United States Government Accountability Office

GAO

Report to Congressional Requesters

May 2011

MORTGAGE FORECLOSURES

Documentation Problems Reveal Need for Ongoing Regulatory Oversight

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Highlights

Highlights of GAO-11-433, a report to congressional requesters

May 2011

MORTGAGE FORECLOSURES

Documentation Problems Reveal Need for Ongoing Regulatory Oversight

Why GAO Did This Study

Mortgage servicers—entities that manage home mortgage loans—halted foreclosures throughout the country in September 2010, finding that documents required to be provided to courts in some states may have been improperly signed or notarized. In addition, academics and court cases are raising questions over whether foreclosures are being brought properly because of concerns over how loans were transferred into mortgage-backed securities (MBS). GAO was asked to examine (1) the extent to which federal laws address mortgage servicers' foreclosure procedures and federal agencies' past oversight, (2) federal agencies' current oversight and future oversight plans, and (3) the potential impact of these issues on involved parties. GAO reviewed federal laws, regulations, exam guidance, agency documents, and studies, and conducted interviews with federal agencies, mortgage industry associations, investor groups, consumer advocacy groups, and legal academics.

What GAO Recommends

GAO recommends that banking regulators and the Consumer Financial Protection Bureau (CFPB) develop plans for overseeing mortgage servicers and include foreclosure practices in any servicing standards that are developed. GAO also recommends that regulators assess the risks that documentation problems pose for their institutions. The agencies generally agreed with the recommendations.

View GAO-11-433 or key components. For more information, contact A. Nicole Clowers at (202) 512-5837 or clowersa@gao.gov.

What GAO Found

Federal laws do not specifically address the foreclosure process, and federal agencies' past oversight of servicers' foreclosure activities has been limited and fragmented. State laws primarily govern the foreclosure process and specify what, if any, documentation is required to foreclose on a property. Several federal laws include mortgage servicing provisions, but they largely are focused on consumer protection at mortgage origination, not specific foreclosure requirements. Although various federal agencies have authority to oversee most mortgage servicers, past oversight of their foreclosure activities has been limited, in part because banking regulators did not consider these practices as posing a high risk to banks' safety and soundness, and some servicers have not been under direct federal oversight. Federal housing and other agencies typically do not monitor servicers' foreclosure activities.

In response to the disclosed documentation problems, federal agencies have recently increased attention to servicing activities. Banking regulators conducted a coordinated review of 14 mortgage servicers and identified pervasive problems with their document preparation and oversight of foreclosure processes, although they did not find widespread instances of foreclosures that should not have proceeded. The regulators issued enforcement actions requiring servicers to improve these practices and plan to assess their compliance, but have not fully developed plans for the extent of future oversight. Further, regulators are considering the need for uniform servicing standards, but whether such standards will address foreclosure activities is yet unclear. Federal housing and other agencies are also reviewing servicer foreclosure practices and considering corrective actions. In July 2011, the newly created CFPB also will have responsibility for mortgage servicing, including over certain nondepository firms currently without federal oversight. How regulators and CFPB will interact and share responsibility for ongoing oversight of servicers is yet unclear, leaving the potential for continued gaps and inconsistency in oversight until final plans are developed.

Foreclosure documentation problems have slowed the pace of foreclosures across the United States, but most entities GAO interviewed indicated that such errors were correctable and that affected foreclosures would proceed. Delays in the pace of foreclosures as servicers correct and refile cases and implement more rigorous processes may benefit borrowers by providing more time to modify loans, but communities may be negatively affected as any vacant properties in foreclosure remain unoccupied for longer periods. Some foreclosures are also being delayed because of allegations that practices commonly used for transferring loans when creating MBS were not completed properly, which some commentators argue may affect whether servicers can prove legal authority to foreclose. Regulators did not always verify these transfer practices during their reviews or assess the potential risks of transfer problems to institutions. The potential financial costs resulting from these issues for investors, institutions that create MBS, and the overall financial system likely will remain uncertain until sufficient numbers of courts render decisions on the appropriateness of these practices.

Contents

Letter 1

Background 3
Federal Laws Do Not Specifically Address the Foreclosure Process, and Past Federal Oversight of Foreclosure Activities Has Been Limited and Fragmented 11
Federal Regulators Have Conducted Reviews in Response to Foreclosure Documentation Problems, but Extent of and Roles in Future Oversight Are Unclear 25
Documentation Problems Will Likely Result in Delays in the Foreclosure Process, but the Impact on Financial Institutions and Others Is Less Clear 38
Conclusions 51
Recommendations for Executive Action 52
Agency Comments and Our Evaluation 53

Appendix I **Objectives, Scope, and Methodology** 57

Appendix II **Comments from the Bureau of Consumer Financial Protection** 60

Appendix III **Comments from the Federal Deposit Insurance Corporation** 62

Appendix IV **Comments from the Board of Governors of the Federal Reserve** 65

Appendix V **Comments from the Comptroller of the Currency** 68

Appendix VI **Comments from the Department of the Treasury** 70

Appendix VII **GAO Contact and Staff Acknowledgments** 71

Figures

Figure 1: Flow of Payments in a Basic Securitized Transaction 5
Figure 2: Typical Judicial and Nonjudicial Foreclosure Processes 7
Figure 3: Regulatory Oversight of Top 25 Servicers, by Percentage of Mortgage Loans Serviced, December 2010 19
Figure 4: Year-End Foreclosure Starts and Foreclosure Inventory, 2000 to 2010 39
Figure 5: Volume and Share of Enterprises and Private Label MBS Issuances, 1995 to 2010 46

Abbreviations

CFPB	Bureau of Consumer Financial Protection
FDIC	Federal Deposit Insurance Corporation
FHA	Federal Housing Administration
FHFA	Federal Housing Finance Agency
FIRREA	Financial Institutions Reform, Recovery, and Enforcement Act
GSE	government-sponsored enterprise
HAMP	Home Affordable Modification Program
HUD	Department of Housing and Urban Development
LPS	Lender Processing Services
MBS	mortgage-backed securities
MERS	Mortgage Electronic Registration System
MHA	Making Home Affordable
OCC	Office of the Comptroller of the Currency
OTS	Office of Thrift Supervision
RESPA	Real Estate Settlement Procedures Act of 1974
SAFE Act	Secure and Fair Enforcement for Mortgage Licensing Act of 2008
SCRA	Servicemembers Civil Relief Act
SEC	Securities and Exchange Commission
TILA	Truth in Lending Act
UCC	Uniform Commercial Code

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United States Government Accountability Office
Washington, DC 20548

May 2, 2011

Congressional Requesters

With record numbers of borrowers in default and delinquent on their loans, mortgage servicers—entities responsible for managing home mortgage loans—are initiating a large number of foreclosures throughout the country. As of December 2010, an estimated 4.63 percent of the about 50 million first-lien mortgages outstanding nationwide were in some stage of foreclosure—an increase of over 370 percent since the first quarter of 2006, when just 1 percent of mortgages were in foreclosure.[1] Requirements for proceeding with foreclosure are largely contained in state laws, and some states require the party seeking foreclosure to prepare documents that are notarized or signed by someone with knowledge of the case and submit them to a court. Beginning in September 2010, several servicers announced that they were halting or reviewing their foreclosure proceedings throughout the country after allegations that the documents accompanying judicial foreclosures may have been inappropriately signed or notarized. The servicers subsequently began resuming some foreclosure actions after reviewing their processes and procedures, but following these allegations, some homeowners have challenged the validity of foreclosure proceedings brought against them. In other states, foreclosures may be processed without the involvement of courts, but challenges to the documentation associated with foreclosures can occur and are occurring in these states as well. In addition, questions over whether documents for loans that were sold and packaged into mortgage-backed securities were properly handled have prompted additional challenges regarding whether the parties filing for foreclosure have the necessary authority to do so.[2] In response, numerous federal agencies have initiated reviews of foreclosure practices at major servicers. Additionally, state attorneys general are engaged in a review of servicers' foreclosure practices.

[1]A home mortgage is an instrument by which the borrower (mortgagor) gives the lender (mortgagee) a lien on residential property as security for the repayment of a loan. A first-lien mortgage creates a primary lien against real property and has priority over subsequent mortgages, which are generally known as junior, or second, mortgages. First liens are the first to be paid when the property is sold.

[2]These challenges question whether the paperwork documenting transfers of loans into securities adequately proves that the trust seeking to foreclose is the actual mortgage holder with the authority to foreclose.

In light of these developments, you asked us to examine various aspects of federal oversight of the residential mortgage foreclosure process. In response to your request, this report addresses (1) the extent to which federal laws address mortgage servicers' foreclosure procedures and federal agencies' authority to oversee activities and the extent of past oversight; (2) federal agencies' current oversight activities and future oversight plans; and (3) the potential impact of foreclosure documentation issues on homeowners, servicers, regulators, and mortgage-backed securities investors.

To address these objectives, we reviewed relevant federal laws, regulations, examination guidance, and other agency documents. We also reviewed relevant literature, examples of reported court cases involving these issues, congressional testimonies, and other relevant publicly available documentation. In addition, we examined agency documentation on current oversight activities, such as an examination worksheet, checklists, and supervisory letters summarizing examination findings. We conducted interviews with representatives of federal agencies, including the Bureau of Consumer Financial Protection (CFPB), Department of Housing and Urban Development (HUD), Department of Justice (Justice), Department of the Treasury (Treasury), Federal Deposit Insurance Corporation (FDIC), Federal Housing Finance Agency (FHFA), Board of Governors of the Federal Reserve System (Federal Reserve), Office of the Comptroller of the Currency (OCC), Office of Thrift Supervision (OTS), and Securities and Exchange Commission (SEC). We also interviewed legal experts and representatives of the mortgage industry—including the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), investor groups, and consumer advocacy groups.

We conducted this performance audit from October 2010 through April 2011 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Mortgages and Mortgage Market Participants

When individuals purchase residential real property with borrowed funds, they usually enter into a contractual agreement, typically called a promissory note, in which they agree, among other things, to make principal and interest payments to the originating lender for a period of time. To secure their debt, lenders obtain a lien on the underlying property as collateral against borrower default, which grants the holder of the lien the right to seize, and usually sell, the property should the borrower fail to pay.[3] In other words, what may be commonly referred to as a mortgage consists of both a promissory note evidencing the debt to be paid by the borrower and the lien or security interest in the underlying property, which generally is provided for in a deed of trust or a mortgage document. In the past, the institution providing the loan was typically a bank or thrift and would normally hold the loan as an interest-earning asset in its portfolio. All activities associated with servicing the loan—including accepting payments, initiating collection actions for delinquent payments, and conducting foreclosure if necessary—would have been performed by this originating institution.

Over the last few decades, the number of participants in and the complexity of the market for home mortgage loans in the United States have increased. Now, institutions that originate home mortgages generally do not hold such loans as assets on their balance sheets but instead sell them to others, who then acquire the right to receive borrowers' monthly payments. In recent years, originating lenders generally have sold or assigned their interest in both the note and the deed of trust to other financial institutions for the purpose of securitizing the mortgage. Through securitization, the purchasers of these mortgages then package them into pools and issue securities known as mortgage-backed securities (MBS) for which the mortgages serve as collateral. These securities pay interest and principal to their investors, which include other financial institutions, pension funds, or other institutional investors.

Multiple entities—including the mortgage servicer, a trustee for the securitized pool (trust), and the investors in the MBS that were issued based on the pooled loans—have specific roles regarding loans. After a

[3]A "holder" "is a person who has legal possession of a negotiable instrument and is entitled to receive payment on it." *Black's Law Dictionary* (9th ed., 2009).

mortgage originator sells its loans to another investor or to an institution that will securitize them, another financial institution or other entity is usually appointed as the servicer to manage payment collections and other activities associated with these loans. Mortgage servicers, which can be large mortgage finance companies or commercial banks, earn a fee for acting as the servicer on behalf of the owner of a loan.[4] In some cases, the servicer is the same institution that originated the loan and in other cases it may be a different institution. The duties of servicers for loans securitized into MBS are specified in a contract called a pooling and servicing agreement, which can vary widely, but may mirror the servicing guidelines issued by the government-sponsored enterprises (GSE) Fannie Mae and Freddie Mac.[5] Servicing duties can involve sending borrowers monthly account statements, answering customer service inquiries, collecting monthly mortgage payments, maintaining escrow accounts for property taxes and hazard insurance, and forwarding proper payments to the mortgage owners. In the event that a borrower becomes delinquent on loan payments, servicers also initiate and conduct foreclosures in order to obtain the proceeds from the sale of the property on behalf of the owners of the loans.

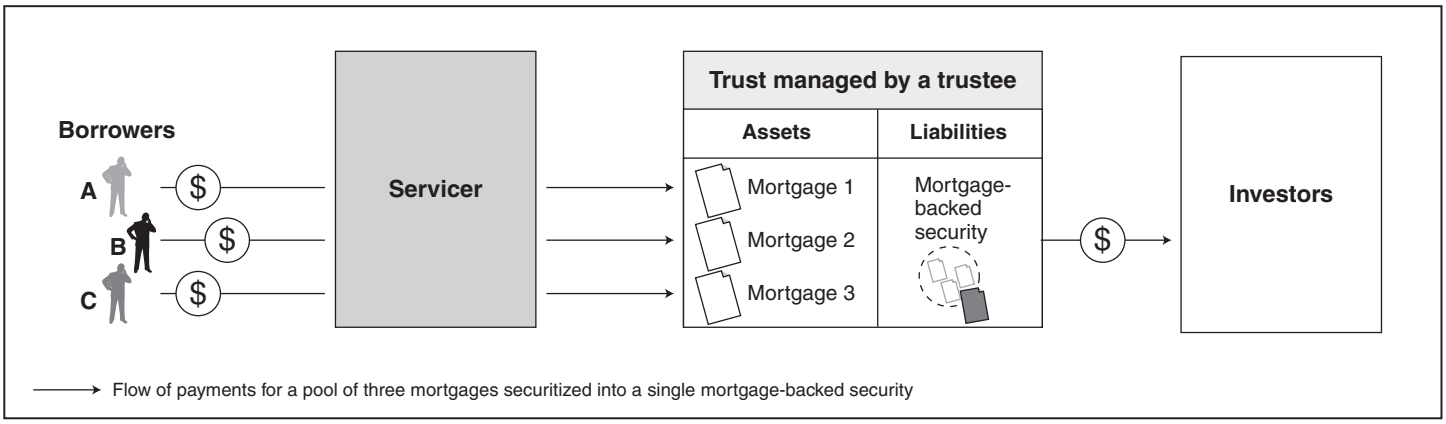
When loans are sold, they are generally packaged together in pools and held in trusts pursuant to the terms and conditions set out in the underlying pooling and servicing agreement. These pools of loans are the assets backing the securities that are issued and sold to investors in the secondary market. Another entity will act as trustee for the securitization trust. Trustees act as asset custodians on behalf of the trust, keeping records of the purchase and receipt of the MBS and holding mortgage liens that secure the investment. Trustees are also the account custodians for

[4]We have previously reported that the servicing fee is usually based on the outstanding unpaid principal balance of the loan and is generally between 25 and 50 basis points. See GAO, *Mortgage Foreclosures: Additional Mortgage Servicer Actions Could Help Reduce the Frequency and Impact of Abandoned Foreclosures*, GAO-11-93 (Washington D.C.: Nov. 15, 2010).

[5]Fannie Mae and Freddie Mac share a primary mission that has been to stabilize and assist the U.S. secondary mortgage market and facilitate the flow of mortgage credit. To accomplish this goal, the enterprises purchase mortgages from primary mortgage lenders. They hold some of the mortgages they purchase in their portfolios, but they package the majority into MBS and sell them to investors in the secondary mortgage market. The enterprises guarantee these investors the timely payment of principal and interest. Fannie Mae and Freddie Mac each have issued servicing guidelines that must be followed by entities servicing loans on behalf of the enterprises. Both enterprises are currently in conservatorship.

the trust—pass-through entities that receive mortgage payments from servicers and disperse them among investors according to the terms of the pooling and servicing agreement. Although trustees may be the legal owners of record of the mortgage loans on behalf of the trust, they do not have a beneficial interest in the underlying loans of the securitization.[6] However, any legal action a servicer takes on behalf of the trust, such as foreclosure, generally may be brought in the name of the trustee. The beneficial interests in these loans accrue to or "are held by" purchasers of the MBS, typically large institutions such as pension funds, mutual funds, and insurance companies.

Figure 1: Flow of Payments in a Basic Securitized Transaction



Source: GAO (analysis); Art Explosion (images).

The Foreclosure Process: Overview and Recent Concerns

If a borrower defaults on a mortgage loan secured by the home, the mortgage note holder is entitled to pursue foreclosure for the property to be sold at auction and obtain title to the property and sell it on behalf of the mortgage owner to repay the loan. Once the borrower is in default, the servicer must decide whether to pursue a home retention workout or

[6]"Beneficial interest" refers to the right to occupy or receive rents or other profits from a property or estate, as distinct from the interest of a nonfiduciary legal owner of the entire estate.

