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The Joint Committee on the Judiciary

Senate Bill 1848

An Act to Require Commercially Reasonable Efforts to Avoid Foreclosure

Good afternoon Chairwoman Creem, Chairman O'Flaherty, and members of the Committee. I am Martha Coakley, the Attorney General of the Commonwealth. Thank you for giving me the opportunity to testify in support of Senate Bill 1848, *An Act to Require Commercially Reasonable Efforts to Avoid Foreclosure*, which I filed with Senator Susan Tucker and Representative Steven Walsh.

As your Attorney General, one of my office's highest priorities has been to combat predatory lending and the foreclosure crisis. As you know, I have dedicated a significant portion of my office's resources to this initiative. From day one of our work, it has been clear that large-scale loan modifications are the only real way to combat the destruction that this crisis is bringing to our communities.

Modifications of monthly loan payments to a sustainable, affordable level make economic sense for all parties involved, lenders and borrowers alike. Loan modifications allow the lender or investor a continuing, though decreased, income stream, the value of which exceeds the expected losses suffered at foreclosure. Data provided to Congress in July of 2009 shows that each **foreclosure averaged losses of $144,000**, in contrast to the **most costly loan modifications that averaged losses of $14,000**. That same data

showed that for the month of June 2009 investors lost a total of **approximately $4.6 billion on foreclosures** and **$45 million on loan modifications**.[1]

Beyond the benefits to investors, affordable loan modifications make sense for all Massachusetts citizens. Communities are more stable when families can remain in their homes. Local governments do not lose tax revenues and spend less safeguarding neighborhoods that fall prey to clusters of foreclosures. According to a report issued by Congress over two years ago, the average cost of a foreclosure for a local government is $19,000; and the impact on neighboring home values is $1,500.[2] Those numbers have surely increased since that time, only further supporting the need for the reasonable loan modifications that would come from our bill's passage.

Before I outline the bill in more detail, it is important to discuss briefly the process and events that lead to this legislation being filed.

In mid-2007, I joined several other Attorneys General across the nation to meet with the top twenty (20) subprime servicers to advocate that they engage in affordable loan modifications. Servicers agreed quickly that this made economic sense and also made numerous public promises to engage in such modifications. During this same time period, I also supported legislation in Massachusetts to amend Chapter 244 of our

[1] Most costly loan modifications refer to loan modifications with write-offs (as opposed to loan modifications with no write-offs). Testimony of Alan White, Valparaiso University School of Law, Before the House Subcommittee on Commercial and Administrative Law, *Home Foreclosures: Will Voluntary Mortgage Modification Help Families Save Their Homes?* (July 9, 2009), available at: http://judiciary.house.gov/hearings/pdf/White090709.pdf. The underlying June 2009 data is available at: http://www.valpo.edu/law/faculty/awhite/data/index.php.

[2] Special Report by the Joint Economic Committee of the U.S. Congress, *Sheltering Neighborhoods from the Subprime Foreclosure Storm*, April 11, 2007.

General Laws to require a 90-day cooling off period between noticing and commencing foreclosure.[3]

I believe that by amending Chapter 244, this Legislature wisely provided creditors and borrowers with more time to explore alternatives to foreclosure, such as loan modifications. My office sought to bring meaning to the 90-day period by engaging three of the nation's largest creditors—Wells Fargo, Citi and Bank of America—and urging them to take on wide-scale loan modifications that could keep people in their homes while maximizing the value of the loan portfolios for their investors. Each entity promised my office that they would be "part of the solution" with respect to the foreclosure crisis, but were unwilling to commit to any of these promises in writing to borrowers, investors or Massachusetts government officials.

After more than two years of attempting to work cooperatively with servicers and creditors, we see that their promises are not being met. In July of 2009, the Federal Reserve Bank of Boston issued a policy paper showing that loan data from 2007 to 2008 indicates lenders have rarely renegotiated loans.[4]

My office has also sought accountability through law enforcement actions. We have drawn a clear connection between the current foreclosure crisis and the unsound, unfair and predatory subprime lending that ran rampant between 2004 and 2007. We filed litigation that explained to the court that companies like Fremont Investment & Loan and Option One Mortgage Corporation sold loan products without regard to the ability of borrowers to repay them, in order to profit from securitizing the loans on the secondary

[3] Ch. 244 § 35B. This bill was enacted pursuant to Chapter 206 of the Acts of 2007 titled "An Act Protecting and Preserving Home Ownership."

