FOR OFFICIAL USE ONLY UNTIL RELEASED BY THE
HOUSE COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON INSURANCE, HOUSING AND COMMUNITY OPPORTUNITY

STATEMENT OF NEIL BAROFSKY

SPECIAL INSPECTOR GENERAL
TROUBLED ASSET RELIEF PROGRAM

BEFORE THE
HOUSE COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON INSURANCE, HOUSING AND COMMUNITY OPPORTUNITY

MARCH 2, 2011

Chairman Biggert, Ranking Member Gutierrez, and members of the Committee, I am honored to appear before you today to discuss the Department of the Treasury's Home Affordable Modification Program ("HAMP").

Since the President's announcement of the HAMP program in February 2009, the Office of the Special Inspector General for the Troubled Asset Relief Program ("SIGTARP") has committed significant resources to provide oversight for the program and to take steps to limit its vulnerability to waste, fraud and abuse. To date, through one completed audit (with two more currently under way) and eight quarterly reports, SIGTARP has offered Treasury 18 recommendations to help maximize program effectiveness and protect the taxpayer from losses due to fraud. Of these, Treasury has fully implemented four recommendations, partially implemented five, not implemented seven, and has stated that it is in process of at least partially implementing the remaining two. SIGTARP's Investigations Division has also been busy policing the program, focusing primarily in its charged cases on those who have used HAMP as a tool to defraud struggling homeowners. Of the 47 individuals and 16 entities that to date have been the subject of criminal or civil actions[1] related to SIGTARP's investigations, HAMP-related frauds have resulted in criminal charges against eight people, civil actions against 23 people (3 of whom were also charged criminally), and civil actions against14 entities. Of the 15 defendants who have been convicted to date for fraud related to the Troubled Asset Relief Program ("TARP"), three have been convicted for participation in schemes relating to HAMP.

As for the program itself, HAMP began with much promise, intended to promote TARP's most specific Main Street goal of "preserv[ing] homeownership." But as SIGTARP and the other TARP oversight bodies – the Congressional Oversight Panel ("COP") and the Government Accountability Office ("GAO") – have detailed in audits and reports, HAMP has been beset by problems from the outset and, despite frequent retooling, continues to fall woefully short of meeting its original expectations. Today the program is under siege from all quarters, with near universal agreement that the program has failed to meet its goals, and the current debate centering mostly on whether the program should be terminated, replaced or revamped. Treasury, it seems, stands alone in defending the status quo.

The frustration expressed from both sides of the aisle is understandable. As SIGTARP described in its January 2011 Quarterly Report to Congress, the numbers as of the end of 2010 were remarkably discouraging. According to RealtyTrac data, a record 2.9 million homes received foreclosure filings in 2010, up from 2.8 million in 2009, and 2.3 million in 2008. RealtyTrac predicts that filings will be 20% higher in 2011, obliterating the 3 million threshold. The recently reported numbers for January 2011 support this prediction, with more than 260,000 foreclosure filings in that month alone. The firm's data further reveal that bank repossessions continue to increase, from just less than 820,000 in 2008 to more than 918,000 in 2009 to 1.05 million in 2010. Some estimate that as many as 13 million homes will be subject to foreclosure filings during the operative stage of HAMP.

In contrast, the number of permanent mortgage modifications under HAMP remains feeble— there were just under 522,000 ongoing permanent modifications as of December 31, 2010, with approximately 238,000 of those funded by and attributable to TARP. The remaining modifications were funded outside of TARP by the Government Sponsored Entities ("GSEs"). A combined total of more than 792,000 trial and permanent modifications had been cancelled,

[1] These numbers do not include multiple administrative actions, such as debarments and suspensions, or filings in bankruptcy cases.

with more than 152,000 trial modifications still in limbo. These permanent modification numbers pale in comparison not only to foreclosure filings, but also to Treasury's initial prediction that HAMP would "help up to 3 to 4 million at-risk homeowners avoid foreclosure" "by reducing monthly payments to sustainable levels." While as of the drafting of this testimony Treasury had not released numbers for January 2011, there is little reason to hope that things will get better.

