OPEN LETTER TO U.S. REGULATORS REGARDING NATIONAL LOAN SERVICING STANDARDS

December 21, 2010

The Honorable Timothy Geithner
Secretary of the Treasury
Department of the Treasury
1500 Pennsylvania Avenue, N.W.
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The Honorable Edward DeMarco
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The Honorable Sheila Bair
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The Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue N.W.
Washington, DC 20551

The Honorable Mary L. Schapiro
Chairman
Securities and Exchange Commission
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Washington, DC 20549

The Honorable John Walsh
Comptroller of the Currency (Acting)
Administrator of National Banks
250 E Street, S.W.
Washington, DC 20219

Re: National Standards for Loan Servicing

Dear Colleagues:

We the undersigned write to you regarding the urgent need to develop national standards for originating, selling and servicing mortgage loans. The private residential mortgage securitization market is frozen as to new issuance. The housing market is suffering from a dearth of credit, which is causing a serious lack of confidence among potential homebuyers.

Widely reported servicer fraud, whether in the foreclosure process or in the systematic assessment of illegal fees against homeowners, is also a serious problem. It's bad for investors, it's bad for homeowners, and it's ultimately bad for a sustainable residential mortgage securitization market and the U.S economy. Fraud is also a symptom of the disease affecting our broader financial system, namely the lack of accountability in the loan servicing industry and the resulting impairment of the value of securities sold to investors.

To that end, new securitization standards should be adopted now. The rules under the Dodd-Frank Act relating to disclosure and risk retention for securitizations, which apply to all market participants, are the place to start. We suggest, therefore, that the agencies concerned, led by FDIC and SEC, undertake a coordinated rule making effort now to start the process and then also report to Congress.

As part of your duties under Section 941 of the Dodd-Frank Act, your agencies must develop new standards for the secondary market in mortgage loans. These standards must promote a sustainable securitization market and, in particular, maintain additional "skin in the game" for sellers of loans so the excesses and abuses of the past are not repeated. As part of this effort, you will be defining the criteria for the highest quality residential mortgages, those which do not need risk retention. This new definition for what constitutes a qualified residential mortgage should be the gold standard in all areas of mortgage origination, securitization packaging and servicing, and disclosure.

Why is there such urgency? Because of the ongoing litany of revelations pertaining to inadequate servicing, lost loan modification documents, and improper foreclosures which reveal significant problems in the mortgage servicing industry. Problems of this magnitude are a threat not only to the economic recovery, but to the safety and soundness of all insured depository institutions. Banks rely upon a functioning secondary market in home mortgages for liquidity management purposes. The chaotic situation in the mortgage market today demands immediate action to ensure all parties are treated fairly and to restore the confidence needed to support a recovery in real estate markets and the entire U.S. economy.

Servicing standards need not be overly complex, but they must address the misaligned incentives and 'tranche warfare' issues that have bedeviled mortgage servicing throughout this crisis. We also believe it is of critical importance to eliminate existing discontinuities in servicing practices with regard to loans held in whole-loan form by banks, versus those in securitization vehicles. Your agencies must address loan servicing as part of the lending process so that the new Dodd-Frank risk retention rules meet the goals set by Congress. To protect borrowers and investors alike, the standards generally should require lenders and servicers to:

* Credit monthly loan payments promptly and correct any misapplication of such funds in a timely manner.

* Engage in loan modifications, including reductions in the payment amount and principal balance, consistent with state law, to address reasonably foreseeable default when a homeowner can make a reasonable payment and it is economically feasible to do so. When existing or future loans are more than 90+ days delinquent, federal regulations should mandate that the credit be assigned to a special servicer.

* Prohibit the commingling of homeowners' monthly mortgage payments with servicers assets except for the time necessary to clear the payments received, but generally not more than two (2) business days.

* Be accountable for lost paperwork on loan modifications and/or for failing to suspend the foreclosure process when a homeowner is actively engaged in the loan modification process.

* Create incentivized compensation structures tied to effectiveness in managing the long-run performance risk of the assets in a securitization.

* Mitigate losses on residential mortgages by taking appropriate action to maximize the net present value of the mortgages for the benefit of all investors in a securitization rather than the benefit of any particular class of investors.

* Make servicer advances to a securitization vehicle a required reporting item. Prohibit the servicer from advancing delinquent payments of principal and interest by mortgagors for more than three (3) payment periods unless financing or reimbursement facilities to fund or reimburse the primary servicers are available.

* Disclose any ownership interest of the servicer or any affiliate of the servicer in other whole loans secured by the same real property that secures a loan included in a given pool of mortgages used in a securitization.

* Eliminate the regulatory incentives that motivate banks to keep troubled portfolio loans in "limbo," without permanent modification or remediation, merely because the bank is successful in obtaining a marginal payment that avoids classifying a loan as non-accrual.

* Establish a pre-defined process to address any subordinate lien owned by the servicer or any affiliate of the servicer, if the first mortgage is seriously delinquent (i.e., 90 days or more past due) to eliminate any potential conflicts of interest.

* Attest annually in writing under penalty of a fine or legal action that a bank or non-bank servicers' foreclosure process complies with applicable laws.

During a December 1, 2010 hearing, Federal Reserve Board Governor Daniel Tarullo acknowledged that "it seems reasonable at least to consider whether a national set of standards for mortgage servicers may be warranted." We agree with Governor Tarullo. The time to act is now.

Recent discussion among regulators as to the need for new legislation to address the servicing issue are misplaced, in our view. We cannot wait for uncertain future legislation to accomplish something that is clearly appropriate under the Section 941 risk retention rules of Dodd-Frank and current law, namely a national standard for loan servicing.

The agencies currently involved in developing the standards for residential mortgages have an opportunity to address this critical issue now. The responsible servicing standards described above would be applicable to all issuers of securitizations and will prevent the problems we are seeing today in the secondary market for mortgage loans.

Yours sincerely,

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Brookings Institution

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Former Chairman, Federal Housing Finance Board

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