintain market integrity, as well as ensure the continued safety and soundness of depository institutions and the broader financial services industry.

III. Other Approaches to Foreclosure Prevention

The goals central to a viable loan modification program are equally important to the success of any other foreclosure prevention proposal. In addition to providing relief to distressed borrowers and avoiding potentially significant losses to security holders, foreclosure prevention initiatives are attractive to the broader economy because of the stabilizing effect it could have on the housing markets. There are numerous challenges and considerations in formulating a viable foreclosure prevention effort that has sufficient reach to provide relief to distressed borrowers, as well as a meaningful impact on the existing housing economy. These include:

- Who is covered (e.g., distressed borrowers in owner-occupied properties)?
- Is the plan appropriately calibrated to assist borrowers unable to pay rather than those unwilling to pay?
- Will the plan prevent foreclosures, rather than forestall eventual foreclosures?
- Should there be a different foreclosure prevention approach for loans held in securitizations versus loans held in portfolio by insured depository institutions?
- Are appropriate market incentives and borrower incentives maintained?

- Can the plan be implemented "operationally" by servicers to reach a sufficient number of borrowers on a wide scale basis, but only those borrowers intended to be covered by the plan?
- Does the plan protect servicers and trustees from potential lawsuits by disgruntled investors?
- Should investors fully absorb losses generated by the irresponsible behavior of borrowers, mortgage brokers and others in the mortgage loan process?
- What role should the government play in the process (including, whether the government should back borrowers and/or investors in the process)?
- What are the appropriate economic incentives for investors, borrowers, servicers and the government in a foreclosure prevention plan?
- What other tax and/or accounting issues present obstacles to implementing a viable foreclosure prevention initiative?
- What is the potential long-term impact of the plan, both on the direction of the current housing market and future financing and investment by the capital markets in housing?

These are key questions and the list is not exhaustive. Given the competing interests and concerns, some suggest that the best way to address the current problem is simply to let market forces prevail. Would this work? Ultimately, yes. But it most likely would not be beneficial to permit that to happen. There are responsible "would-be" homeowners who chose not to enter the high-risk housing market of the past several years. What they and everyone else would gain by allowing unaided market forces to sort out the current mortgage market crisis would be perhaps even lower housing prices than in recent months, but this would be offset by significantly higher financing costs and uncertainty in the mortgage and capital markets over the long run.

The impact of the current market situation on mortgage lending and financing has been clear during the past several months. Subprime lending virtually dried up in many parts of the country and, until recently, even the lowest risk jumbo loans have been hard to find at rates remotely competitive with conforming mortgage loans. Both of these types of loan products have been historically funded to a significant extent by the capital markets.

Recently, government initiatives have supplanted the role of the capital markets in some areas by providing relief in the form of additional funding by increasing the conforming loan limit for loans purchased by Fannie Mae and Freddie Mac, as well as the loan limit for loans guaranteed by the Federal Housing Administration (FHA). In addition, the Office of Federal Housing Enterprises Oversight (OFHEO), which regulates the GSEs, recently eased the portfolio limits on Fannie Mae and Freddie Mac, and also reduced by one-third an OFHEO-directed capital surplus requirement imposed on the GSEs. All of these initiatives will increase the ability of the GSEs and the FHA to make mortgage loans, particularly in the jumbo loan market.

Finally, the FHA recently modified its FHASecure refinancing program to allow ARM borrowers who missed two mortgage payments within the past 12 months to participate in the program at a 97 percent loan-to-value (LTV) ratio, and ARM borrowers missing three mortgage payments within the past 12 months to participate at a 90 percent LTV. These modifications will help prevent mortgage foreclosures.

Thus, we have already witnessed a relatively robust government response to encourage new lending, along with other government and quasi-governmental initiatives to prevent foreclosures. However, more needs to be done to address preventable foreclosures. In particular, I believe the benefits of foreclosure prevention are very real and extend far beyond the immediate impact on distressed borrowers and holders of mortgage loans facing foreclosure. This is perhaps the most important aspect of the current foreclosure problem. While a "bailout" of irresponsible borrowers, lenders and investors is not appropriate, it may be appropriate to properly align incentives to protect those who otherwise acted responsibly or were victimized during the past several years. I believe tailoring a solution for this aspect of the issue is in our collective best interest.