Treasury, for its part, has at least begun to acknowledge the program's shortcomings, with Secretary Geithner recently conceding that HAMP "won't come close" to the initial estimate of helping 3 to 4 million at-risk homeowners avoid foreclosure. The Secretary also recently acknowledged what SIGTARP and the other oversight entities have been stating for some time, that loan servicers – which by design bear the central responsibility for implementing HAMP – "are still doing a terribly inadequate job." Further, the Secretary admitted that the program suffers from a design flaw that goes to its very heart, with the recognition that the incentives to servicers that were intended to serve as the engine of HAMP simply "have not been powerful enough." While these admissions about the fundamental flaws in HAMP represent a step forward, they come very late in the game and appear to be unaccompanied by any consequential changes to the program or meaningful statement of program goals. Indeed, it is apparent that Treasury has no intention of meaningfully responding to these failures in performance or design. Just last week a Treasury official reportedly declared at a Mortgage Bankers Association conference that the attendees would not "see any major new programs coming out," and that while Treasury "may tweak around the edges," its "primary objective in 2011 is excellence in the program we have."[2] As a result, supporters of HAMP have little reason to hope that it will be anything more than it is today – a program that benefits only a small portion of distressed homeowners, offers others little more than false hope, and in certain cases causes more harm than good.

HAMP's failure to meet its original expectations has many causes, starting with a rushed launch based on inadequate analysis, an insufficient incentive structure, and without fully developed rules, which has required frequent changes to program guidelines. The unnecessary confusion and delay that accompanied the hasty rollout were exacerbated by Treasury's initial decision (later corrected) to encourage servicers to accept homeowners into trial modifications without requiring adequate documentation of income, despite SIGTARP's warning of the hazards of doing so. And while Treasury now acknowledges that "when HAMP was launched in early 2009, servicers were totally unequipped to deal with a crisis," Treasury's design of HAMP as a program so entirely dependent on servicer competence, along with its decision to flood those same "unequipped" servicers with trial modifications based on unverified data, in no small part contributed to the well-documented servicer failures that followed.

Perhaps most fundamentally, despite consistent and repeated recommendations from SIGTARP and the other TARP oversight bodies, as well as members of Congress, Treasury has steadfastly refused to adopt meaningful goals and benchmarks for HAMP. Rather than develop such goals and metrics, which would allow more meaningful oversight, promote accountability, and provide guidance for useful change, Treasury instead has regularly changed its criteria for success, citing at different times the total number of trial modification offers extended to borrowers, regardless

[2] Jon Prior, *Treasury makes adjustments to give HAMP a chance*, HousingWire (Feb. 24, 2011) (online at www.housingwire.com/2011/02/24/treasury-makes-adjustments-to-give-hamp-a-chance).

of whether they were accepted, and then the total number of trial modifications, regardless of whether they became permanent, which far fewer than half have actually done.

Treasury's continued reliance on trial modifications as a measure of success – just last month it highlighted the "temporary relief" such modifications provide, reinforcing its prior declaration that "every person who is in a temporary modification is getting a significant benefit" – is particularly troubling in light of the harm and suffering that often accompany failed trial modifications. In SIGTARP's October 2010 Quarterly Report, SIGTARP provided examples of the damage that failed trial modifications have inflicted, including complaints received through SIGTARP's hotline. Since then, there have been countless published reports of HAMP participants who end up worse off for having engaged in a futile attempt to obtain the sustainable relief that the program promised. Failed trial modifications often leave borrowers with more principal outstanding on their loans, less home equity, depleted savings, and worse credit scores. And even in situations where they never missed a payment, such borrowers may face back payments, penalties, and even late fees that become due once their trial modification is cancelled. The impact of these added burdens becomes even greater when trial modifications are allowed to continue long past the three-month period called for by the program. While it may be true that some homeowners benefit from the "temporary relief" of a trial modification even though the modification ultimately fails, Treasury's repeated references to the benefits of failed modifications ignores the real and often debilitating harm that such modifications have inflicted on many families, and appears to be little more than an attempt to define specific failures as successes.