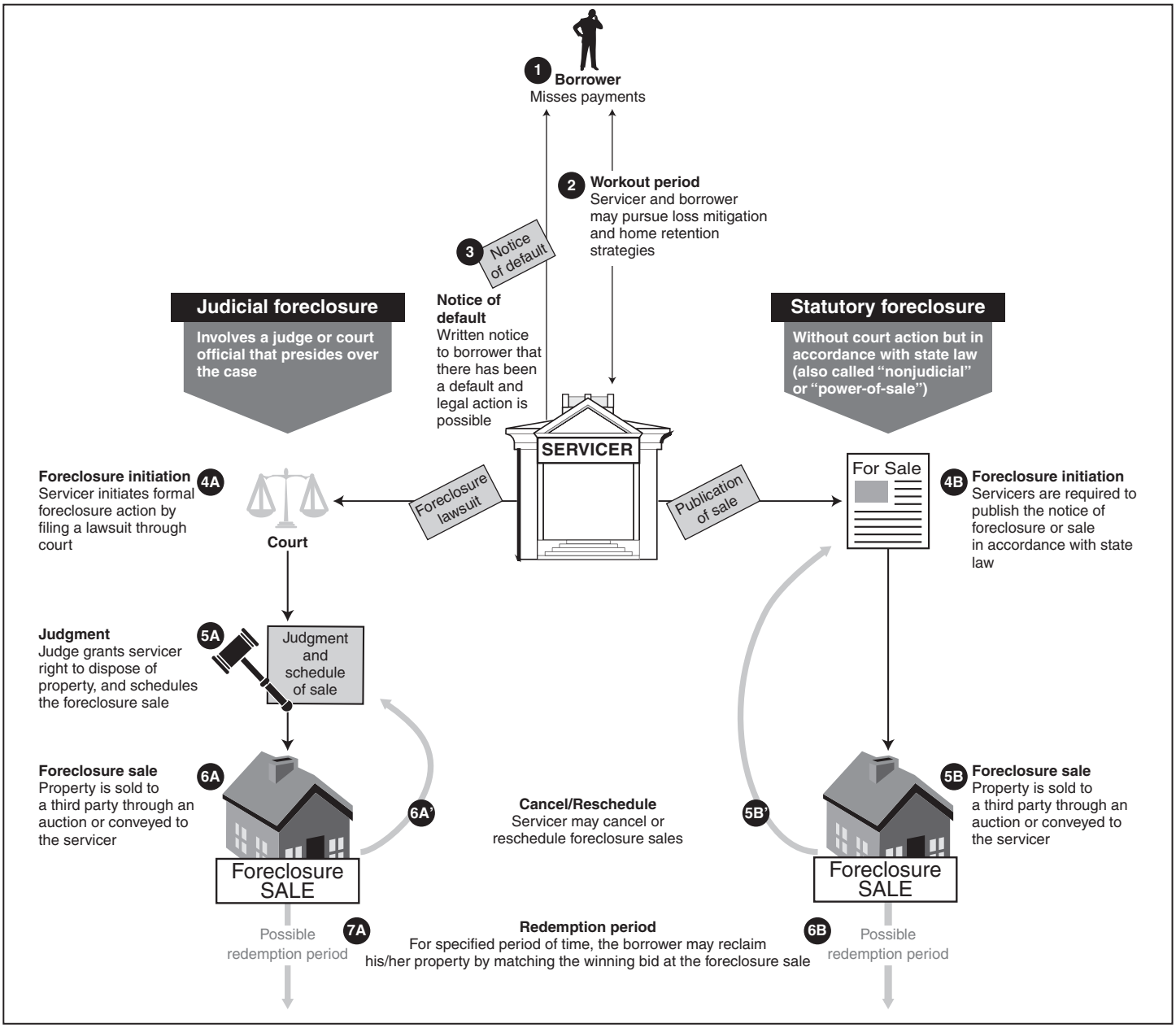
other foreclosure alternative or to initiate foreclosure.[7] The mortgage owner or servicer generally initiates foreclosure once the loan becomes 90 days or more delinquent. As shown in figure 2, states generally follow one of two foreclosure methods. In a judicial foreclosure, a judge presides over the process in a court proceeding. Servicers initiate a formal foreclosure action by filing a lawsuit with a court and in some states may submit supporting documents, such as notarized sworn statements, or affidavits, as part of the lawsuit.[8] A nonjudicial foreclosure process takes place outside the courtroom, typically by the trustee named in the deed of trust.[9] Trustees, and sometimes servicers, generally send a notice of default to the borrower and publish a notice of sale in area newspapers or legal publications.

[7]Home retention workouts are employed when the borrower has a desire to keep the home and the capacity to carry payments under the workout plan. Home retention workouts can take the following forms: (1) repayment plans, which involve a contracted plan to make up past due amounts; (2) forbearance, which includes a defined period when no or only partial payments are required followed by a repayment plan to make up the arrearage; and (3) loan modifications, which involve a permanent altering of one or more of the loan terms. Other foreclosure alternatives include two types of voluntary home-loss workout, which avoid foreclosure but require the borrower to give up the home. These two types are deed-in-lieu transfers, in which the borrower essentially gives the investor the keys to the property and executes a deed to transfer title to the investor, after the investor agrees to release the debtor from any liability on the outstanding mortgage balance, and short sales, in which the lender agrees to accept proceeds from the sale of the home to a third party even though the sale price is less than the sum of the principal, accrued interest, and other expenses owed.

[8]An "'affidavit' is [a] voluntary declaration of facts written down and sworn to by the declarant before an officer authorized to administer oaths." *Black's Law Dictionary* (9th ed., 2009).

[9]According to HUD, as of July 2008, 25 states used a nonjudicial process as their normal method of foreclosure, 19 states used a judicial process, and 6 states used both.

Figure 2: Typical Judicial and Nonjudicial Foreclosure Processes



Source: GAO (analysis); Art Explosion (images).

Beginning in September 2010, several major servicers announced potential problems with their internal procedures for executing documents required to be submitted in a judicial foreclosure. These procedural problems referred to servicers' practice of having a small number of employees sign a large number of affidavits and other legal documents that mortgage companies subsequently submitted to courts and other public authorities to execute foreclosures, so-called robosigning. This practice has raised concerns as to whether individuals who claimed in affidavits to have personal knowledge of the facts necessary to legally foreclose on a property actually had that knowledge and whether legal documents were properly notarized in accordance with state law. As a result, questions were raised about whether mortgage companies had met the necessary prerequisites to foreclose on certain properties, particularly in the judicial foreclosure states that have such documentation requirements.

In addition, questions have been raised about servicers being able to prove that they have authority to act on behalf of the mortgage owner, or are able to prove who the owner is in order to foreclose. State laws may vary on who has authority to bring a foreclosure action, but in all cases the legal holder of the mortgage note (and its legal representatives, acting in the name of the mortgage holder) generally has the right to foreclose on the property. Challenges over this authority, or standing, in foreclosure actions have been raised.[10] Some of these challenges may center on whether the servicer has acquired the rights of a mortgage holder when paperwork documenting a sale or assignment of interest in a mortgage is missing or deficient in some way—for example, if it is not properly endorsed by the parties or if the assignment occurred after the foreclosure complaint was filed.

Federal Agencies Involved in Overseeing Institutions That Originate and Service Loans

Several federal agencies share responsibility for regulating the banking industry in relation to the origination and servicing of mortgage loans.[11] Chartering agencies oversee federally and state-chartered banks and their mortgage lending subsidiaries. At the federal level, OCC has authority to oversee nationally chartered banks. OTS oversees state- and federally chartered savings associations, or thrifts, (including mortgage operating subsidiaries) as well as savings and loan holding companies and lenders

[10]"Standing" refers to "[a] party's right to make a legal claim or seek judicial enforcement of a duty or right." *Black's Law Dictionary* (9th ed., 2009).

[11]12 U.S.C. § 1813(q).

owned by a savings and loan holding company.[12] The Federal Reserve oversees insured state-chartered member banks, while FDIC oversees insured state-chartered banks that are not members of the Federal Reserve System. Both the Federal Reserve and FDIC share oversight with the state regulatory authority that chartered the bank. In addition, OTS shares oversight for state-chartered savings associations with the state regulatory authority that chartered the savings association. The Federal Reserve also has general authority over entities that may be owned by federally regulated holding companies but are not federally insured depository institutions. The Federal Trade Commission has authority to enforce certain federal consumer protection laws for nonbank financial services providers. Upon assumption of its full authorities on July 21, 2011, CFPB will have the authority to regulate mortgage servicers with respect to federal consumer financial law.[13] On that date, consumer financial protection functions from seven existing federal agencies will transfer to the new agency.[14] For mortgage servicers that are depository institutions with more than $10 billion in assets or their affiliates, CFPB will have exclusive supervisory authority and primary enforcement authority to ensure compliance with federal consumer financial law.[15] Additionally, if a servicer is a nondepository institution, CFPB will have both supervisory and enforcement authority to ensure compliance with federal consumer

[12]OCC will assume oversight responsibility of federal savings associations from OTS in July 2011. Concurrently, FDIC will assume oversight responsibility of state-chartered savings associations from OTS and the Federal Reserve will assume oversight responsibility of savings and loan holding companies and lenders owned by a savings and loan holding company from OTS, according to OTS officials.

[13]The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), enacted on July 21, 2010, established CFPB as an independent bureau within the Federal Reserve System. Section 1066 of the Dodd-Frank Act authorized the Secretary of the Treasury to provide administrative services necessary to support the CFPB before the transfer date and to exercise certain of its powers until the appointment of a CFPB Director. 12 U.S.C. § 5586. "Federal consumer financial law" is a defined term in the Dodd-Frank Act that includes over a dozen existing federal consumer protection laws, including the Truth in Lending Act, the Real Estate Settlement Procedures Act, and the Equal Credit Opportunity Act, as well as title X of the Dodd-Frank Act itself. 12 U.S.C. § 5481(12), (14).

[14]The seven agencies are the Federal Reserve, FDIC, Federal Trade Commission, National Credit Union Administration, OCC, OTS, and HUD.

[15]12 U.S.C. § 5515.

financial law.[16] Finally, CFPB will have rulemaking authority with respect to mortgage servicers, including authority that transfers from other federal agencies such as the Federal Reserve and the Federal Trade Commission.[17]

Other agencies are also involved in overseeing certain aspects of U.S. mortgage markets but do not have supervisory authority over mortgage servicers. For example, FHFA has direct supervisory authority over Fannie Mae's and Freddie Mac's activities, but does not have supervisory authority over servicers in general.[18] The Federal Housing Administration (FHA) oversees institutions approved to service loans that FHA insures for the servicers' compliance with servicing regulations on, for example, the timing of foreclosure initiation. Similarly, Treasury has a contractual relationship with servicers that voluntarily participate in the Home Affordable Modification Program (HAMP) and can review these servicers' compliance with Treasury's loan modification guidelines.[19] In addition, staff from SEC also review some of the registered offerings that private issuers of MBS file. Justice has authority to investigate and prosecute civil or criminal enforcement cases. In particular, the Financial Fraud Enforcement Task Force, led by Justice, is charged with coordinating an interagency effort to combat mortgage, loan, and lending fraud committed against the U.S. Treasury, among other financial crimes. Additionally, the Federal Trade Commission is responsible for enforcing certain federal consumer protection laws for brokers, lenders, and servicers that are not depository institutions, including state-chartered independent mortgage lenders.

[16]CFPB's nondepository supervision authorities specifically extend to any covered person that "offers or provides origination, brokerage or servicing of loans secured by real estate for use by consumers primarily for personal, family or household purposes, or loan modification or foreclosure relief services in connection with such loans." 12 U.S.C. § 5514(a)(1)(A).

[17]12 U.S.C. § 5512. The Federal Trade Commission will retain its current enforcement authority.

[18]On September 6, 2008, FHFA placed Fannie Mae and Freddie Mac in conservatorship out of concern that their deteriorating financial condition and potential default on $5.4 trillion in outstanding financial obligations threatened the stability of financial markets.

[19]The Home Affordable Modification Program is a program designed to help borrowers avoid foreclosure and stay in their homes by providing incentives for servicers to perform loan modifications.

Federal Laws Do Not Specifically Address the Foreclosure Process, and Past Federal Oversight of Foreclosure Activities Has Been Limited and Fragmented

Requirements for Foreclosure Processes and Needed Evidence Are Governed Mostly by State rather than Federal Laws

State rather than federal laws largely govern foreclosure processes in the United States. Foreclosure proceedings, including specifying who can bring foreclosure actions and what procedures must be followed as part of such actions, are generally governed by state laws. State foreclosure laws establish certain procedures that mortgage servicers must follow in conducting foreclosures and minimum time periods for various aspects of the foreclosure process. State laws on who has authority, or standing, to bring a foreclosure action generally provide that the legal holder of the mortgage note (and its legal representative, such as a servicer or trustee acting in the name of the mortgage holder) has the right to foreclose on the property.[20] In addition, although state laws vary greatly, in order to foreclose on a property, servicers generally may need evidence that (1) they are the original owner of (or are a holder in due course of) the mortgage on the property or have authority to act on behalf of the owner (or holder) and (2) the borrower is in default on the mortgage.

State laws also vary on the evidence required to support a foreclosure. In states with judicial foreclosure processes, the state laws generally require that a foreclosing party file an action—which may have to include certain documentation—with a court. For example, mortgage holders often are required to prove the amount of the borrower's outstanding obligation and that the borrower is in default through notarized affidavits. In addition, to prove the authority, or standing, to foreclose, a foreclosing entity may be required to submit to the court the original promissory note and mortgage.

[20]Congressional Research Service, Memorandum, *"Robo-signing" and Related Mortgage Documentation Problems*. (Washington, D.C.: November 15, 2010).

State laws may allow foreclosing entities to submit other evidence to establish standing. For instance, the relevant state law may allow for the submission of affidavits attesting to the fact that the entity had the note but that the original note is lost, destroyed, or otherwise cannot be produced for the court. In other instances, mortgage holders may produce copies of the original note and mortgage, or deed of trust, accompanied by an affidavit attesting to the fact that the holder has physical possession of the originals. Affidavits may require a testament that the signers have personal knowledge of the facts to which they are swearing or that they have personally examined the attested facts. Affidavits usually must be signed in the presence of a notary or other witnesses.

In states that allow parties to bring foreclosure actions without court approval—nonjudicial foreclosure states—foreclosing parties are generally required to adhere to all of the procedural and notice requirements established by state law. Mortgage holders are expected to be able to meet the same two criteria that are required in a judicial foreclosure process—that they have authority, or standing, to foreclose and that the borrower is in default. However, evidence documenting these facts is not usually required to be filed with a court or any other entity. If the borrower being foreclosed upon believes that the action is unjustified, he or she must file a lawsuit with a court to contest the foreclosure. In nonjudicial foreclosure states, therefore, servicers might not need to produce documentation supporting their right to foreclose or proving the borrower's default unless a foreclosure is contested.

Federal Laws That Apply to Mortgage Lending Focus on Loan Origination and Do Not Specifically Address the Foreclosure Process

Because state laws primarily govern the foreclosure process, federal laws related to mortgage lending are focused on protecting consumers at mortgage origination and during the life of a loan, but not necessarily during foreclosure. Among the federal laws that apply to residential mortgage lending and subsequent servicing of such loans are the Fair Housing and Equal Credit Opportunity Acts, which address granting credit and ensuring nondiscrimination in lending; the Truth in Lending Act (TILA), much of which addresses disclosure requirements for consumer credit transactions; the Real Estate Settlement Procedures Act of 1974 (RESPA), which focuses primarily on the regulation and disclosure of mortgage closing documents; the Fair Credit Reporting Act, which addresses consumer report information, including use of such information in connection with mortgage lending; and the Secure and Fair

Enforcement for Mortgage Licensing Act of 2008 (SAFE Act), which requires licensing and/or registration of mortgage loan originators.[21]

These various federal consumer protection laws address some aspects of mortgage servicers' interactions with borrowers, but do not include specific requirements for servicers to follow when executing a foreclosure. For example, TILA, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), requires servicers to notify borrowers of impending interest rate changes on hybrid adjustable rate mortgages and will require certain disclosures in monthly statements to borrowers.[22] Amendments to the regulations implementing TILA that took effect in October 2009 also prohibit, for certain loans, imposing a late fee on a late fee.[23] In addition, RESPA requires a servicer of a federally related mortgage loan to provide initial and annual escrow account statements, notices of transfer of servicing, and timelines for responding to certain written requests from borrowers, such as requests for the identity, address, and other relevant contact information of the lien holder.[24] RESPA also outlines rules regarding referring borrowers to affiliated businesses for services and requirements for maintaining escrow

[21]Fair Housing Act, 42 U.S.C. §§ 3601–3619; Equal Credit Opportunity Act, 15 U.S.C. §§ 1691-1691f; Truth in Lending Act, 15 U.S.C. §§ 1601-1667f; Real Estate Settlement Procedures Act of 1974, 12 U.S.C. §§ 2601-2617; Fair Credit Reporting Act, 15 U.S.C. §§ 1681-1681x; SAFE Act, 12 U.S.C. §§ 5101-5116.

[22]Pub. L. No. 111-203, title XIV, §§ 1418, 1420, 124 Stat. 1376, 2154 (2010) (Dodd-Frank Act). Section 1420 also requires that monthly statements be provided to borrowers.

[23]Regulation Z implements TILA. See 12 C.F.R. § 226.36(c)(ii); 73 Fed. Reg. 44522 (July 30, 2008). The regulations also require prompt crediting of mortgage loan payments and the provision of payoff statements within a reasonable time; those requirements were later essentially codified by section 1464 of the Dodd-Frank Act.

[24]12 U.S.C. § 2605. A "federally related mortgage loan" generally with certain exceptions includes any loan, that is (1) secured by a lien on single family, or up to four-family, residential real property if the proceeds of the loan are used to either purchase the property or to prepay or pay off an existing loan secured by the same property; and (2) is made in whole or in part by any lender the deposits or accounts of which are federally insured, or is made by any federally regulated lender; or (3) is made, or insured, guaranteed, supplemented, or assisted in any way, by the federal government or in connection with a housing or urban development program administered by the federal government; or (4) is intended to be sold by the originating lender to the Federal National Mortgage Association, the Government National Mortgage Association, the Federal Home Loan Mortgage Corporation, or a financial institution from which it is to be purchased by the Federal Home Loan Mortgage Corporation; or (5) is made by certain creditors who make or invest in residential real estate loans aggregating more than $1,000,000 per year. 12 U.S.C. § 2602(1).

accounts that the servicer establishes or controls on behalf of a borrower to pay taxes, insurance premiums, or other charges.[25] With respect to foreclosure processing specifically, according to Federal Reserve officials, among the only federal laws that address the foreclosure process they had identified were the Protecting Tenants at Foreclosure Act of 2009, which protects certain tenants from immediate eviction by new owners who acquire residential property through foreclosure; the Servicemembers Civil Relief Act (SCRA), which restricts foreclosure of properties owned by active duty members of the military; and federal bankruptcy laws.[26]

Past Oversight of Foreclosure Activities by Bank Regulators Has Been Limited and Fragmented

Bank regulators are responsible for overseeing most entities that conduct mortgage servicing, but their oversight of foreclosure activities generally has been limited. As part of their mission to ensure the safety and soundness of financial institutions, banking regulators have the authority to conduct reviews of any aspect of banks' activities, including mortgage servicing activities. The majority of the mortgage servicing in the United States is performed by financial institutions and other subsidiaries of holding companies that are under the oversight of OCC, OTS, Federal Reserve, or FDIC. Federal banking regulators have responsibility for helping ensure the safety and soundness of the institutions they oversee, promoting stability in the financial markets, and enforcing compliance with applicable consumer protection laws. To achieve these goals, regulators establish capital requirements for banks and conduct on-site examinations and off-site monitoring to assess their financial condition, including assessing their compliance with applicable banking laws, regulations, and agency guidance.[27] Additionally, federal bank regulators can take a variety of enforcement actions to rectify any identified deficiencies, including deficiencies in financial institutions' mortgage origination, transfer, securitization, and foreclosure processes.[28] These

[25]12 U.S.C. §§ 2607, 2609. Section 1463 of the Dodd-Frank Act has expanded some of these requirements and created new requirements. For example, it decreased the timelines applicable to servicer responses to written requests from borrowers and required servicers to respond within 10 days to borrower requests for the identity of the owner of their loan. It also created new restrictions on the force-placement of hazard insurance, requires prompt refund of escrow accounts after loan payoff, and requires timely action by servicers to correct errors.