It is with this backdrop that we developed the OTS Plan. As you know, the OTS regulates an industry comprising mostly mortgage lenders. Thus, we have extensive experience in aspects of the mortgage markets, including lending, funding and consumer protection issues. In developing and fine-tuning our proposal, we have met with many stakeholders in the mortgage market in an attempt to identify potential pitfalls, and to understand incentives and disincentives at work in the marketplace. In that process, we have learned a great deal about the difficulties that any attempt to address foreclosure prevention will face. Crafting a solution to the current foreclosure challenge requires extreme sensitivity to all of these constituencies, as well as other competing interests. I know that you are extremely familiar with these issues, Mr. Chairman, given your own legislative efforts to address the problem. In this regard, you have asked for our thoughts on the HOPE Act, your foreclosure prevention proposal.

A. Overview of the HOPE for Homeowners Act

Based on our review of the major provisions of the HOPE Act, it would make available to the FHA such sums as are necessary from 2008 through 2012 to guarantee new mortgages to refinance existing eligible mortgages originated before January 1, 2008, on owner-occupied properties at risk of foreclosure. The proceeds from new FHA-guaranteed loans would be used to pay off existing lenders or mortgage holders after write-down of the existing loan to an amount approximately equal to 87 percent of the current fair market value (FMV) of the property. In this regard, the loan-to-value ratio of the new FHA-guaranteed loan cannot exceed 90 percent of the current FMV of the property and there is an additional 3 percent of FMV fee payable to the FHA at origination of the FHA-guaranteed loan. This effectively brings the amount payable to the original loan holder down to 87 percent of the current FMV of the property (with no recovery of other prepayment penalties or default/delinquency fees).

In addition to the 3 percent FHA origination fee, the borrower must forfeit to the FHA an amount equal to half of any profits from appreciation in the value of the property after the FHA refinancing plus a decreasing percentage (through the fifth year after the FHA refinancing) of the equity in the property created at time of the FHA refinancing (i.e., the difference between the FHA loan amount and then FMV of the property) upon a sale of the property following the FHA refinancing. It is noteworthy that, while the borrower becomes fully vested after five years in the amount of equity created at the time of the FHA refinancing, it appears that the borrower must share with the FHA the amount of any appreciation in the property whenever the property is subsequently sold – and even if the FHA share exceeds the amount of the original write-down required to do the FHA refinancing.

To be eligible for a new FHA-guaranteed loan under the HOPE Act, the original loan holder must agree to accept an amount equal to 87 percent of the current FMV of the property, as highlighted above, with no prospect of additional recovery regardless of the future performance of the underlying collateral.

A final provision of the draft that I want to highlight is a proposed mechanism for the bulk refinancing of existing loans. It is our understanding that this provision is intended to establish an auction procedure that may or may not be utilized depending on the overall state and stability of the housing markets. While we appreciate the concept of establishing such a mechanism for the bulk refinancing of existing distressed mortgages, the parameters of the program are not clear to us. Of particular concern is the possibility that such a mechanism could further depress housing prices rather than stabilize them. At this time, we withhold any additional comment on the bulk refinancing auction mechanism until we have a better understanding of the intent and application of the provision.

B. Overview of the OTS Foreclosure Prevention Proposal

The OTS Plan is designed to avoid foreclosures of owner-occupied properties held in securitizations where a distressed borrower is unable to refinance a loan because the fair market value of the property is less than the current outstanding loan amount. The plan was developed with several objectives in mind. First, it was intended as a market-driven solution that relies on existing programs, avoids a new government guarantee or assistance, and does not result in the transfer of unacceptable risk to an insured depository institution's books. Second, the plan was structured to ensure that the solution minimizes motivations for "gaming" the system by borrowers currently able to pay under their existing loan. A third objective was to avoid providing a windfall to borrowers and investors in the securitization. Finally, the OTS Plan is intended to identify a solution that optimizes investor incentives and motivations to seek it out while maintaining borrower incentives to preserve the value of the property.

With these objectives in mind, the OTS Plan was developed as a program in which:

- Depository institutions could offer and underwrite FHA-guaranteed loans based on a percentage of the current fair market value of the property (e.g. 90 percent);
- Proceeds of the new FHA loan would be used to provide a partial pay-off of the outstanding balance of the original mortgage loan to the holder of that loan; and
- Existing holders of the original loan would receive a "negative equity interest" equal to the difference between the partial pay-off and the balance of the original mortgage loan held by the securitization pool. Alternatively, it was envisioned that the negative equity interest could be shared among the existing loan holders, the FHA (or other entity protecting FHA's insurance risk), and/or the borrower/homeowner as needed properly to align incentives.

Pursuant to the OTS plan, the proceeds of the new FHA loan would be used to pay off the original loan at a discounted payout (i.e., less than the original outstanding loan amount). The original loan holder would receive a negative equity interest (as a non-interest bearing second position claim) equal to the amount of the discount between the new FHA loan and the unpaid balance on the original mortgage. However, this amount could be reduced by a designated percentage, e.g., 15 percent, which would be paid to the borrower upon sale in order to maintain borrower incentives to preserve the property and maximize its value at sale. The negative equity interest also could be adjusted to provide for a designated percentage to be paid out to an existing second mortgage loan holder to recognize the write-off it would have to make to permit the FHA refinancing to proceed.