[4] Federal Reserve Bank of Boston Report, *Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitization*, 09-4 (July 2009).

market. These loans predictably ended in default and foreclosure. Given their responsibility, we asked the court to find that these lenders should not be allowed to foreclose like any other creditor, but should help mitigate the disaster that their loan products predictably caused. Our litigation has been successful, and the trial courts have issued orders affording our office the right to object to unfair loans, prior to foreclosure. The Supreme Judicial Court upheld one of these orders in Commonwealth v. Fremont, and confirmed that it was, in fact, unfair to originate loans without assessing a borrower's repayment ability, and that requiring reasonable loan modifications was appropriate and served the public interest.

As a result of these enforcement actions, my office has been able to obtain agreements with current servicers, such as Litton Loan Servicing, LLP, and Carrington Mortgage Servicing that require commercially reasonable loan modifications. These agreements show that servicers are able to offer reasonable loan modifications, when such modifications are more profitable than foreclosure. Litigation works, but it is limited by case-by-case enforcement. I believe a more efficient and effective use of taxpayer resources would be through the consistent, predictable mechanism proposed in this bill.

Despite by best efforts over the last two years to make loan modifications happen, reasonable loan modifications are still not occurring in Massachusetts on the scale needed to prevent further harm to our communities and families. Although we believe that local, community-based banks are already engaging in such reasonable behavior with the comparably smaller amount of delinquent loans they service, national lenders who hold a significant portion of the loans in distress in the Commonwealth have not adopted

reasonable loan modification programs on a large-scale basis. The federal government has recently created the Making Home Affordable Loan Modification Program to encourage loan modifications before foreclosure by national lenders, but this Program has not been sufficiently comprehensive, or perhaps not been adequately enforced, to affect the offering of wide-scale loan modifications.

We can no longer stand by and hope that servicers will do the right thing. The foreclosure crisis has come at an enormous price to borrowers, neighbors, governments, and taxpayers, and will continue unless government officials take more robust action. We cannot allow this damage to our communities and the Commonwealth to continue, particularly when reasonable solutions to stem this harm exist.

The proposed bill—requiring commercially reasonable efforts to avoid foreclosures—follows up on the promises made to my office by the national industry, and serves to help our neighborhoods survive these hard economic times. The provisions fulfill our responsibility to take reasonable steps to minimize the ongoing foreclosure crisis.

Specifically, the legislation requires that creditors take commercially reasonable efforts to avoid foreclosure in the Commonwealth on mortgages securing owner-occupied homes. This would apply only to loans on principal residences, and to loans with certain, well-known, risky features, such as interest-only loans, adjustable rate mortgages, and loans with short-term introductory interest rates. Such commercially reasonable efforts include:

1. Analyzing the borrower's monthly payment;
2. Analyzing, according to a "net present value test", whether offering the borrower a loan modification at the affordable monthly mortgage payment

is more valuable to the creditor than the losses it will incur upon foreclosure; and

3. Taking into account the interests of the creditor, investors and taxpayers, in the event the creditor has received federal or state money.

Creditors will be in compliance with this legislation if they offer an affordable loan modification whenever it is shown that under the net present value test, a loan modification is more profitable than foreclosure. In those instances where a loan modification is more profitable to the creditor, the creditor must identify what an affordable monthly payment would include, and in an effort to achieve it either: reduce the interest rate, reduce the principal amount owed, or increase the amortization period within the limits prescribed in the legislation. The legislation also provides a safe harbor for creditors to comply with this requirement of commercial reasonableness.

I believe that this proposed legislation would promote the best interests of creditors, investors, borrowers and taxpayers in ensuring that foreclosures do not happen without first assessing whether a loan modification is a more economically sensible alternative.

Thank you for the opportunity to be heard on this critical matter, and I look forward to continuing to work with the Committee on this important issue.