[26]12 U.S.C. §§ 5201 note, 5220 note (expires December 31, 2014). 50 App. U.S.C. §§ 501–597b.

[27]12 U.S.C. § 1831o.

[28]12 U.S.C. § 1818.

enforcement actions include the ability to issue cease-and-desist orders, to impose civil money penalties, and to suspend or prevent entities or individuals from conducting business on behalf of a financial institution, under certain circumstances. Although federal laws do not specifically address the foreclosure process, officials at the federal banking regulatory agencies stated that their agencies have the necessary authority to oversee the compliance of institutions under their jurisdiction with any applicable state laws, including those pertaining to foreclosing on a home mortgage.

As part of overseeing the safety and soundness of banks, the banking regulators have developed a variety of guidance that outlines expectations for banks to follow in conducting their operations, but the extent to which this guidance addresses how foreclosures should be conducted has been limited. Each of the banking regulators has guidance that addresses various aspects of lending, including for home mortgages, and that establishes expectations regarding extending credit, conducting appraisals of properties, and other activities. For example, the federal banking regulators have developed uniform real estate lending standards that require depository institutions to establish and maintain comprehensive, written real estate lending policies that are consistent with safe and sound banking practices.[29] These policies must address certain lending considerations, loan administration procedures, and portfolio diversification standards, among other requirements. Regarding foreclosure, these lending guidelines noted only that institutions should have procedures that address foreclosure timing and compliance with servicing agreements. Further, the Interagency Guidelines Establishing Standards for Safety and Soundness state that institutions should have loan documentation practices that ensure that any claim against a borrower is legally enforceable.[30]

[29]Section 304 of the Federal Deposit Insurance Corporation Improvement Act of 1991 requires the federal banking agencies to prescribe uniform real estate lending standards. 12 U.S.C. § 1828(o). The standards established by the federal banking regulators require every depository institution to establish and maintain comprehensive, written real estate lending policies that are consistent with safe and sound banking practices and appropriate to the size of the institution and nature and scope of its operations. The lending policies must establish loan portfolio diversification standards; prudent underwriting standards; loan administration procedures for the bank's real estate portfolio; and documentation, approval, and reporting requirements to monitor compliance with the bank's real estate lending policies. OCC (12 C.F.R. part 34, subpart D), Federal Reserve System (12 C.F.R. part 208, subpart E), FDIC (12 C.F.R. part 365), OTS (12 C.F.R. § 560.100 and 560.101).

[30]For example, see 12 C.F.R. part 364, App. A(II)(C).

The examination handbooks that FDIC, Federal Reserve, OCC, and OTS examiners follow when conducting examinations of banks' servicing activities do not address the specifics of how foreclosures are to be conducted, but the guidance does address a number of foreclosure-related activities. For example, these regulators' examination guidance addresses such topics as how to assess the costs of foreclosure or the value of the homes for which ownership is acquired through foreclosure. In addition, the guidance addresses how to value servicing rights, which provide the stream of income that servicers receive from conducting servicing on behalf of other loan owners, such as MBS trusts. The value of this income is shown as an asset on the balance sheet of the servicer. Each of the regulators' guidance also notes that institutions should have foreclosure procedures and that examiners should assess whether the institutions' procedures address the timing of foreclosure. For example, the Federal Reserve guidance suggests selecting a sample of loans to determine whether foreclosure was instituted in a timely manner. The regulators' examination guidance also expects institutions to consider the risks that arise when contracting with third parties to conduct any business activities on their behalf and the controls and monitoring that should be established throughout the arrangement. The guidance for OCC, OTS, and the Federal Reserve also instructs their examiners to assess the methods—such as policies and procedures or management reports—that institutions use to ensure that their foreclosure procedures comply with applicable laws, regulations, and investor guidelines. Finally, OCC and OTS guidance notes that examiners should review internal bank reports on foreclosure trends.

The extent to which bank regulators have conducted reviews of the foreclosure activities of banks or banking subsidiaries that perform mortgage servicing has been limited because these practices generally were not considered as posing a high risk to the safety and soundness of the institutions. Because mortgage servicers generally manage loans that are actually owned or held by other entities, they are not exposed to significant losses if the loans become delinquent.[31] In addition, we have previously reported that the percentage of loans in foreclosure had

[31]Staff at one of the banking agencies acknowledged that servicers could be subject to significant losses on loans that they are managing that are held in their own portfolios or in the portfolios of their affiliates.

historically been very low (less than 1 percent) from 1979 to 2006.[32] According to OCC and Federal Reserve staff, these agencies conduct risk-based examinations that focus on areas of greatest risk to their institutions' financial positions, as well as some other areas of potential concern, such as consumer complaints. Because they determined that the risks from mortgage servicing generally had not indicated the need to conduct more detailed reviews of these operations, federal banking regulators have not regularly examined servicers' foreclosure practices on a loan-level basis. Instead, previous federal regulatory examinations of mortgage servicers have focused on loan modifications or on the income banks earn from servicing loans.

Oversight also has been fragmented, and not all servicers have been overseen by federal banking regulators. Multiple agencies have regulatory responsibility for most of the institutions that conduct mortgage servicing, but until recently, some nonbank institutions have not had a primary federal or state regulator. As shown in figure 3, of the top 25 servicers in 2010 that represent 75 percent of the market, the majority—over 90 percent—were depository institutions that are subject to oversight by one of the federal banking regulators. For example,

- OCC is the primary regulator for banks that service 78.3 percent of loans serviced by the top 25 servicers.
- The Federal Reserve oversees bank holding companies or their depository institution subsidiaries and state-chartered member banks that may conduct servicing that together account for 4.1 percent of the loans serviced by the top 25 servicers.
- OTS, whose functions are scheduled to be transferred to OCC, FDIC, and the Federal Reserve on July 21, 2011, oversees servicers that are savings associations, which account for 4.7 percent of the volume of the top 25 servicers.[33]
- FDIC acts as the primary regulator for servicers that represent 1.1 percent of the loans serviced by the top 25 servicers.

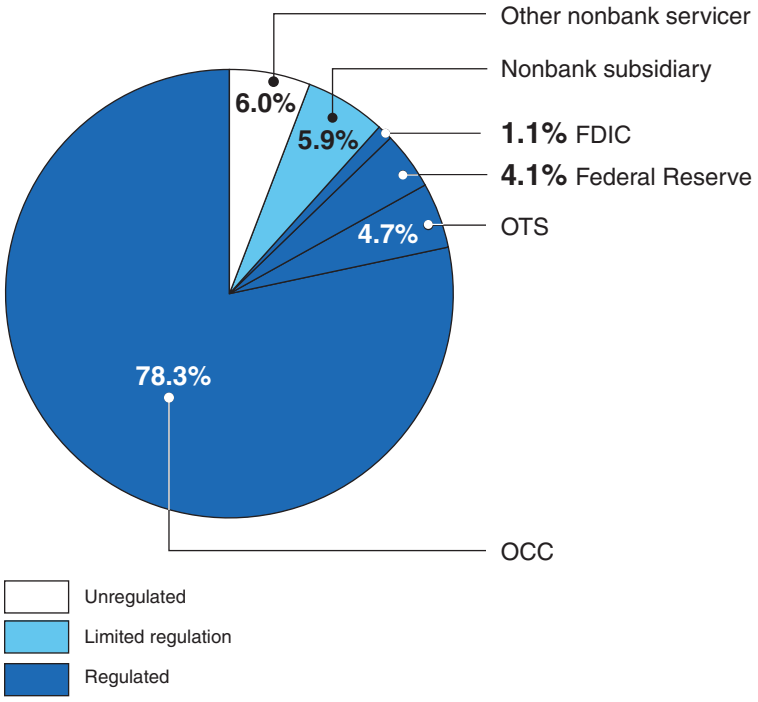
[32]GAO, *Troubled Asset Relief Program: One Year Later, Actions Are Needed to Address Remaining Transparency and Accountability Challenges*, GAO-10-16 (Washington, D.C.: Oct. 8, 2009).

[33]12 U.S.C. § 1813(q). OTS also has jurisdiction over savings and loan holding companies and their subsidiaries. 12 U.S.C. § 1467a.

In addition, many federally regulated bank holding companies that have insured depository subsidiaries, such as national or state-chartered banks, may have nonbank subsidiaries, such as mortgage finance companies. Under the Bank Holding Company Act of 1956, as amended, the Federal Reserve has jurisdiction over such bank holding companies and their nonbank subsidiaries that are not regulated by another functional regulator.[34] These nonbank subsidiaries accounted for about 5.9 percent of the top 25 servicers' volume in 2010. In some cases nonbank entities that service mortgage loans are not affiliated with financial institutions at all, and therefore were not subject to oversight by one of the federal banking regulators. These entities accounted for about 6 percent of the top 25 servicers' volume in 2010.

[34]12 U.S.C. § 1844(c)(2). "Functional regulation" refers to the premise that risks within a diversified organization can be managed properly through supervision focused on the individual subsidiaries within the firm. That is, securities activities are supervised by securities regulators, banking activities by banking regulators, and insurance activities by insurance regulators.

Figure 3: Regulatory Oversight of Top 25 Servicers, by Percentage of Mortgage Loans Serviced, December 2010



Source: GAO analysis of Inside Mortgage Finance data.

Note: We identified institutions' share of the mortgage servicing market as reported in an industry publication, *Inside Mortgage Finance*. According to our analysis of these data, the home mortgage loans serviced by the top 25 institutions accounted for about 75 percent of all loans outstanding.

In addition to fragmented oversight among multiple regulators, past oversight of servicers has been uneven, particularly with respect to nonbank entities. Although the Federal Reserve has authority over nonbank subsidiaries that are affiliates of bank holding companies, until recently the Federal Reserve had generally not included these entities in its examination activity because their activities were not considered material risks to the bank holding company. In a previous report on predatory lending, we raised questions about the activities of some of these less regulated nonbank entities and recommended that federal

regulators actively monitor their activities.[35] However, regulators continued to view the firms as not posing material risks. In 2007, after widespread defaults on mortgage loans began occurring, the Federal Reserve conducted a targeted review of consumer compliance supervision at selected nonbank subsidiaries that originate loans. Additionally, in October 2009, the Federal Reserve began a loan modification initiative, including on-site reviews, to assess whether certain servicers, including nonbank subsidiaries of bank holding companies, were executing loan modification programs in compliance with relevant federal consumer protection laws and regulations. A Federal Reserve official recently testified that the current foreclosure documentation problems underscore the importance of using the agency's authority to send examiners into nonbank affiliates of bank holding companies.[36] Further, the Federal Reserve received certain authority in the Dodd-Frank Act to supervise certain nonbank financial institutions that have been determined to pose a potential threat to the financial stability of the United States.[37]

There also have been gaps in past oversight. For example, nonbank servicers have historically been subject to little or no direct oversight by state or federal regulators. We have previously reported that some states require mortgage servicers (including state-chartered banks) to register with the state banking department.[38] State banking regulators generally

[35]GAO, *Consumer Protection: Federal and State Agencies Face Challenges in Combating Predatory Lending*, GAO-04-280 (Washington, D.C.: Jan. 30, 2004). See also GAO, *Alternative Mortgage Products: Impact on Defaults Remains Unclear, but Disclosure of Risks to Borrowers Could Be Improved*, GAO-06-1021 (Washington, D.C.: Sept. 19, 2006), and *Information on Recent Default and Foreclosure Trends for Home Mortgages and Associated Economic and Market Developments*, GAO-08-78R (Washington, D.C.: Oct. 16, 2007).

[36]Statement by Daniel K. Tarullo, Member Board of Governors of the Federal Reserve System before the Committee on Banking, Housing and Urban Affairs, United States Senate, Washington, D.C.: December 1, 2010.

[37]Section 113 of the Dodd-Frank Act provides the Financial Stability Oversight Council the authority to require that a nonbank financial company be supervised by the Board of Governors of the Federal Reserve System and be subject to prudential standards in accordance with title I of the Dodd-Frank Act if the council determines that material financial distress at such a firm, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the firm, could pose a threat to the financial stability of the United States. 12 U.S.C. § 5323(a). The Council has issued a notice of proposed rulemaking regarding the designation criteria in section 113. 76 Fed. Reg. 7731 (Feb. 11, 2011).

[38]GAO, *Alternative Mortgage Products: Impact on Defaults Remains Unclear, but Disclosure of Risks to Borrowers Could Be Improved*, GAO-06-1021 (Washington, D.C.: Sept. 19, 2006).

oversee independent lenders and mortgage servicers by requiring business licenses that mandate meeting net worth, funding, and liquidity thresholds. According to officials representing state banking supervisors, bank examinations focus on loan origination and, until recently, did not include an evaluation of servicing or foreclosure practices. In our 2009 report on how the U.S. financial regulatory system has not kept pace with the major developments in recent decades, we noted that the varying levels, and in some cases complete lack, of oversight of nonbank institutions that originated mortgages created problems for consumers or posed risks to regulated institutions.[39]

Other Federal Agencies' Involvement in Reviewing Servicing Activities Also Has Been Limited

In addition to federal banking regulators, federal housing agencies and others have oversight responsibilities for various aspects of mortgage servicing, but these agencies' past efforts also focused primarily on servicers' loan modification and preforeclosure activities rather than the processes associated with foreclosure.

- FHA, which oversees mortgage servicers that manage the home mortgage loans insured by that agency, uses a risk-based approach to monitor those institutions. Furthermore, according to FHA staff, the agency's mortgage insurance contract provisions do not authorize direct oversight of the mortgage foreclosure process. FHA does have regulations that provide expectations for servicers related to foreclosure activities.[40] These regulations address the timely initiation of foreclosure, completion of foreclosure within specified time frames, and conveyance to HUD of properties with clear and marketable title following foreclosure sale.[41] According to FHA staff, past servicer reviews have focused on monitoring compliance with requirements for assisting delinquent borrowers to remain in their homes by considering loan modifications, payment plans, or other options to avoid foreclosure, called loss mitigation. For example, FHA examiners would review whether servicers considered all loss mitigation alternatives before foreclosure was initiated. The staff noted, however, that examiners have not previously conducted in-depth reviews of servicers' foreclosure practices.

[39]GAO, *Financial Regulation: A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System*, GAO-09-216 (Washington, D.C.: Jan. 8, 2009).

[40]24 C.F.R. part 203, subparts B, C.

[41]See, for example, 24 C.F.R. 203.366, concerning conveying marketable title.

- FHFA also conducts housing oversight activities, but its past oversight of foreclosure activities has also been limited. FHFA has no direct authority over servicers, but does have authority to ensure that the housing GSEs are being run in a safe and sound fashion, as well as the power to impose operational, managerial, and internal control standards on the companies.[42] According to FHFA staff, their agency has monitored foreclosure trends and policies at Fannie Mae and Freddie Mac, but the agency did not in the past routinely examine these enterprises' oversight of their servicers' foreclosure procedures. Like the banking regulators and FHA, FHFA has focused its past efforts on the institutions' loan modification and preforeclosure efforts. For example, according to FHFA staff, recent oversight activities have included an operational risk assessment of the GSE's HAMP program as well as reviews of GSE oversight of servicer performance in adhering to foreclosure timeline standards and oversight of retained foreclosure attorney networks and examinations of foreclosure claim filing performance. Similarly, the GSEs also were not actively taking steps to ensure that the servicers they contracted with to manage the loans they purchased or pooled into MBS were following appropriate foreclosure practices. Representatives from the GSEs reported that they conduct targeted reviews of servicers that focus on evaluating processes and procedures. While the GSEs conducted reviews of delinquent loans and tested whether certain key elements of the servicers' management of loans in default were being properly followed, the reviews did not specifically check that servicers were in compliance with foreclosure practices based on state-specific laws and guidance. They said that they require servicers to follow proper legal procedures with respect to all aspects of their business operations, including their foreclosure documentation practices, as part of their contractual obligations with the GSEs and expect servicers to report problems with their activities.

- Treasury ordinarily does not have any direct role in oversight over entities that conduct mortgage servicing. However, under HAMP, which was initiated in 2009, mortgage servicers contract with Treasury to help troubled homeowners obtain modifications of their mortgage loans. As part of this program, Treasury has conducted compliance reviews and is

[42] 12 U.S.C. § 4513. FHFA oversees the government-sponsored enterprises Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System. The Federal Home Loan Bank System was created by the Federal Home Loan Bank Act as a government-sponsored enterprise to support mortgage lending and related community investment by making loans, called advances, to its member institutions, which in turn lend to home buyers for mortgages. Advances are secured by home mortgage loans and other collateral. 12 U.S.C. §§ 1421-1449. We did not review the Federal Home Loan Bank System for this report.

assessing servicer compliance with HAMP requirements. These requirements, and thus Treasury's oversight, do not cover foreclosure activities.