Upon a later sale of the property by the borrower, any appreciation in the value of the property (reflected in the sale price) above the discounted payout (i.e., the amount paid to the original loan holder with the proceeds of the FHA loan) would be payable to the holder of the negative equity interest up to the full amount of that interest (less any prior second mortgage holder allocation and/or borrower offset to preserve the value of the property), with any sale proceeds beyond the amount of the negative equity interest accruing to the borrower.

The OTS Plan provides a market-driven solution that does not "bail out" investors or borrowers. It allows responsible borrowers to avoid foreclosure and stay in their homes, it allows lenders to underwrite FHA guaranteed mortgages based on acceptable "loan to value" ratios while utilizing current appraised values, and it allows servicers to maximize proceeds for the securitization. Our plan provides an incentive for the original loan holders (including the opportunity for participation by existing second lien holders) and the borrowers to participate in the program. The plan also avoids a windfall to borrowers by requiring any appreciation in a subsequent sale to be paid to holders of the negative equity interest up to the amount of the discount that the original loan holders took when the original loan was cashed out (again, less any allowance to a prior second lien holder and any borrower incentive to maintain and maximize the value of the property). And the plan relies on an existing framework – including FHA-insurance – for addressing problem loans in securitizations. Finally, the OTS Plan creates a potentially marketable financial instrument in the negative equity interest.

Following is an example of how the OTS Plan would operate based on a $220,000 subprime mortgage loan extended in March 2006 on residential property then appraised at $240,000:

- Distressed borrower facing reset in May 2008 that will significantly increase the monthly mortgage payment; borrower will have difficulty making the payment at the reset amount.
- Fair market value of the property is now at $200,000.
- Borrower informs servicer of borrower's financial distress pursuant to inquiry by servicer about the borrower's ability to make the new (reset) payment.
- Servicer refers borrower to FHA-insurance program at ABC FSB that will make a mortgage loan to the borrower at 90 percent of the current fair market value of the property (i.e., an $180,000 mortgage loan).
- Servicer agrees to take $180,000 partial pay-off in order to maximize proceeds and prevent an unnecessary foreclosure, modifies the original loan obligation down from $220,000 to $40,000, subordinates it to the FHA guaranteed first mortgage, and makes it 0% interest. The maturity of this modified loan (negative equity certificate) is based on either the original maturity or when the borrower sells the property. It is non-recourse with repayment limited to property appreciation when the property is sold. We also believe that there is merit in having the borrower share in appreciation with the securitization trust.
- Borrower has $180,000 FHA-insured fixed interest rate loan with an affordable monthly payment.
- If borrower sells property in 18 months at a sale price of $236,000, the first $40,000 of the $56,000 difference (appreciation) between the sale price and the refinanced loan amount is payable to the securitization trust (with a percentage to the borrower as an incentive, if applicable) on their negative equity interest in the property.

C. Comparison of the HOPE Act with the OTS Plan

Like the HOPE Act, the OTS Plan is intended as a mechanism to aid the growing number of borrowers who will find themselves in financial difficulties because their mortgages are "underwater." It is not a "silver bullet" that will provide a single solution to the current crisis. There is no single solution. The intent of our proposal is to provide another meaningful tool to add to the options available for foreclosure prevention and revitalization of the mortgage market.

The OTS proposal has a number of similarities to the HOPE Act, including reliance on the FHA to guarantee new loans to replace existing loans held by distressed borrowers in owner-occupied properties. This is a key concept that enables the leveraging of existing governmental resources in a meaningful partnership with private lenders. Ensuring that new FHA loans are based on the current FMV of the property is also a key common element of both proposals. Finally, using the proceeds of the new FHA loan to pay existing loan holders via a partial pay-off to extinguish their existing mortgage position is also a common element of the proposals. This would provide a significant new tool to servicers and lenders seeking to avoid preventable foreclosures. However, the way this is accomplished is different under the HOPE Act and the OTS Plan.

First, under the OTS plan, the intent is to provide a negative equity position to the securitization trust in an amount equal to what it charged off by taking the partial pay-off from the proceeds of the new FHA loan. This is intended to avoid the situation of a future windfall to borrowers whose debt is written down and the value of their home returns in several years to the original loan amount (or more) upon sale of the property.

