Statement of George Miller
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Committee on Financial Services
United States House of Representatives

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Good morning and thank you for the opportunity to testify here today. I am honored to be here representing the American Securitization Forum (ASF) on actions that mortgage market participants can undertake to help prevent mortgage foreclosures and mitigate losses. We commend you for calling this hearing, and look forward to offering our views on these important matters.

Background

The American Securitization Forum is a broad-based, not-for-profit professional forum that advocates the common interests of the securitization market and its participants. ASF members include over 375 firms, including issuers, investors, financial intermediaries, trustees, rating agencies, financial guarantors, legal and accounting firms, mortgage insurers, and data analytics vendors, among other firms. ASF's mission and goals can succinctly be summarized as: (1) build consensus on best practices in the market; (2) advocate on behalf of our members; and (3) provide high quality educational events for industry participants and policymakers. ASF is an affiliate of the Securities Industry and Financial Markets Association.

As a general matter, no securitization market constituency--including lenders, servicers and investors--benefits from subprime loan defaults and foreclosures. Foreclosure is usually the most costly means of resolving a loan default. As a result, it is typically the least-preferred alternative for addressing a defaulted loan, whether or not the loan is held in a securitization trust. ASF therefore strongly supports the policy goal of avoiding foreclosures wherever reasonable alternatives exist.

Overview of Typical Securitization Document Modification Provisions

A basic principle underlying the servicing of subprime (or other) loans in securitization transactions that are unable to perform according to their contractual terms is to maximize recoveries and minimize losses on those loans. This principle is embodied in the contractual servicing standards and other provisions that set forth the specific duties and responsibilities of servicers in securitizations. In turn, these contractual provisions are relied upon by investors in mortgage-backed securities, who depend primarily upon cash flows from pooled mortgage loans for the return on their investment.

Servicing of subprime residential mortgage loans included in a securitization is generally governed by either a pooling and servicing agreement (PSA) or servicing agreement (SA). Typical PSA and SA provisions require servicers bound by those contracts to follow accepted servicing practices and procedures as they would employ "in their good faith business judgment" and that are "normal and usual in its general mortgage servicing activities."

Most subprime securitization transactions authorize the servicer to modify loans that are in default or for which default is imminent or reasonably foreseeable. The "reasonably foreseeable" default standard derives from and is permitted by the restrictions imposed by the Real Estate Mortgage Investment Conduit sections of the Internal Revenue Code of 1986 (REMIC) on modifying loans included in a securitization for which a REMIC election is made.

Contractual loan modification provisions in securitizations typically also require that the modifications be in the best interests of the securityholders or not materially adverse to the interests of the securityholders, and that the modifications not result in a violation of the REMIC status of the securitization trust.

In addition to the authority to modify the loan terms, most subprime PSAs and SAs permit other loss mitigation techniques, including forbearance, repayment plans for arrearages and other deferments which do not reduce the total amount owed but may extend the term of payment. In addition, these arrangements typically permit loss mitigation through non-foreclosure alternatives to terminating a loan, such as short sales of deeds-in-lieu.

Based upon the economic and contractual principles outlined above, and consistent with applicable governing documents and regulatory and accounting standards, we support the use of loan modifications (along with other loss mitigation tools) by servicers in securitization transactions in appropriate circumstances. In general, "appropriate circumstances" would include situations where a servicer has concluded that a particular loan is in default or that default is reasonably foreseeable, and that the loan modification or other loss mitigation action contemplated by the servicer is likely to maximize recovery and minimize loss on that loan.

Servicers' Foreclosure Prevention and Loss Mitigation Efforts

Given the volume and deteriorating credit performance of subprime residential mortgage loans originated in 2005 and 2006 that are approaching their initial interest rate reset dates, servicers are now confronting a formidable loss mitigation challenge. A significant number of these loans have already defaulted, and additional defaults are likely. In some cases, these defaults are caused by the borrower's inability to afford the higher interest payment upon rate reset. In other cases, borrowers were unable to afford even the introductory, fixed rate of interest. To the extent that defaulted loans ultimately progress to foreclosure, borrowers lose their homes, and securitization investors face the prospect of substantial losses on their investments.