- SEC is involved in ensuring that appropriate public disclosures are made as part of the issuance of MBS, but it does not have a direct role with respect to foreclosure activities related to the loans in these pools. SEC staff told us they receive a first annual report on publicly traded residential MBS that includes information such as the overall performance and status of loans in the pool.[43] When MBS are underwritten and issued, a company (usually an investment bank) must disclose certain information about the securities to inform potential investors of the risks involved. SEC has the authority to enforce civil securities fraud statutes related to any inaccurate disclosures, such as about the performance or ownership of the loans in the pool.[44] However, we previously reported that officials from SEC told us that they did not examine servicers' policies or activities for these securitized assets. SEC staff told us that they also reviewed information included in the publicly filed financial statements of publicly traded companies engaged in mortgage servicing. This information generally included aggregate trends in foreclosure activity but did not address actions taken related to individual loans.

- The Federal Trade Commission is responsible for enforcing certain federal consumer protection laws for entities that are not depository institutions, including state-chartered independent mortgage lenders. As a result, it can take enforcement actions against nonbank mortgage servicers if it receives a complaint and then determines that such an entity had violated one of the various federal consumer protection laws. In recent years, the Federal Trade Commission has completed a number of enforcement actions against mortgage servicers.[45] However, the Federal Trade Commission is

[43]According to SEC staff, section 943(2) of the Dodd-Frank Act requires new securitization issuances to keep filing certain reports after the first year. See 15 U.S.C. § 78o-7 note; 76 Fed. Reg. 4489 (Jan. 26, 2011).

[44]Under federal securities laws, individuals could be liable for fraud if they made material misstatements or omissions in their SEC filing with intent to deceive or defraud. Criminal penalties may be imposed for willful violations of the federal securities laws or for willfully committing fraud. See, for example, 15 U.S.C. § 77x.

[45]See *FTC v. Countrywide Home Loans, Inc.*, No. CV10-4193 (C.D. Cal. filed June 7, 2010); *FTC v. EMC Mortgage Corp.*, Civil No. 4:08-cv-338 (E.D. Tex. filed Sept. 9, 2008); *U.S. v. Fairbanks Capital Corp.*, Civil No. 03-12219-DPW (D. Mass. filed Nov. 12, 2003). The defendants in each of these cases did not admit to any of the allegations of wrongdoing set forth in the Federal Trade Commission's complaints but agreed to settle to resolve the matters.

not a supervisory agency and thus does not conduct ongoing monitoring of compliance, including of nonbank mortgage servicers.

- Justice has general authority to investigate and prosecute instances of fraud, through both civil and criminal enforcement, and thus can be involved in mortgage-related activities if fraud against the government, lenders, borrowers, or investors occurs. However, according to Justice staff, their agency does not have bank regulatory authorities; therefore, it does not engage in routine review of servicers' activities as bank regulators do.[46] Justice staff could not comment on any ongoing investigations, but said that cases completed in the past involving mortgage servicers involved issues other than foreclosure.[47] In 2009, the Obama administration established the Financial Fraud Enforcement Task Force in response to the financial crisis. The task force's Mortgage Fraud Working Group is focused on a wide array of mortgage fraud, including mortgage lending fraud and foreclosure rescue schemes. To date, this group's activities have focused on investigating issues related to mortgage origination, short sales, and appraisals and tracking the market for indications of mortgage fraud.

[46]According to Justice staff, the primary governing statutes that relate to mortgage servicing for civil and criminal enforcement are the False Claims Act, 31 U.S.C. § 3729, which addresses fraud against the government; Title 18 of the U.S. Code, 18 U.S.C. §§ 1341, 1343, and 1344; and the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA), 12 U.S.C. 1833a, which provides for civil penalties for bank fraud, mail and wire fraud, illegal participation, embezzlement and other bank fraud-related offenses.

[47]See *US ex rel. Hastings v. Countrywide Home Loans, Inc.*, Case No. 2:07-cv-03897-JFW-PLA (C.D. Ca. filed Oct. 8, 2008); *US ex rel. Pace v. Bank of America NA*, Case No. 2:09-cv-07157-SVW-SS (C.D. Ca. filed Oct. 1, 2010); and *US ex rel. Conrad v. Countrywide Home Loans, Inc.*, Case No. 1:04-cv-01863-RGL (D.D.C. filed Oct. 27, 2004).

Federal Regulators Have Conducted Reviews in Response to Foreclosure Documentation Problems, but Extent of and Roles in Future Oversight Are Unclear

Federal Regulators Have Recently Increased Attention on Servicing Activities and Identified Problems through a Coordinated Review

In response to the foreclosure process deficiencies that various mortgage servicers publicly announced beginning in September 2010, federal banking regulators have conducted specific reviews of certain servicers' foreclosure activities. When reports of foreclosure documentation problems surfaced, banking regulators initially ordered servicers to conduct self-assessments of their foreclosure management processes and correct any deficiencies. Consequently, some servicers temporarily halted foreclosure proceedings in order to review their foreclosure processes and to verify the soundness of documentation preparation procedures. Further, OCC, the Federal Reserve, OTS, and FDIC began a coordinated on-site review of 14 mortgage servicers to evaluate the adequacy of controls over servicers' foreclosure processes and to assess servicers' policies and procedures for compliance with applicable federal and state laws.[48]

Regulatory staff told us that as part of these reviews, their examiners evaluated internal controls and procedures for processing foreclosures and reviewed samples of individual loan files to better ensure the integrity of the document preparation process and to confirm that files contained appropriate documentation. Examiners reviewed more than 2,800 loan files—which they noted was a relatively small number of foreclosure files given the volume of recent foreclosures processed by these servicers—comprising approximately 200 foreclosure loan files with a variety of characteristics from each servicer. According to one of the banking agencies, 9 of the servicers included in the file review had completed

[48]OCC led reviews of eight servicers, the Federal Reserve led two reviews, and OTS led the remaining four reviews; FDIC participated in the reviews in a backup role.

about 608,000 foreclosures in 2010.[49] The foreclosure files selected for review included ongoing and completed foreclosures, foreclosures conducted in both judicial and nonjudicial states, and a judgmental sample of files based on the findings of initial file reviews and consumer complaints. The on-site reviews were conducted largely in November 2010.

The reviews uncovered similar weaknesses in many of the mortgage servicers' foreclosure practices, although one regulator noted that each weakness was not evident at every servicer, nor was every deficiency uncovered in each loan file. Generally, the examinations revealed severe deficiencies in three primary areas:

- First, examiners identified shortcomings in the preparation of foreclosure documents. For example, according to agency officials, affidavits used in foreclosures frequently were signed by persons who did not satisfy personal knowledge requirements and were not properly notarized, which represented practices not conducted in accordance with state laws.

- Second, regulators found that most servicers did not have adequate policies, staffing, or oversight of their internal foreclosure processes. Regulators' reviews revealed that most servicers lacked sufficient policies to guide personnel engaged in foreclosure activities, including policies that outlined how affidavit documents should be legally prepared and notarized. Additionally, examiners found that most servicers did not have effective quality controls or internal review processes in place to detect deficiencies in foreclosure procedures. Regulatory staff reported that servicers did not generally review document execution processes or verify compliance with regulations and state and local laws during internal audits of foreclosure processes. Further, the regulators' reviews also revealed that most servicers did not maintain sufficient staffing levels to process the increasing volume of foreclosures, nor were staff adequately trained to perform this work in compliance with relevant laws and regulations. For example, regulators found that one servicer that had previously understaffed this function and had not provided adequate training increased its document-signing staff from 5 to 80 and revised its training to include guidance for judicial foreclosures to address deficiencies in foreclosure processing.

[49]See also Office of the Comptroller of the Currency and Office of Thrift Supervision, *OCC and OTS Mortgage Metrics Report*, *Disclosure of National Bank and Federal Thrift Mortgage Loan Data*, *Fourth Quarter 2010* (Washington, D.C.: March 2011).

- Third, regulators found that all the servicers had not sufficiently overseen the activities of third-party service providers, particularly in oversight of foreclosure attorneys, who were performing foreclosure activities on behalf of these servicers. Regulatory staff said that their reviews indicated that servicers had relied on attorneys to execute foreclosures in compliance with applicable laws, but had failed to conduct due diligence assessments of these attorneys' foreclosure practices. Many servicers had also failed to adequately supervise other firms that also conducted foreclosure activities on behalf of servicers, such as firms that track loan ownership or process foreclosure-related documents.

As a part of the reviews of foreclosure documentation problems, banking regulators also conducted on-site reviews of two bank service providers that were involved with processing or maintaining foreclosure-related documents and found similar weaknesses. In conjunction with staff from other regulatory agencies, OCC staff led an examination of MERSCORP and its wholly owned subsidiary, Mortgage Electronic Registration System (MERS), an electronic registry established by the mortgage finance industry that tracks mortgage ownership and transfers of servicing rights, and Federal Reserve staff led a similar on-site review of foreclosure-related activities at Lender Processing Services (LPS), which provides various data and document processing services to mortgage lenders and servicers.[50] The regulators identified some weaknesses in governance and oversight at both firms and found that internal controls were insufficient to identify deficiencies. To address these issues, the agencies are taking formal enforcement actions against MERS and LPS.[51]

[50]MERS was created in 1995 to streamline the mortgage process and to reduce costs as lenders can buy and sell loans without having to record and pay a fee for each assignment. According to its Web site, MERS serves as the nominal mortgagee of record. LPS, through two subsidiaries, provided document execution activities related to foreclosures. According to regulators, those subsidiaries discontinued their document execution and signing activities in early 2010.

[51]These actions were taken under the agencies' authority in 7(d) of the Bank Service Company Act, 12 U.S.C. § 1867(d), and section 8(b) of the Federal Deposit Insurance Act, 12 U.S.C. § 1818(b).

Bank Examiners Found That Borrowers in Files Reviewed Were Delinquent and Servicers Generally Had Necessary Documents to Foreclose

While the bank regulators' examinations of the 14 servicers revealed material weaknesses in these entities' overall foreclosure management processes, examiners generally did not find in the files they reviewed cases in which the borrowers were not seriously delinquent on the payments on their loans or that the servicers lacked the documents necessary to demonstrate their authority to foreclose. The reviews did not include an analysis of the payment history of each loan prior to foreclosure or potential mortgage-servicing issues outside of the foreclosure process.[52] For example, examiners focused their reviews on foreclosure procedures and documentation preparation and did not examine whether servicers had followed other requirements, such as FHA requirements for assessing the borrower for a loan modification or other loss mitigation alternatives, before initiating foreclosure. Nonetheless, regulatory staff told us that examiners or internal servicer reviews of foreclosure loan files had identified a limited number of cases in which foreclosures should not have proceeded—even though the borrower was seriously delinquent—and servicers' internal controls over, for example, procedures for staff knowledge of the case, could have made a difference.[53] For example, one supervisory letter noted that one servicer's internal review had identified instances of foreclosures that proceeded despite the borrower having received a loan modification, which should have halted the foreclosure process. A Federal Reserve official told us that while its examiners uncovered only one case in its file review where foreclosure was initiated against a borrower in a loan modification status, the examinations raised concerns about the level of communication between servicers' foreclosure and loan modification staff. In addition, regulatory staff told us that some servicers reported instances where foreclosures proceeded against military service members on active duty in violation of SCRA.[54] According to regulatory staff, violations of SCRA were not reported by all servicers. According to our discussions with regulatory staff, 2 servicers of the 14 included in the regulators' review preliminarily identified almost 50 instances of foreclosures proceeding against military service members on active duty in violation of SCRA. They noted that some of these cases may have been prevented had servicers had better

[52]However, Federal Reserve staff said that examiners checked for evidence that servicers were in contact with borrowers and had considered alternative loss mitigation efforts, including loan modifications.

[53]Regulators noted that they did not review a sufficient number of foreclosure files to reliably estimate the total number of foreclosures that should not have proceeded.

[54]50 App. U.S.C. §§ 501–597b.

internal controls, such as procedures to ensure that staff reviewing files took steps to obtain information to verify active duty status and borrower eligibility for SCRA protection prior to taking foreclosure action.

From the sample loan reviews of the 14 servicers, the bank regulatory officials said that examiners generally did not identify any concerns related to transfers of loan documents that would impede the servicer's ability to initiate foreclosure. On the basis of their reviews of more than 2,800 files, examiners determined that servicers generally were able to effectively demonstrate ownership of promissory notes and were generally able to locate original notes and mortgage documents that are required to be in the possession of the foreclosing party under most state laws. However, bank regulatory officials told us that examiners did not always verify, as part of the loan file review process, whether documentation included a record of all previous mortgage transfers from loan origination to foreclosure initiation, as may be required by some state laws or contracts.[55] In addition, with some exceptions, examiners found that notes appeared properly endorsed and mortgages appeared properly assigned. In a few instances, examiners uncovered notes that were not properly endorsed, which could subject the servicer to challenges on its authority or standing to foreclose. Additionally, while each of the regulators stated that servicers could generally produce requested documentation, servicers at times had required some time to find necessary documents. In part, these difficulties in locating necessary documents quickly was likely exacerbated by the examiners' finding that many servicers did not maintain formal foreclosure files, but relied on third parties such as foreclosure attorneys to maintain documents, including judicial affidavits and promissory notes, on behalf of the servicer.

[55]Potential problems arising from loan transfer practices are discussed later in this report.

Future Oversight Plans of Regulators and the Degree to Which Potential National Servicing Standards Would Address Documentation Issues Are Yet Unclear

On the basis of their findings from the coordinated review, regulators are taking formal enforcement actions against each of the 14 servicers, but the extent of their future oversight of servicing activities has yet to be determined.[56] Regulators recently issued formal enforcement orders to these servicers, and these servicers are required to take corrective actions to address identified deficiencies and weaknesses.[57] According to bank regulatory staff and these enforcement orders, each of the 14 servicers is required to enhance its compliance program with respect to oversight of foreclosure processes and to ensure that mortgage servicing and foreclosure practices comply with applicable laws and regulations. In addition, enforcement orders require servicers to align staffing levels with servicing volume and to enhance training to ensure that personnel involved in processing foreclosures are aware of compliance obligations. Regulators' enforcement actions also require servicers to reassess and strengthen their vendor management processes to improve supervision over third-party service providers, including external law firms and MERS. Because examiners reviewed a relatively small number of foreclosure files, enforcement orders require each servicer to retain an independent firm to conduct a comprehensive review of past foreclosure actions from January 1, 2009 to December 31, 2010 to identify borrowers who were financially harmed by servicer deficiencies identified in the independent review, and to remediate those borrowers, as appropriate.[58] Further, the servicers are required to retain an independent firm to assess the compliance, legal, and reputational risks in their servicing operations, in particular the risks of deficiencies in foreclosure activities and loss mitigation. According to the regulators, some servicers have already begun to implement new foreclosure policies and procedures, including strengthening internal controls, increasing the number of staff, and enhancing training. For example, OTS found that one servicer had revised its affidavit processing and notarization procedure to come into compliance with state law by requiring signing officers to review supporting documentation, including

[56]These actions were taken under the agencies' authority in section 8(b) of the Federal Deposit Insurance Act, 12 U.S.C. § 1818(b).

[57]In addition to the actions against the servicers, the Federal Reserve and OTS have issued formal enforcement actions against 12 parent holding companies to require that they enhance on a consolidated basis their oversight of mortgage servicing activities, including compliance, risk management, and audit. Those actions also were taken under authority of section 8(b) of the Federal Deposit Insurance Act, 12 U.S.C. § 1818(b).

[58]Federal Reserve System, Office of the Comptroller of the Currency, and Office of Thrift Supervision, *Interagency Review of Foreclosure Policies and Practices*, (Washington, D.C.: April 2011).

documents used by attorneys in preparing affidavits, before signing affidavits and to require an authorized notary to witness the affiant's signature.

Although regulators have taken enforcement actions against servicers, they have not identified specifically how they will change the extent and frequency of future oversight of servicers going forward. According to the regulators' report on their coordinated review, regulators will take steps to help ensure that corrective actions taken by servicers and as required by the enforcement orders are fully implemented.[59] Staff at one of these agencies told us that they will substantially revise their supervisory strategy to include plans to assess servicer compliance with any enforcement orders and to evaluate servicers' implementation of corrective action plans. However, although regulatory staff recognized that additional oversight would likely be necessary for servicers' foreclosure activities in the future, as of April 2011 they had not determined what changes would be made to guidance or to the extent and frequency of examinations. For example, staff from the Federal Reserve acknowledged that the recent Dodd-Frank Act directs them to conduct additional oversight of bank holding companies and their nonbank subsidiaries, including those that perform mortgage servicing.[60] These staff said that they were developing a standardized work plan for examinations of all mortgage servicers supervised by the Federal Reserve, but they said that they had not finalized plans for the extent and timing for conducting such ongoing oversight.

Moreover, regulators with whom we spoke expressed uncertainty about how their organizations will interact with and share responsibility with the new CFPB regarding oversight of mortgage servicing activities. This agency was established in the Dodd-Frank Act and, once it assumes its full authority, will have direct authority to conduct examinations of and enforce consumer protection regulations for the largest depository institutions and their affiliates as well as nonbank institutions, with regard to servicing activities. This includes authority to enforce various consumer protection statutes currently overseen by other regulators—including authority to enforce TILA and RESPA. Although bank regulatory staff told

[59]As OTS will dissolve in July 2011, OTS officials told us that the agency will not effect long-term change as a stand-alone institution but will continue to work with its sister agencies to implement enforcement actions.