The HOPE Act would prevent a potential windfall to an existing borrower to a more limited degree, but would also take from the borrower half of any proceeds above the original loan amount if the appreciation in the property reaches that amount. While the HOPE Act would enable a borrower to recoup the entire equity gain (based on the difference in the FHA loan and FMV of the property at the time of that loan) on the sale of the property after five years, the borrower would only get half of any appreciation. Again, it is important to stress that the borrower's half share of any subsequent appreciation remains a half share even for proceeds that exceed the original loan amount.

In contrast, the OTS proposal does not provide a time limit on recovery in a subsequent sale, only a dollar limit on recovery equal to the amount of the initial shortfall. While we acknowledge that it makes sense for a borrower to have an incentive to preserve property value and to maximize proceeds from a future sale, we do not believe borrowers should be absolved outright of their prior obligation. Finally, the OTS proposal does provide an additional borrower incentive by allowing the borrower to keep the sale proceeds in excess of the amount due to the original loan holder (i.e., after payment on the negative equity interest).

Fundamental to the OTS proposal is the underlying premise that most real estate values tend to increase over time. Assuming this is true with the properties held by many currently distressed borrowers, such borrowers could reap a significant future windfall if they are permitted to retain profits from a future sale rather than making the proceeds available to pay off the remaining amount of their original obligations, which would effectively now be provided to them interest free. At the same time, such borrowers would forfeit to the government half of any appreciation above the original loan amount. Arguably, only the government would have a true benefit in this situation – by receiving half of the future appreciation on the property.

Another important difference between the OTS proposal and the HOPE Act is that the OTS proposal would provide to the original loan holders as much of the current FMV of the property as is feasible for a new lender to extend under a FHA loan to minimize the shortfall in the original loan obligation. In contrast, while the HOPE Act has a comparable target as envisioned in the OTS plan of issuing FHA-guaranteed loans at or around 90 percent of the current FMV of the property, the draft would impose an additional fee payable by the original loan holder. This fee, equal to 3 percent of the current FMV of the property, would be absorbed by the original loan holder as a reduction in the proceeds payable to the holder. While we understand the merits in imposing this fee may be important, it may make sense to transfer its cost to the borrower that is getting the benefit of the new FHA-guaranteed loan, for example, by tacking the fee onto the back end of the transaction and making it collectible at the time of the subsequent sale of the property. This would still diminish negative equity, but not the upfront short sale payment to the original loan holder.

In sum, Mr. Chairman, the OTS proposal differs from the HOPE Act draft in two important respects. First, it results in less of a shortfall to existing loan holders, which we believe is important to minimize the negative impact on market forces and create incentives for loan holders to participate in the program. We think the key to success for this approach is for the loan servicer to have enough incentive – through a stake in the future upside potential – to be moved to action to save the home from foreclosure. If the servicer, acting on behalf of the original loan holder, does not have sufficient incentive, then no action will be taken, more homes will be lost to foreclosure and this crucial foreclosure prevention effort will fall painfully short of its mark. In this regard, we would note that the negative equity interest created under the OTS plan has the potential to be shared among existing lien holders, the FHA or other insurer, and the original borrower in whatever manner best aligns their interests to facilitate a foreclosure prevention solution.

Second, the OTS proposal holds existing borrowers to a significantly higher degree of accountability for their past actions. Again, we think this is a highly desirable result from a public policy standpoint. We must remember that while the number of problem loans is large, over 93 percent of homeowners continue to pay their mortgages as agreed, and over 93 percent of mortgages held by the thrift industry are paying as agreed.

For these reasons, Mr. Chairman, we continue to believe that the merits of the OTS Foreclosure Prevention Proposal – subject to further refinements, including ways to improve borrower incentives to optimize future sale value, should be considered as part of any foreclosure prevention solution. As I stated before, the OTS proposal is not a panacea, but a tool that lenders can use to stem the rise in foreclosures, and we have been encouraged to continue to develop the plan. While the OTS Plan does not require legislation, certainly Congressional endorsement of the approach would significantly facilitate its implementation on a wide-scale basis.

V. Conclusion

Thank you, Mr. Chairman, Ranking Member Shelby, and Members of the Committee, for the opportunity to testify on behalf of the OTS on the HOPE Act and the OTS Plan.

We believe that foreclosure prevention efforts that keep distressed borrowers in their homes by partially paying off their current "underwater" mortgages with an FHA-insured loan and allocating the balance to a negative equity interest offer the best option to reduce preventable foreclosures. A negative equity interest that would pay out in the event of future appreciation upon sale of the property can be apportioned to allow incentives to be aligned in a way that that will maximize the number of foreclosures prevented.

We look forward to working with the Committee to address the continuing challenges in the mortgage markets, and in fashioning a strategy to limit needless and preventable foreclosures. Thank you.