

July 25, 2008

---

**Testimony of James B. Barber**

*On Behalf of the*

AMERICAN **BANKERS** ASSOCIATION

*Before the*

House Committee on Financial Services

United States House of Representatives



**Testimony of James B. Barber  
On Behalf of the  
American Bankers Association  
Before the  
House Committee on Financial Services  
United States House of Representatives  
July 25, 2008**

Chairman Frank and members of the Committee, my name is James B. Barber. I am Chairman and CEO of Acacia Federal Savings Bank, Fall Church, VA. Acacia Federal is a federally chartered savings bank, with approximately \$1.5 billion in assets. We service approximately \$1.1 billion in residential single family loans, 3,700 loans in the mid-Atlantic region. Most of these loans are serviced and owned by the bank. I am pleased to be here today on behalf of the American Bankers Association (ABA). ABA brings together banks of all sizes and charters into one association, and works to enhance the competitiveness of the nation's banking industry and to strengthen America's economy and communities. Its members – the majority of which are banks with less than \$125 million in assets – represent over 95 percent of the industry's \$13.3 trillion in assets and employ over 2 million men and women.

We share your concern, Mr. Chairman, about rising foreclosures and the need to limit such actions wherever possible in order to preserve homeownership. Everyone suffers – borrowers, lenders, investors, and the neighborhood where a property is located – when a foreclosure occurs. It is, therefore, in all our interests to find ways to avoid such an outcome. Thus, it is no surprise that banks are actively engaged in voluntary loan modifications and other loss mitigation programs both on an individual basis and as a part of broad industry efforts such as the HOPE NOW initiative. We believe that the legislation prepared by this committee and passed by the House of Representatives Wednesday will provide further tools to assist lenders and borrowers as they seek to avoid foreclosure.

I have three points I would like to make in my testimony today.

- Foreclosure is the last, worst option for both lenders and borrowers, and the industry is committed to avoiding foreclosures, when possible.

- Loan modification and workout efforts, like those being carried out by members of the HOPE NOW Alliance, are having some positive effects, and passage of the Hope for Homeowners provisions crafted by Chairman Frank and the House Financial Services Committee will provide more tools to help homeowners.
- A return to more prudent and traditional underwriting models will be the key to finding sustainable solutions to mortgage issues today and to avoiding problems in the future.

## **I. Foreclosure is the last, worst option**

No one wants a foreclosure to occur. It's obviously devastating for the borrower and an expensive proposition for the financial institution, so it is a benefit to both lenders and borrowers to find ways for homeowners to stay in their homes. Independent studies found that losses from foreclosures amounted to over \$50,000 per foreclosure or between 30 and 60 percent of the outstanding loan balance. But avoiding foreclosure is not a simple process, by any means, and it is complicated by the fact that a phone call or letter from a lender may not be warmly welcomed by a fearful borrower. For example, according to a recent policy paper by the Mortgage Bankers Association, borrowers in 21 percent of foreclosures initiated in the third quarter of 2007 either could not be located or would not respond to repeated attempts by lenders to contact them. Considering this fear, it is no surprise that 57 percent of the nation's late-paying borrowers still do not know that their lenders may offer alternatives to help avoid foreclosure, according to a report from Freddie Mac.

Two other complications exist that muddy the waters when considering if and how foreclosure can be avoided. First, not all borrowers have the desire or financial wherewithal to keep their property. Some borrowers are investors for whom the financial benefits of a particular property have changed, others have hyper-extended their credit, and still others have seen dramatic changes in their financial situation (loss of job, divorce, etc.). Second, although Acacia Federal retains most of the mortgages we originate in portfolio, often financial institutions sell mortgages into the secondary market rather than retain them. Fortunately, these complications can and are being sorted out. Although the process is slow, it is working.

Encouraged by the Department of the Treasury and the Department of Housing and Urban Development (HUD), counselors, investors, and other mortgage market participants formed an

alliance to reach out to borrowers who may have or expect to have difficulty making their mortgage payments and to offer them workable options to avoid foreclosure. It is important to note that this alliance includes 27 loan servicers, as of April, who together represent more than 90 percent of subprime mortgages.