[60]See, for example, 12 U.S.C. § 5365.

us that they will continue to look at banks' mortgage servicing activities to assess the potential impact on such institutions' safety and soundness, they have not yet determined how this oversight will be shared with CFPB, which is to focus on ensuring that consumers are adequately protected. According to regulatory staff and the staff standing up CFPB, the agencies intend to coordinate oversight of mortgage servicing activities as CFPB assumes its authorities in the coming months. In addition, the staff standing up CFPB said that supervision of mortgage servicing will be a priority for the new agency, but as of April 2011 oversight plans had not been finalized. As previously discussed, fragmentation among the various entities responsible for overseeing mortgage servicers heightens the importance of coordination on plans for future oversight. In recent testimony, the Acting Comptroller of the Currency expressed concern about the lack of clarity regarding CFPB's regulatory role and stated the need for CFPB to clearly define its role and responsibilities so that regulatory agencies can practice appropriate oversight.[61] Some of the elements we identified as important for ensuring effective regulation in our 2009 report on reforming the U.S. financial regulatory system highlight the importance of regulatory coordination as part of the oversight of foreclosure practices. In that report, we noted that effective oversight requires regulators to develop appropriately comprehensive regulations and clearly defined goals so that they can effectively conduct activities to implement their missions. This report also noted that when regulators have different goals, such as the banking regulators with their focus on institutions' safety and soundness and CFPB's focus on consumer protection, having mechanisms for regulators to coordinate oversight is important to prevent gaps and inconsistencies in oversight.[62] CFPB staff told us they are aware of these concerns and said that they would continue to communicate with other regulators on servicing issues and general coordination of examinations.

As part of addressing the problems associated with mortgage servicing, including those relating to customer service, loan modifications, and other issues, various market participants have begun calling for the creation of national servicing standards, but the extent to which any final standards would address foreclosure documentation and processing is unclear. For

[61]Testimony of John Walsh, Acting Comptroller of the Currency, Office of the Comptroller of the Currency, before the Committee on Banking, Housing, and Urban Affairs, United States Senate, Washington, D.C.: February 17, 2011.

[62]GAO-09-216.

example, a December 2010 letter from a group of academics, industry association representatives, and others to the financial regulators noted that such standards are needed to improve the certainty associated with mortgage securitizations and ensure appropriate servicing for all loans, including those in MBS issuances and those held either in portfolios of the originating institution or by other owners. This letter outlined various areas that such standards could address, including requirements that servicers submit written attestations that foreclosure processes comply with applicable laws and that loan modifications be pursued whenever economically feasible.

Similarly, some regulators have made statements in support of such standards. For example, OCC has developed draft standards, and in his February 2011 testimony, the Acting Comptroller of the Currency expressed support for such standards, noting that they should provide the same safeguards for all consumers and should apply uniformly to all servicers. He also stated that standards should require that servicers have strong foreclosure governance processes that ensure compliance with all legal standards and documentation requirements and establish effective oversight of third-party vendors. In addition, a member of the Board of Governors of the Federal Reserve System testified that consideration of national standards for mortgage servicers was warranted.[63] Further, in a recent speech on the urgent need for mortgage reform, FDIC's Chairman urged servicers and federal and state regulators to act now to create national servicing standards.[64] Most of the regulators with whom we spoke indicated that such national servicing standards could be beneficial. For example, staff from one of the regulators told us that national standards would create clear expectations for all servicers, including nonbank entities that are not overseen by the banking regulators, and would help establish consistency across the servicing industry. The regulators' report on the coordinated review also states that such standards would help promote accountability and appropriateness in dealing with consumers

[63]Statement by Daniel K. Tarullo, Member, Board of Governors of the Federal Reserve System, before the Committee on Banking, Housing and Urban Affairs, United States Senate, Washington, D.C.: December 1, 2010.

[64]Speech delivered by FDIC Chairman Sheila Bair at Mortgage Bankers Association's Summit on Residential Mortgage Servicing for the 21st Century, January 19, 2011. For example, Chairman Bair has suggested that servicers provide borrowers a single point of contact to assist them throughout the loss mitigation and foreclosure process who is authorized to put a hold on any foreclosure proceeding while loss mitigation efforts remain ongoing.

and strengthen the housing finance market. In response to our draft report, multiple agencies commented that an interagency effort to develop national servicing standards is currently under way. While the banking agencies, HUD, Treasury, and FHFA are collaborating to create standards that would address problems in mortgage servicing, including deficiencies in foreclosure processing, as of April 2011 it was still uncertain what any final standards would address and how they would be implemented. According to CFPB staff, whatever the outcome of the interagency negotiations, CFPB will have substantial rulemaking authority over servicing and under the Dodd-Frank Act is required to issue certain rules on servicing by January 2013. In the past, we have reported that opportunities for problems involving financial institutions and consumers increase when activities are not subject to consistent oversight and regulatory expectations.[65] As a result, including specific expectations regarding foreclosure practices in any standards that are developed could help ensure more uniform practices and oversight in this area.

In response to recently disclosed foreclosure documentation problems, federal housing agencies and entities also conducted reviews of servicer practices. For example, FHA recently returned to the six largest servicers of FHA-insured mortgage loans, following earlier examinations on servicers' loss mitigation practices, to review servicer foreclosure processes.[66] According to agency officials, FHA issued questionnaires to targeted servicers—all of which were also being reviewed as part of the bank regulators' reviews—to obtain information on their foreclosure practices, and the agency performed on-site examinations that included review of individual loan files. Agency officials also reported that examiners reviewed servicing transfer documentation to ensure that assignments were properly recorded and exhibited no break in chain of title. FHA officials stated that they are in the process of consolidating and reviewing exam findings and plan to issue an executive summary report. While FHA plans to issue letters to servicers requesting corrective action plans, agency officials noted that many of the servicers had already implemented corrective measures to remedy deficiencies in foreclosure processes. Internally, FHA is also considering changes in servicing guidance to better ensure the soundness and timeliness of the foreclosure process.

[65]GAO-09-216.

[66]FHA is reviewing foreclosure processes as part of a broader examination that includes evaluation of payment processing and document handling.

FHFA is also responding to revelations of foreclosure documentation problems. In October 2010, FHFA issued a statement of support for the GSEs' efforts in addressing documentation concerns after both Fannie Mae and Freddie Mac issued letters to their respective servicers reminding them of their legal and contractual obligations and requiring that they assess their foreclosure processes and correct any deficiencies. Subsequently, FHFA issued a four-point policy framework to the GSEs and servicers for assessing and remedying foreclosure process deficiencies that asked them to

- verify that their foreclosure processes were working properly,
- remediate any deficiencies identified in their foreclosure processing,
- refer suspicions of fraudulent activity to appropriate regulatory officials, and
- avoid delaying the processing of foreclosures in the absence of identified problems.

According to GSE officials, in response, some servicers reported problems with their foreclosure procedures and are taking steps to remediate deficiencies.

In addition, FHFA and the GSEs are evaluating future measures to improve mortgage servicing. As announced by FHFA in a recent press release, FHFA directed Fannie Mae and Freddie Mac to work on a joint initiative, in coordination with FHFA and HUD, to consider alternatives for future mortgage servicing structures and servicing compensation for single family loans; however, any changes are not expected to be implemented before 2012.[67] Separately, FHFA also directed the GSEs to work together to align their guidelines to servicers to establish, among other things, consistent timelines and requirements for communications with

[67]Federal Housing Finance Agency, *FHFA Announces Joint Initiative to Consider Alternatives for a New Mortgage Servicing Compensation Structure*, (Washington, D.C.: January 18, 2011).

borrowers.[68] Moreover, both Fannie Mae and Freddie Mac have already begun to enhance oversight of their attorney networks. According to an official from one of the GSEs, changes in oversight include increased staffing levels in the GSEs' legal and business units and on-site staff at servicer locations in one state.

Other federal agencies are also taking steps to address foreclosure documentation issues.

- In October 2010, Treasury issued a reminder letter to Making Home Affordable (MHA) servicers reiterating servicer obligations to comply with applicable federal and state laws.[69] As a consequence of reported irregularities in the foreclosure process, Treasury instructed its compliance agent, MHA-Compliance, to review internal policies and procedures governing preforeclosure activities at the 10 largest servicers.[70] While Treasury's efforts are primarily focused on loss mitigation efforts and compliance with HAMP requirements, Treasury is also working to improve servicer processes and to help borrowers.

- SEC also responded in October 2010 by reaching out to certain companies about the adequacy of the disclosures that publicly traded companies that perform mortgage servicing, which includes many of the largest servicers, have made to their shareholders about the potential financial risks to their companies that are associated with mortgage foreclosure documentation issues. SEC issued a letter to public companies engaged in mortgage servicing activities reminding them of their disclosure obligations and identifying items to consider in disclosure statements, including potential material impacts on operations because of liabilities resulting from documentation problems. SEC officials noted that reporting companies did include disclosures regarding foreclosure documentation issues in

[68]According to a GSE representative, the GSEs are required to establish appropriate incentives to encourage and support servicer contact with borrowers in the early stages of delinquency, consistent timelines and requirements for communications with borrowers, incentive structures for early engagement, and updated foreclosure process timelines. The representative also noted that the work will include consideration of appropriate penalties to encourage efficient resolution and liquidation of properties in cases where foreclosure is necessary.

[69]MHA is a federal program overseen by Treasury that provides opportunities for struggling homeowners to modify or refinance their mortgages or otherwise avoid foreclosure through a short sale or deed-in-lieu of foreclosure.

[70]MHA-Compliance is a separate division of Freddie Mac contracted to perform compliance activities and to ensure that servicers satisfy obligations under MHA requirements.

recent filings. For example, 2 of the largest servicers disclosed that they had instituted a moratorium on foreclosures because of alleged irregularities in foreclosure documentation processing.

- Justice is also taking actions to address foreclosure documentation issues. Justice staff could not comment on investigations, but told us that they are working with investigatory and regulatory partners to look into the servicers' foreclosure practices. While they said that federal civil and criminal statutes could apply in complaints or charges in areas of mortgage fraud, including mail and wire fraud, false statements, Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) civil actions, and fraud against the government, if the mortgage loans involved were federally insured or guaranteed, Justice staff told us that the state attorneys general and other regulators also have enforcement authority to address these issues.

As multiple investigations into mortgage servicer activities are under way, numerous federal agencies and state officials recently formed a group to help coordinate these efforts. Participants include the federal banking regulators as well as agencies such as Justice, Treasury, FHFA, HUD, SEC, and FTC, with input from CFPB. Additionally, some of these agencies are coordinating with state officials, including representatives from the 50-state Attorney General group formed to investigate robosigning allegations and other deficient servicer practices. Agencies participate in weekly check-ins, and meetings are conducted as needed. The goal of this group is to provide a comprehensive and coordinated process for conducting reviews of mortgage servicing activities, developing solutions, and enforcing accountability. The group enables agencies to share information across agencies and to minimize duplication in investigative efforts and to coordinate remedial actions.

Multiple federal agencies with the state attorneys general are considering resolution options with the largest servicers. According to media reports, a concept paper aimed to facilitate discussion and input from the servicers was provided to these servicers. Among the discussion topics in the paper were potential steps to improve foreclosure processes and comply with affidavit preparation standards and note transfer requirements as enumerated in the concept paper. However, some lawmakers have expressed concerns about some of the topics in this paper. As of March 2011, no resolution has been reached.

Documentation Problems Will Likely Result in Delays in the Foreclosure Process, but the Impact on Financial Institutions and Others Is Less Clear

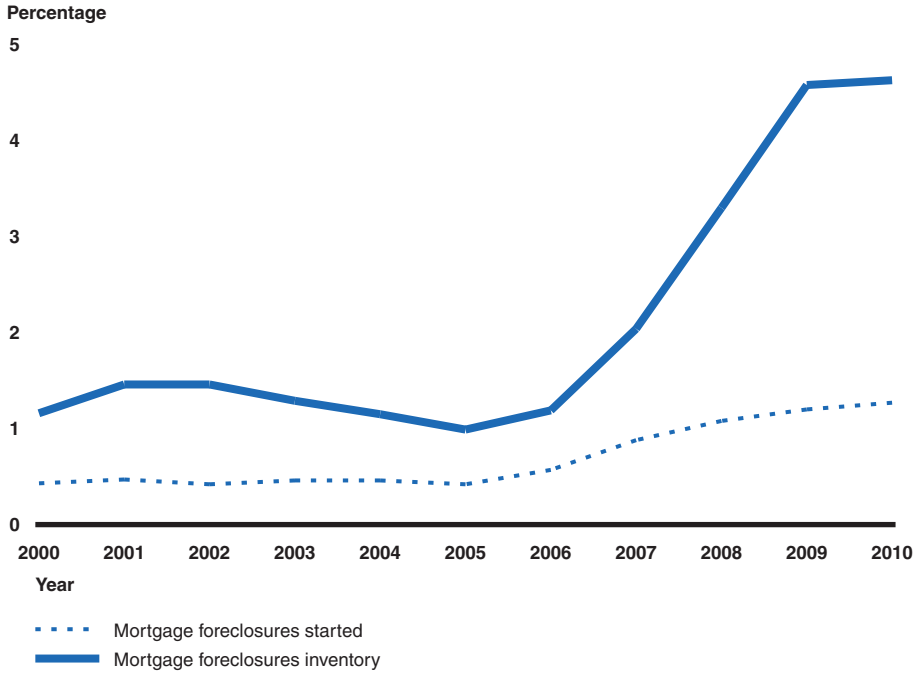
Improper Documentation Practices Will Likely Add Delays in the Foreclosure Process, but as Problems Are Corrected, Foreclosures Will Proceed

To date, a key impact of the problems relating to affidavits and notarization of mortgage foreclosure documents appears to be delays in the rate at which foreclosures are proceeding, but many foreclosures are expected to be completed eventually. One reason that the rate at which foreclosures are being completed has slowed is that servicers have been performing internal reviews of their procedures and, in some cases, have implemented moratoriums on foreclosures in both judicial and nonjudicial states. In addition, several states have called for moratoriums on foreclosures or otherwise taken actions that could stall the foreclosure process in these states. As shown in figure 4, the percentage of loans in some stage of foreclosure (foreclosure inventory) increased to a year-end historical high of 4.63 percent in December 2010. According to legal academics, financial industry representatives, and government regulators, servicers' missteps in foreclosure documentation are, in large part, responsible for the delays in foreclosure completions. In addition, a recent report issued by OCC and OTS notes that the number of foreclosures completed during the fourth quarter of 2010 decreased 49.1 percent from the previous quarter largely as a result of the foreclosure moratoriums implemented by the largest servicers.[71] Further, we have reported that data on new foreclosure filings and delinquencies suggest that servicers are not

[71] *OCC and OTS Mortgage Metrics Report, Disclosure of National Bank and Federal Thrift Mortgage Loan Data, Fourth Quarter 2010* (Washington, D.C.: March 2011). This report provides performance data through December 31, 2010, on first-lien residential mortgages serviced by selected national banks and federally regulated thrifts comprising 63 percent of all mortgages outstanding in the United States.

initiating foreclosures on many loans normally subject to such actions.[72] New foreclosure starts declined from 1.42 percent in September 2009 to 1.27 percent in December 2010.

Figure 4: Year-End Foreclosure Starts and Foreclosure Inventory, 2000 to 2010



Source: GAO analysis of Mortgage Bankers Association National Delinquency Survey data.

Note: The Mortgage Bankers Association's quarterly National Delinquency Survey covers about 80 percent of the mortgage market and presents default and foreclosure rates (i.e., the number of loans in default or foreclosure divided by the number of loans being serviced).

Despite these initial delays, some regulatory officials as well as legal academics and industry officials we interviewed indicated that foreclosure documentation issues are correctable. Once servicers have revised their processes and corrected documentation errors, most delayed foreclosures

[72]GAO, *Troubled Asset Relief Program: Treasury's Framework for Deciding to Extend TARP Was Sufficient, but Could Be Strengthened for Future Decisions*, GAO-10-531 (Washington, D.C.: June 30, 2010). While the foreclosure start rate grew 36 percent from the last quarter of 2007 to the last quarter of 2009, the rate for delinquencies of 90 days or more grew by 222 percent over the same period. From the fourth quarter of 2009 to the first quarter of 2010, delinquencies have fallen somewhat, while the foreclosure starts have remained fairly constant.

in judicial states will likely proceed. For example, in cases where affidavits were signed by a person without the required personal knowledge of the case or were not signed in the presence of a notary, legal representatives and industry observers said that courts generally may allow the foreclosures to proceed once the affidavits are refiled with the appropriate signatures and notarization. In addition, some legal representatives told us that because almost all foreclosures involved borrowers who were seriously delinquent on their loans, most would likely proceed once the paperwork is corrected. Revising and refiling the required documentation will take time, however, as servicers may potentially have thousands of cases to review. For example, Fannie Mae representatives said that one of its servicers plans to file over 100,000 revised affidavits and another plans to file 50,000 revised affidavits, even though not all of the documents were necessarily defective.

Increased scrutiny of documents by servicers and courts may reduce inaccuracies, but the increased demand on judicial resources could contribute to further delays. Some legal academics and attorneys we spoke with told us that state courts previously assumed the accuracy of documents provided by servicers as part of foreclosure cases, but some courts are increasingly skeptical of foreclosure documentation and are now looking more closely at documents submitted in foreclosure cases. In certain circumstances, judges are insisting that servicers more rigorously adhere to foreclosure strictures, such as requirements that the original note be produced. Additionally, some courts have been imposing their own new requirements to help ensure the accuracy of filings; for example, in New York state and Cuyahoga County, Ohio, attorneys are required to sign statements affirming that the facts in affidavits are accurate. Although these requirements may be intended to help ensure the accuracy of information submitted to the court, some market observers have argued that these additional procedures are contributing to the delay in processing foreclosures. However, some banking industry representatives, attorneys, and government officials that we interviewed noted that cases with documentation problems should diminish with improved attention to accuracy on the part of servicers and courts.

In nonjudicial states where production of foreclosure documentation in court generally may not be required, information on the prevalence and impact of foreclosure documentation problems is unavailable because documents, such as affidavits, that have been called into question in judicial states may not typically be required to complete foreclosures. Without judicial review of documentation supporting foreclosures or certification that foreclosures are justified, some academics and others

indicated that errors may go unchecked unless borrowers contest foreclosures, an action that would prompt a judicial review. Further, those we spoke with noted that, unlike in judicial states, where a judge must approve foreclosures, in nonjudicial states, the borrowers must contest foreclosures, which can be expensive and difficult.

