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Testimony of Richard Neiman

Congressional Oversight Panel

"TARP Accountability and Oversight: Achieving Transparency"

Joint Economic Committee

United States Congress

March 11, 2009

Chairwoman Maloney, Vice Chairman Schumer, and distinguished members of the Committee: I am Richard H. Neiman, the Superintendent of Banks for the State of New York. I am also a member of the Congressional Oversight Panel, and I appreciate this opportunity to comment on the ongoing evaluation of the Treasury Department`s implementation of the Emergency Economic Stability Act (EESA). I should note that the views expressed in this testimony are my own, and do not necessarily reflect the opinion of the Panel or any other members.

Overview of Panel Reports

The Panel is charged by statute to provide monthly reports to Congress assessing the effectiveness of the Treasury`s implementation of the Troubled Asset Relief Program (TARP), including foreclosure mitigation efforts.

The Panel`s first report was issued in December, and set out a framework for future inquiry through a set of ten tough but fair questions. These questions cover fundamental issues, including: is the strategy working to stabilize markets and reduce foreclosures? What have banks done with the money? And is the public receiving a fair deal? The regular monthly reports have explored these issues in more depth, in addition to a Special Report on regulatory reform issued in January.

Given the limited time for prepared remarks, I will focus on the Panel`s most recent report on foreclosure mitigation which I took a lead role in preparing. As the only bank regulator on the Panel and as one who has led his state`s foreclosure prevention efforts, I believe I bring a unique perspective to this critical issue. I look forward, however, to questions from the Committee on the full range of the Panel`s responsibilities.

Panel Report on Foreclosure Mitigation

The Panel`s March report highlights the symptoms that gave rise to the housing crisis, as well as major impediments to a solution. The report provides a roadmap for successful foreclosure prevention going forward. Let me summarize the major impediments.

1. Affordability. The key to any sustainable modification program is whether the borrower can afford the monthly payments. A problem that began with exploding

mortgage products that may have been inappropriate at inception has now expanded to borrowers who are falling behind for many reasons, such as illness, divorce, or job loss in the economic downturn. Existing modification plans have not adequately addressed this critical impediment of affordability, leading to high rates of re-default. Voluntary modification efforts often leave the borrower with the same or higher monthly payments through repayment plans or the capitalization of amounts past due. The Panel is concerned that the commonly used housing payment ratio of 38% of the borrower`s gross income remains too high to be affordable, and is encouraged that the President`s Homeowner Affordability and Stability Plan targets a 31% housing ratio.

2. Negative equity. Negative equity can occur when property values decline or if appraisals were inflated. Borrowers in this situation are unable to refinance, and cannot sell the home unless the lender agrees to a reduced payoff in a short sale. Panel data shows a strong correlation between high negative equity and default; however, this is not necessarily evidence of a causal relationship. Further, the survey data received from the federal banking regulators was limited by the lack of current borrower income information which may under-estimate the importance of affordability in this result.

3. Securitization contracts. Mortgages that have been securitized are subject to the terms of pooling and servicing agreements (PSAs) that may present obstacles to loan modifications. These PSAs often contain restrictions on the number of loans within the pool that may be modified and the circumstances in which modification is permissible. As modification and other loss mitigation outcomes may impact the various tranches of investors differently, litigation risk may be a disincentive for servicers to engage in modification. A safe harbor from litigation for servicers that modify loans, as outlined in the Helping Families Save Their Homes Act of 2009, would help to overcome this impediment.

4. Servicer incentives. The fee arrangements for servicers can also create misaligned incentives. In particular, servicers need incentives to engage in intervention while borrowers are still current but when default is imminent, to preserve the borrower`s credit history and retain a fuller range of workout options. The President`s Homeowner Affordability and Stability Plan does address this issue by providing incentive payments to servicer for early outreach, as well as ``pay for success`` incentives to both servicers and borrowers based on performance of the modified loan.

5. Borrower outreach and servicer capacity. The Panel`s report documents the lack of servicer capacity to reach borrowers at- risk. There is a clear distinction between the regular work of servicers in payment processing and collections, which is largely automated, and loan modification efforts, which are labor- intensive and involve highly trained staff. Servicing firms are set up for payment processing, but many are not as well-equipped to handle the volume of individual modification cases.

6. Junior mortgages. Multiple mortgages on the same property also complicate the foreclosure prevention effort. In the case of a refinance or of a modification that involves an increase in the loan amount, the second lien holder must consent to subordination or the first lien holder loses priority. Some junior lien holders are charging high fees to subordinate or extinguish their liens. The President`s Plan provides fee incentives to first

lien holders to extinguish subordinate liens in the course of modifying the primary mortgage, but more needs to be done to ensure all mortgage payments are stabilized.

These are the principal impediments to successful avoidance of foreclosure. The President`s Plan addresses many of these critical elements, particularly affordability and servicer incentives, and is estimated to help 7 to 9 million homeowners at risk.

While these projections are encouraging, the Panel has additional areas of concern that are not fully addressed. In particular, the Plan does not include a safe harbor for servicers operating under pooling and servicing agreements to address the potential litigation risk. And while the modification aspects of the Plan will be mandatory for banks receiving TARP funds going forward, the level of broader industry acceptance remains unclear.

The more detailed guidelines on the President`s Plan were just released on March 4, and the Panel will continue to monitor implementation and advise Congress and the American people accordingly.

Need for Expanded Data on Foreclosure and Delinquencies

One important recommendation to Congress in the report goes to the adequacy of mortgage loan performance data. Access to complete information on foreclosures and loans in default is unavailable and the reason is simple: there is no mortgage loan performance data reporting requirement for the industry. Congress and the regulators need to have much better data available so they can ensure the smooth and efficient functioning of the national housing finance market and prevent future crises.

That is why the Panel believes that Congress should create a national mortgage loan performance reporting requirement applicable to banking institutions and others who service mortgage loans, to provide a source of comprehensive intelligence about loan performance, loss mitigation efforts and foreclosure. Federal banking or housing regulators should be mandated to analyze such data and share the results with the public. A similar reporting requirement exists for new mortgage loan originations under the Home Mortgage Disclosure Act. Because lenders already report delinquency and foreclosure data to credit reporting bureaus, it would be feasible to create a tailored performance data standard that could be put into operation swiftly.

Conclusion

We cannot solve the financial crisis without dealing with the root of the problem: the millions of American families who are at risk of losing their homes to foreclosure. I appreciate the opportunity to share my views, and hope that dialogue between the Panel and this Committee becomes a regular occurrence. Events are developing rapidly, and many of the tools needed to respond are best accomplished with the support of progressive legislation. I would be pleased to provide more details on the Panel`s work to date or answer any questions. Thank you.