In recent months, Treasury's evolving defense of HAMP has featured the claim that HAMP has had a beneficial impact on private modifications that occur outside of the HAMP program. This too is a questionable measure of success. While Treasury may deserve credit for having had a positive, if inadvertent, impact on industry practice, according to a December 2010 COP report, "when pressed, Treasury acknowledges that there is no clear causal link between HAMP and proprietary modifications." Furthermore, while data suggests that proprietary modifications have generally improved from the homeowner's perspective since the launch of HAMP, the terms of such modifications are typically far less advantageous, often including more unfavorable terms for the borrower, higher rates of redefault, and broader imposition of servicer fees that are specifically prohibited in HAMP. In other words, it is odd for Treasury to celebrate modifications whose terms would largely be unacceptable from both the borrower's and Treasury's perspective in HAMP. Furthermore, touting such proprietary modifications as a HAMP "success" also undermines Treasury's defense of the need to continue HAMP. If it truly views these modifications in such an admiring light, it raises the very serious question as to why taxpayers should continue to fund HAMP.

Of course, any credible measure of HAMP's success would include a comparison of the original expectation of helping 3 to 4 million families with sustained permanent modifications with the number of families that will actually receive them over the course of the program. Remarkably, despite recommendations from oversight bodies and requests from Congress, Treasury still refuses to provide even the most basic estimate of the total number of permanent modifications it expects to complete and maintain under HAMP. Instead, in recent testimony to this Committee, a Treasury official merely promised "to reach out to as many eligible homeowners as possible to our program's expiration in 2012." In December 2010, COP attempted to fill the void left by Treasury by estimating that, if current trends hold, HAMP will result in only 700,000 to 800,000 effective permanent modifications. Unfortunately, COP's bleak projection appears all too reasonable, with participation trends getting worse with each passing quarter. For example, HAMP produced only a net increase of slightly more than 18,000 permanent modifications per month over the most recent quarter, down 35% from the quarter before that, and a far cry from the 20 to 25,000 trial modifications *per week* Treasury officials once predicted. Even of these, TARP is responsible for only approximately 10,000 modifications per month, with the GSEs providing the balance.

Rather than confirm or reject COP's estimate, or provide one of its own, Treasury does something astonishing: Albeit in the context of calculating HAMP's total cost, it suggests both that COP's estimate might be accurate, which would mean roughly an additional 180,000 to 280,000 ongoing permanent modifications by program's end, or that the total might be *twice* COP's estimate, which would mean roughly an additional 870,000 to 1,070,000 ongoing permanent modifications by program's end. Treasury's suggestion that the number of new ongoing permanent modifications might vary by a factor of close to 10 can hardly give comfort to those interested in saving HAMP. Nor does it provide the American people and their representatives in Congress with the kind of information that is absolutely necessary in evaluating whether the program should be shut down, significantly revamped, or permitted to stay on its current course. We were all led to believe when HAMP was launched that it would help 3 to 4 million families stay in their homes through permanent modifications to sustainable levels. Given Secretary Geithner's acknowledgement that Treasury will "not come close" to that number, any credible assessment of HAMP must start with Treasury's clear articulation of the number of sustained permanent modification it believes HAMP will deliver.

The foundation for Treasury's claim that HAMP is a success appears to be that at least the program is helping *some* families, even if nowhere near the number originally promised. While, as Treasury repeatedly points out, for the more than 520,000 families that benefit from ongoing permanent HAMP modifications the program has certainly been successful, this does not make the program itself successful. Instead, the program should be defined by its failure to reach, if COP's estimate is accurate, the 2.2 to 3.3 million families from Treasury's initial estimate that will never be reached but who would have benefited from a better designed, better executed, and better managed program. To be sure, if HAMP continues in the status quo, some incremental number of families will certainly benefit from new, ongoing permanent modifications. But without any estimate from Treasury about what that incremental number will be, it is nearly impossible to measure the incremental benefit against the additional costs of continuing at the current pace, including the additional administrative costs, the opportunity costs of not pursuing potentially more effective alternatives, the harm inflicted on those who will inevitably enter into modifications that later fail, and further harm to Government credibility.