Delays in the Foreclosure Process May Have Both Positive and Negative Effects on Homeowners, Communities, and the Mortgage Market

Legal academics and representatives of the mortgage industry reported mixed views on the implications of delays in the foreclosure process for borrowers. Borrowers whose mortgage loans are in default may benefit from the additional delays in the foreclosure process if the additional time allows them to obtain income that allows them to bring mortgage payments current or cure the default, or to work out other payment solutions, such as loan modifications. According to representatives of housing counseling and legal aid groups we spoke with, mortgage default and foreclosures are often caused by borrowers' inability to make mortgage payments because of unemployment. An extended period before a foreclosure is completed may allow borrowers to obtain employment and to begin making mortgage payments again. Additionally, as foreclosures stall, lenders and borrowers may have additional time and opportunity to work out loan modifications. However, according to legal services attorneys we interviewed, these delays also leave borrowers unsure about how long they may be able to remain in their homes. Even if a court dismisses a foreclosure based on faulty documentation, the borrower may still be subject to a new foreclosure proceeding if the bank assembles the necessary paperwork and resubmits the case. In addition, mortgage industry participants noted that fees such as taxes and insurance may continue to accrue on borrowers' loans during the delay, making it more difficult for them to catch up on payments. Even if a foreclosure action can be completed properly, weaknesses in servicers' foreclosure processes could otherwise adversely impact borrowers. For example, according to the banking regulators' report on their coordinated review, these weaknesses could result in inaccurate fees and charges assessed against a borrower. In addition, borrowers could find their loss mitigation options curtailed because of dual-track processes that result in foreclosure even when a borrower has been approved for a loan modification.

Delayed foreclosures resulting from documentation problems could have negative impacts on communities as more properties may become vacant. When borrowers are unable to make mortgage payments and foreclosure

appears imminent, they sometimes vacate properties to secure new housing. Our previous work has demonstrated that properties are more likely to become vacant once foreclosure is initiated.[73] As such, properties may become vacant before foreclosure is completed. We have reported that neighborhood and community problems stemming from vacancy include heightened crime, blight, and declining property values.[74] Additionally, such problems result in increased costs to local governments in policing and securing vacant homes. Delays in the foreclosure process, though temporary, could exacerbate the problems communities are facing from vacancy because of foreclosure.

Various market observers and regulators also indicated that the delays caused by the foreclosure documentation problems could negatively affect the recovery of U.S. housing prices in the long term. According to one rating agency's analysis, the recovery of the housing market could be delayed as servicers work through the backlog of homes in foreclosure. In addition, according to the rating agency's analysis, the foreclosure documentation problems and resulting delays in foreclosures being completed were likely to reduce the number of home sales at the end of 2010, but not necessarily home prices during that period because fewer foreclosed homes—which typically sell for less than other homes—would be on the market. Once the issues are resolved and foreclosures are completed, however, the analysis projected that the backlog of foreclosed homes would delay the recovery of the housing market. The regulators' report on their coordinated review also notes that the deficiencies and weaknesses leading to delays in foreclosure processing have had an adverse impact on the functioning of the mortgage market. Regulators reported that such delays could be an impediment for communities working to stabilize local neighborhoods and housing markets. The regulators' report on their coordinated review states that these delays could lead to extended periods of depressed home prices.

[73]GAO-11-93.

[74]GAO-11-93.

Impacts on Servicers, Trusts, and Investors because of Loan Transfer Documentation Problems Are Unclear

On the basis of servicers' disclosures of problems with foreclosure documentation and recent court decisions, some academics and others have argued that the way that mortgage loans were transferred in connection with some MBS issuances could affect servicers' ability to complete foreclosures and create financial liability for other entities, such as those involved in creating securities. As previously discussed, when a loan is originated, a lender can choose to hold the loan as an income-producing asset in its own portfolio or it can sell the loan to another institution that intends to pool it with other loans and create an MBS that can be sold to investors. In a typical MBS issuance, the documents that represent the loan—the promissory note and the mortgage deed that secures the property as the collateral for the loan—are required to be transferred to an entity known as a document custodian. The document custodian holds these loan documents on behalf of the trustee for the MBS trust, which is the legal owner of the loans in the pool. The trustee acts on behalf of the trust and receives the payments from the pooled loans underlying the MBS issuance and distributes them to the securities investors. Between loan origination and the time when a mortgage is placed in an MBS trust, both the note and mortgage may be sold and transferred several times between various entities that facilitate the creation of loan pools for MBS issuances before being physically delivered to the document custodian designated by the MBS trustee.

Some cases decided in 2007 and 2008 found that servicers were not able to present sufficient evidence that they had the right to foreclose on properties owned by MBS trusts. For example, courts dismissed complaints to foreclose on the mortgages of 46 properties in two federal court cases in Ohio because the servicer (on behalf of the trust) failed to submit to the court a copy of the assignment of the note and mortgage evidencing its status (on behalf of the trust) as holder of the note for these loans.[75] According to real estate attorneys who researched these issues, these cases led real estate lawyers and courts to reexamine the paperwork necessary to foreclose. Simultaneously, at least one legal academic began

[75] *In re Foreclosure Cases*, 2007 WL 3232430 (N.D. Ohio 2007) (dismissed without prejudice for failing to file executed assignment demonstrating that the plaintiff seeking foreclosure was the holder and owner of the note and mortgage as of the date the complaint was filed), and *In re Foreclosure Actions*, 2007 WL 4034554 (N.D. Ohio 2007) (case was dismissed without prejudice for failing to produce documentation demonstrating that the plaintiff was the owner and holder of the note and mortgage). See also *In re Foreclosure Cases*, 521 F. Supp. 2d 650 (S.D. Ohio 2007); *DLJ Mtge. Capital, Inc. v. Parsons*, 2008 WL 697400 (Ohio Ct. App. 2008) (reversing summary judgment for lack of evidence that the party seeking foreclosure was the owner of the note and mortgage at the time of summary judgment).

researching discrepancies in servicers' preparation and management of documentation as these issues arose in and related to bankruptcy proceedings involving foreclosure matters.[76] Further, investors have made claims about servicer irregularities regarding securitized loans.[77] As reports of other discrepancies in the preparation and notarization of foreclosure documentation surfaced in September 2010, questions about the documentation related to mortgage transfers similarly came to national attention.

According to GSE officials, the potential problems related to transfers of loans as part of MBS issuances do not appear to affect the purchases and subsequent securitization of loans by housing GSEs. As shown in figure 5, most of the MBS issuances in 2008 were by the GSEs.[78] According to staff from Fannie Mae and Freddie Mac, the GSEs' policies, procedures, and processes used to obtain the underlying supporting documents for the loans that these two GSEs purchase provide substantial assurance that they will have adequate proof of ownership of the loans and could provide required documents as needed for foreclosing on their loans. Representatives of Fannie Mae and Freddie Mac noted that they have strict note delivery requirements and oversight of document custodians. For example, Fannie Mae and Freddie Mac staff said that they require that notes be endorsed without designating a payee—as provided for in the Uniform Commercial Code (UCC) and known as endorsing in blank—so that when the GSEs purchase loans, take possession of the notes, and become the owner and holder, they can give temporary possession of the notes to their servicers, as necessary, so that the servicers can (1) be holders, (2) commence enforcement actions, and (3) readily provide a court with the note endorsed in blank as evidence of their status as holder if required. In addition, the GSEs stated that the document custodian is required to complete a prepurchase certification that it, among other

[76]See Katherine Porter, *Misbehavior and Mistake in Bankruptcy Mortgage Claims*, 87 Tex. L. Rev. 121 (2008).

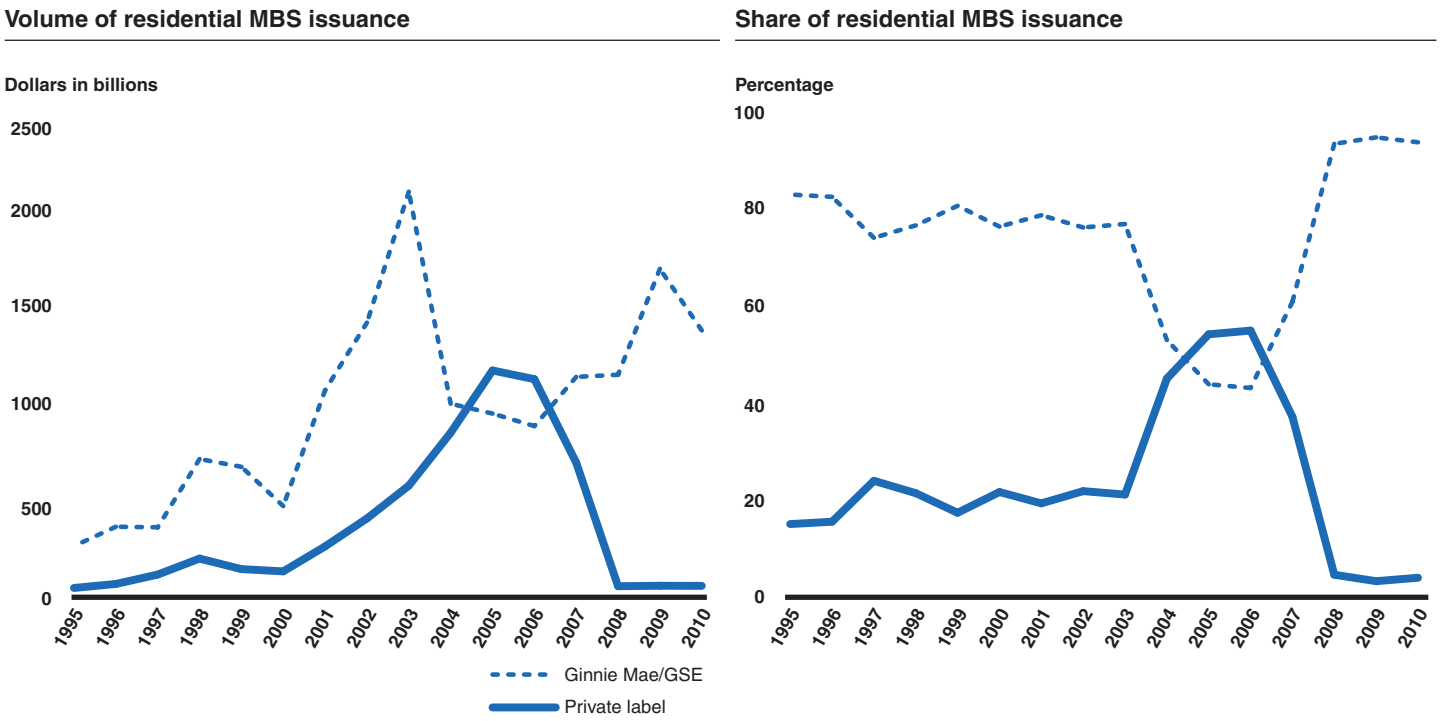
[77]See, for example, *Footbridge Limited Trust v. Countrywide Financial Corp.*, Case No. 1:10-cv-00367-PKC, 95-97 (S.D. N.Y. Jan. 15, 2010) (complaint filed).

[78]These data include Fannie Mae, Freddie Mac, and the Government National Mortgage Association (Ginnie Mae). Ginnie Mae is a wholly owned government corporation that guarantees the timely payment of principal and interest on securities issued by private institutions and backed by pools of federally insured or guaranteed mortgage loans. Securities guaranteed by Ginnie Mae finance the vast majority of loans backed by the Federal Housing Administration and Department of Veterans Affairs, among other federal agencies.

things, has taken physical possession of the notes. Further, the staff either review the adequacy of the documentation of any previous transfers at the time of the purchase or rely on servicers' statements that they own the loans when they sell them under penalty of having to repurchase the loans if the ownership is not clear. The GSEs also require that either the servicer or MERS be listed as the mortgagee of record in local public land recording offices.[79] Finally, the GSEs require that the notes and certain other documentation be held by approved document custodians, and Fannie Mae and Freddie Mac occasionally examine these custodians. Fannie Mae and Freddie Mac staff indicated that as a result of their documentation requirements, the potential problems related to transfers of loans have not been, nor are likely to be, a concern regarding mortgage-backed securities issued by Fannie Mae and Freddie Mac.

[79]As will be discussed later, the use of MERS as a foreclosing entity has been challenged in some court cases. According to FHFA, both Fannie Mae and Freddie Mac have eliminated the option for servicers to foreclose in the name of MERS.

Figure 5: Volume and Share of Enterprises and Private Label MBS Issuances, 1995 to 2010



Source: GAO analysis of data from *Inside Mortgage Finance, 2010 and 2011 Mortgage Market Statistical Annual, Volume II.*

After other documentation problems and questions involving potential loan transfer problems surfaced, some legal academics began arguing that loans that were sold into pools and then securities issued primarily by non-GSE entities—known as private label MBS—may not have always been transferred properly. According to these academics, the contracts—known as pooling and servicing agreements—that govern loan transfers in private label securitization deals often called for the notes and mortgage deeds supporting the pooled loans to be transferred into the MBS trust by having each party in the securitization process endorse the note.[80] They argue that a servicer may not be able to prove its right to foreclose on a

[80]According to one academic, the following language is a common provision in Section 2.01 of many pooling and servicing agreements: "the original Mortgage Note bearing all intervening endorsements showing a complete chain of endorsement from the originator to the last endorsee, endorsed 'Pay to the order of _____, without recourse' and signed (which may be by facsimile signature) in the name of the last endorsee by an authorized officer."

property if the trust on whose behalf it is servicing the loan is not specifically named in the transfer documentation. In addition, one academic recently testified before Congress that a specific chain of transfers identifying the loan originator, securitization sponsor, depositor, and finally the MBS trust may be necessary to ensure that the loans placed in the trust will remain in the trust if one of the parties in the chain files for bankruptcy.[81] Further, these legal academics argue that in order to provide such protections in the event of bankruptcy, pooling and servicing agreements also generally require documentation to be physically delivered to the trustee.

According to some legal academics, if the transfer of the mortgages and notes into private label MBS trusts are found to be insufficient to prove that the trusts own the loans, then MBS investors, trusts, the servicers working on their behalf, and the institutions that originated these mortgage loans or created the MBS issuances could be subject to potentially serious consequences. For example, according to some academics, if loans were not properly transferred, then the trusts may not actually own the loans and they (and the servicers acting on their behalf) would not have the right to foreclose on the property of borrowers in default. Furthermore, if the MBS trusts did not properly obtain ownership of the loans underlying the securities in accordance with the terms of the pooling and servicing agreement, these academics argue that the tax-exempt structure of the MBS trust may be voided, and thus the trusts may owe taxes on the income to the trust. In addition, attorneys, a representative of investors, and other studies noted that if the investors in the MBS issuance may not have received what they were promised when they purchased the securities, they may press legal claims against the creators of the trusts or force them to reimburse the investors for some amount of improperly transferred loans. With almost $1.3 trillion of private label securities outstanding at the end of 2010, if these arguments are correct this liability could be significant.

However, other market participants have an opposing view and argue that mortgages were pooled into securities using standard industry practices that were sufficient to create legal ownership on behalf of MBS trusts. According to these market participants, the practices that were typically

[81]Statement by Adam J. Levitin, Associate Professor of Law, Georgetown University Law Center, before the Committee on Financial Services, Subcommittee on Insurance, Housing, and Community Opportunity, House of Representatives, Washington, D.C.: November 18, 2010.

used to transfer loans into MBS trusts comply with the Uniform Commercial Code, which generally has been adopted in every state. Among other things, provisions in the UCC govern the transfer of negotiable instruments, such as checks and mortgage promissory notes.[82] As a result, according to their argument, if mortgage notes being transferred into MBS pools were endorsed in blank, then this would be sufficient under the UCC, and thus the transfers of loans to the private label securities' trusts would be legally sufficient to establish the trusts' ownership. According to these market participants, these practices were the customary means by which loans were transferred as part of creating private label MBS.

Additional Court Decisions May Determine Ultimate Effect of MBS Loan Transfer Problems, and Regulators Have Not Assessed the Extent of This Risk

Although some courts may have addressed MBS loan transfer practices in certain contexts, the varying circumstances of these cases limit their use in determining whether such problems are widespread or what effects they may have on foreclosures or on market participants. For example, in a bankruptcy case recently decided in New Jersey, the judge concluded that the loan in question had not been properly endorsed and transfered to the trust of the particular private label MBS pool that had purchased the loan as required by both the UCC and the trust's own pooling and servicing agreement and disallowed the servicer's proof of claim against the borrower.[83] Banking industry analysts told us that this ruling should not lead to permanent dismissals of foreclosures. For example, analysts from one rating agency told us that based on their review of several securitizations—including the security that included the loan involved in the New Jersey case—these problems might not be widespread. Specifically, the rating agency determined that out of 9,233 loans in the security, only 180 had some discrepancies in the paperwork such as missing assignments of mortgage, notes, endorsements, deeds of trust, or powers of attorney.[84] In a different

[82]The residential mortgage notes in common usage typically are negotiable instruments, similar to a check. As a general matter, under the UCC, a negotiable mortgage note can be transferred from one party to another through an endorsement of the mortgage note and the transfer of possession of the note to the new party or an agent in its behalf. This process is similar to endorsing a check by signing the back and depositing it in a bank. An assignment of the related mortgage is also typically delivered to the transferee or its agent. Such assignments generally are in recordable form, but may not be required to be recorded in local land record offices.

[83]*Kemp v. Countrywide Home Loans, Inc.*, 440 B.R. 624 (Bankr. D. N.J. 2010).

[84]Moody's Investors Service, *Moody's Weekly Credit Outlook:* "Interviews Show Countrywide's Mortgage Processing Did Not Systematically Fail," (New York, NY: January 10, 2011).

case, the Supreme Judicial Court of Massachusetts found that the lower court did not err in concluding that the securitization documents submitted by the plaintiffs failed to demonstrate that they were the holders of the subject mortgages at the time of foreclosure.[85] The court also stated, regarding an argument that assignments in blank evidenced and confirmed the assignments, that it does not "regard an assignment of land in blank as giving legal title in land to the bearer of the assignment" (which was a statement of Massachusetts law and not necessarily the law in other jurisdictions). Some attorneys representing mortgage servicers pointed out that the court's opinion seems to suggest that had the servicers been able to show sufficient supporting documentation listing these particular loans and properties, this would have supported proof of ownership despite the failure to properly endorse the loans when originally transferred to the MBS trusts. According to one rating agency, this Massachusetts case will not significantly prevent foreclosures from going forward because it does not invalidate the fundamental principles of loan transfers during securitization; rather, this decision upholds that MBS trusts can prove mortgage ownership in more than one way. Another attorney we spoke with who works on MBS issuances further noted that it was uncertain whether this ruling would have a broad impact in states outside of Massachusetts.