#### *Contacting at-risk borrowers*

The alliance is making significant strides in contacting borrowers who may be at risk. HOPE NOW servicers have mailed 1,200,000 letters to at-risk homeowners who have not been in contact with their mortgage servicer. On average, 20 percent of those receiving the letter contact their servicer, far more than the typical 2-3 percent response rate that servicers get when sending their own mailing. Other homeowners call the Homeownership Preservation Foundation's HOPE Hotline rather than their servicer. The Hotline reported in the first quarter that 11 percent of its callers knew about the hotline from a HOPE NOW letter they received.

#### *Determining feasibility of workout or modification*

Whether a homeowner contacts a lender through a HOPE NOW effort or through some other means, the first step is an evaluation process where the lender and the borrower seek to determine whether it makes the most sense to work out an alternative payment plan or modification, or simply get out of the property through some means other than foreclosure. Unfortunately, in some cases, foreclosure is the only option, and will help provide the borrower with a foundation for starting over. For example, loans originated with little documentation of income and to borrowers who still cannot document sufficient income to qualify under today's credit standards, are poor candidates for modification. When such loans are restructured, there is only a 60 to 65 percent chance for success, according to Fitch Ratings. That suggests that modified loans experience a 35-40 percent redefault rate over the subsequent two years – not a good resolution for either the borrower or the lender.

#### *Choosing the best workout for the borrower and lender*

When it is determined that some kind of workout or modification will work, there are several tools available to lenders. Informal forbearance and repayment plans are generally the first tool lenders and servicers employ to help borrowers. Mortgage borrowers may be allowed to miss a payment, with the explicit understanding the payment(s) will be made up in time. This is often used for people suffering a short-term cash crunch due to temporary unemployment or illness. A

borrower may also be given a special forbearance plan, which will typically combine a period of postponed or reduced payments followed by repayment of the arrearage over an extended time frame, but within the original term of the loan.

Loan modifications are the next level of options. A loan modification is a change in the underlying loan agreement. A lender or servicer might extend the term of the loan, change the interest rate, change repayment terms or make other alterations such as writing down the principal. Similarly, a servicer may attempt to refinance the delinquent borrower into a new loan. Loan modifications are one solution for borrowers who have an ability to repay a loan, and have the desire to keep their home, but may need some help in meeting this goal because the current loan terms are not sustainable for that borrower.

Finally, if the financial situation is such that a workout or modification does not make sense, a borrower can turn to other options, such as a deed in lieu of foreclosure or a short sale. These options will avoid foreclosure in the case where a borrower no longer desires the property or is financially unable to continue owning it, even with a different payment plan.

#### *Making solutions work with securitized mortgages*

Many of these options can be made available for mortgages that are held at the bank (portfolio mortgages) and for mortgages that have been securitized and sold on the capital markets. Banks have been working with local customers to make loan modifications on loans held in portfolio for many years; it is part of standard practice. Now that most mortgages in recent years have been sold and securitized, there has been concern that the complicated set of rules and relationships intended to protect various classes of investors would make it hard for loan servicers to work with customers having difficulty. Because of this, many industry participants have gathered to create the HOPE NOW Alliance. Working with the American Securitization Forum (ASF), the industry created a process to better work with at-risk customers whose loans have been securitized. The process has been standardized so that servicers can create payment plans that can help customers keep their property, if it is financially viable.

## **II. Loan modification efforts are meeting with some success, but more can be done**

Although many adjustable, subprime mortgages have yet to enter the reset process, progress has been made in the loan modification effort. HOPE NOW estimates that more than 1.7 million homeowners have avoided foreclosure since July 2007 because of industry efforts. In May alone,

mortgage servicers provided loan workouts for approximately 170,000 at-risk borrowers, a sign that workouts are increasing.

Although other loan types can be troubled, one of the key concerns for the first part of 2007 has been subprime mortgages, which represent the bulk of resetting securitized mortgages right now. Of approximately 718,000 subprime loans scheduled to reset between January and May of this year, 37,700 (5.3 percent) have already been modified. An additional 323,000 (45 percent) of these were paid in full when the homeowner refinanced the loan or sold the property. Of the remainder, only 1,800 (0.5 percent) of the loans that were current at their date of reset have started the foreclosure process. Many of the remaining mortgages were already in the foreclosure process before the reset date had arrived. In some cases, this was due to a popular mortgage structure, the use of a second lien. In some cases, borrowers took out home equity loans or home equity lines of credit to purchase other goods or services or to make improvements on the home. In other cases, borrowers used second liens to avoid mortgage insurance. The holders of second liens in some cases have preferred the foreclosure process over developing a workout plan with the borrower. Fortunately, second liens may be less of an issue as the resetting process continues. Fitch noted in a recent report that in 2007, fewer mortgages were initiated with “piggyback” second loans. As 2007 mortgages reset, there may be fewer instances where a borrower is able to arrange a workout with one lender only to face foreclosure on a second.