As a consequence, servicers of mortgage loans have redoubled their efforts both to help borrowers avoid foreclosure and to minimize losses to securitization investors.

Based on our experience, most servicers have developed and are implementing procedures to reach out to hybrid ARM borrowers well in advance on an interest rate reset, in an effort to identify and prevent potential payment problems before they occur. Much of this outreach is being centralized and coordinated through the HOPE NOW Alliance, further outlined below. Among other things, this initiative—in which ASF has been an active participant—is designed to connect borrowers with servicers and non-profit counseling organizations more efficiently, and on a national scale.

In addition, most servicers have made substantial additional investments in loss mitigation personnel, and have developed and implemented enhanced internal processes and procedures to identify and pursue home retention options with borrowers wherever possible. In addition to loan modifications, these options include pursuing refinancing opportunities for qualified borrowers, structuring forbearance arrangements and repayment plans, establishing trial periods for reduced payments (which in some cases may be converted into formal loan modifications), and other deferments that can reduce or postpone payments owing under the loan

Recent Industry Developments

The application of loan modifications and other loss mitigation techniques to distressed or potentially distressed subprime loans has received intensive focus from servicers and the broader securitization industry. Working with a broad range of industry members, ASF has taken concrete steps to facilitate wider and more effective use of loan modifications in appropriate circumstances.

Last June, we published recommended industry guidance designed to establish a common framework relating to the structure, interpretation and application of loan modification provisions in securitization transactions. This document, entitled "Principles, Guidelines and Recommendations for the Modification of Securitized Subprime Residential Mortgage Loans" (attached hereto as Exhibit A) concludes that loan modifications, for subprime mortgage loans that are in default or for which default is reasonably foreseeable, are an important servicing tool that can often help borrowers avoid foreclosure as well as minimize losses to securitization investors.

Promulgation of the above loan modification recommendations was an important step toward broader securitization market collaboration toward foreclosure avoidance solutions. For example, both ASF have been active participants in the HOPE NOW Alliance that was formed on October 9, 2007 under the leadership of Treasury Secretary Paulson and HUD Secretary Jackson, and with support and participation from many of our member firms. HOPE NOW, a collaboration of counselors, servicers, investors, and other mortgage market participants, seeks to maximize outreach efforts to homeowners in distress, and to provide effective counseling and other resources to help them remain in their homes.

Simultaneously with the announcement of the HOPE NOW Alliance, ASF also released guidance supporting the view that borrower counseling expenses may be viewed as servicing advances, and where consistent with operative securitization documents, can be reimbursed from securitization trust cashflows. We believe that the engagement of borrower counseling services and reimbursement of related expenses can serve as an important complement to servicers' existing obligations to service loans, mitigate losses and maximize recoveries in securitization transactions. ASF's statement should help to provide funding directly from securitization trusts for the delivery of these important borrower counseling resources.

Notwithstanding these important steps, additional action can be taken. In particular, given the large volume of impending interest rate resets on subprime hybrid ARMs and potential defaults on those loans, questions have been raised regarding whether it is operationally feasible for servicers individually to underwrite and renegotiate individual loan terms, absent guidance on more streamlined approaches that servicers might apply. Members of Congress, federal regulators and others have encouraged servicers to develop and implement more systematic approaches for evaluating loans for potential refinancing and modification.

In response to this challenge, we are actively working with servicers and other industry members to lever their existing efforts, and to encourage and facilitate their ability to implement more streamlined approaches to meeting the loan modification and broader loss mitigation challenge they now face.