The impact of these problems likely will remain uncertain until definitive, controlling court decisions are issued, establishing whether typical processes for transferring loans into private label MBS were legally effective or how such problems can be resolved. Adding to this uncertainty may be differing views on court decisions on the appropriateness of foreclosures being initiated in the name of MERS.[86] In the near term, industry observers noted that these cases could lead to increased litigation and servicing costs for servicers and more foreclosure delays. According to SEC filings and risk analyses and reporting by some servicers, some financial institutions have set aside funds or performed

[85] *U.S. Bank National Ass'n v. Ibanez*, 941 N.E. 2d 40 (Mass. 2011).

[86] In a recent testimony, a MERS official cited a number of cases where, according to MERS, courts found that MERS had the authority to initiate foreclosure proceedings. Statement by R. K. Arnold, President and CEO of MERSCORP, Inc., before the Committee on Banking, Housing and Urban Affairs, United States Senate, Washington, D.C.: November 16, 2010. However, academics and industry participants have cited cases that seem to come to different conclusions. On March 8, 2011, MERS proposed changes to its procedures that would require an execution of assignment of the mortgage from MERS to the servicer or to another party designated by the beneficial owner of such mortgage loan before initiating foreclosure proceedings.

estimations of the potential risk and liability from lawsuits. Several large servicers' annual SEC filings that we reviewed noted the possibility of increased litigation and other costs resulting from regulatory reviews of servicing activities, but servicers did not provide estimates of the potential amounts because of the uncertainty in the number and types of cases they may be involved in. Another reason the impact of these problems remains uncertain is that investors face challenges in bringing claims against servicers. Representatives of investors noted that although investors may have viable claims against servicers for inappropriate documentation practices, it is difficult for investors to obtain the information needed to prove that documentation inaccuracies have occurred. In addition, investors may not want to pursue legal claims against servicers because of the impact large-scale claims could have in the market, as new private label securitization issuances have recently declined.

Although tasked with overseeing the financial safety and soundness of institutions under their jurisdiction, some banking regulators stated that they have not yet fully assessed the extent to which MBS loan transfer problems could financially affect their institutions. Federal Reserve staff said that the agency has conducted an assessment of the extent to which any of its institutions may be required to repurchase loans. The Federal Reserve also required the institutions it supervises that originated large numbers of mortgages or sponsored significant MBS to assess and provide for these risks as part of their overall capital planning process. Regarding the extent to which loan transfer problems can affect their institutions, banking regulatory staff at OCC, the Federal Reserve, and OTS told us that their servicer reviews generally did not uncover problems with servicers' authority to foreclose, although examiners noted instances where documentation in the foreclosure file alone may not have been sufficient to prove authority to foreclose without reference to additional information. However, according to staff at one of the agencies, while examiners reviewed files to determine whether the name of the entity on the foreclosure initiation paperwork matched the name on the mortgage note to confirm that the foreclosing entity was the owner of the note and had standing to foreclose, they did not always verify that loan files included accurate documentation of all previous note and mortgage transfers—leaving open the possibility that such transfer problems exist in the files they reviewed. According to the regulators' report on the coordinated review, servicers may bear legal costs related to disputes over note ownership or authority to foreclose and may be subject to claims by investors as a result of delays or other damages caused by weaknesses in foreclosure processes. The enforcement orders resulting from the coordinated review require servicers to retain an independent firm to

assess risks such as these. In addition, the regulators' report states that the agencies will more frequently monitor the servicers involved in the reviews until they have corrected the identified weaknesses. For example, OCC staff said that as part of their assessment of servicers' compliance with the enforcement orders, examiners will review servicer processes to ensure that mortgages are assigned properly before initiating foreclosure. However, regulators have not definitively determined how mortgage transfer problems might financially affect other institutions they regulate, including if any of the institutions involved in the creation of private label MBS could face any financial repercussions. With almost $1.3 trillion in private label securities outstanding as of the end of 2010, the institutions and the overall financial system could face significant risks. Given the banking regulators' role in helping ensure the safety and soundness of regulated institutions in order to protect the deposit insurance fund, having affected institutions complete such assessments, analyzing their results, and requiring institutions to take any necessary steps to mitigate their risks could reduce the magnitude of any resulting problems.

Conclusions

Until the problems regarding foreclosure documentation came to light, federal regulatory oversight of mortgage servicers had been limited, as such activities were viewed as low risk to safety and soundness. However, regulators' examinations since then have revealed that servicers had generally failed to properly prepare required documentation and lacked effective supervision and controls over their foreclosure processes. The resulting delays in completing foreclosures and increased exposure to litigation highlight how the failure to oversee whether institutions follow sound practices can heighten their risks and create problems for the communities in which these foreclosures are occurring. Banking regulators plan to follow up with servicers to better ensure that they implement agreed-upon corrective actions, and the new CFPB also plans to conduct oversight of mortgage servicing activities. However, the extent to which these regulators will conduct ongoing supervision of mortgage servicers in the future, as well as the goals for this supervision and the roles that each regulator will play, have not been definitively determined. Until such plans are developed, the potential for continued fragmentation and gaps in oversight remains.

Recently, some regulators and market participants have begun working to develop national servicing standards that could provide consistent expectations for how servicers conduct many activities and interact with borrowers. Such standards could cover a wide range of servicer activities, including those at loan origination and throughout the ongoing life of a loan.

However, the extent to which such standards will address the weaknesses and lack of consistency among servicers' foreclosure practices is not yet clear. If such standards are developed, ensuring that they also provide expectations for servicers to follow as part of the foreclosure process could be a way to improve uniformity in the servicers' practices.

Finally, the extent to which foreclosures and the financial standing of some mortgage market participants will be affected by legal challenges to the way that loans were transferred as part of creating private label MBS is uncertain. Some observers argue that the typical practices could render some securitizations invalid, which could prevent justified foreclosures and create significant financial liabilities on the part of various institutions that created MBS issuances. In contrast, other market participants have indicated that loan transfer practices were acceptable. Until additional court decisions provide definitive guidance, the extent of the impact is unclear, as is the potential that regulated financial institutions will face losses arising from increased litigation or the need to repurchase loans from MBS trusts if improper transfers are discovered. Although such losses could be substantial, the affected financial institutions have not completed assessments of the possible impact on their firms, and banking regulators have not fully assessed the possible impact on the safety and soundness of these institutions if such problems are found to be legitimate. Such assessments could focus on institutions that sold significant numbers of loans to creators of private label securities, which appear to be at greater risk of loan transfer problems than those sold to GSEs. Completing the assessments of these potential risks and fully ensuring that regulated institutions are taking steps to proactively address them could reduce the potential threat to the soundness of these institutions, the deposit insurance fund, and the overall financial system.

Recommendations for Executive Action

To help ensure strong and robust oversight of all mortgage servicers, we recommend that the Comptroller of the Currency, the Chairman of the Board of Governors of the Federal Reserve System, the Director of the Office of Thrift Supervision, the Chairman of the Federal Deposit Insurance Corporation, and the Bureau of Consumer Financial Protection take the following actions:

- develop and coordinate plans to provide ongoing oversight and establish clear goals, roles, and timelines for overseeing mortgage servicers under their respective jurisdiction, and

- if national servicing standards are created, include standards for foreclosure practices.

In addition, to reduce the likelihood that problems with mortgage transfer documentation problems could pose a risk to the financial system, we recommend that the Comptroller of the Currency, the Chairman of the Board of Governors of the Federal Reserve System, the Director of the Office of Thrift Supervision, and the Chairman of the Federal Deposit Insurance Corporation assess the risks of potential litigation or repurchases due to improper mortgage loan transfer documentation on institutions under their jurisdiction and require that the institutions take action to mitigate the risks, if warranted.

Agency Comments and Our Evaluation

We requested comments on a draft of this report from CFPB, FDIC, FHFA, Federal Reserve, Federal Trade Commission, HUD, Justice, OCC, OTS, SEC, Treasury, Fannie Mae, and Freddie Mac. We received written comments from CFPB, FDIC, the Federal Reserve, OCC, and Treasury that are presented in appendixes II through VI. We also received technical comments from CFPB, FDIC, Federal Trade Commission, FHFA, Freddie Mac, HUD, OCC, Treasury, Federal Reserve, and Justice, which we incorporated where appropriate. Fannie Mae, OTS, and SEC did not have any comments on the draft report.

The agencies generally agreed with our recommendation on developing and coordinating plans to provide ongoing oversight of mortgage servicers. The Associate Director for Research, Markets & Regulations at CFPB said in his letter that CFPB has already been engaged in discussions about mortgage servicing with various federal agencies as part of preparing to take on the authorities that will transfer to it in July 2011 and is committed to coordinating constructively with other federal and state agencies to ensure that oversight responsibilities are exercised in an efficient and effective manner. The Director of the Division of Risk Management Supervision at FDIC said in her letter that FDIC agrees with our recommendation and noted the importance of a thorough regulatory review of servicers' loss mitigation efforts given that the scope of the coordinated review was limited to the foreclosure process. The letter also states that FDIC will continue to monitor servicers under its jurisdiction for these issues and will work with the other regulators to ensure a more coordinated and comprehensive approach to the review of mortgage servicers going forward. The Director of the Division of Consumer and Community Affairs for the Board of Governors of the Federal Reserve System said in her letter that the Board agrees with the recommendation

and noted that the recent enforcement actions require servicers to implement significant revisions to mortgage loan servicing and foreclosure processing practices. In his letter, the Acting Comptroller of the Currency stated that OCC agreed with our recommendations and noted that the agency will continue to oversee the mortgage servicers under its jurisdiction, and will emphasize in the near term ensuring that these entities are taking steps to remedy any deficiencies in their foreclosure processes.

The agencies also generally agreed with our recommendation on including standards for foreclosure practices in any national servicing standards that are created. The Associate Director for Research, Markets & Regulations at CFPB noted in his letter that CFPB has effective authority to adopt national mortgage servicing rules for all mortgage servicers, including those for which CFPB does not have supervisory authority. The Director of the Division of Risk Management Supervision at FDIC agreed with this recommendation and noted that FDIC successfully proposed the inclusion of loan servicing standards in the proposed rules to implement the securitization risk-retention requirements of the Dodd-Frank Act that address several servicing issues. She also said that any servicing standards should ensure that appropriate loss mitigation activities are considered when borrowers are experiencing financial difficulties. The Director of the Division of Consumer and Community Affairs for the Board of Governors of the Federal Reserve System said in her letter that the intent of the interagency effort to develop national standards for mortgage servicing was to address the problems found in the servicing industry, including in foreclosure processing. She also noted that the agencies would coordinate their efforts. The Acting Comptroller of the Currency noted that efforts are under way to develop national servicing standards, and that these are intended to include provisions covering both foreclosure abeyance and foreclosure governance. The Under Secretary for Domestic Finance at Treasury said that the agency has been closely engaged with the interagency group reviewing errors in mortgage servicing and that it supports national servicing standards that align incentives and provide clarity and consistency to borrowers and investors regarding their treatment by servicers. In response to these comments we added a reference to the interagency efforts to develop national servicing standards in the body of the report.

Regarding our recommendation that the regulators assess the risks of potential litigation or repurchases due to improper mortgage loan transfer documentation on institutions under their jurisdiction, the Director of the Division of Risk Management Supervision at FDIC said that the agency

strongly supports this recommendation and noted the agency's particular interest in assessing the potential litigation associated with servicing deficiencies to protect the interests of the deposit insurance fund. The Director of the Division of Consumer and Community Affairs for the Board of Governors of the Federal Reserve System said in her letter that the Federal Reserve has conducted a detailed evaluation of the risk of potential litigation or repurchases to the financial institutions it supervises. She also noted that the agency will continue to monitor the affected institutions' capital and reserves and take information from reviews servicers are required to complete as part of the enforcement orders into account when assessing this risk in the future, including reviewing the risks that servicers may suffer losses because of the lack of legally enforceable documentation of ownership. OCC and Treasury did not comment on this recommendation.

As we agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution of it until 30 days from the date of this report. At that time we will send copies of this report to interested congressional committees, CFPB, FDIC, FHFA, Federal Reserve, Federal Trade Commission, HUD, Justice, OCC, OTS, SEC, and Treasury. The report also is available at no charge on the GAO Web site at http://www.gao.gov.

If you or your staff have any questions about this report, please contact me at (202) 512-5837 or clowersa@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix VII.

A. Nicole Clowers
Acting Director, Financial Markets
and Community Investment

List of Requesters

The Honorable Robert Menendez
Chairman
Subcommittee on Housing, Transportation
and Community Development
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable John Conyers, Jr.
Ranking Member
Committee on the Judiciary
House of Representatives

The Honorable Luis V. Gutierrez
Ranking Member
Subcommittee on Insurance, Housing
and Community Opportunity
Committee on Financial Services
House of Representatives

The Honorable Michael Capuano
Ranking Member
Subcommittee on Oversight and Investigations
Committee on Financial Services
House of Representatives

The Honorable Al Franken
United States Senate

Appendix I: Objectives, Scope, and Methodology

This report focuses on various aspects of federal oversight of the mortgage foreclosure process. Specifically, this report addresses (1) the extent to which federal laws address mortgage servicers' foreclosure procedures and federal agencies' authority to oversee activities and the extent of past oversight; (2) federal agencies' current oversight activities and future oversight plans; and (3) the potential impact of foreclosure documentation issues on homeowners, servicers, regulators, and mortgage-backed securities investors.

To determine the extent to which federal laws address foreclosure procedures, we reviewed relevant federal laws and our prior reports. We also conducted interviews with representatives of federal agencies and asked for their insight on relevant federal laws. The federal agencies we interviewed include the Department of Housing and Urban Development (HUD), Department of Justice (Justice), Department of the Treasury (Treasury), Federal Deposit Insurance Corporation (FDIC), Federal Housing Finance Agency (FHFA), Board of Governors of the Federal Reserve System (Federal Reserve), Office of the Comptroller of the Currency (OCC), Office of Thrift Supervision (OTS), and Securities and Exchange Commission (SEC).

To determine federal agencies' oversight authority and extent of past oversight, we analyzed the relevant sections of agencies' authorizing laws and agency regulations and exam guidance. We also interviewed agency officials for their views on the extent to which their current authority allows the agency to oversee institutions conducting servicing and servicers' compliance with state foreclosure laws. In addition, we asked agency representatives about the extent and substance of their past oversight activities regarding mortgage servicers. We compared and contrasted the agencies' authorities to identify any gaps in their ability to oversee mortgage servicing and foreclosure activities and summarized their previous oversight actions. We also reviewed our past reports and other studies on federal oversight of the mortgage servicing industry.

To determine what actions the federal banking regulators have taken to address deficiencies in foreclosure processes, we interviewed officials from the four federal banking regulatory agencies (Federal Reserve, FDIC, OCC, and OTS). To obtain additional information on the regulators' coordinated review and to further understand the scope of their efforts, we evaluated regulators' examination review worksheet and analyzed the supervisory letters and draft enforcement orders issued to servicers following the reviews. In addition, we interviewed officials from the federal housing agencies and the government-sponsored entities, Treasury,

SEC, and Justice to report on other agencies' recent efforts to address foreclosure process deficiencies and to understand the extent of interagency coordination in addressing weaknesses in mortgage servicing practices. We also reviewed and analyzed relevant congressional testimonies and other publicly issued statements from agency officials. Further, we interviewed representatives of state attorneys general and state banking supervisors. To report on future oversight of mortgage servicers, we conducted follow-up interviews with OCC, OTS, and the Federal Reserve to discuss the findings of their coordinated reviews and to determine what changes, if any, regulators planned to make in future oversight based on these findings. Since the new Bureau of Consumer Financial Protection (CFPB) will accept responsibilities for overseeing mortgage servicing activity in the future, we contacted CFPB representatives to clarify the extent of CFPB's regulatory authority and to determine what role this new agency will play in future oversight of mortgage servicers. We also discussed the guidance and extent of oversight conducted by the two large housing government-sponsored enterprises, the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac).

To determine the potential impacts and implications of foreclosure documentation issues, we reviewed various studies from other agencies and organizations conducting similar work. We also searched for reported cases in the "Federal and State Cases combined" database of Lexis and Westlaw and limited the time frame to the last 5 years. Our search attempted to identify examples of relevant cases to estimate the prevalence of challenges to foreclosures or challenges to proof of claims submitted in bankruptcy matters related to foreclosures, which involved mortgage documentation and chain-of-title issues. We did identify some potentially relevant cases, but determined that not enough cases were found or materially on point to definitively indicate the prevalence. We also reviewed congressional testimonies, and other relevant publicly available documentation. In addition, we interviewed legal academics and attorneys representing both borrowers and servicers and representatives of rating agencies, the mortgage industry, investor groups, and consumer advocacy groups about the impacts of these issues on their constituencies. Because of servicers' involvement in ongoing litigation in various state courts, we did not directly interview servicers about these issues. Therefore, we obtained information about actions mortgage servicers are taking and the impacts of these issues on servicers from legal academics and representatives of industry associations, such as the Mortgage Bankers Association and Association of Mortgage Investors. In addition, we obtained the insight of staff from banking regulatory agencies who

have directly examined mortgage servicers on these issues and from mortgage servicers' public statements and SEC filings. We categorized the information we gathered from these various sources to identify the most common types of impacts and implications of foreclosure documentation issues these sources attributed to different stakeholder groups.