Clearly, the targeted industry effort is having a positive effect, though we believe things could be improved. Legislation crafted by you and this committee, Mr. Chairman, has a key component which the ABA believes will provide additional tools for assisting more troubled borrowers. The Hope for Homeowners Act contained in that legislation will create a voluntary program through which troubled borrowers will be able to work with servicers to reduce their indebtedness, gain some equity in their homes, and stabilize their financial situation. While servicers and investors choosing to participate in the program will have to take a significant haircut as the existing loan is replaced with an FHA loan, we expect that many might choose to do so, rather than force a foreclosure. Just as with the current HOPE NOW efforts, there will be hurdles such as how to negotiate with second lien holders. The program will not be a silver bullet to solve all the problems in the mortgage markets, but it will give lenders, borrowers, and investors further options and will help to keep some borrowers in their homes.

### **III. More prudent and traditional underwriting models are key to solving the current and avoiding future problems**

The vast majority of community banks – and most large banks as well – have long followed traditional, prudent underwriting models. By doing so, they have avoided troubled loans and prevented borrowers from getting into untenable financial situations. Much of the poorly underwritten lending was done by non-bank brokers, many of whom have gone out of business. In the case of Acacia Federal, we have had relatively few delinquencies and foreclosures. Our experience is no accident. Our underwriting has been sound. Most delinquencies and foreclosures have been the result of job loss, health issues, other family problems, or, in some cases, borrower misrepresentation. During 2007, we experienced two foreclosures, and delinquencies increased to 1.2 percent. This year we have had approximately 18 foreclosures and our single-family delinquencies have increased to 1.6 percent, which is directly related to our underwriting practices. We did not materially stretch our underwriting guidelines during the boom years to match those of many non-bank institutions, and consequently, we lost market share. In today's environment, we are trying to build that market share back, as are many other community banks.

Recent changes to Regulation Z finalized by the Federal Reserve to implement the Home Owners' Equity Protection and Truth in Lending Act emphasize the need for more prudent and traditional underwriting. ABA supports many of these changes including regulations to strengthen the integrity of appraisals and prohibit deceptive advertising. ABA also supports requirements that mortgage lenders properly consider a borrower's ability to repay the mortgage, whether it is a fixed or adjustable rate loan. In fact, we believe that some of the elements of these new rules codify the underwriting practices of many of our members. The use of these practices throughout the mortgage industry will help to ensure that future lending is done in a prudent and safe manner.

The standards set by the Federal Reserve in Regulation Z are tough. The challenge will be to apply the rules in a targeted manner that addresses the subprime problems without unnecessarily restricting credit. The ABA has embraced the Federal Reserve's approach, and we will continue to work with the Federal Reserve and other regulators to help ensure that only the intended results are achieved. For instance, the new regulation might unintentionally affect parts of the prime market rather than the high-cost mortgage market, as intended.

Similarly, ABA will work with the banking agencies to help ensure that other regulatory responses to past mortgage origination and underwriting practices do not unintentionally cause a credit crunch by impeding the offer of credit for good loans that consumers can repay and that will

help communities grow and prosper. We want a return to universal underwriting practices like those maintained at most banks, and we want to codify and promote those practices for all lenders, but the prudent extension of credit cannot be restricted or we will face dire economic consequences. Therefore, we stand ready to assist in restoring housing and mortgage markets in which both borrowers and lenders have confidence.

In conclusion, ABA members agree that foreclosures are difficult processes that create a lose-lose situation. We strive, together with the rest of the mortgage industry, to work toward avoiding foreclosures, and we appreciate the work of this Committee to provide additional tools and solutions to achieve that end. We are committed to working with our borrowers who experience trouble to review their financial situation and try to find a win-win solution. This commitment is evidenced in the performance of loan portfolios at banks like mine, where significant problems have not occurred, even as markets turned down and housing prices have fallen. This commitment is also reflected in the numbers of foreclosures that have been avoided, although we think that more can be done. We support the work of this committee to provide more tools to help homeowners stay in their homes.