In particular, ASF is now involved in an effort, working with subprime mortgage servicers and in consultation with investors, other securitization market participants and federal regulatory agencies, to:

1) Develop criteria by which servicers can systematically evaluate their subprime ARM portfolios, for the purpose of efficiently segmenting loans and borrowers to identify various potential loan disposition options, including the identification of loans that may be suitable candidates for refinancing, modification or other loss mitigation arrangements; and

2) Develop analytic tools and methods that servicers can apply on a more systematic and streamlined basis to evaluate loan affordability, borrower capacity and willingness to repay, and other factors that are relevant to decision-making regarding refinancing opportunities, loan modifications and other loss mitigation actions that may be appropriate for individual borrowers.

The purpose of this effort is to assist servicers in their efforts to streamline their loan evaluation procedures, and to expedite their decision making process relating to loss mitigation actions for individual borrowers who may be unable to fulfill the original terms of their loans. While this effort is designed to streamline servicers' decision making processes, it preserves the essential requirement that loan affordability and maximization of recovery to investors must be determined on an individual, loan-by-loan basis--including through the systematic application of reasonable, presumptive criteria in appropriate circumstances.

We believe that streamlining the process of evaluating borrower characteristics and matching them up efficiently with the appropriate loss mitigation options will ultimately help servicers manage their responsibilities in a changing market, while appropriately balancing the interests of borrowers and investors. We are pursuing these efforts in earnest and hope to report out progress on these efforts in the near future.

Much attention has been given to loan modifications as a potential foreclosure avoidance solution for distressed subprime mortgage borrowers. However, it should be noted that for those borrowers who are coming up on a reset date, have generally been current in their introductory mortgage payments, and have built up some equity in their home, refinancing options--either private industry products or FHA products--remain an important option to achieve a sustainable, long-term solution.

For borrowers with significantly impaired credit or little equity in their home, these refinancing opportunities may not be available. However, if a borrower has been able to stay relatively current in their introductory rate, but cannot afford the reset rate, servicers should be able to consider various loss mitigation options, including but not limited to loan modifications, to maintain the loan in a performing status and help that borrower stay in his or her home.

H.R. 4178, Emergency Mortgage Loan Modification Act of 2007

The Emergency Mortgage Loan Modification Act of 2007 would create a safe harbor from liability for servicers or others who modify certain types of residential mortgage loans. While we appreciate and support the need for clarity and legal certainty for servicers in effecting loan modifications, we have concerns about H.R. 4178 as introduced.

As a general matter, we have concerns with any legislation that would abrogate or interfere with previously established, private contractual obligations. PSAs typically require that the actions of the servicer, among other requirements, not be materially adverse to the interests of the certificate holders. Changing this standard would alter the commercial expectations of investors and could undermine the confidence of investors in the sanctity of agreements which are central to the process of securitization, and would discourage investment in markets that need liquidity -- both now and over the longer term.

As indicated above, we believe that market-driven initiatives to streamline the process of effecting loan modifications in appropriate circumstances is in the best interests of homeowners and investors alike. However, members of the servicing community have raised legitimate concerns about their legal exposure for implementing this framework, partly in response to the strong encouragement of regulators and policymakers to do so. Therefore, we would like to continue to work with Representative Castle and the Committee to determine if additional steps may be necessary or helpful to address any legal, regulatory, accounting or other obstacles to the delivery of loan modifications and other loss mitigation relief to borrowers pursuant to industry-developed frameworks, including the streamlined approach outlined above.

In summary, the securitization industry shares your goal of delivering assistance to borrowers who are otherwise at risk of default and foreclosure. Therefore, while we believe that that legislation should be carefully crafted to avoid the perception that it is a revision of existing contracts, an acknowledgement that a prudent servicer may rely on reasonable analytic tools and presumptions, such as those outlined above, could be an effective and necessary tool to reach this goal.

Conclusion

Chairman Frank Chair and distinguished Members, I thank you for the opportunity to participate in today's hearing. We believe that the interests of secondary mortgage market participants continue to be aligned with borrowers, communities and policymakers to help prevent foreclosures. To that end, ASF stands ready to assist, and commend your leadership on these important matters.

Thank you.