To provide context and additional support for our findings throughout the report, we gathered and analyzed data on financial market trends from two industry sources, *Inside Mortgage Finance* and Mortgage Bankers Association. We analyzed data on servicing volume and securitization issuances from *Inside Mortgage Finance*. We discussed the reliability of these data with an official from *Inside Mortgage Finance*. In addition, we have relied on data from *Inside Mortgage Finance* for past reports and determined that they are sufficiently reliable for the purpose of presenting and analyzing trends in financial markets.[1] We analyzed data on foreclosure filings and foreclosure inventory from Mortgage Bankers Association National Delinquency Survey. In a previous report, we assessed the reliability of these data by reviewing existing information about the quality of the data, performing electronic testing to detect errors in completeness and reasonableness, and interviewing Mortgage Bankers Association officials knowledgeable about the data.[2] To assess the reliability of the data for this report we reviewed prior assessments of the data and contacted an MBA official about any potential limitations to the use of the data or changes in data collection methods. We determined that the data were sufficiently reliable for purposes of the report.

We conducted this performance audit from October 2010 through April 2011 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

[1]GAO, *Troubled Asset Relief Program: One Year Later, Actions Are Needed to Address Remaining Transparency and Accountability Challenges*, GAO-10-16 (Washington, D.C.: Oct. 8, 2009).

[2]GAO, *Troubled Asset Relief Program: Status of Efforts to Address Defaults and Foreclosures on Home Mortgages*, GAO-09-231T (Washington, D.C.: Dec. 4, 2008).

Appendix II: Comments from the Bureau of Consumer Financial Protection

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

April 19, 2011

Ms. A. Nicole Clowers
Acting Director, Financial Markets and Community Investment
U.S. Government Accountability Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Ms. Clowers:

Thank you for the opportunity to comment on the GAO's draft report titled *Mortgage Foreclosures: Documentation Problems Reveal Need for Ongoing Regulatory Oversight*. I want to note up front that the Consumer Financial Protection Bureau (CFPB) does not currently have authority with regard to the issues covered within the report. When CFPB receives its full authorities, however, it will have authority to set standards for mortgage servicing.

The report sets forth an important analysis of the documentation problems that emerged last year in residential mortgage foreclosures. The report finds that past federal oversight of mortgage servicers' activities has been "limited and fragmented." In this regard, the report describes lack of comprehensive federal standards for mortgage servicers, the absence of any direct federal oversight of some servicers, and the fact that federal banking regulators did not consider mortgage servicing practices as presenting high risk to bank safety and soundness.

While the report acknowledges that the CFPB will play a role with regard to oversight of mortgage servicing practices, we wish to emphasize the extent to which the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) addressed the problem of limited and fragmented federal oversight of mortgage servicers by vesting new jurisdiction and powers in the CFPB for consumer protection.

In particular, Congress gave the CFPB effective authority to adopt national mortgage servicing rules for all mortgage servicers (including mortgage servicers for which CFPB does not have supervisory authority). This rulemaking power includes authorities under various federal laws to be transferred to the CFPB from other federal agencies – such as the Board of Governors of the Federal Reserve System, the Department of Housing and Urban Development, and the Federal Trade Commission – as well as new rulemaking authorities conferred upon the CFPB in the Dodd-Frank Act. In addition, the CFPB will have exclusive supervisory authority and primary enforcement authority over any mortgage servicer that is a depository institution with total assets of over $10 billion, or an affiliate of such a depository institution, to ensure that it complies with the Federal consumer financial laws (including any rules in this area adopted by the CFPB). For the first time, moreover, the Dodd-Frank Act placed non-depository mortgage servicers under direct federal authority. The Act accomplished this by giving the CFPB supervisory as well as enforcement authority over non-depository servicers with respect to the Federal consumer financial laws.

The Dodd-Frank Act is quite clear with respect to both the extent and the limits of the CFPB's jurisdiction over mortgage servicers. As a practical matter, the CFPB is still in the process of establishing its infrastructure, hiring staff, and making other preparations to take on the authorities that will transfer to it on the designated transfer date of July 21, 2011. We are fully committed to coordinating constructively with the prudential regulators to ensure that we exercise these responsibilities in an efficient and effective manner.

Indeed, we have already been engaged in discussions about mortgage servicing with various federal agencies as part of our preparatory efforts. Given the complexity of the issues raised concerning servicer operations and the historical role that the states have played in regulating foreclosure activities, we also believe federal-state coordination will be critical to addressing the issues raised in the report. The CFPB stands ready to partner with the other agencies and the states to make significant progress in this area.

Sincerely,

Rajeev Date
Associate Director
Research, Markets & Regulations
Consumer Financial Protection Bureau

Appendix III: Comments from the Federal Deposit Insurance Corporation

FDIC
Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990
Division of Risk Management Supervision

April 28, 2011

Mr. Richard J. Hillman
Managing Director, Financial Markets and Community Investment
United States Government Accountability Office
411 G Street NW
Washington, DC 20548

Dear Mr. Hillman:

Thank you for the opportunity to comment on the GAO's draft report titled "Mortgage Foreclosures: Documentation Problems Reveal Need for Ongoing Regulatory Oversight" (GAO-11-433). We agree with the recommendations provided in the report and are committed to working to improve regulatory oversight of mortgage foreclosure practices.

The report focused on the findings of the interagency review of the 14 largest mortgage servicers. While we are not the primary federal regulator for any of the largest mortgage servicers, the Federal Deposit Insurance Corporation (FDIC) participated in the interagency reviews at the invitation of the primary regulator, as the back-up regulator to protect the interests of the deposit insurance fund. As noted in the report, the findings of the interagency review clearly show that the largest mortgage servicers had significant deficiencies in numerous aspects of their foreclosure processing. Accordingly, on April 13, 2011, the three primary federal regulators of the 14 largest servicers published final Consent Orders against these servicers based on the findings of this review. The FDIC was signatory to one of the Orders as the primary federal regulator of an insured depository whose loans were serviced by an affiliated servicer under the holding company. The effect of this Order is to require the bank to ensure that its affiliated servicer takes corrective measures to fully address deficiencies identified in the interagency review.

We support GAO's recommendation that the federal banking agencies develop and coordinate plans to provide ongoing oversight and establish clear goals, roles, and timelines for overseeing mortgage servicers under their jurisdiction. The Orders incorporate requirements that, if fully implemented, will help prevent a recurrence of the most significant problems with foreclosure processing. It is essential that the implementation of the Orders incorporate specific, measurable actions of these servicers to address the deficiencies identified in the interagency review.

It is also important to note that the interagency review was limited in scope. The horizontal review and resulting Consent Orders did not encompass issues beyond the foreclosure process. As a result, the review did not review allegations of improper servicing or loss mitigation, such as misapplied payments, unreasonable fees, inappropriate force-placing of insurance, failure to adequately consider a borrower for a loan modification, or requiring a borrower to be delinquent in order to qualify for a loan modification. The Orders require the servicers to undertake a comprehensive third party review of risk in servicing operations and to reimburse borrowers injured by servicer errors. Furthermore, investigations by State and Federal law enforcement agencies related to these allegations are on-going.

A thorough regulatory review of loss mitigation efforts is needed to ensure processes are sufficiently robust to prevent wrongful foreclosure actions and to ensure servicers have identified

the extent to which individual homeowners are harmed. The FDIC will continue to use its full range of authorities to work with the primary federal regulators to promote these results.

As noted in the report, the FDIC directly supervises only a limited portion of the mortgage servicing industry, which collectively service less than four percent of residential mortgages. The FDIC has issued guidelines for an institution's real estate lending policies and standards for safety and soundness, including guidance related to foreclosure timing, loss mitigation, enforceability of claims against borrowers, and loan administration procedures. FDIC examiners review selected loans and supporting loan documentation during examinations to ensure an institution is complying with such guidelines. Significant exceptions are commented upon in the reports of examination.

When evidence of foreclosure documentation issues such as "robo-signing" came to light in the fall of 2010, the FDIC commenced a review of FDIC-supervised banks engaged in mortgage servicing. The review has not identified "robo-signing" or any other deficiencies that would warrant formal enforcement actions. The FDIC will continue to monitor these servicers, as well as the performance of institutions servicing loans through FDIC securitizations or resolution programs.

We also support GAO's recommendation that, if national servicing standards are created, the federal banking agencies include standards for foreclosure practices. To that end, in developing the proposed rules to implement the securitization risk-retention requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the FDIC successfully proposed the inclusion of loan servicing standards in the Qualified Residential Mortgage (QRM) requirements. Long-term confidence in the securitization process can only be restored by including loan servicing standards that result in a proper alignment of servicing incentives with the interests of investors, and that are designed to achieve the best value for all investors, and not for any particular class or tranche. The servicing standards included as part of the QRM requirements address many of the most significant servicing issues. In addition to aligning incentives between investors and servicers, the proposed standards also should promote greater fairness to borrowers by ensuring that appropriate loss mitigation activities, including loan modifications, are considered when borrowers are experiencing financial difficulties.

Lastly, we strongly support GAO's final recommendation that the federal banking agencies assess the risks of potential litigation repurchases due to improper mortgage loan transfer documentation on institutions under their jurisdiction and require that the institutions take action to mitigate the risks, if warranted. To protect the interests of the deposit insurance fund, the FDIC has an especially keen interest in assessing the potential litigation associated with servicing deficiencies at the largest servicers.

In summary, although various federal agencies have authority to oversee most mortgage servicers, past oversight of their foreclosure activities has been limited. We fully support a more coordinated and comprehensive approach to the review of mortgage servicers going forward.

Thank you again for the opportunity to review this report and submit comments.

Sincerely,

Sandra L. Thompson
Director

Appendix IV: Comments from the Board of Governors of the Federal Reserve

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

SANDRA F. BRAUNSTEIN
DIRECTOR
DIVISION OF CONSUMER
AND COMMUNITY AFFAIRS

April 20, 2011

A. Nicole Clowers
Acting Director
Financial Markets and Community Investment
U.S. Government Accountability Office
Washington, DC 20548

Dear Ms. Clowers:

Thank you for the opportunity to comment on the draft report entitled "Mortgage Foreclosures: Documentation Problems Reveal Need for Ongoing Regulatory Oversight," GAO-11-433. The draft report finds that foreclosure documentation problems have slowed the pace of foreclosures across the United States; and while the delay may benefit borrowers by providing more time to modify loans as servicers correct and refile cases, it may also negatively impact communities as vacant properties in foreclosure remain unoccupied for longer periods. Additionally, the draft report states that the potential financial impact resulting from investor allegations regarding the improper transfer of securities in mortgage-backed securitizations (MBS) remain uncertain until outstanding litigation is fully adjudicated.

The draft report notes that the banking agencies coordinated reviews of large mortgage servicers and identified pervasive problems with documentation preparation and oversight of the foreclosure process. To begin to address those problems, on April 13, 2011 the Board of Governors of the Federal Reserve System (the Board) announced formal enforcement actions requiring 10 banking organizations to address a pattern of misconduct and negligence related to deficient practices in residential mortgage loan servicing and foreclosure processing.

The Board's actions also require each servicer to take a number of remedial steps, including making significant revisions to certain residential mortgage loan servicing and foreclosure processing practices. Each servicer must, among other things, submit plans acceptable to the Federal Reserve that:

- Strengthen coordination of communications with borrowers by providing borrowers the name of the person at the servicer who is their primary point of contact;
- Ensure that foreclosures are not pursued once a mortgage has been approved for modification, unless repayments under the modified loan are not made;
- Establish robust controls and oversight over the activities of third-party vendors that provide to the servicers various residential mortgage loan servicing, loss mitigation, or foreclosure-related support, including local counsel in foreclosure or bankruptcy proceedings;

2

- Provide remediation to borrowers who suffered financial injury as a result of wrongful foreclosures or other deficiencies identified in a review of the foreclosure process; and
- Strengthen programs to ensure compliance with state and federal laws regarding servicing, generally, and foreclosures, in particular.

The draft report recommends three actions that the Chairman of the Federal Reserve Board should take, two of which are to be taken with the Comptroller of the Currency, the Director of the Office of Thrift Supervision, the Chair of the Federal Deposit Insurance Corporation, and the Director of the Bureau of Consumer Financial Protection. These recommendations direct the agencies to:

- Develop and coordinate plans to provide ongoing oversight and establish clear goals, roles, and timelines for overseeing mortgage servicers under their respective jurisdiction; and
- Include standards for foreclosure practices if national servicing standards are created.

The Board agrees with these recommendations. Indeed, in December 2010, Governor Daniel Tarullo, in testimony on behalf of the Board before the Senate Banking Committee, called for the development of national mortgage servicing standards. Since that time, the Federal Reserve has initiated an interagency effort with the other financial regulators, including the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, and the Consumer Financial Protection Bureau, to develop a set of national standards for mortgage servicing for all consumer mortgage lenders and servicers. The intent of the proposed standards would be to address the problems that we have found in the servicing industry, including in foreclosure processing, and to coordinate the efforts of the multiple regulatory agencies to ensure that in the future consumers will be treated properly and consistently. Of note, the enforcement actions announced last week require servicers to implement significant revisions to mortgage loan servicing and foreclosure processing practices.

The third recommendation is that the Board, in conjunction with the Comptroller of the Currency, the Director of the Office of Thrift Supervision, and the Chair of the Federal Deposit Insurance Corporation, assess the risks to institutions under their jurisdiction of potential litigation or repurchases due to improper mortgage loan transfer documentation and require that the institutions take action to mitigate the risks, if warranted. The Federal Reserve has conducted a detailed evaluation of this risk, the so-called "put-back" risk, to financial institutions supervised by the Federal Reserve. We have also required institutions we supervise that originated large numbers of mortgages or sponsored significant MBS to assess and provide for these risks as part of their overall capital planning process. This exercise was included in the recently completed Comprehensive Capital Analysis and Review (CCAR), which involved 19 bank holding companies. In addition, as part of the recently announced foreclosure orders, the servicers will be required to conduct a review of foreclosures conducted from January 2009 through December 2010. The Federal Reserve will also take that information into account in assessing put-back risk to the institutions we supervise.

This will include a review of risks that servicers may suffer losses because of the lack of legally enforceable documentation of ownership.

The ultimate financial loss for any originator or securitizer subject to put-back risk is dependent upon a wide range of factors that can be firm or transaction specific, such as the quality of initial underwriting, the incidence of fraud, the performance of sold mortgages, whether the mortgages were sold to Fannie Mae and Freddie Mac or as private label securitizations, the relative strength of representations and warranties for a transaction, the willingness of investors to pursue certain claims, and the outcome of pending litigation. The Federal Reserve will continue to follow closely developments in this market, and will continue to monitor affected firms to ensure they maintain appropriate capital and reserves to protect against future mortgage put-back losses.

We will continue to monitor all of these issues and instruct our supervised institutions accordingly. We appreciate the professionalism of the GAO's review team in conducting this study.

Sincerely,

Appendix V: Comments from the Comptroller of the Currency

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

April 15, 2011

Ms. A. Nicole Clowers
Acting Director, Financial Markets and Community Investment
United States Government Accountability Office
Washington, DC 20548

Dear Ms. Clowers:

We have received and reviewed your draft report titled "Mortgage Foreclosures: Documentation Problems Reveal Need for Ongoing Regulatory Oversight." Your report responds to Congressional requests for information concerning various aspects of federal oversight of the residential mortgage foreclosure process.

You found that: (1) federal laws do not specifically address the foreclosure process and past federal oversight of foreclosure activities has been limited and fragmented; (2) federal regulators have conducted reviews in response to foreclosure documentation problems, but the extent and roles in future oversight are unclear; and (3) documentation problems will likely result in delays in the foreclosure process, but the impact on financial institutions and others is less clear.

You recommend that the federal banking regulators and the Consumer Financial Protection Bureau (CFPB) develop plans for overseeing mortgage servicers and include foreclosure practices in any servicing standards that are developed. You also recommend that regulators assess the risks that documentation problems pose for their institutions.

We agree and are pleased to report that development of servicing standards is well underway on an interagency basis. While still a work in progress, the standards, as currently drafted, include provisions covering both foreclosure abeyance and foreclosure governance. The former emphasizes communication with the borrower and the latter emphasizes compliance with legal requirements, documentation, vendor management and other controls.

The OCC will continue to oversee the mortgage servicers under our jurisdiction through regular onsite review and monitoring. In the near term, emphasis will be on assessing compliance with enforcement actions to be sure that those unsafe or unsound practices and other deficiencies in the banks' servicing and foreclosure processes are remedied.

Consistent with the OCC's model of supervision by risk, the servicers are being required by the enforcement actions to assess the risks present in their servicing operations. In turn, these

assessments will be evaluated by our examiners together with the banks' plans to mitigate and manage those risks.

We appreciate the opportunity to comment on the draft report.

Sincerely,

John Walsh
Acting Comptroller of the Currency

-2-

Appendix VI: Comments from the Department of the Treasury

UNDER SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON

April 19, 2011

A. Nicole Clowers
Acting Director
Financial Markets and Community Investment
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Ms. Clowers:

Thank you for providing the Department of the Treasury ("Treasury") an opportunity to review and comment on your draft report on problems in the mortgage foreclosure process, entitled *Mortgage Foreclosures: Documentation Problems Reveal Need for Ongoing Regulatory Oversight ("Draft Report").*

The Draft Report provides a detailed description of the mortgage servicing and foreclosure processes, including investigations by federal and state agencies into errors made by certain financial institutions in those processes.

Although Treasury does not have regulatory authority over servicers and the recommendations in the Draft Report are not directed at Treasury, we have been closely engaged with the interagency task force seeking to address errors in mortgage servicing and foreclosure processing. As we have said before, servicers that acted improperly must be held accountable and the system must be reformed to prevent these problems from occurring again. To that end, we support a set of national servicing standards to align incentives and provide clarity and consistency to borrowers and investors regarding their treatment by servicers, especially in the event of delinquency.

Thank you again for your work on this important issue.

Sincerely,

Jeffrey A. Goldstein
Under Secretary for Domestic Finance

Appendix VII: GAO Contact and Staff Acknowledgments

GAO Contact

A. Nicole Clowers (202) 512-5837 or clowersa@gao.gov

Staff Acknowledgments

In addition to the contact named above, Cody Goebel (Assistant Director), Simon Galed, Beth Garcia, Marc Molino, Jill Naamane, Linda Rego, and James Vitarello made key contributions to this report.

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