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August 23, 2012

Edward J. DeMarco
Acting Director
Federal Housing Finance Agency
400 7th Street, S.W.
Washington, DC 20024

Re: *Notice of Massachusetts Statute Requiring Commercially Reasonable Loan Modifications*

Dear Director DeMarco:

I write to inform you of the new Massachusetts law requiring all creditors, including Fannie Mae and Freddie Mac, to take commercially reasonable steps to avoid foreclosure upon certain mortgage loans. We also continue to urge you to reconsider FHFA's refusal to engage in principal reductions for struggling homeowners.

A. New Statute

On August 3, 2012, Governor Deval Patrick signed Chapter 194, An Act to Prevent Unnecessary and Unreasonable Foreclosures (codified at M.G.L. c. 244 § 35A) effective immediately. This new statute is designed to prevent unnecessary foreclosures by mandating loan modifications when they make economic sense, and demonstrates again the Commonwealth's commitment to protecting homeowners and stabilizing the housing market. Among other things, the statute:

- Requires creditors¹ that hold or control certain types of loans (*e.g.*, interest-only loans, adjustable rate mortgages, and loans with short-term introductory interest rates) to make commercially reasonable efforts to achieve a commercially reasonable loan modification;
- Codifies the recent Massachusetts Supreme Judicial Court decision (*Commonwealth vs. Henry Ibanez*) by requiring creditors commencing foreclosure to show they are the

¹ A "Creditor" is defined by the Act as "a person or entity that holds or controls, partially, wholly, indirectly, directly, or in a nominee capacity, a mortgage loan securing a residential property, including, without limitation, an originator, holder, investor, assignee, successor, trust, trustee, nominee holder, Mortgage Electronic Registration System or mortgage servicer, including the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation. 'Creditor' shall also include any servant, employee or agent of a creditor." M.G.L. c. 244 § 35A (a).



current legal mortgage holders of record and forbidding them from misrepresenting their holder status;

- Prohibits creditors from passing on to third parties the costs of remedying prior improper foreclosures or absence of recorded assignments;
- Prohibits creditors from imposing foreclosure-related "junk fees" (for goods or services not performed); and provides a safe harbor to creditors that have considered the net present value of receiving payments pursuant to a modified mortgage loan as compared to the anticipated net recovery following foreclosure.²

We expect Fannie Mae and Freddie Mac, like all creditors, to comply with these statutory obligations as they conduct business in Massachusetts. Specifically, we expect that Fannie Mae and Freddie Mac will pursue common-sense loan modifications for borrowers when the economic benefits of a modified loan exceed the significant losses anticipated at foreclosure. These loan modifications are critical to assisting distressed homeowners, avoiding unnecessary foreclosures, and restoring a healthy economy in our Commonwealth.

B. Principal Reduction

This law highlights the imperative of preventing *unnecessary* foreclosures. It also highlights once again FHFA's continued refusal to use principal reduction as a critical foreclosure avoidance tool, including FHFA's recent decision not to implement the Home Affordable Modification Program Principle Reduction Alternative (HAMP PRA). Although the Massachusetts statute does not expressly require creditors to offer principal reductions, it does advance the consensus that asset managers achieve higher recoveries when they employ a broad range of loss mitigation strategies, including the targeted use of principal reductions.^{3,4} Indeed, as Fannie Mae recently concluded following its own analysis of HAMP modification performance data with and without principal reduction, "principal reduction leads to a 20% reduction in re-default probabilities as compared to a modification utilizing forbearance, and principal reduction leads to a 24% reduction in re-default probabilities as compared to a modification that receives payment reduction, but neither forgiveness nor forbearance."⁵ Fannie Mae further concluded that "the absolute differences in probabilities that we see here would be expected to increase over time."⁶

² M.G.L. c. 244 § 35A(c).

³ "Traditionally, servicers have higher recoveries the greater the range of strategies asset managers and loss mitigation staff can use." FitchRatings, Global Rating Criteria for Structured Finance Servicers, August 16, 2010.

⁴ "The data indicate that the re-default rate declines with the magnitude of the reduction in the monthly payment, but also that there-default rate declines relatively more when the payment reduction is achieved through principal forgiveness as opposed to lower interest rates." Federal Reserve Bank of New York, Staff Reports, "Second Chances: Subprime Mortgage Modification and Re-Default, August 2010.

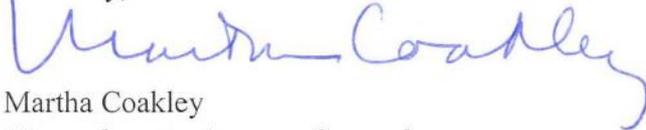
⁵ U.S. Department of the Treasury, The Effect Of The Principal Reduction Alternative (PRA) On Redefault Rates In The Home Affordable Modification Program (HAMP): Early Results. This summary was performed by Fannie Mae in its role as HAMP program administrator.

⁶ Id.

Fannie Mae's conclusions are consistent with FHFA's June 25, 2012 analysis, provided to the Department of the Treasury, that the HAMP PRA could help up to half a million homeowners and result in savings to the GSEs of \$3.6 billion compared to standard GSE loan modifications and save taxpayers as much as \$1 billion net.⁷ This data demonstrates that, in appropriate cases, loan modifications providing principal forgiveness can help struggling homeowners avoid foreclosure, save taxpayers' money, and work to stabilize the housing market: all stated goals of the FHFA.⁸ This data is also plainly inconsistent with your recent statement that "HAMP PRA does not clearly improve foreclosure avoidance while reducing costs to taxpayers relative to the approaches in place today."⁹ We urge you to reconsider.

We again strongly urge FHFA to increase the availability of federal loan modification programs, including principal forgiveness, to prevent *unnecessary* foreclosures, protect homeownership and work towards stabilizing our housing market. We would appreciate the opportunity to discuss these issues with you as well as any questions you may have regarding our new Massachusetts statute. We intend to monitor the compliance of all creditors doing business in Massachusetts. Please feel free to contact me directly or Deputy Attorney General Chris Barry-Smith in our office at (617) 963-2539 if you have any questions or concerns.

Cordially,



Martha Coakley

Massachusetts Attorney General

⁷ Memorandum of Michael Stegman, Counselor for Housing Finance Policy, The Case for Principal Reduction (July 31, 2012) (Excerpt from analysis provided by the Federal Housing Finance Agency – Meeting with Treasury Secretary Geithner – June 25, 2012).

⁸ Federal Housing Finance Agency, Strategic Plan (Fiscal Years 2013-2017). Preparing a Foundation for a More Efficient and Effective Housing Finance System: Liquidity ~ Stability ~ Access.

⁹ Federal Housing Finance Agency, Statement By Edward J. Demarco, Acting Director, Federal Housing Finance Agency, On The Use Of Principal Forgiveness By Fannie Mae And Freddie Mac.