One defense Treasury offers against terminating HAMP is its claim that the servicing industry "was not and still is not fully equipped to deal with this crisis. Ending HAMP now will mean that the fate of struggling homeowners will be solely up to the servicers." While Treasury's acknowledgement of the abysmal performance of servicers is important, its use of that observation to justify the continuation of HAMP ignores two critical realities: First, by its very design, HAMP puts the "fate of struggling homeowners" squarely in the hands of servicers. Under HAMP, servicers not only operate as the point of contact for distressed homeowners seeking to participate in the program but also administer the loans on behalf of investors. In short, Treasury has placed virtually all of HAMP's eggs in the servicer basket. Second, Treasury's implicit suggestion that it can and will control servicer behavior within HAMP is utterly belied by experience. Despite nearly daily accounts of servicer errors and more serious misconduct, Treasury reported to SIGTARP that as of December 31, 2010, it had yet to impose a financial penalty on, or withhold or claw back incentives from, a single servicer for any reason other than failure to provide data.

Anecdotal evidence of servicer failures, of course, has been well chronicled. From the repeated loss of borrower paperwork, to blatant failure to follow program standards, to unnecessary delays that severely harm borrowers while benefiting servicers themselves, stories of servicer negligence and misconduct are legion, and the servicers' conflicts of interest in administering HAMP — they too often have financial interests that don't align with those of either borrowers or investors — have been described by SIGTARP and others. Treasury's tepid reaction to date to servicer non-compliance with the requirements of HAMP and its related programs appears to be driven in part by the fear that forcing servicers to comply with their contractual obligations will drive them away from HAMP. Treasury recently told COP that since participation by the servicers is purely voluntary, "our abilities to enforce specific performance are extremely limited" and "aggressive enforcement [is] difficult." This same fear of servicer withdrawal was offered by Treasury in response to SIGTARP's recommendation that Treasury reconsider its decision to make its Principal Reduction Alternative program entirely voluntary, and Treasury continues to operate an appeals system that leaves the ultimate decision of whether to approve or deny a modification squarely with the servicer. TARP's oversight bodies — SIGTARP, COP, and GAO — have all called on Treasury to get tough on servicers. Without meaningful servicer accountability, the program will continue to flounder.

In recent testimony, Treasury has offered an additional justification for failing to get tough on servicers, stating that "Congress didn't give us the tools to impose fines, as Mr. Barofsky is suggesting. What we have is the ability to withhold payment when they enter a permanent modification." This statement appears to be a retreat from earlier Treasury press releases and statements warning that servicers would suffer consequences and face monetary penalties for failure to meet performance obligations. Indeed, a November 30, 2009, Treasury press release specifically stated that "servicers failing to meet performance obligations under the Servicer Participation Agreement will be subject to consequences which could include monetary penalties and sanctions." SIGTARP has asked Treasury to clarify its position on when it may impose penalties, claw back prior payments, or withhold payments to servicers for violations of program guidelines or other provisions of the Servicer Participation Agreement, as well as any legal authority it believes supports its position. And, of course, if Treasury believes that it needs additional tools from Congress to effectively manage HAMP, it should propose legislation that would give it the necessary authority it believes it lacks.

Another of Treasury's current defenses of the HAMP is its claim that SIGTARP "has explicitly stated that it does not support terminating the program." I can only assume that this is a reference to my testimony before the House Committee on Oversight and Government Reform in January of this year. At that hearing, which included overwhelmingly bi-partisan criticisms of HAMP, I suggested in response to a question as to whether HAMP should be terminated that while hope for the program was "slipping away," Treasury should be given the chance to respond swiftly to Congressional criticisms, articulate meaningful program goals, and implement changes to meet those goals before giving up entirely on the one TARP program that was specifically targeted to help Main Street, and fulfill the Emergency Economic Stabilization Act's goal of "preserv[ing] home ownership." What has happened since that hearing? Very little. While Treasury has acknowledged some of HAMP's shortcomings, it has offered no meaningful plan going forward, and no meaningful way to measure program success. Instead it continues to refuse to set forth its expectations for the program and reportedly promises a conference of mortgage servicers that it all it will do is possibly "tweak around the edges." As a result, those who argue for keeping HAMP alive have an increasingly daunting task, and absent meaningful action from Treasury, SIGTARP's "support" of HAMP's continued existence is all but exhausted.

Chairman Biggert, Ranking Member Gutierrez, and members of the Committee, I want to thank you again for this opportunity to appear before you, and I would be pleased to respond to any questions that you may have.